
THE RISE OF CHINA AND ITS INVESTMENT IMPLICATIONS

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At a time when global geopolitical tension, particularly in Asia, is high, it was a pleasure to speak with two China experts on our podcast last week. First, we spoke to Graham Allison, Harvard professor and author of a very important book called *Destined for War: Can America and China Escape Thucydides's Trap*. Our second guest was Perth Tolle, founder of Life + Liberty Indexes. Tolle grew up in China and has firsthand experience in China that led her to create a freedom-oriented investment firm and indexing strategy.

Allison started our discussion by explaining what caused him to start researching *Destined for War*. Allison is a longtime student of history, having also authored a book on the Cuban missile crisis and the very close calls that almost triggered a nuclear war. The founder of Singapore, Lee Kuan Yew, and Allison's mentor, Henry Kissinger, encouraged him to study what was happening in China.

Allison discussed his historical study dating back 500 years during which he identified 16 cases of a rising power threatening an established power—and in 12 of those 16 cases it led to war. It is not inevitable that the current paths of China and its threat to the U.S. lead to war, but odds do favor that outcome. The study of history shows that the key catalyst that often ignited the war was actions by a third-party provocateur that compels one of the other two parties to respond.

Allison points to Kim Jong Un as the leading candidate to be such a third party currently. Allison discusses a number of historical analogies, including the 1914 assassination of an archduke who, in Allison words, "did not matter at all, but produced a spark that lit a fire that burned down all of Europe."

Taiwan is another potential candidate to be the third-party spark. Allison described how Taiwan and China both have a belief that they are "one country, but two systems"—where they disagree is which system would ultimately prevail in the future if they were to become one country. If Taiwan were to try to establish greater independence, Allison sees this as another situation that could drag the United States into war.

The Largest Global Economy

Documenting how far China's economy has progressed, Allison likes to quiz his Harvard class with this question: At what time do students think China will become No. 1 in the world with either the largest middle class, the biggest producer of smartphones, the fastest supercomputers or the largest national economy (in [purchasing power parity \[PPP\]](#) terms)—in 2030, 2040 or not in their lifetimes? All these things already happened. Allison describes how the PPP economic size is what really matters—because this is what dictates the purchasing power of the Chinese and how many battleships and airplanes they can buy to support their military.

Lee Kuan Yew counseled Allison that America is going to find it very difficult because China is destined to become the biggest economy in the history of the world. The rise of China will be one of the key issues over the coming decade, and how we manage escaping this Thucydides trap will be of extreme importance.

Discussing Life + Liberty Indexes

In thinking about investment implications, it was interesting speaking to Perth Tolle on her freedom-oriented investment firm. Tolle shared her perspective, having moved from China as a kid to the United States and then having worked in Hong Kong under the influence of China. Many of those experiences working in Hong Kong gave her the idea to start Life + Liberty Indexes.

One example: Tolle saw the lives of unofficial children who were off the grid as a result of being the second child during the one-child policy. These kids had no birth certificate, no school record and no state benefits. Tolle was born in China during the one-child policy and was witness to the crime and trafficking that it has caused. Her personal experience helped shape her belief in human freedoms and respect for human rights as something China needs to address for more sustainable longer-run outcomes.

Tolle believes that one needs human and economic freedoms in place to create a solid foundation for growth and innovation and she constructed her Life + Liberty Indexes to allocate weight to countries by proprietary metrics in this regard. Tolle sees freer countries as growing faster and allocating capital more efficiently.

Investing in China?

China, Hong Kong, Taiwan and South Korea—all very closely tied to China—make up more than one-half of many emerging market indexes. Tolle sees [market cap-weighted](#), broad emerging market indexes as just getting China in disguise.

If one is going to invest in China, Tolle very much believes in the people of China and their potential, but she is more skeptical of the government and government-run companies. She advocates for utilizing an ex-state-owned investment concept both for China investing and also more broadly in her Life + Liberty Index family.

This was a great discussion with two experts on China, and we believe it will continue to be one of the most important political situations over the coming decade. I encourage you to listen to the full conversation with Allison and check out his book *Destined for War*—while also following Tolle and her Life + Liberty Indexes. See link below.

For more investing insights, check out our [Economic & Market Outlook](#)

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Market capitalization-weighting : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.