GAME OF BRIDGE OR GAME OF THRONES BETWEEN CHINA AND U.S.?

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It's a mess.

The entire German yield curve is negative. The U.S. 3-Month Treasury yield is at 2%, while the 10-Year yield currently sits close to 1.65%. Excluding U.S. debt with 20 years to maturity or more, U.S. short-term Treasuries now have the highest yield among all developed-nation debt.

President Trump announced a surprise 10% tariff on China against the advice of most of his advisors earlier this month. China then responded with a surprise devaluation of its currency, letting the yuan-to-U.S.-dollar exchange rate cross the psychologically significant level of 7. The U.S. Treasury department retaliated by attaching a toothless "currency manipulator" label to China.

If this is not enough drama for financial markets, China has its hands full with pro-democratic protests in Hong Kong almost daily, with many of them becoming increasingly violent. Rumor has it that China is also getting ready to allow its gross domestic product growth number to slip under the psychologically significant level of 6%, not wanting to take short-term measures to stimulate the economy.

Amid these heart-wrenching headlines, Liqian Ren and I had three guests join us on last week's episode of the "Behind the Markets" podcast to help us sort through the noise.

Professor Jeremy Siegel highlighted that it is not normal for rates to be inverted, but short-term rates are the highest among all the other developed government yields at any duration. He recommended an immediate 50 basis point cut from the Federal Reserve (Fed) because the economy is soft. He said the possibility of President Trump's re-election in 2020 solely rests on economic performance over the next year and acknowledged that the Fed will yield to pressure from the White House, which could lead the central bank's independence to suffer.

Our first guest, Marc Chandler, who writes a popular blog called "Marc to Market," cautioned against a dramatic move, saying that the Fed's credibility and independence could be called into question.

Chandler also mentioned that many index strategies hold negative-yielding government bonds because they must follow an index benchmark. Capital gains could cushion part of the negative yield if investors expect the yields to go even lower.

We were also joined by Alfred Muluan Wu, who was previously a journalist in mainland China. He studied and taught in Hong Kong and recently moved to Singapore as a professor at the Lee Kuan Yew School of Public Policy at the National University of Singapore.

Professor Wu mentioned that the ongoing Hong Kong protests are more widespread than the 2014–2015 civil protests.

Even after Hong Kong's leader tabled the bill on the extradition treaty that brought close to 10% of population to the street, the protests continue to go on, as the democratic movement demands an independent commission.

Hong Kong has been both a window and door to China's economic story over the past 40 years. The question now, however, is: Will it remain the political window and door to China for the *next* 40 years? In 1997, when it was handed back to China with a 50-year "one country, two systems" understanding between the United Kingdom and China, the expectation was that China and Hong Kong would be similar by 2047. Now, 2047 suddenly seems not too far away, and the economic and political frustrations in Hong Kong run high.

If the U.S. and China continue to escalate economically, Hong Kong is likely to be affected. How to politically manage a potential decline will be a top challenge for both Hong Kong and China.

There are many more details packed into last week's episode. Please listen to both conversations below.

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DEFINITIONS

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

1-3 month U.S. Treasury Bill : A short-term debt obligation backed by the U.S. government with a maturity of less than 3 months.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten years.

Devaluation : deliberate downward adjustment to the value of a country's currency, relative to another currenc.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Duration : A measure of a bond's sensitivity to changes in interest rates. The weighted average accounts for the various durations of the bonds purchased as well as the proportion of the total government bond portfolio that they make up.

Basis point : 1/100th of 1 percent.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Capital gains : Positive difference between the sale price of an asset and the original purchase price.