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GLOBAL PERSPECTIVE *from the Investment Advisory Group*

Growing Backlash Against China

As the origination point of the COVID-19 outbreak, China is facing growing backlash. As fatalities, economic damage, and suffering continue as a results of the virus, rhetoric against China could bring about tangible impacts to the country.

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A Worrisome and Growing List

COVID-19

The predominant Western narrative is that China delayed disclosing the virus and inexplicably wanted the pandemic to happen. Adding fuel to the fire are headlines like Australia's Foreign Minister, Marise Payne, calling for a global inquiry into the origin of COVID-19 and China's handling of it. Similarly, a leading newspaper in Germany called for billions of dollars in reparations to Germany from China for the cost of the virus to its economy. As global containment efforts extend longer than initially anticipated, frustration and resentment towards China will likely continue to build.

De-globalization & World Trade

The pandemic exposed the weaknesses of globalization and supply chain optimization, including just-in-time inventory. As COVID-19 spread, countries realized that the production of even relatively simple but mission-critical medical equipment like masks, protective gowns, or ventilators should not be offshored. The US sees bipartisan support for reduced reliance on pharmaceutical and healthcare equipment from China. A new round of tariffs against Chinese products or incentives to produce more goods domestically could trigger a new trade war between the US and China.

Global trade activity is set for a historic slump. The world's largest container liner, Maersk, warned of up to a 25% volume drop during the second quarter of 2020. Some of this drop is expected to be regained quickly when the restrictive lockdowns are lifted, but going back to pre-virus heights could take many years or a decade if the de-globalization trend takes hold.

Investment Flows

President Trump has been very vocal about the US government's main pension fund investing in Chinese equities, citing national security risk to the US. Controlling investment flows will be a new chapter in the financial fight with China.

Like all other economies around the world, the Chinese economy's projected growth rates are pointing toward a dismal year. Capital inflows, in the form of portfolio investments, could help boost its economy. The US Federal Savings Plan's recent decision to delay the transfer of funds with Chinese companies could have knock-on effects for global markets if the US starts to limit where investment flows are directed.

This year, corporate governance of Chinese companies listed in the US fell under scrutiny. The high profile Chinese coffee chain, Luckin Coffee, once touted as Starbucks' main competitor in China, suspended trading after disclosure of fraud with fabricated sales figures. Chinese companies' disclosure standards were already in question and this incident galvanized the already-negative sentiment against Chinese companies listed in the US. Additional checks and balances could be introduced to new listings of Chinese companies in US, limiting much needed IPO capital to many firms in China.

US Election Cycle

Before the virus, it was widely expected that China would own center stage for the 2020 US election cycle. Like the 2016 election cycle, as we get closer to November, rhetoric against China could pick up. With US unemployment at the highest level since the Great Depression, slogans including "bring jobs back" could resonate well with many on both sides of the aisle.

Our Take

Defining "success" in handling the COVID-19 pandemic is tricky if not impossible, so it's much easier for politicians to use China as a scapegoat. China undoubtedly made critical mistakes during the month of January 2020 by not accepting the severity of the pandemic immediately. Furthermore, the country silenced whistleblower medical doctors that tried to warn the world. The West had enough time to prepare when the city of Wuhan, a city similar to the size to London, went into full lockdown, and neighboring countries like South Korea, Hong Kong, Singapore and Taiwan started to deal with the virus head-on.

Globalization has been increasing since the Second World War, reaching extreme heights with China's entry to the World Trade Organization. Globalization was beginning to lose some of its allure due to continuous trade imbalances, losing manufacturing jobs to countries where cheap labor is abundant and geopolitical risks via supply chains. COVID-19 just accelerated that process. It would be impossible to unwind seven decades of globalization in a year, but 2020 will be a year to remember from many geopolitical angles.

Bottom Line

As we came into 2020 before COVID-19, we expected a modest uptick in global trade volumes with optimism regarding the Phase-I trade deal between China and the US. That optimism was replaced by a global recession with external demand collapsing due to virus containment efforts. While containment efforts continue with sporadic success in some countries, the path to recovery remains uncertain.

In a virus-stricken world, the backlash against China, where the virus originated, is unavoidable. Rhetoric against China will intensify as global fatalities, economic damage and suffering escalate. This could result in tangible economic impacts to the country. We continue to recommend an underweight position in Emerging Market equities where China is over 40% of the index.

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