

# The CIO Monthly Perspective

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## KNOW THYSELF, KNOW THY OPPONENT

Are we up for the challenge of Cold War II?

The Scripture has a passage (Ecclesiastes 9:7-9) that advises people to enjoy life while it lasts. Well, now is the time to heed that advice as the macro environment appears to be in a rare state of nirvana. While COVID-19 is still wreaking havoc in many parts of the world, the U.S. is racing towards normalization with two shots in the arm - vaccination and financial stimulus. The moneyed class is enjoying the strongest start of any U.S. bull market going back nearly 80 years with the S&P 500 Index having gained 87% from March 2020's trough to the end of April 2021. Less wealthy adults and children were each handed \$1,400, and the unemployed were placated with an extra \$300 weekly benefit that will last into early September, all funded with borrowed money. This has resulted in record highs for personal income, up 29% year-on-year in March. Corporate America is reporting record earnings that easily blew past consensus estimates. The red-hot housing market is reminiscent of the mid-2000s, and cryptocurrencies and various meme stocks favored by hordes of YOLO traders (you only live once!) make the dot-com era look downright amateurish. To top it all off, instead of attempting to take away the proverbial punchbowl, inflation-seeking central bankers are handing out drinks to keep the party going.

Unfortunately, the Good Book also cautions that heaven and earth will pass away. The sugar high that we are enjoying will not last indefinitely, and markets will start to discount a less benign environment at some point. With GDP and earnings growth likely to peak in the current quarter, the so-called "smart money" that focuses on the second derivative may have started taking some chips off the table. To wit, some of the once red-hot investments - the SPAC Index, the ARK Innovation ETF, Tesla, etc. - have fallen more than 20% from their peaks. Some of the market's favorite reopening plays have stalled out in April. The failure of Apple's blowout earnings to elicit a rally is also a potential warning sign. With the S&P 500 Index having gained nearly 30% from last November through April - a seasonally strong period - the adage "sell in May and go away" may be apropos this year. Indeed, with elevated valuations, margin debt at historic highs, tax hikes ahead, and many positive catalysts seemingly discounted, the stock market's risk/reward tradeoff has become less favorable. While it is always difficult to time the market, investors should brace for a potential pullback in the months ahead, which would be a healthy development. It may also be time to consider long-short strategies that can capitalize on some of the mispriced opportunities.

## THAT 80's SHOW

It was almost Christmas 1986, but there was no holiday cheer in the interrogation cell. For the umpteenth time, Václav Havel was about to be psychologically harassed by a no-name state security henchman. Havel had no fear for the communist regime's secret police apparatus as he had grown used to being ostracized, spied on, interrogated, and even imprisoned. He knew his international renown as Czechoslovakia's leading dissident playwright had kept authorities from brutalizing him the way they did with lesser-known activists. His plays were popular at home and abroad for satirizing the absurdity of the totalitarian society, which led the authority to ban him from the theater world after the Prague Spring movement was crushed in 1968. He had continued to write, however, and his works were produced abroad to great acclaim. The regime's attempt to "cancel" him had ironically catalyzed his evolution as a political and human rights activist.

That particular interrogation in the ancient city of Český Krumlov felt quite unusual to Havel. The officer kept looking at his wristwatch while asking nonsensical questions. Havel soon realized that the officer's job was to keep him away from his hotel room long enough for the secret police to go through his manuscripts. Havel had driven to this remote city in the South Bohemian region alone so he could focus on writing a long document commemorating the tenth anniversary of the publication of Charter 77, a human rights manifesto issued in January 1977 with more than 200 signatories. The government had banned this "anti-socialist, and demagogic, abusive piece of writing" and persecuted its supporters. Havel and five other initiators were tried and imprisoned. Many signatories were dismissed from work, denied of education for their children, forced into exile, or coerced to collaborate with the secret service. However, Charter 77 had galvanized much silent support at home and recognition abroad.

Anticipating that the secret police, having read the draft of his document, would find an excuse to confiscate the completed work, Havel made several copies of it and put them in his bag and in the glove compartment of his car where the police could easily search and find them. He also hid a copy under a mat in the trunk. As he expected, shortly after starting the drive back to Prague, he was stopped by traffic cops who wanted to check if he had illegally chopped down a Christmas tree from the forest to take home. They searched his belongings and were pleased to find and confiscate the "illegal" documents. After the usual interrogation and harassment, Havel was released and allowed to drive back to Prague. Upon returning to Prague, Havel removed the hidden document from the trunk and handed it to an intermediary with the foreign press. The following morning, the communist regime was shocked to see Havel's article all over the foreign media.

Equity Markets Indices <sup>1</sup>	3/31/21 Price	4/30/21 Price	MTD Change	YTD Change
MSCI All Country World	673	702	4.2%	8.6%
S&P 500	3973	4181	5.2%	11.3%
MSCI EAFE	2208	2269	2.7%	5.6%
Russell 2000 <sup>®2</sup>	2221	2266	2.1%	14.8%
NASDAQ	13247	13963	5.4%	8.3%
TOPIX	1954	1898	-2.9%	5.2%
KOSPI	3061	3148	2.8%	9.5%
Emerging Markets	1316	1348	2.4%	4.4%

### Fixed Income

2-Year US Treasury Note	0.16%	0.16%	0	4
10-Year US Treasury Note	1.74%	1.63%	-11	71
BBG Barc US Agg Corp Sprd	0.91%	0.88%	-3	-8
BBG Barc US Corp HY Sprd	3.10%	2.91%	-19	-69

### Currencies

Chinese Renminbi (CNY/\$)	6.55	6.47	-1.2%	-0.8%
Brazilian Real (Real)	5.63	5.44	-3.5%	4.6%
British Pound (\$/GBP)	1.38	1.38	-0.2%	-1.1%
Euro (\$/Euro)	1.17	1.20	-2.4%	1.6%
Japanese Yen (Yen/\$)	110.72	109.31	-1.3%	5.9%
Korean Won (KRW/\$)	1131.90	1112.40	-1.7%	2.4%
U.S. Dollar Index (DXY)	93.23	91.28	-2.1%	1.5%

### Commodities

Gold	1708	1769	3.6%	-6.8%
Oil	59.2	63.6	7.5%	31.0%
Natural Gas, Henry Hub	2.61	2.93	12.4%	15.4%
Copper (cents/lb)	400	448	12.1%	27.3%
CRB Index	185	200	8.0%	19.0%
Baltic Dry Index	2046	3053	49.2%	123.5%

Source: Bloomberg

Three years after that cat-and-mouse folly over a political document, Czechoslovakia's communist regime was toppled by peaceful protestors as a hollowed out Soviet Union was powerless to stop the tide of history. Václav Havel was named the president by the transition government and his newly-formed party then went on to win a landslide victory in the country's first free election in 44 years. True to his values and ideals, he pursued policies of tolerance and reconciliation. He was instrumental in dismantling the Warsaw Pact and in helping NATO expand eastward. After 13 years at the helm of a chaotic political transition that included the breakup of Czechoslovakia into two independent states, he stepped down from the Czech Republic's presidency in February 2003 as a rare breed of

statesman who had openly psychoanalyzed his own self-doubt and foibles. Following his passing in 2011, several international awards for human rights activists were established in his honor. Despite the passage of time, Havel has remained one of the most admired figures from the Cold-War era.

## COLD WAR REDUX?

Today, more than half of Americans are millennials or younger, meaning that they are either not interested in or are too young to remember the dark history of totalitarianism and inspiring stories of dissidents fighting for human dignity and basic rights during the Cold War. That is a shame since those who cannot remember the past are condemned to repeat it. Many people take for granted our freedom of speech and liberty, but do not appreciate how fragile democracy really is. Hong Kong is a blatant example, where over the last twelve months, many rights were abruptly stripped away under the guise of patriotism. The erstwhile city-state that had once held the top spot as the world's freest economy for 25 straight years is not even on the Heritage Foundation's Index of Economic Freedom anymore.

Hong Kong is just one of the flash points that has led to an escalation of tension between China and the U.S.-led liberal democracies. Investors' hopes of an improvement in the U.S.-China relationship were dashed after China's top two diplomats unleashed a public diatribe against the U.S. in the first high-level meeting between the two countries after President Biden took office. These so-called "wolf warrior" diplomats' vitriolic performance in Alaska achieved their desired outcome of stirring up nationalism back home, but also incited greater support for a new Cold War among American politicians and electorates.

The new cold war, or strategic competition with China, is much more complicated than the Cold War that ended thirty years ago. During the first Cold War, there was a clear demarcation between the two camps, and the lack of deep economic and cultural ties between the two sides made it easy to foster an "us-vs.-them" mentality. Various institutions - the media, academia, businesses, and NGOs - had no problem speaking up against the repression behind the iron curtain. Their support for the likes of Václav Havel and the economic boycott against the Soviet bloc played an important role in bringing down the Soviet Empire.

The strategic competition with China, on the other hand, is fraught with contradictions, intertwined interests, and conflicting objectives even among the U.S.-led liberal democracies. China has, after decades of opening up to the West, created a complex web of symbiotic relationships with so many Western entities such that nearly every move we make, tactical or strategic, would

create winners and losers at home and abroad. This tangled web makes it difficult to build a unified front among liberal democracies to effectively deal with China as a strategic competitor and a rising superpower guided by a very different value system.

## HOW CHINA VIEWS THE U.S.

In the book *The Art of War*, Chinese military strategist Sun Tzu from 2,600 years ago wrote, "Know thyself, know thy opponent; a hundred battles, a hundred victories." Well, China has taken this advice to heart and has done a superb job in studying and understanding the U.S. China benefits from a transparency asymmetry - it can get so much intelligence from the West's open society, yet it has managed to remain quite opaque itself. China knows how many satellites, missiles, nuclear warheads the U.S. possesses from publicly available data, yet we are still trying to figure out China's actual military spending. Being proficient in English as a result of it being a compulsory subject in secondary schools, China's elites, from business executives to high-ranking officials, can easily mingle with foreigners and gain firsthand insights about us. Most of our experts, however, must rely on translation services, which may not always capture nuances in Chinese. Indeed, most Americans probably don't know much about China beyond what they glean from the superficial coverage in the media.

I recently came across the works of Dr. Jin Canrong, a Professor and Associate Dean at Renmin University's School of International Studies. He is an expert on Sino-U.S. relations and had lived in the U.S. as a visiting professor at the University of Michigan. He has become quite popular in China in recent years for espousing the view that the country's ascendancy to hegemony is inevitable. While his views may not fully reflect those of the Chinese Communist Party (CCP), many of them have been borne out by Beijing's actions in recent years.

Dr. Jin said that most countries evolve along three stages - subsistence, development, and prosperity (or dignity). For a select few, there is a fourth stage, hegemonic power. The CCP's past leaders have guided China through the first two stages, and Chairman Xi Jinping's mission is to realize dignity, or parity with the U.S. and then surpass it in the not-too-distant future to realize China's hegemonic destiny.

According to Dr. Jin, U.S. hegemony is built on four pillars that have created a virtuous circle - technology leadership, unrivaled military, the reserve currency status, and a soft power built on Hollywood. America's technology leadership helps sustain its military dominance via the most advanced surveillance and combat equipment. Our supreme military power gives investors the confidence in U.S. hegemony, which leads to capital inflow - financial and human - that helps to support the U.S. economy and the

greenback's global reserve currency status. Hollywood is an effective propaganda machine that exports America's values, culture, and lifestyle around the globe. This combination of hard and soft power has enabled the U.S. to surpass the U.K. and emasculate rising challengers – Germany, Russia, Japan, and the European Union – over the last 100 years. Today, the U.S. is attempting to do the same to China as it is the only country with the economic and military power to potentially dethrone the reigning world leader.

Dr. Jin attributed the U.S. enmity toward China to three beliefs. The first can be characterized as “white supremacy” – he said many Americans cannot stand the thought of China, a non-white country, becoming a world leader. The second is religion. As a country largely built on Christianity, America has a sense of righteousness and believes that God would take her side over the atheist Communist China. The third is the belief in the superiority of democracy over China's central command model. Interestingly, this last point is affirmed by President Biden's recent characterization of the Sino-U.S. competition as democracy versus autocracy.

Despite the aforementioned American superiority and beliefs, the U.S. has become less confident and more irritable. At a public forum in late 2019, Dr. Jin said that the U.S. has entered menopause and was resorting to tactics such as trade war, technology embargos, financial sanctions, and reputation damage (e.g., accusing China of human rights abuses) to contain China's rise. He also surmised that the U.S. will eventually play the Taiwan card to further escalate the tension.

## CHINA'S GRAND DESIGN

In assessing his country's prospect of challenging the U.S. for global hegemony, Dr. Jin said that China is unlike any rivals that the U.S. has ever faced. None of America's erstwhile challengers were able to match the U.S. in economic power, especially in manufacturing prowess. By his estimates, China's GDP would be 30% larger than the U.S. by the end of this decade, and its manufacturing economy would be three times that of the U.S. He boasted that China will account for 50% of global manufacturing by that time. In other words, time is on China's side as it has the size advantage to outmuscle the U.S.

China's near-term objective, according to Dr. Jin, is to force the U.S. to accept China as an equal power to jointly rule the world. To that end, Chinese citizens are proud that the U.S. has acknowledged the “great power competition” between the two countries, which they view as an affirmation of China's rising global status. Over time, as China surpasses the U.S., it will reset the rules of the game. China's ascendancy will be measured on several fronts – visa-free travel for Chinese citizens around the world,

internationalization of the renminbi at the expense of the U.S. dollar, Mandarin as a global language, and control of key international organizations.

Dr. Jin has been quite explicit in outlining China's strategies in this great power competition. He urged the CCP to make deeper penetration into the U.S. in areas of mutual interests so that China would not only make more profits and gain greater market control, but also expand its political influence. He pointed out how tight some of the U.S. federal and local elections are, and how China's influence could make a difference in those races. The central idea here is to get the CCP's soft power deeply ingrained in the West to complicate and even undermine any attempt at curbing China's rise.

On world affairs, he acknowledged that geopolitical instability is not good for China economically, but ideal from a strategic vantage point. He advocated bogging down the U.S. with at least four concurrent distractions and enemies. He counted terrorism and Russia as two of them, but lamented China's lack of success in shaping Brazil into a foe of the U.S. Of course, it goes without saying that North Korea, Iran, Venezuela, and Cuba are all aligned with China. The aim, according to Dr. Jin, is to keep the U.S. off-balance and exhausted with troubles and threats, saddled with great debt, and eventually driven back to isolationism.

Dr. Jin has exhorted the CCP to expand its global influence with the Belt-and-Road initiatives, the Asian Infrastructure Investment Bank (an alternative to the IMF, World Bank, and the Asian Development Bank), island constructions in the South China Sea, and the establishment of the East China Sea Air Defense Identification Zone. The goal is to achieve regional leadership in the Asia-Pacific and military supremacy in the Western Pacific.

To counter U.S. military presence in the Indo-Pacific, Dr. Jin said China should aggressively expand its naval power and precision-guided “carrier-killer” missiles. The People's Liberation Army (PLA) has made tremendous progress to that end – China as a regional power is estimated to possess 360 warships, dwarfing the U.S. fleet of 297 ships deployed around the globe. China has also developed the world's largest hypersonic air-launched anti-ship ballistic missile, which could potentially enable the PLA to hit targets in the vast Pacific and Indian Oceans.

Dr. Jin also advocated expanding the military competition from the traditional air, sea, and land theaters to the Internet, space, and electronics. China already possesses some of the most advanced Internet applications and is well-prepared for cyber warfare. Regarding the space race, he boasted that China has the capability to take down U.S. satellites. On electronics, or the technology race, he lauded China's leadership in 5G, drones, and various parts of the electric vehicle supply chain, etc.

The above-mentioned views were expressed by Dr. Jin before the COVID-19 pandemic. Today, after having dealt with the pandemic better than any major countries, the CCP is likely feeling even more confident. Indeed, the Wall Street Journal (WSJ) recently published an article titled *China's Message to America: We're an Equal Now*. It observed that America's chaotic pandemic response, racial upheaval and political riots have solidified Chairman Xi's faith in the Chinese system's superiority. The CCP believes that COVID-19 has hastened America's decline. In public, however, Chairman Xi continued to reiterate that China will not pursue hegemony or an arms race regardless of how powerful it becomes. Xi was merely calling for a "more fair and equitable" global governance.

## SQUABBLING ON THE TITANIC

While COVID-19 has led to much higher indebtedness, and perhaps deeper social and economic divides in the U.S., it has also created a greater realization of the threats posed by China. China is perhaps the most unifying issue among politicians across the ideological spectrum. The bipartisan "Strategic Competition Act of 2021" is expected to pass by a wide margin. To the chagrin of Beijing and Sinophiles, Team Biden has also kept its predecessor's hawkish stance.

The challenge that U.S. policymakers face is that, with the global economy so tightly integrated with and dependent on China, decoupling from it will be costly. There is also push back from businesses and academia, which have so much financial interest tied to China such that some have become Beijing's most effective lobbyists.

The business community's interest in China is quite understandable - which CEO would want to be shut out of an economy that will be the biggest in the world? The CCP has sought to exploit this greed and fear by rolling out new rules that would let it selectively punish global companies that comply with trade restrictions set by the U.S. As if on cue, the head of a premier U.S. manufacturing company, which also happens to be a major defense contractor to Uncle Sam, suggested publicly that he hopes "we can sort of separate intellectual property, human rights and other things from trade." Several leading U.S. companies that have fashioned themselves as enlightened, woke, and responsible corporate citizens have reportedly lobbied against the Uyghur Forced Labor Prevention Act. Hollywood, the alleged propaganda arm of the U.S. government in Dr. Jin's opinion, is known to have self-censored its works in order to please their Chinese financiers and the CCP's Publicity Department. Some have joked that Wall Street firms are now rushing into China while the CCP is expelling foreign journalists and NGOs.

Academia is often known to harbor pacifist or even anti-establishment views, so its ambivalence about China's rise

is perhaps not a surprise. China is an important revenue source for many American universities since international students from China, which numbered around 360,000 pre-COVID-19, had brought in more than \$10 billion of annual revenues. Over the years, Chinese entities have showered many U.S. faculty members with grants, consulting work, and fancy awards. Indeed, nearly half of the 100 distinguished experts who co-signed a 2019 open letter to the White House and Congress titled "*China is Not an Enemy*" were affiliated with universities. The letter claimed that the "fear that Beijing will replace the United States as the global leader is exaggerated," and opposed the "counterproductive effort to undermine and contain China's engagement with the world." Hmmm, I wonder what these esteemed experts would have thought of Prime Minister Churchill's immediate predecessor in 1940.

The more alarming development is that the anti-U.S. military sentiment fostered on campus has graduated into the business world. In recent years, a number of U.S. technology companies - Amazon, Microsoft, Alphabet, to name a few - have faced employee protests against collaboration with the Pentagon. In 2018, more than 3,000 Google employees signed a protest letter and successfully forced the company to discontinue "Project Maven," an artificial intelligence (AI) partnership with the Pentagon for non-offensive purposes. Ironically, that incident took place just a few months after Alphabet opened a lab in Beijing to work on basic AI research. According to Fei-Fei Li, the executive who had opened the lab, "A.I. and its benefits have no borders." Peter Thiel, a conservative technology entrepreneur and investor, recently blasted some of the Silicon Valley digerati as "useful idiots" and "CCP fifth column collaborators" for transferring technology to China. Incidentally, Thiel also wondered aloud whether Bitcoin should be thought of as a "Chinese financial weapon against the U.S." Indeed, it is estimated that roughly 65% of Bitcoin mining has occurred in China. In mid-April, a power outage in Xinjiang reportedly caused the Bitcoin network's hash rate (a measure of processing power) to drop by as much as 40%. Now that is a huge wealth transfer from the West to the East.

In short, the so-called American exceptionalism is not pre-ordained and has to be maintained with diligence and vigilance. China appears to be quite unified in its pursuit of greatness. America, on the other hand, seems to be bogged down with numerous domestic conflicts and feuds. We are sailing in uncharted macro and geopolitical waters and it is counterproductive to behave like petty passengers squabbling over who should keep the furniture and chinaware on the Titanic. Time is quickly running out for Pax Americana.

## UNITED WE STAND

Before anyone panics into ordering white flags from



Chinese manufacturers, let me point out that China's rise to global dominance is far from a foregone conclusion as the country also faces many internal issues: an aging workforce and population, elevated debt burden, over-dependence on infrastructure investment, and inefficiency in many industries. Externally, Beijing has few "real friends" as most of its allies are aligned with China for economic or geopolitical gains rather than shared values. China's expansion around the globe will only get more expensive. While Dr. Jin believes that China's size and scale will enable the country to outmuscle the U.S., he forgets to mention that the combined GDP of liberal democracies will still be larger. Indeed, alliance building is key to each country's success, and the Biden Administration has been busy sending the "America is back" messages to allies.

Geopolitically, Hungary, Germany, and Australia are currently three important chess pieces in China's global design. In the timeless strategy of divide and conquer, the CCP has been actively driving a wedge between the U.S. and its European allies. The unanimity requirement among the 27 members of the European Union (EU) to pass major policy initiatives, especially on common foreign and security issues, has created fertile ground for the CCP to exert its influence. Beijing has sought to sway some of the EU member states to its side with financial and various other incentives, and it might have succeeded in turning Hungary into its Trojan Horse. Hungary has pursued an "opening to the East" policy and was the first European recipient of Chinese COVID-19 vaccines. Prime Minister Viktor Orbán recently overcame stiff opposition to approve a controversial €1.5bn project, largely financed by loans from China, to build a Chinese university campus in Budapest. He then blocked the EU from issuing a statement criticizing China's policies in Hong Kong; it has effectively killed off the EU's plan to sanction China.

Germany's export-driven economy makes it vulnerable to a decline in Chinese demand. In a recent phone call with Chancellor Angela Merkel, Chairman Xi said, "China's development is an opportunity for the EU. We hope the EU can make the right judgment independently and achieve strategic autonomy in the real sense." Xi also reminded Merkel that "China has been the biggest trading partner for Germany." It is a clear message to Germany to pick sides, as most observers realize that as Germany goes, so goes the EU.

Beijing has used Australia to demonstrate to the West the economic cost of standing up to the CCP. The relationship between Canberra and Beijing has deteriorated rapidly after the former publicly called for an international investigation into the origin of COVID-19. To prevent other countries from joining Australia, Beijing retaliated ferociously by slapping tariffs of up to 218% on Australian wine, and by reducing purchases of Australian commodities such as beef, coal, barley by nearly 80%.

Beijing's calculation is that there is only so much economic pain Australians can bear, such that they may opt for a more China-friendly government in the next election.

Trade will become an even more powerful policy tool for China as its economy grows, just like it is for the U.S. For liberal democracies, the only effective way to deal with this threat is to have a unified front on major issues as China can ill afford to impose sanctions on an entire block of trading partners.

## TECH SUPREMACY

One area that the U.S. still maintains a lead in is technology. Indeed, the new great power competition really boils down to the race for technological supremacy. Historians will debate whether Beijing has ditched Deng Xiaoping's "lie low and bide your time" strategy too soon, as its overt demonstration of raw power in recent years has alarmed the U.S. into restricting technology exports. Semiconductors may be the most important component in this race as it functions as the lifeblood of the modern economy and the brain that controls everything from drones to autonomous vehicles. China's inability to access the most leading-edge semiconductor technologies could seriously hamstring its ascendancy. Interestingly, the quest for semiconductor supremacy now puts Taiwan, which Beijing considers a renegade province, in a critical geopolitical position as it possesses the world's most advanced semiconductor manufacturing technologies and facilities. Taiwan has, in essence, become a chokepoint for the global economy. It's no wonder that the PLA has recently escalated its provocation in the Taiwan Strait while the U.S. has become more explicit in its support of the island's security. It would be a black swan event should the PLA make a military incursion on Taiwan.

## RIP CHIMERICA

At a recent *Uniquely Rockefeller Special Client Event*, former National Security Adviser Lieutenant General H.R. McMaster suggested that businesses and investors should adhere to the Hippocratic oath of "do no harm" when it comes to the Sino-U.S. strategic rivalry. While that message may appear straightforward, it raises some profound questions. On one end of the spectrum, some may decide not to invest in Chinese stocks and bonds, as it seems inappropriate to finance a strategic competitor seeking to subjugate the U.S. in the long run. However, does that ban extend to non-Chinese companies that do business with China? How about international banks that underwrite Chinese securities? On the other end of the spectrum, there are investment consultants advocating dedicated China exposure in both public and private markets, as they argue that China's weight in global investment benchmarks will likely continue to rise. It begs the question on the independence and objectivity of index

providers who wield enormous power in channeling fund flow. The WSJ reported in early 2019 that the world's largest index provider was pressured by China to increase the country's weight in its emerging market equity index, and its business in China has boomed after the benchmark was adjusted. As of the end of March 2021, China's weight in the MSCI Emerging Market Index has grown to 38%. I suspect that, over time, U.S. regulators will set more limits on what public pension funds can invest in China, and the ESG community may also grow more vocal about China-related investments.

Given the nature of the Sino-U.S. rivalry and country-specific idiosyncrasies, it would be too simplistic to treat China as a typical overseas market or just another component in the benchmark. There are China-specific issues regarding insufficient transparency and investor protection, capital control, government intervention, and deviation from international norms. These issues may not matter for short-term trading, but could be material for longer-term investments, especially those with limited liquidity. For those seeking to invest in China's private equity market, they may want to ask what makes themselves so special that the CCP, which can control practically every aspect of the market, would let these foreigners in on the most lucrative deals. It's a clubby world where *guanxi* (connection) outweighs most other factors.

The Sino-U.S. rivalry will also affect companies outside of China. Some will experience higher cost structures as they adjust their sourcing strategy, and others may gain from this trend. Businesses that have benefited from growing exposure to China may see that turned into a potential risk as there will likely be increasing pressure to choose sides. On the macro level, the disinflationary impulse from two

decades of China's growing role as the world's factory will likely diminish in the years ahead as the decoupling trend gains momentum.

In the final analysis, the macro backdrop will likely become less market friendly as the world's two biggest economies turn increasingly hostile toward each other. In 2007, historian Niall Ferguson coined the term "Chimerica" to describe the symbiotic relationship between China and America. Today, he observes that Chimerica's funeral had started when Donald Trump took office, and that Cold War II has already begun. He is not sanguine about America's prospect and has warned that great empires can collapse suddenly without much warning. In a recent *Bloomberg Opinion* article, Ferguson even surmised that Taiwan may be, to the American Empire, what Suez was to the British Empire in 1956; he fears that America's inability to defend Taiwan against an attack from China might expose itself as a paper tiger and trigger a downward spiral.

Notwithstanding Dr. Ferguson's pessimism, I believe it is the human heart, or our desire for liberty, that will triumph in the long run. As Václav Havel said in his historic speech before the Joint Session of the U.S. Congress in February 1990, "*The salvation of this human world lies nowhere else than in the human heart, in the human power to reflect, in human modesty, and in human responsibility.*" The one great advantage that America has, according to Havel, is that we have been an uninterrupted democracy for more than 200 years. Ultimately, as President Biden assured our allies, democracy will prevail over autocracy. Of course, it will take hard work and shared sacrifice to realize that desired outcome.

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