

THE National Investor

Oct. 4, 2019

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ANALYSIS & COMMENTS

“GUT CHECK TIME” OVER CHINA



“China (has) declined to adopt promised reforms. . .”



“No force can stop the Chinese people.”

As I have been explaining for quite some time now, what some are *still* calling a “trade war” with China has revealed itself more and more as something *far* more substantial. I have quipped that—especially since May 1, when President Trump did *not* blink when China attempted for the umpteenth time to get by with all manner of things, and walked away from a comprehensive deal that would have held their feet to the fire—we had moved past the “sneakers, soybeans and cell phones” trade and tariff tit-for-tat to more of a **broad New Cold War**.

And that new war continues to grow ever more complex; and perhaps intractable.

Even several weeks ago when I warned that renewed Chinese promises to buy more American agricultural products *sans* their own import tariffs. . .and when Trump postponed the effective dates of new/increased tariffs on Chinese goods sent to the U.S. . . and when otherwise there was (again!) false hope for a larger breakthrough or deal, that folks should not hold their breath. **Quoting another pundit, I referred to all of this and some related very minor such steps as little more than a “pantomime for the markets.”** Trump—as always, it seems—wanted to keep the stock market levitated via frequent (albeit empty) promises that a “deal” was on its way. For his part, Chinese President Xi Jinping needed to

show his own pro-active engagement, so as to at least slow down capital flight and the growing credit market issues I have been discussing in painful detail since about August 1 now, when I adopted my decidedly more bearish take on things.

Yet lately the gloves have been off again more than on. In Trump's latest speech several days ago before the United Nations General Assembly, he was full-throated in his condemnation of China on several fronts. Explaining the core trade/economic disputes he said, in part, "Not only has China declined to adopt promised reforms, it has embraced an economic model, dependent on massive market barriers, heavy state subsidies, currency manipulation, product dumping, forced technology transfers and the theft of intellectual property and also trade secrets on a grand scale." Further "offending" China, he alluded as well to a litany of human rights abuses over the years, *many still ongoing*. On all of this—and despite the claims of many Democrat Party leaders to the contrary—the president *has* marshalled some support from other nations with the same gripes.

China naturally is fighting back. His presiding over the People's Republic's 70th birthday party this week rudely interrupted on two fronts (the New Cold War with the U.S. and growing protests in Hong Kong), President Xi blew off the comments of Trump specifically and America's newfound backbone generally as coming from ". . .an economic hegemon that no longer rules the roost" and is afraid it is sliding into history as a great power. Stirring up his own nationalistic sympathies amid the pomp of the military parades and all, **Xi insisted that China's return to a great global empire in its own right was unstoppable.**

A NEW FRONT ABOUT TO OPEN UP IN THIS WAR?



The "leak" last Friday of an added possible game plan in Washington that would severely curtail Chinese access to U.S. markets—and vice versa--caused a little angst as trading ended the week. **It should have caused more.** And even though Trump adviser Peter Navarro pushed back on this Monday morning in a *CNBC* interview, it's VERY clear that such a thing represents more than anything so far a "nuclear option" for those who want to *really* cripple China. (NOTE: listen to <http://www.kereport.com/2019/09/30/the-importance-of-the-monthly-and-quarterly-closes-trade-updates-and-impeachment-proceedings/>,

where on Monday I went into considerable detail on the genesis of and *legitimate* reasons for this possible move.)

For the relatively few who *are* paying attention to what BY FAR would be the most profound market development yet in the New Cold War, reactions in some quarters are telling. President Xi for arguably the first time directly warned of a calamity *for China* if America were to follow through with delisting the 100+ major Chinese companies that trade in the U.S., etc. Correct me if I missed another such instance: but I do not remember another occasion in the last year that this tussle has raged that Xi has so frankly admitted such vulnerability. He knows—as he *appealed to Wall Street interests in pushing back—*

that there indeed are those in the U.S. “Deep State” who have as their objective knocking China back down several pegs on the ladder it has been climbing.

And speaking of the American Deep State, this issue is *widening* the gulf between two “camps”, if you will, which on *most* other issues are usually aligned: Wall Street on the one hand and the Deep State on the other. On China, they could hardly be farther apart.

It was back on May 1, as you remember, when The Deep State visibly “won” Trump’s allegiances, recovering them from Wall Street which then—and *now*—is pining for any kind of a “deal” solely to protect their profits/regimen. As we’ve seen anew this week by some hysterics over the idea of severely curtailed capital flows back and forth, Wall Street is motivated *by money*. They care little if anything about China’s spying, human rights abuses, military incursions or anything else. Hedge fund manager Kyle Bass spoke well to this and related subjects—see <https://www.cnbc.com/2019/09/30/kyle-bass-ip-reform-needs-to-be-included-in-us-china-trade-deal.html> --on Monday as well.

Thanks to legislation called the Foreign Investment Risk Review Modernization Act enacted into law last August, there is at least some enhanced understanding of the threats America faces today due to past administrations being so lax on China (such as the “O’Biden” Administration, which exempted Chinese companies listing in America from disclosure, audit and related rules back in 2013.) *At the least*, negotiations between the U.S. and China which are slated to resume next week in Washington will have more overtly added to them this new leverage/demand on America’s part: that if Chinese companies are to continue having access to U.S., markets, they will play by transparent U.S. rules.

I have commented before that the real danger of this New Cold War with China is *not* that economies/policies over time will be unable to adapt. **It is that MARKETS are unprepared.** The occasional hissy fits that Wall Street has thrown over “trade wars” in recent months will be *nothing* compared to what we will see if actual steps are taken to de-list Chinese companies from the New York Stock Exchange, etc.

And that—and more—is what the military-defense-intelligence Establishment is pushing for; and by all appearances they remain in the driver’s seat. That “Deep State” apparatus is the body—not Wall Street—that is pushing numerous *legitimate* gripes concerning a China that has gotten away with too much for too long. They are less worried about the here and now of



Wall Street, investor profits and the level of the Dow. They are more animated with issues such as that represented by the above bragging photo from a couple years back on Chinese state television. That is one of several new military bases on a man-made island in the South China Sea; and in a location—atop Fiery Cross Reef—hundreds of miles from the Chinese mainland and in waters disputed by China’s neighbors. . .and by the U.S.

Indeed, the Pentagon is itself aggressively seeking to have its voice heard on the issue of what favorable advantages Chinese corporations have been given in the past. *Specifically*, it has been compiling its own list of companies with ties to China’s military; it does not want them to any longer

have the ability—via benign, favorable advantages, etc.—to obtain sensitive technologies, information or anything which are then passed on to China’s military. In addition to such things, even weapons supply chains are being scoured for any ties that could ultimately benefit the People’s Liberation Army.

It is a mark of just how much this investment/listing issue is forcing its way to the forefront when you look at *the timing of its being made known*. Mere weeks removed from Trump having postponed some tariffs set to take effect this past week—October 1 specifically, of course, the People’s Republic’s birthday—in a polite gesture, this FAR more meaningful issue reared its head instead. That, in turn, caused Xi to address this new threat from America during his parades, et al.

And it suggests that—if the Deep State and these (and below) broader issues continue to keep Trump’s loyalty, to the “expense” of Wall Street and those worried *only* about profit—traders are presently setting themselves up for MAJOR disappointment.

AND LEST YOU FORGET ABOUT THESE OTHERS. . .



While potential moves to either de-list or make accountable Chinese corporations is probably *the* most important element to focus on now—especially for investors—that several others are gaining greater prominence demonstrates that, *whatever* the motivations, U.S. policy makers seem to be of a mind to clean up (or try to) LOTS of long-festering issues *now*. In no particular order of importance, consider some of them:

* **Human rights issues** – Having for a while “politely” brushed such mundane things under the rug, as have past administrations, in the name of cooperation (and profits) the Trump Administration is more willing to call China on the carpet for its human rights abuses. Now, I’m not saying that *everyone* lately rediscovering the atrocities of persecution of religious minorities, the ghoulish ways in which organs are harvested from live people, etc. is insincere. But this does go to show at least somewhat that *this* present U.S. administration, at least, really is of a mind to go to the mat on these and other matters.

For more, see <https://nypost.com/2019/06/23/the-ugly-truth-about-chinas-organ-harvesting/>.

As Bass suggested in that above-linked interview that America in the first place has anything to do with China in light of such atrocities is a question that should be asked more seriously.

* **Weaponizing debt** – Bailed-out Chinese institution Bank of Jinzhou has already suspended interest payments on external, U.S. dollar-denominated debt. As I pointed out at the time, that this happened *after* the bank was bailed out is telling. Threats have come that if “obligations” to China or Chinese companies are gone back on by the U.S., more such moves could happen.

Trump, of course, has made threats of his own in this regard. Chiefly, he has mused about *defaulting* on U.S. Treasury bonds owed by China, claiming as an “offset” and right to do this the fact that America owns a slug of pre-PROC bonds, which the present regime claims no obligation for.

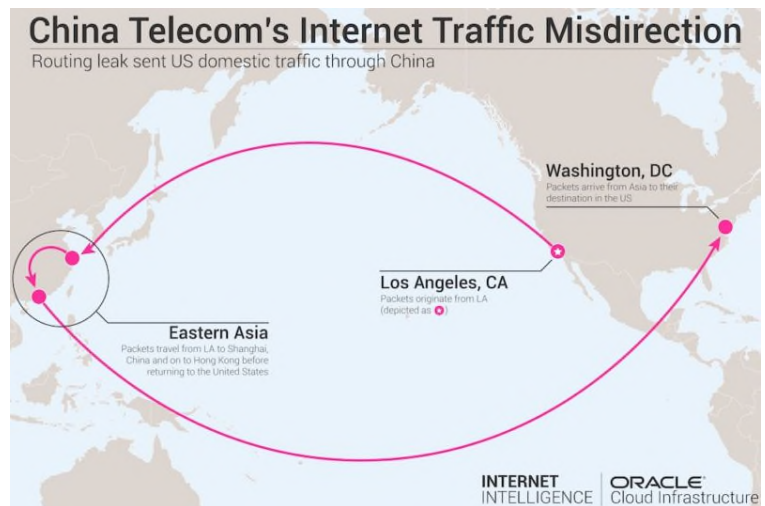
* **Putting the screws to China via Hong Kong, too** – Besides the growing protests in Hong Kong looking bad for China and giving Trump even greater moral authority in this New Cold War, a bipartisan group of U.S. Senators—Sen. Jim Risch (R-ID) and Sen. Bob Menendez (D-NJ), the Republican chairman and ranking top Democrat on the Senate Foreign Relations Committee, and Senate Banking Committee counterparts Sen. Mike Crapo (R-ID) and Sen. Sherrod Brown (D-OH), want a review of what we export in many contexts *to Hong Kong*.

“We believe it is critical that the United States take appropriate measures to ensure China does not abuse Hong Kong’s special status under US law to steal or otherwise acquire critical or sensitive US equipment and technologies in support of its strategic objectives or to infringe on the rights of people in Mainland China, Hong Kong, and elsewhere,” the senators wrote in a letter reportedly sent to both Secretary of State Mike Pompeo and Commerce Secretary Wilbur Ross.

* **Internet traffic**—The U.S. side is *still* smarting over the revelation late last year that via some “snafu”, volumes of U.S. domestic e-mail traffic were re-routed through China (see <https://arstechnica.com/information-technology/2018/11/strange-snafu-misroutes-domestic-us-internet-traffic-through-china-telecom/>.)

Already, it seems as though markets have *at least* got it into their heads that the U.S. and much of the rest of the world will go their own 5G way, and China its own.

* **Moves on strategic metals, etc.** – Though it did not elicit the reaction from Xi that the issue of de-listing Chinese companies and curtailing investment flows did, I have to believe that about the *second-most* aggravating thing witnessed and endured by Xi of late was the meeting several days ago between Trump and Australia’s P.M. Scott Morrison (the two below outside The White House.) And unlike the Trump Derangement Syndrome-afflicted Democrat Party and media angry that Trump asked Morrison, too, to “investigate” the political attacks on him, Xi couldn’t care less about *that*.



Instead, he has to reckon with the wooing away from China’s orbit even a little of one of its key natural resource suppliers. As is a suddenly *very* Trump-friendly Canadian P.M. Justin (“Who shall I Dress Up as Today?”) Trudeau, Morrison seemed very pleased—and very cooperative—to pledge greater sourcing for natural resources and strategic metals of all kinds to the U.S. And adding even more “insult” to China, Australia (already, of course, with greater political and cultural affinity with the U.S.) is supportive of America’s attempts to curtail China’s military expansion in its own neighborhood.

GUT CHECK TIME FOR AMERICA...AND FOR TRUMP

As “imperfect a vessel” as Donald Trump indeed is—and though you or I might have handled some *details* of all this differently—it’s clear that the time has come to belatedly deal with China.

And it’s likewise clear that Trump has embraced this historic role.

Further, he seems at his core to *truly want* a peaceful, mutually beneficial outcome.



Earlier this year I shared with you a discussion by Bannon where he laid out a scenario—one which he himself seems to prefer, and claims his onetime boss does likewise—where *everyone wins*. China would further open and make transparent both its markets and its legal/business framework. Tariffs would disappear ultimately; *the world over, in fact*.

Sadly, neither Trump nor Bannon appears likely to get that. I have for a while laid out my own view on this; one which leaves the question more as, “As the U.S. and China decouple and move farther apart, will this road be gone down peacefully...or otherwise?”

MUCH more than you’ll get from the Establishment media and the Democrat Party (which *used to* take the lead on wanting to fix all these things with China, but has since—consumed by such a personal, visceral hatred of Trump—pretty much thrown away any policy interest or credibility in the minds of those still able to think rationally) **Trump is on the right side of history here more than not**. And as I feel is *still* the case where the 2020 election is concerned, I likewise believe that *this New Cold War with China is Trump’s to lose*.

Seemingly contrary to his inclination prior to May to possibly make an easy deal and turn out (like his last few predecessors) to be an easy mark for China, Trump now *seems* to be in this for the duration. He seems to get ever more the strategic and military factors at stake; and is unwilling to leave such things unaddressed in this process. That subject especially was very eloquently addressed recently by former Navy SEAL Admiral William McRaven, who described the present time as a “Holy S**t” moment where China’s military and related advances are concerned (For this BIG eye-opener, check out <https://news.yahoo.com/navy-seal-oversaw-bin-laden-160142342.html>)

None of us knows what we are going to get in the end yet; I’ll certainly have more to say as negotiators meet again late next week, and afterward. If—as recent appearances make *very* clear, at least to Yours truly—Trump remains more in that Deep State camp, then not only will there *not* be any kind of a major deal forthcoming, but the New Cold War will intensify. Perhaps dramatically so.

This, naturally, will intensify the pressure on the president; not only from Wall Street and business interests generally, but from many in his own party who are going to get *major* heat from corporate donors. Sadly, Trump might not be able to count on their open ended support. Especially if

Wall Street and/or the economy falter even more, not a few Republican senators may be whispering to the White House out of public view (initially, anyway) that their support could be limited.

In the Biblical epistle of James, the writer quips that “A double-minded man is unstable in all his ways.” As a country, our relationship with China as such is not the first time America has been double minded, *if not duplicitous and hypocritical*. Were it not for American money, greedy capitalists and military intrigues, there would never have been a Soviet Union with which we were at odds for a couple generations. Having first been largely responsible for that “Evil Empire’s” creation and especially its post-World War 2 emergence, we later saw the need for its destruction.

Likewise, having (more so on Wall Street in this case) enabled and built China as, first, a mercantilist colony of Corporate America, now we have the same “need” to either rein in or cripple *this* monster of our own making. **It’s sad that as a man who is often double minded *himself* on things is at the helm for this task, the country he leads is at cross purposes.** China now doubtless still hopes *their* cause will be aided by America’s political acrimony and double-mindedness.

Were Barack Obama the one right now saying and doing what Trump is concerning China, both the Democrat Party and the media would already be underway with a P.R. campaign and preparations to add his visage to Mount Rushmore. But with the hated Trump in charge, their only contribution to this epochal issue of China is “Impeach!” “Orange Man bad!”

Likely of more concern *and danger* to Trump than hate-crazed Democrats is that the two main organs of American power are at cross purposes and render our country itself quite double minded as to our objectives. Whether the Deep State or Wall Street prevail remains to be seen; and the answer to this question will settle (or not) some issues *decades* into the future, as well as be of perhaps more immediate relevance to investors.

We are about to find out whether Donald J. Trump truly is a statesman (albeit a brash one never “housebroken” politically) or not.

Stay tuned...

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