

# The U.S. Versus China: The Geopolitical Fight of Our Time and What it Means for Investors

## Speaker Key:

DP	David Pett
KM	Kevin McCreadie
RC	Regina Chi
GV	Greg Valliere

Time code	Speaker	Text
00:00:06	DP	The relationship between the two biggest economies in the world continued to deteriorate during U.S. President Trump's tenure at the White House. But will a new administration in Washington DC flip the switch? On this episode of Inside Perspectives, Kevin McCreadie, AGF's CEO and Chief Investment Officer, welcomes back Greg Valliere, AGF's Chief U.S. Policy Strategist, and AGF's Portfolio Manager, Regina Chi, to discuss market implications of a relationship that remains full of friction and fraught with frustration.
00:00:37		I'm your host, David Pett. Let's get into it. Thanks for being here. Greg, I think this is your second or third time on the podcast. You're becoming a regular. And Regina, I believe this is the first time since our very first podcast, way back in the fall of 2019, so welcome. I want to start today's conversation with a quote, the week that changed the world. This is how U.S. President Richard Nixon described his historic visit to China in February of 1972.
00:01:05		And it's really tough to argue with him. Nixon made the trip to, quote, unquote, normalize relations between the two countries, which has been severed, following the Chinese communist revolution in 1949. And now here we are, almost 50 years on, set to talk about a relationship that continues to evolve and influence the global economy and financial markets more than any other currently at play in the geopolitical arena. Kevin, I'll start with you.
00:01:30		How central has the U.S. China relationship been to the experience of investors over the years?
	KM	Thanks, David, and thanks, everyone, for joining us. China, if you go back over the last 50 years, it might even have been before Nixon, around the same time as the ping-pong diplomacy, there was a great ping-pong match, I think, which started to thaw what was really a tough period coming out of Vietnam.

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		The U.S. had seen the Chinese back North Vietnam. A very unpopular war in the U.S., and so the need to create some type of peace in the region with China, I think, was pretty imminent.
00:02:00		And you fast forward 50 years to today, China's become the second largest economy in the world. And along that path, pace of change has been unprecedented, in terms of how quickly China has changed. If you were in China in the 70s, there were not a lot of roads. Major cities did not exist the way they look today. Probably not a lot of cars either. An expensive purchase was something as simple as a very cheap wristwatch. So, it was [?] an agrarian economy that today is a superpower in 50 years, which we've seen nothing like that in modern history and probably history in itself.
00:02:29		And from a markets perspective, China started as a place where many global companies could manufacture cheaply. And so it helped boost profits, helped boost profit margins by offshoring [?] wages, if you will. And it had probably a damping effect on inflation, to allow us to have probably a pretty good run-up around where bond markets went and other things. So, the deflationary spiral that we saw in the beginning as China emerged from cheap labor to today has probably changed, too. It's not cheap to manufacture in China anymore, as it has become more westernized, if you will.
00:02:59		And at the same time, it's no longer a manufacturing destination, but a global brand destination. So, think of it as if you're a big company today and you want to sell into the second largest economy in the world, it's no longer about manufacturing. It's about end market sales. So, it's been an incredible transition for markets, as well as the economy and just the society of China, these 50 years.
	DP	And then, Regina, I'd be curious to know how you view this relationship has developed over the years.
	RC	There's been an underlying belief that the U.S. can readily mold China.
00:03:29		And it was not only Nixon, Johnson, it was Clinton and Obama, who all hoped that could tame China with greater interaction. But the reality is that diplomatic and commercial engagement have not brought political and economic openness, and Trump really addressed the past assumptions with China, and they focused on bilateral trade deficit and IP theft. Now under Biden's administration, it's all this, plus human rights issues. But

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		over the years, both nations have been trapped in this web of codependency. China has turned, increasingly, to the U.S. and the rest of the world for their economic growth.
00:04:02		At the same time, the U.S. has become heavily reliant on China as a major source of growth, as well as cheap manufacturing. And so, as Kevin mentioned, U.S. multinationals have benefitted the most with the access to cheap labor and manufacturing, and this, in turn, has given them a huge access to an economy of 1.4 billion people with a growing income, middle income class and rising disposable income.
	DP	And then, Greg, you, of course, have a unique perspective on this as well, I'm sure, given the fact that you're so involved in the political side of markets.
00:04:33		What's your take on what we've seen over the last few decades, in terms of this relationship between the U.S. and China?
	GV	As Kevin and Regina both said, I think, for years and years, things got better and better. But I have to be candid with you, when I talk to people here, in Washington, there's real antipathy towards the Beijing government, towards Xi and his allies, over several issues. One would be the treatment of dissidents. Another would be China's hacking into U.S. firms, especially firms that are working on vaccines.
00:05:03		And still another is what is perceived to be a lack of transparency by Beijing on the virus. Not really being fully candid with the rest of the world as to what's going on. These fears may be exaggerated, but I have to report to you that while maybe the rhetoric from Joe Biden is a little gentler than Donald Trump's, Donald Trump was very crude and hostile, rhetorically, I think that Biden realizes that his own party, the Democrats, are ambivalent, at best, at warming up relations with China.
00:05:34	KM	It's funny, Greg, one of the few unifying things we see out of Washington these days is really around China. Nothing much has got done on a bipartisan basis, but something could get done. Many things will get done, I think, as it relates to future initiatives around moving ourselves away from China independence, China's control over technology, and other things. So, it may be a source, not just a Biden or Trump issue, but a source of unification on some of the policy issues in Washington today.

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00:05:59	GV	That's a really good point, Kevin. And I would just mention that there's legislation pending in the Senate to maybe crack down on China and spend more money on manufacturing here, in the U.S. And the legislation is sponsored by Chuck Schumer, the Senate Majority Leader, a Liberal Democrat and a fellow senator from Indiana, who's one of the most conservative Republicans. So, Kevin, you're right. I think that there is a unified sense that we have to get more aggressive, and Joe Biden, himself, has said, on many occasions, that China is eating our lunch and he wants to do something about it.
00:06:32	DP	Maybe we can get into a little bit more about what those major issues are there wedging a divide between these two countries. Kevin, is there something, in particular, that perhaps worries you more than others on this front?
	KM	I think the common word that you'll hear everyone talk about is technology, IP theft, technology transfer. And the state of technology and the dependence of what we're going to need for the next decade and decades beyond and should it be controlled by China? If you roll back to the Trump and Biden election, we probably all thought that China really wanted to have, and rooted for, Biden as President.
00:07:05		I'm not so sure of that any longer. To Greg's earlier comment, Biden has picked up where Trump left off. He's not thinking about rolling back tariffs that we can see at all. And, if anything, I think he's going tougher. Maybe what the Chinese liked about Trump was that he had a disengagement policy around the world, where he said, basically, isolation is the U.S. is going to be on its own. Whereas Biden is probably going to look for a more coalition type approach. He'll get the EU and others to help him in his thinking around China.
00:07:32		But really, I think, in my mind, if you had to take one word on China today it's technology, the future of technology and the dependence on it for all countries in the developed world, as we move into what is going to be 5G and beyond that, AI, quantum computing. Many of the things that will, over the next decade, emerge as dominant technologies.
	RC	I can add to that. As we go into U.S. China trade tensions 2.0, I think it's going to be a lot tougher. And I would agree with both Greg and Kevin that the Biden administration will be much more aggressive in certain aspects, especially under Katherine Tai, who is now the new U.S. Trade Representative.

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00:08:05		She firmly believes that the U.S. needs new trade laws to head off anti-competitive threats from China, rather than reacting to them. And that's what we've been doing in the past. She wants tools to address China's massive subsidies and the state driven economic system, and right now, I'm not sure what these tools will entail, but it could mean that she's laying out the groundwork for future new tariffs to shield U.S. industrials and to use as leverage in negotiations.
00:08:31		So, as tough as Robert Lighthizer was, I think Katherine Tai will be tougher. We haven't seen her yet, but I think she'll be going into talks with China relatively soon. And she has said, in the past, that the U.S. can't shy away from being tough on China. But it must be fair and the relationship will be a mix of competition, cooperation, and confrontation.
	KM	If I can add one thing there, which is I want to separate the word technology from what happened in the past. And this may be controversial, but if you're Apple and you went to China and you didn't think that your IP was going to get copied, I'm not really going to believe that, because you knew that, with a wink, that that was the case.
00:09:04		And in fact, that was the trade-off for you to get access to \$1.4 billion, 1.4 billion people, to sell your goods to. That's not what we're talking about. We're talking about the dependence of emerging technology in the future that will control, basically, some of economic growth around the world. If you don't get it, you can't have access to it. So, separate the past and IP theft that many groused about, versus what, in the future, could be in the emergence of technology and the dominance and control of them.
00:09:30	GV	I think a really crucial factor here, in Washington, is China's behavior going forward. When we look at China, we see the repression in Hong Kong, we see forced sterilization of Muslims in western China, we see the lack of transparency on the virus. If China were to loosen up a bit and become less repressive, I think that would have a very positive impact on the politicians here, in Washington.
	RC	Greg, this will never happen. Not under President Xi Jinping.
	GV	I know.

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00:09:59	RC	It's a top down, authoritarian government, full stop. There's a very big ideological difference between the western world and China.
	GV	I was just going to say that I think that China could make things a lot better, if they treated their people differently. But Regina's right. Xi is not inclined to do that. Until he is inclined to be a little more tolerant of any kind of dissent, I think there's going to be real suspicion of China here, in Washington.
	RC	I think even [?] Chinese people do not feel that they're poorly treated by the government, to be honest.
00:10:30		And with respect to Hong Kong and Taiwan, they're seen as renegade provinces. So, there's a lot of deep history with respect to taking back Hong Kong, and who really, quote, unquote, owns Taiwan or who does Taiwan belong to? I think it's really in the lens that we look at versus their lens.
	KM	But the other side of that coin, though, is if you look at China today, Regina, they're concerned with more stability, social stability. They're worried about inflation. They're worried about social unrest more than ever, that I've seen.
00:11:01		Versus taking a full-on pedal to the metal growth perspective. Because housing prices have got out of control, food prices are out of control. And so I think while Taiwan and Hong Kong may be viewed as rightful properties of China, I think that there's probably a growing social unrest concern at the Chinese government official level today that would, maybe, make them think about social unrest in those other provinces or those regimes, Taiwan and Hong Kong.
	RC	I absolutely agree with that, Kevin, because their biggest national security is not Taiwan and Hong Kong, it's financial risk.
00:11:33		And this is why, much as they want to have growth, they want financial stability. So, as much as they ease, they're quickly eager to pull it back. So, financial security is critical for them, and this is why you see so much regulation in the financial space. And that's not going to change. When you look at their balance sheet versus the rest of the world, it's very, very strong.
	DP	Greg, I want to pick up on something that Regina and Kevin have both mentioned, and you as well. It sounds like the stance towards China, from a U.S. perspective, is still one of strength.

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00:12:04		But has the diplomacy or the communication of that changed at all over the first few months of Biden's tenure?
	GV	No. I must say, David, I don't think it has changed that much. I do not see any imminent end of the tariffs. I think, for now, Biden is content to maintain the tariffs. I think, if you talk to people in the Pentagon, their greatest concern is Taiwan. I certainly wouldn't predict any kind of military action, but we all know that Taiwan is crucial for semiconductor chips.
00:12:34		They're the world's leading manufacturer. So, I do think that there is anxiety, still, in Washington over Chinese expansion in that part of the world, in the South China Sea, for example. Even Australia has had strained relations with China. So, this anxiety over Chinese hegemony over that part of the world still persists, even though we have a new administration in Washington.
	KM	I think the way that the world was preoccupied with COVID when the Hong Kong situation was basically allowed to be flipped.
00:13:04		And I think that maybe has emboldened China to think about Taiwan differently. You also have to remember the Winter Olympics are going to be in China in 2022, so it's hard to see the Chinese doing something truly provocative with Taiwan until then. But I would say that after the Chinese Olympics, it's probably a real possibility, a real threat. Especially given how complacent the world seems to be around how Hong Kong was flipped.
	RC	I don't know if anyone saw The Economist cover where there was a picture of Taiwan titled the most dangerous place at the moment.
00:13:32		I just thought that was a bit of an exaggeration, in my view. I would agree with Kevin that I don't see military action now, especially going into the Olympics, but there could be something over the next three to five years, if there are missteps. The real danger is not China launching a premeditated war. It's China being forced to react if red [?] lines are crossed. And so, recall the Taiwan Strait Crisis. We don't want a repeat of this. So, we'll just see what happens, but there's a codependency between China and Taiwan.
00:14:01		And having military action there won't benefit anyone, especially given the fact that you have Taiwan Semiconductor

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		having their largest leading-edge manufacturing based in Taiwan.
	DP	I'm just wondering, on that front, have any of you noticed their stance? Has it changed at all, since Biden took office?
	GV	I would say there hasn't been a dramatic change, other than the tone with China. The tone has been a bit more conciliatory, but in terms of policies, no. I'd say the most fascinating change is one that we see in several issues right now in Washington.
00:14:31		And that's a growing rift between Joe Biden and traditional Democrats and the progressive left. The progressive left has been quite outspoken in recent days about this legislation from Schumer and others to crack down on China. The progressive left feels that it is racist or not justified. The progressive left also is quite upset over Biden's lack of condemnation of Israel. So, this will be a theme on many subjects, whether it's the level of new taxes or the level of new spending.
00:15:01		But on China, as well, the left in Washington feels that we should be more conciliatory, and for now, I haven't seen us doing that.
	KM	From my perspective, Greg, on the change in tone from China, I think it is really about the U.S.' efforts with the EU to build a coalition against China. It really started around some of the human rights issues and sanctions that were trying to be imposed by the U.S., the EU, the UK, Canada, relating to the Uighur situation. And that was the first time we saw China respond pretty aggressively, in terms of its tone, saying don't try that, because we'll put a ban on goods from those countries.
00:15:35		So, in the past, that's always been a threat, but never really been applied against U.S. goods. But there's clearly a change in tone toward both the U.S. and the EU that you wouldn't have thought with Biden. Maybe under Trump, yes, but I guess the assumption, going in, was that things with China under the Biden administration would certainly have a more normal tone to it, and that's not been the case.
	RC	I can add to that, because of this multilateral approach that the Biden administration is taking, a lot of countries are being forced to pick sides.
00:16:03		Look at the resurgence of the Quad, which is India, Australia, the U.S., Japan, and look what's happening with Australia and its spat with China. Right now, China is Australia's largest trading partner, and nearly a third of its exports go to China.



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		Relationships have massively deteriorated because Australia was calling for an international enquiry over the handling of the coronavirus. And so, what was Beijing's response? Beijing's response was slap [?] anti-duty, anti-dumping, and anti-subsidy duties, as much as 80%, against Australia and Bali.
00:16:36		It also pays anti-dumping duties, between 100% to 200%, on wine imports. And so, you can see the economic impact by picking sides, and it's hurting Australia at the moment.
	DP	That's an interesting point, Regina, because it seems to me that the relationship, up until recently, a lot of how we globalized is due to that relationship between China and U.S. as a central point to that. And now perhaps as that breaks down, you're seeing a ripple effect and maybe a deglobalization movement, at least in part, due to that. Any thoughts on that, guys?
00:17:10	KM	The deglobalization was really started under Trump and his isolationist policies, I think. Greg can maybe add onto that, but this was make America great. And I think what started out as on tariffs and was meant to bring home jobs and manufacturing to the U.S., well, that was a fallacy. Those jobs didn't come back to the U.S.. They went to Vietnam where people are going to manufacture. There is supply chain risk, for sure, though, and it's not rhetoric.
00:17:35		I think we were exposed to the fact that some of the PPE that was needed during COVID, some of the pharmaceutical ingredients during COVID, and certainly, a lot of semiconductors, as we see the shortage now, are relying upon Chinese supplies. So, I'd say the deglobalization that Trump started, I'm not sure it will persist in the world we're moving to. Biden has basically flipped that on its head. He's reached out, as I said, to the EU and others. He's going to pursue a very different policy agenda with our allies, one that is probably a more coordinated role against China.
00:18:04		What you're going to see from China is the forming of relationships with probably some other people that we're not so wild about. Take the latest approach to Russia. Russia and China are now lined up against the EU and the U.S., probably so that globalization or a coordination amongst certain partners will have to be higher in the future than they were under Trump. That's to be seen over the next decade. It's not a one- or two-year view on that.

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	GV	I'd make another point, if I might, and that is I think the Trump administration pretty much proved the premise that tariffs don't work.
00:18:35		They raised prices on manufacturers here, in the U.S. They led to reciprocity from other countries. So, I am encouraged that with Biden, we're going to see tariffs diminish and probably be lifted. We saw some progress just recently with western Europe. I think that will continue and I think that will continue. And I think eventually, there will be a reassessment of tariffs on China. I don't think these tariffs are permanent. There's just too much trade at stake, whether it's soybeans or whatever.
00:19:02		So, I do think that one positive note here is the repudiation of tariffs by most of the countries in the world that realise they don't work.
	DP	Let's spend the last bit of our conversation trying to put this into some perspective for investors. Are we too complacent about the importance of the U.S. China relationship at the moment? Or do we have this right that we understand what's at stake and we're acting accordingly. Thoughts on that.
	RC	I don't think that investors are being too complacent, but I also think that the market could put too much weight on it.
00:19:35		Markets can still continue to do well with or without the tensions, and if we look at 2020, China was up 30% in a year that was a challenge. And if we look at 2019, even in the middle of the U.S. China trade war, China continued to outperform. So, I think that we have to separate the noise from the opportunity set that we have. China remains a very deep investable market with a lot of innovation and growth.
00:20:02		And if we could separate out the two, and we can invest in companies that are not exposed to the U.S. China tensions and trade war.
	GV	I would make the point that perhaps relations have got so icy that there's not a lot of room for things to get much worse. Maybe things will start to improve. I think, in both countries, there's a widespread appreciation of what Kevin said earlier, that technology is the key, whether it's semiconductors or a wide range of products.
00:20:30		So, I would think that there could be a gradual thaw under Biden. Nothing imminent, but I think that there's room for

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		improvement. There's not a lot of room left for further deterioration after the last four years. I think there's some room for improvement.
	KM	And from my perspective, for investors today, in the near-term, China is ... Between Hong Kong and mainland China and A [?] shares [?], you're probably looking at something that's north of 40% of the emerging market benchmark. A country with 1.4 billion people that today, even in a year of COVID, was able to actually grow its absolutely level of GDP.
00:21:04		No country in the world was able to do that in 2020. So, when you look forward, if you are a, as we said, multinational that wants to enter that market to sell those goods, there's going to be a pretty good demand as the middle classisation [?] continues in China. So, from an investor perspective, I think there's been a lot of noise around it, but it doesn't make it uninvestible in the near-term. If anything, it's a pretty good opportunity.
	DP	One last question from me. Regina, you talked a little bit about the impact of the pandemic and this idea of the blame game.
00:21:33		Were there any other tangible effects of the pandemic in terms of how this relationship functions between the U.S. and China?
	RC	Sure. I think the most obvious was this web of codependency that I talked about earlier. It became very obvious during the pandemic. And as you know, during the worst points of COVID-19, the whole world relied on China for PP&E. And China provided nearly half the world's supply of face shields, protective garments, gloves, goggles.
00:22:00		And it was these things that they exported, which allowed them to grow out of the recession that China was in, due to their own lockdowns. So, there was a huge realization that each country and region had to step up their own local production of medical equipment. And so, I think that was a big eyeopener for the world, but also, if we look at the supply side disruptions that we've been seeing, that also shows the shift points of global trade. And that's also giving pause to where to invest next.
	KM	There is one thing that I think when we look at the future, and we have to separate the near-term versus the longer-term.
00:22:33		This next decade is really going to be the story around China and the U.S., and others. If you go back in time, the U.S. has

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		never had an adversary or a competitor like China. If you think about Japan, it was probably economically a competitor, but never militaristically. If you look at Russia, it was the opposite. It was militaristically, but never economically a competitor. China will be both and is both, one would argue, over the next decade. And some of the incursions in the South China Sea to other countries, even going back to the Biden administration, this is a reset.
00:23:05		This is in the Obama administration. The Biden administration is a reset of what Obama's policies were, which were really to take an active stance in that part of the world. And so, I think the next decade is going to have those ramifications.
	RC	I think it's a great wake up call. It's great that the individual respective countries are thinking about reinvesting in their home markets and investing in key technologies that they were depending on from China, especially from a manufacturing standpoint.
00:23:32		So, I think that there could definitely be ways that they can cooperate, especially with respect to climate change, and they're both committed to reducing carbon emissions. And so, I would agree with Greg that they will be thawing, but it will take time and we have yet to see the playbook from Kathy Tai and even Kurt Campbell who is the new Asia [?] czar.
	DP	Okay, that sounds like a good place to end. Thanks again to Greg and Regina for joining us, and Kevin, as always, until next time.
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