



Treasure Island

From the streets of Hong Kong. Sounds like some degree of normalization could be productive.

Enjoy the read. Comments or questions always welcome.

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Investment Outlook

Treasure Island

The global markets last week have been dominated by news about China's new "Corona virus." It is impossible to say (on January 31st) what may be the economic and market impact: The only comparison we have is with the 2003 SARS outbreak, when our 50 staff in Hong Kong worked from home for 2 months. In China and the region, 800 people died, about 10% of those infected. This time, there is only a 2% mortality rate, even though infections are growing rapidly. Our best guess is that it will be regionally contained; and by March/April, economic activity will rebound rapidly. My final observation on this Chinese epidemic is that it will undermine the absolute controlling activity of the Chinese Communist Party, just as Chernobyl in 1986 eventually undid the USSR. Information has to flow freely in a medical emergency; and, eventually, people will rebel against internet censorship when it affects their lives and their family's health.

On January 25, I had the opportunity to attend a private meeting in London with US Treasury Secretary Steven Mnuchin, and I asked him whether he thought that the "Phase One" US-China trade deal would work to restrain China's model of "state capitalism" and protect intellectual property. Apart from balancing the US-China trade deficit in the short term, the challenge in the long term is to get China to follow the "fair trade" norms of the WTO; and President Trump deserves some credit for forcing this issue, in which he has been closely followed by Canada, Japan, and the European Union. (They all have trade deficits with China.)

We cannot yet forecast the outcome, but one thing is clear – China's breakneck growth economy period from 2000 to 2016 is finished – it will grow at a normal pace of 3% to 5% in the future.



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Also, China has agreed to open up its financial sector and stabilize the Renminbi. Many foreign banks and fund managers are already taking advantage of this enormous opportunity. It is estimated that there are over US\$6 trillion of domestic savings in China.

China outspends Taiwan on defense by 15 times. The assumption has always been that China would be deterred from an invasion by the implicit bargain that the US would come to Taiwan's aid. Now China has intermediate range missiles, which can reach US bases in Japan and Guam.

In February, President Xi and the PLA Air Force released a music video called, "My War Eagles are Circling the Treasure Island," likely to preempt any doubts that they would act, should Taiwan attempt to declare independence.

Why does China regard Formosa, or Taiwan, as a Treasure Island? Primarily because the "Treasure" is the Last Emperor's collection of Chinese antiques housed in the heavily fortified National Palace Museum north of Taipei. This was carried by KMT soldiers, escaping from the mainland in 1948 in about 24,000 crates. It has a symbolic, almost religious, meaning for the Chinese people.

The other "Treasure" in Taiwan is TSMC, Taiwan Semiconductor Manufacturing Corporation, which is the world leader in fabricating microscopic chips with 5 nanometer width (the best that China can do is 28 nanometers). Indeed, TSMC is on track to deliver 3 nm by 2022.

The re-election of President Tsai Ing-wen of the DPP, in January, has shown a surprising swing among Taiwanese voters against the Mainland, in particular, because of their reaction to recent events in Hong Kong.

In the meantime, we have invested not only in TSMC (up 100%) but also Wiwynn, a leading manufacturer of servers for "the Cloud." The Taipei market, up 15% in 4 months, has outperformed the region and South Korea (up 11% over the same period). Samsung Electronics has had a strong recovery (up 31% in the last 6 months) on the back of recovering fundamentals in memory and OLED, as well as strong smartphone performance.



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President Tsai of Taiwan gave an interview to the BBC on January 15, asserting that China must treat Taiwan “with respect,” and skirting dangerously close to the “Red Line” of independence. There is no doubt that China is increasingly prepared for the military option; they may exercise the economic option first. China accounts for 30% of Taiwan’s total trade.

In the meantime, the Chinese New Year of the Mouse (or the Rat) began on January 25; and there is no doubt of President Xi Jinping’s confidence in his remarks to senior aides recently. China has deftly dodged US tariffs by shifting trade volumes to other countries in Southeast Asia; and, overall, exports are up 7% year on year, and China’s share of world trade has been maintained. It will be tough for the USA to keep China down, even if its growth rate slows. We expect technological and medical innovation in China to continue, but (February 3) it is true to say that the closure of the US border to Chinese tourists, and businessmen, in the wake of the virus, will have a deep and widespread effect on economic activity, also in the technology sector. We are becoming more cautious about the 2020 outlook, and, fortunately, have a hedged short position in the Hang Seng Index.

India looks set to continue its steady business recovery under Prime Minister Modi, in particular, bank lending after the 2019 squeeze in the sector. The new budget (which we will comment on next month) appears to be pro-growth and pro-business. India will be less affected than SE Asia by events in China.

We wish all our readers a happy and prosperous Year of the Golden Rat!

A handwritten signature in dark ink that reads "R. Lloyd George". The signature is written in a cursive, flowing style.

Robert Lloyd George
3 February 2020
Hong Kong



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