BRANDES INSTITUTE SUMMIT:

What's Ahead for the United States and China?

As the world watches, tense and evolving relations between the two largest economies are reshaping everything from geopolitics to investor portfolios.

In Brief

- Amid trade sanctions and a global pandemic, relations between the United States and China have reached a new low in recent memory.
- A Biden Administration will likely seek multilateral solutions to trade disputes, but could face headwinds with partners dependent on Chinese capital and trade.
- Investors may find opportunities in Chinese technology and consumer growth companies, and with smaller countries benefiting from redrawn supply chains. Risks abound, underscoring the importance of a careful investing strategy.

As part of the Brandes Institute/Rady Summit, the following panelists participated in a discussion addressing "U.S.-China Geopolitics and Implications:"

- **Susan Shirk, PhD,** Research Professor and Chair of the 21st Century China Center School of Global Policy & Strategy, University of California, San Diego
- **Dylan Loh Ming Hui, PhD,** Assistant Professor, Public Policy and Global Affairs Programme, Nanyang Technological University of Singapore
- **Louis Lau, CFA,** Director, Investments Group, Brandes Investment Partners
- **Moderator: Anita Krishnamoorthy, CFA,** Chief Executive Officer, Brandes Investment Partners (Asia) Pte. Ltd

Few relationships are more important to the world or more fraught with risk than that between China and the United States. Though the two largest economic powers continue to depend upon one another financially, relations have "deteriorated to a point not seen ever before in recent memory," said Dylan Loh Ming Hui.

And considering China's economic might and emergence as an innovation power the tensions are creating "proxy wars" over technology companies, added Susan Shirk.

Will relations worsen or improve with a new U.S. administration? What are China's long-term goals? What opportunities and risks does this complex relationship present for global investors?

Below are some of the prominent themes that emerged during a wide-ranging conversation.
Listen to the Complete Panel Discussion >

Theme 1: A Shifting Balance of Power

The rising tensions are in some ways inevitable as the relationship changes from one of unquestioned U.S. economic superiority to one of parity and competition. During its remarkable, decades-long rise, China "really bent over backwards through its actions, as well as its words to demonstrate that its intentions were friendly," Shirk said. Yet since the mid-2000s, with China's growing confidence on the world stage, that conscious deference has increasingly given way to a more assertive stance, she noted.

A turning point was the global financial crisis of 2008-2009. The crisis "created this sense of triumphalism in China, because China recovered first," Shirk added. That more aggressive and confident behavior accelerated with Xi Jinping coming to power in late 2012.

The shifting power balance and China's changed international behavior have created tensions and pressures for multiple parties. The United States has diminished leverage to compel or influence Chinese actions. Other countries throughout Southeast Asia, though reluctant to do anything to jeopardize relations with either country, are increasingly being forced to choose sides, Shirk said. Yet perhaps the greatest risks and challenges belong to China itself. At an extremely delicate moment, China risks "overreaching," she said, in a manner that will encircle itself. "The Chinese perspective is very much that the United States is on the ropes. It's in decline."

Underestimating U.S. strength and resiliency, or overestimating the inevitability of its own dominance on the world stage could cause a negative backlash. And, domestically, the Xi Jinping government's tightening control of the Chinese population via increased monitoring and censorship could lead to widespread domestic disruptions.

Theme 2: The Future of Trade

The Trump Administration's hardline, largely unilateral stance with China, including trade restrictions and tariffs, has ramped up rhetorical tensions, but done little to alter the balance of trade, Lau said. "Since 2018, when the tariffs were put on China, the U.S. trade deficit with China temporarily decreased. But then in the latest year [2020], it actually went up near a similar level [on a monthly basis] as it's been two to three years ago," he said. "So, I think the U.S. needs to reevaluate trade policy and tariff policy."

A Biden Administration is likely to take a more nuanced and multilateral approach, Lau said, seeking partnerships and agreement with traditional U.S. allies such as Europe and Japan on approaches to trade disagreements with China. Yet that may pose challenges, he added. Japanese and European economies are stuck in low-growth mode. "Both are very dependent on China, whether it's luxury goods or tourism for Europe or the auto sector for Japan," he said. "So, they have been very reluctant to band together with the U.S. to wholeheartedly agree with, let's say, banning Huawei, for instance, or even criticizing China for their perceived role in the coronavirus."

In any case, China is shifting its emphasis away from purely export-driven growth and focusing more on domestic consumption. This trend, combined with the tariffs, is creating opportunities for countries such as India, Vietnam, Malaysia and others to ramp up their own exports. And the coronavirus pandemic has prompted major companies to look for more local supply chains. As U.S. companies do so, this is likely to create "near shoring" opportunities for Mexico, Lau said.

Theme 3: A More Inward-Looking China

While the U.S. and China continue to rely on one another, "I see an intensification of a tech 'decoupling' taking place," Loh said. Already, for example, mobile phone operating systems are beginning to diverge. Another possibility: the rise of the "splinternet"—separate platforms that tangentially intersect, if at all.

Many Korean and Taiwanese tech component manufacturers are aligned to U.S. tech giants. Thus, a decoupling of technologies presents risks for the largest Chinese tech companies in terms of their ability to source semiconductors and other key components, Loh noted. But it also creates opportunities for Chinese businesses to step in and fill the void.

"Right now, China spends $300 billion a year importing semiconductors from overseas," Lau said. Overseas manufacturers currently enjoy a five- to seven-year technology lead over China, he added, and China is racing to close that gap.

On the road to greater autonomy, China is also taking steps to strengthen its currency and reduce its reliance on the U.S. dollar. "We see this very clearly as well in a Chinese push to adopting a digital sovereign currency, or what is known as central bank digital currency," Lau said. China "is at the forefront of this technology," he added. Such measures could accelerate the phenomenon of smaller countries in Southeast Asia having to choose between the behemoths, he noted. "If you were to create a financial ecosystem where other states then depend on you for infrastructure or to transact in the renminbi easily, does that take away the financial autonomy of countries in the region?"

Domestically, as China looks inward, the Communist government is tightening control over society and media, consolidating power and diminishing freedoms. This runs counter to accepted wisdom in the West throughout China's economic rise—that greater financial freedom would inevitably lead to social and political freedoms. Of special note is the future of Hong Kong, a once-independent economic powerhouse that moving forward will look more like other Chinese cities, Lau said.

Theme 4: Opportunities and Risks for Markets and Investors

Considering the rapidly changing U.S.-China relationship, it's no wonder that the outlook, risks and opportunities for investors have shifted, as well. Political tensions have "filtered down to the company level, creating different implications from what we were used to seeing for the last 10 to 15 years," Lau said. "And this has really created a new investment paradigm."

For tech investors, some decisions may come down to timing. "We have to ask questions about how fast does Chinese domestic semiconductor manufacturing catch up? Which science should we be investing on? Should we invest in Chinese domain technology companies or should we invest in peers in other countries that are a little bit more advanced, but then they could be surpassed maybe in the next five to 10 years?" Lau asked. "These are important questions to address."

Looking beyond technology, there may be opportunities in Chinese consumer-driven companies in everything from e-commerce to manufacturers of home appliances, but investors should be aware of certain challenges. "It's becoming increasingly difficult for Chinese companies to become global companies because they are prevented from growing in the U.S. market. They have to divest once they reach a certain market size. And so, we need to be careful about Chinese companies that have reached some sort of a plateau in the market," Lau said.

Much depends on China's ability to open its markets and provide market clarity and reliability for outside investors. With the expansion of domestic consumption, China is shifting from being a supplier of global capital to a consumer of capital, Lau said. With that comes the need to "make China an attractive foreign investment destination…. That means opening up the financial markets, opening up the insurance market, opening up the auto market. And you'll notice that a lot of the opening up has taken place after Chinese companies have become dominant in those industries," he said, "because [China] needs to continue to attract foreign capital, but yet protect its domestic companies."

Conclusion

While there are certainly enormous points of contention between the two countries, the United States and China remain economically inter-dependent. The challenge in the years to come will be to focus on shared interests and needs, Shirk said, and "to preserve some space for cooperation on issues like the pandemic and climate change." Whether differences or commonalities define the relationship moving forward remains to be seen, but the relationship between the countries likely will continue to shape the future of the entire world.

View the full, free 75-minute conversation, as well as other discussions in the Brandes Institute/Rady Summit series. Register Now >

This material was prepared by the Brandes Institute, a division of Brandes Investment Partners®. It is intended for informational purposes only. It is not meant to be an offer, solicitation or recommendation for any products or services. The views expressed by Brandes Institute Advisory Board members and other panel discussion participants do not necessarily represent the opinions of Brandes Investment Partners nor the Brandes Institute.

The information provided in this material should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any security transactions, holdings or sectors discussed were or will be profitable. International and emerging markets investing is subject to certain risks such as currency fluctuation and social and political changes; such risks may result in greater share price volatility.

Brandes Investment Partners does not guarantee that the information supplied is accurate, complete or timely, or make any warranties with regard to the results obtained from its use. Brandes Investment Partners does not guarantee the suitability or potential value of any particular investment or information source.

Past performance is not a guarantee of future results.

No investment strategy can assure a profit or protect against loss.

11988 El Camino Real, Suite 600, P.O. Box 919048 | San Diego, CA 92191-9048 | 858-755-0239 | 800-237-7119 | brandesinstitute@brandes.com