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Western investors increasingly see capital risk when investing in Chinese firms, and politicians are beginning to add pressure. At the same time, China is only becoming more aggressive geopolitically and economically. A further decoupling of the two powers is likely.

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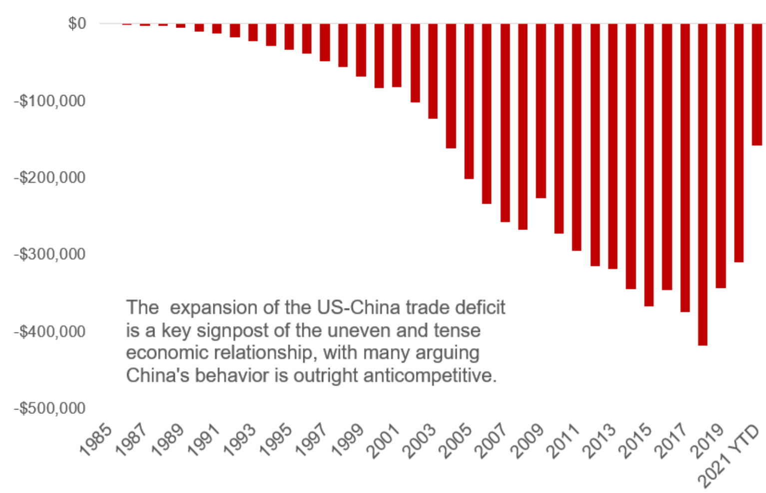
A MORE HAWKISH ATTITUDE TOWARD CHINA

Tensions building. While issues with China predate both Presidents Trump and Biden, the number and the severity are growing. They include China's intellectual property theft, subsidies for state-owned enterprises, and territorial claims in the South China Sea, among many other items. China's brand has suffered long-term damage over the pandemic, and as a result, the US and its allies are less willing to concede on these long-simmering issues. At the same time, China is becoming increasingly aggressive geopolitically and economically, exerting control over Hong Kong (with sights on Taiwan), while using trade to inflict economic pain on others. All in all, a further decoupling between the two powers is likely.

Different tactics, similar goals. Investors initially saw President Biden as being softer on China than President Trump, but this is not turning out to be the case. Although Biden's tactics differ from Trump's aggressive use of tariffs and sanctions, the US seems to be adopting a more permanently hawkish position on China. Biden's strategy includes building a unified front with allies and re-exerting US influence in the Indo-Pacific region to serve as a counterbalance to China. And the administration is increasingly making competition with China a key agenda item. This is also one of the few issues that has bipartisan support in Congress, which is now looking to invest billions to support domestic manufacturing, the US semiconductor industry, and development of future technologies.



Legal action. Congress also recently passed a law that allows firms to be delisted from US exchanges if they do not comply with US accounting rules after 3 years—which China-based companies have long refused to do. Thus, the US could move to accelerate the delisting of these companies, creating a line of demarcation for investors that they will have to accept more risk. As a starting point, the SEC announced that it will seek additional disclosures from China-based companies pre-IPO with a focus on potential regulatory risk from the Chinese government, whether the issuer has Chinese government approval to list on US exchanges, the risk of delisting for not allowing US audits, etc. US efforts could escalate if China continues to intervene in China-based companies, and this will be another risk to investors going forward.

Internal disfunction. China's recent decisions to sanction firms like Didi (a ride-sharing behemoth) are not one-time events and are indicative that the Communist Party will likely always put itself ahead of corporate profits. In that case, Didi's stock plummeted as China announced a cybersecurity investigation into the company shortly after its IPO. Increasingly, Western investors see capital risk when investing in Chinese firms, and politicians are beginning to add pressure. From China's perspective, trepidation against US listing argues that it now sees more <u>cost</u> from accepting Western money than <u>benefit</u>, an inflection point in the decoupling. In the end, it may be time for investors to rethink globalization overall.

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