

With a combined 50+ years of experience, 2X Wealth Group is committed to educating and empowering investors. We firmly believe financial literacy helps people make better decisions.

From Beijing to Wall Street

The Changing Investment Climate

Changing political circumstances impact investment climates. As we write this, the horrific pictures of desperate people clinging to the wheels of a U.S. air force plane, frantic to get out of Afghanistan, are on our minds. The world has changed. We are turning inward as a country. Leaving Afghanistan is just one example.

The previously inalienable belief in free trade continues to erode across the globe. Having goods manufactured in the cheapest place gives way to having goods manufactured in a place where we can rely on getting them. This shift from "just in time manufacturing" to "just in case" is likely to be inflationary.

In our country, many people attributed the Chinese Cold War to former President Trump's war mongering. In reality, the problem goes much deeper. The loss of well-paying manufacturing jobs created a class of disaffected manufacturing workers and more political awareness of the negative consequences that can accompany free trade. Although, poor relations between the U.S. and China continue to escalate under President Biden, a more important issue is emerging - the significant changes occurring within China itself.

China has moved from *promoting growth* of Chinese companies on the world stage to *regulating* these companies in the pursuit of common prosperity.

In 1979, China implemented free market reforms, opening their economy to foreign trade and investment. The Chinese government pushed for economic expansion in order to reduce poverty, but there were unintended consequences. In the process, giant companies with tentacles reaching every part of Chinese society and associated billionaires were created.

Now, in the interest of social fairness, China is pursuing wealth redistribution and common prosperity, taking aim at the upper echelon who they believe have become too wealthy and too influential on the world stage. Xi Jin Ping said the need for common prosperity is critical for the party to maintain power and to transform the country into a "fully developed, rich, and powerful nation by 2049, the 100th anniversary of the People's Republic of China."¹

1. Laura He, CNN Business, August 18, 2021

The Financial Fallout of China's New Social Policy

Recently, the Chinese government intervened in capital markets to pursue various communist party goals - stability of the financial system, reduction of individual power, protection of consumer privacy, reducing the cost of raising children (to promote population growth), and prevention of online gaming for children. The wide-ranging crackdown across industries detailed below demonstrates the party's increased control.

- In November of 2020, the Chinese government pulled the IPO of ANT financial (a non-bank lender that is one-third owned by Alibaba) two days prior to launch. It would have been one of the largest IPOs in history.
- After publicly criticizing the Chinese government, Jack Ma, co-founder, and former executive chairman of Alibaba disappeared for months. In 2017, Jack Ma, was ranked as one of the world's 50 greatest leaders in Fortune. In 2021, with a net worth of \$51.5 Billion, he ranked as the 3rd richest man in China and 26th in the world. ²
- In July 2021, DIDI, China's ride hailing service went public in the U.S. as one of the largest IPOs of the past decade. Just days later, the cyberspace regulator in China ordered app stores to remove DIDI, preventing the acquisition of new users. The stock ultimately fell 50% post-IPO debut.
- In late July 2021, China cancelled education companies' for-profit status. The regulations included restrictions on raising foreign capital and was meant to curtail expensive tutoring.
- In mid-August, news organizations reported the Chinese government acquired 1% of Bytedance (the Chinese social media company behind Tik Tok) and established one seat on the board of directors as of April 2021.
- On August 27, regulators published a draft set of rules for algorithms used in the domestic technology market. These algorithms are used to personalize and recommend content and services to consumers.
- On August 30, China established a new rule, drastically restricting online gaming for minors.

The consequence for these actions? The Chinese broad index ETF(MCHI) fell 28% from the February highs and the Chinese Internet ETF (KWEB) fell 52%.

The U.S. isn't sitting still – the SEC is stepping up regulation of Chinese companies that trade on U.S. exchanges.

"The Securities and Exchange Commission is looking at ways to take steps that pave the way for delisting Chinese companies that don't comply with U.S. auditing standards. **SEC Chairman Gary Gensler has warned that many U.S. investors aren't aware of the risks embedded in Chinese ADRs.** This is because of a complex corporate structure called a variable interest entity, or VIE, that's used to skirt China's foreign ownership rules and results in U.S. investors owning shares in a shell company with a contract with the Chinese business operators." ³

2. Bloomberg's Billionaire Index

3. Barron's Magazine. August 30, 2021

The Chinese government's actions have fundamentally affected the ability of their companies to make money. The question is what investors should pay for companies who are not in control of their own destinies and whether it makes sense for U.S. investors to participate.

We are wary of making major changes with events that are ephemeral. As investors, we must be open to changing our minds when we get new evidence, however. We suspect that the political winds won't shift quickly and have reduced our international exposure (specifically to China) preferring to invest in U.S. companies and European companies who can benefit from selling products to emerging markets.

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