Time to Lock in Some Themes

It has been barely 24 hours and the anger to rant is starting to build (the power of social media) – see Sunday's Not Angry Enough to Write report.

But as earnings season begins in earnest, let's just lock in a few longer-term themes that are important and will influence markets in the coming weeks, months, and years. Years seems so long, but many of the T-Report readers have a much longer attention span than me and are making corporate (or investment) decisions where "years" is the correct timeframe.

Don't Give Kabuki Theater a Bad Name

Every so often, we get to experience the "Kabuki Theater" of the debt ceiling negotiations in D.C.

More often than not, it is obvious that we are just watching some stylized and elaborate act designed to get votes, raise campaign funds, and get some pork earmarked for certain causes. It is easy for markets to ignore.

I'm increasingly concerned that we (the markets) are treating this year's edition as yet another round of Kabuki Theater. However, that may be giving Kabuki Theater a bad name. Properly done, it requires great effort, planning, and skills. I am far from convinced that certain individuals are following the same script within their own parties (let alone between parties).

We've been getting asked questions about U.S. CDS (up from 25 bps in January to 55 bps today according to Bloomberg). Seems like people are buying a "lottery" ticket, where you pay a small premium on the hopes that we will get a "Failure to Pay Credit Event" allowing you to benefit from the low dollar price of some longer-dated bonds. However, there seem to be worse bets out there for someone looking for ways to capture dysfunctionality in D.C.

This time could be different for the debt ceiling.

From "Made in China" to "Made by China"

If you go back 20 years, U.S. companies were shifting production to China. This production shift was often done with the hopes of selling their products into China.

Over time, the selling opportunities seemed disappointing relative to the potential. For some manufacturers, Chinese competitors appeared and targeted the domestic marketplace. Quality was an issue. How the IP was obtained was also questionable, but no one did much about it because China was still making "our" goods cheaper than we could make them ourselves. Also, "we" had largely accepted the difficulties of selling "our" goods into China, so it didn't bother "us" that much.

Going forward, I expect China to start selling more of their goods internationally (competing directly with "our" goods). Their IP/knowledge (from the product to production) has improved. Quality has also improved (still not as good as "ours", but the gap is closing). Their products will be undeniably cheaper to make because their R&D is much lower (for obvious reasons). They have a government that is building relationships across the globe and isn't afraid to spend a lot of money to get their agenda accomplished – which may increasingly include selling their products globally.

So, I think that we are shifting away from "**Made in China" to** "**Made by China":**

- China manufacturing or assembling products under global brands that are then sold by those global brands.

- China manufacturing their own brands for their own distribution, not just domestically but globally.

While some of this is long-term in nature, the **one immediate conclusion is that while the "re-opening" might support commodity prices, it isn't great for most global companies**. Many no longer have major supply chain issues and this isn't going to "open up" the Chinese market for their goods.

The World Wide Dark Web

Even before Russia invaded Ukraine, we were discussing China's efforts to secure natural resources across the globe. Some of it was already being transacted in Yuan or was being set up to be done outside of the dollar in the future.

Since the invasion, there has been a **"magnetic" pull to China** for autocratic/resource rich nations.

- **Autocratic nations** are pulled towards China because China doesn't care what they do domestically, so long as it doesn't interfere with their trade.
- **Resource rich nations** have been drawn to China because those are the countries that China cares about and engages with.

While the dollar will remain the world's "reserve currency" there are going to be more and more transactions occurring directly in Yuan. Those countries, including China, will trade in dollars as appropriate, but there will be an increasing (almost "underground" or "dark web") economy built up around the Yuan.

While there are many longer-term implications, **there are some near-term ones as well:**

- The power of economic sanctions as a tool will continue to diminish as this "alternative" economy further develops (and I already don't believe in sanctions).
- While this "prediction" is not a consensus view within Academy's Geopolitical Intelligence Group, I'm in the camp that believes that China selling weapons to Russia is likely, which will further solidify this "new world order" of autocratic nations tightly linked and co-dependent (or even dependent) on China.

Earnings, Positioning, Freight, Bank Deposits, Inflation, etc.

There will be plenty of time to talk about these topics in the coming days, but in the meantime, I wanted to get the themes discussed in this report concisely laid out because they not only have longer-term implications, but also point to some near-term opportunities.

At this pace, I'll be "exploding" with angry rants less than 48 hours after being "back in the office"!

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