Xi/Biden – Photo Op or "Defining" Moment?

I just want to make sure that we are on the same page:

- I generally view these international meetings (G-20, UN, COP 25, and Davos) as much more about "photo ops" and "soundbites" rather than anything material. However, I think that this time could be different.
- **I have been negative on our relationship with China**.
    - **The need to carefully safeguard intellectual property**.
    - **The need to secure supply chains**. For corporations (and for the nation as a whole), as we reassess what "wartime production" means, the war might not feature a traditional enemy, and could include anything from cyber to pandemics.
    - **The competition for chips**. This is a tricky one, as it is really about high-end, military, AI, and quantum computing grade chips, but it is impacting the entire industry and IP.
    - **Rare earth metals, critical minerals, and processing**. We largely ceded this to China as we failed to deal with many of the countries that have these minerals in abundant supply and we regulated ourselves out of much of the processing.
    - The threat to global sales of U.S. products, especially in emerging markets, as China **transitions from "Made in China" to "Made by China."** This is a natural progression for Chinese brands, but it introduces a new competitor for our domestic brands.
    - **The rise in trade that is being denominated in yuan** (versus the dollar or other currencies). This is only a "negative" because it reduces the impact of sanctions in many regions, as trade can easily continue in other currencies.
    - **Investing in China.** My concern has been about "the ability to get the money out" and "what rules could be changed" especially in cases where the rules were bent to allow for certain investments or financial activities to occur.
    - **Taiwan, the South China Sea, China's military, Geopolitics, and Diplomacy**. While these are more in the purview of Academy's Geopolitical Intelligence Group, everyone is well aware of the risks, and these risks are a concern for many of our clients.

Based on everything that we've done so far, I still think that we could get some "positive" surprises out of this meeting.

The Case for a "Defining" Moment

It is important for me to get this on the record, partly because it may surprise people given the litany of issues that were raised in the first section.

The reasons why I think that we could get a positive surprise out of this meeting are:

- **Tariffs**. If you weren't mired in the back and forth around the tariffs that Trump put in place, then you saved yourself some misery. It was probably the first time that I can remember where one's political affiliation seemed to really impact one's views on tariffs. **"Trade wars are bad!"** I was in the "we've been in a trade war for 2 decades and this is the first time that we've fired a shot" camp. In any case, there was real vitriol at the time and many pieces were written against tariffs. **But the election came and went, and the tariffs were largely unchanged.** I believe that many of those senior economic advisors who opposed tariffs still do, which means that there must be an inclination to cut back on tariffs. In fact, many expected that the administration would roll back tariffs on day one and these people were somewhat surprised when that didn't happen. **Rolling back some tariffs seems possible.**

- **The chip industry**. This is incredibly important, and we initially addressed this in World War V3.1. The risk has always been about finding the "right level" of technology to restrict. If it's too low, then we don't accomplish our national security objectives. If it is too high, then we won't allow companies to profit from existing developments or use those profits to propel us into the future (the Chips Act helps but isn't sufficient). I must imagine that lobbyists are saying that some recent proposals have gone too far. **Real potential for some pullback on rhetoric.**
- **Iranian oil. Venezuelan oil. The SPR.** We have been "pragmatic" (to say the least) in many cases around the world. So-called "lines in the sand" have been moved. But let's just focus on oil and what has happened in the past year as we "fought inflation." By all accounts, Iran is selling over 3 million barrels of oil a day despite sanctions that should be keeping that number much lower. The U.S. struck a deal to start accessing Venezuelan oil, which required a commitment to free elections. The Venezuelan courts killed the free election idea, but so far there is no indication that we have lost interest in getting Venezuelan oil. Not long ago, we said something about replenishing the Strategic Petroleum Reserve when oil was below $80. If we did this, it was at a snail's pace. **So, for anyone arguing that the U.S. has changed its current stance, I must mention the "pragmatic" behavior that we've seen recently.**
- **Too much geopolitical uncertainty.** The attack by Hamas and Israel's response has opened a new front for U.S. involvement in the region (in terms of support). The Ukrainian offensive stalling doesn't help matters there, where international support for Ukraine (after almost 2 years) seems to be diminishing. China has been careful not to act against anyone, and many of their diplomatic actions seem to encourage a reconciliation in these conflicts. At the same time, their activity around Taiwan has escalated, pilots have acted more "daring" around U.S. military aircraft, and their Coast Guard has interfered with the resupplying of the Second Thomas Shoal by the Philippines. **Wouldn't it be nice to de-escalate this?** With so much going on around the globe, de-escalating the risks here so that the U.S. and China can focus on all the problems already on their plates would be very helpful, especially coming into an election year.
- **China's slowing economy.** China's economy has still not kicked into gear post-COVID. This is partly because companies across the globe have less interest in creating manufacturing facilities there, the Belt and Road Initiative seems to have slowed, and the real estate market is in decline (which limits the ability of many citizens to consume). Xi has a middle class that he and the Chinese Communist Party would like to placate (remember, after some protests, the government did an about-face on the COVID lockdowns). Xi is not in a position to play hardball and should want a deal (he does have the advantage of knowing that he has a "lifetime" to achieve his goals, so his negotiating strategy can be longer-term in nature).
- **Inflation.** Inflation remains a legitimate fear. I'm not in the runaway inflation camp, though I do think that geopolitical/reshoring/ESG inflation will put upward pressure on inflation for the next several years (1% to 3% above "normal" inflation). However, I understand the fear (especially if India's economy kicks into an even higher gear). **Some sort of deal would likely be seen as deflationary (driving bond yields lower and stock prices higher).**

So, be prepared for the meeting this week to come across as highly conciliatory prompting an "everything rally" into year-end. We don't even need to see concrete actions taken. If the messaging is strong, that messaging (combined with seasonality and a lot of negativity priced into the market) should be enough to get the job done.

Bottom Line

I suspect that I will rant about any "deal," saying that the U.S. traded short-term benefits for longer-term problems, but that won't stop a "deal" from helping markets near-term.

We will know more by the end of the week, but position for the "everything rally" in case this meeting turns out to be far more than a mere "photo op" and delivers a deal that will be pitched as "historic!"

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