DIVIDEND CAFÉ – SEPTEMBER 23, 2022 – PODCAST TRANSCRIPTION

Well, hello and welcome to another Dividend Cafe. I'm recording in the middle of the day a trading day that is on Friday, and I really have been planning all week to do Dividend Cafe today on some foreign policy matters, some international affairs geopolitical dynamics, and that's what I'm gonna do. I just wanna briefly comment on the fact that it has turned into quite a blood bath and equity markets. And I do think right now, unless something changes that I'm gonna devote next Friday's Dividend Cafe to a little primer, a kind of refresher on bear markets that, that we certainly are in right now across broad equity markets, but those things come and go and those things matter. And those things require some behavioral refreshers, and we're gonna do all that, but then it would just be malpractice for me to ignore the other key thematic things that I think are playing out right now in the economy, in on the world stage, if you will.

And I am firmly convinced that there are some alignments taking place. There are developments in matters of global geo concerns that are profoundly important to investors. I can't unpack all the details of that importance today, but I wanna lay the kind of general framework for what we're seeing, how we're evaluating it and where I believe the directional movement is going and, and, and how that matters to investors as a, as a kind of just high level view that I think can be done without controversy. It can be done without a particular partisan alignment. It seems to me fair enough to say that the country, the four countries that are essentially adversarial to the United States and varying degrees, Vying levels, varying context that matter the most are China, Russia, Iran in Saudi Arabia. And I'll walk through each real quickly, again, just providing the basic bullet points in context that I believe to be non-controversial or somewhat divorced from any kind of partisanship as it pertains to China, we're well aware.

They are the world's only major economic superpower along with us in size and scale. The United States and China are the two biggest games in town that can impact global economic health. There has been a reasonably symbiotic relationship for over 20 years in the sense that for writer for wrong and whether people like it or not. So, I say this more descriptively than prescriptively. China has incredibly benefited from having us to buy stuff they make, and we have benefited from having them make us stuff meaning they have produced an awful lot of downward pricing pressure and corporate profitability and other metrics. Now, again, if I get out of the simple points I'm making and go into more complex points, there are a lot who would dispute the net efficacy of us being a bigger buyer of Chinese exports. That would point to either human rights concerns, which I think is fair enough, or they would point to how it is hollowed out.

Some of the manufacturing and industrial capacity of the United States. There's a lot of controversy there. I'm not going into today. And I have strong opinions on the subject that I think about consider and contemplate all the time. But it's just a little diversion from what our focus is right now. The main issue though, that is even less controversial and where China has played a role in us economics, is that they have certainly played a big role in funding. Our deficits. We run huge deficits, we're a low saving nation. We are a net debtor nation and they are a net creditor nation. And that's the bottom line. So, there has been that economic relationship of each country helping to scratch different itches for the other all the while. There is most certainly an adversarial dynamic, them being a communist country and us being a not communist country, them being in a very different paradigm of the rights that they grant to citizens and, and us being of course, a a liberal free democracy by charter this thing we call the constitution.

So, I think that there is an intensification of the tension in us, China relations in the last seven years around trade around tariffs, around currency and around COVID. And, and yet the factor matter is China is a potent large force. And, and we need to talk about some other aspects here in a moment, moving on from China, Russia is, is kind of the no brainer right now, given their aggressions and invasion in Ukraine earlier this year. I think that Ukraine essentially represents a kind of ground zero of what the great divide is. Russia believing in the fall of communism followed the Soviet union that they have been mistreated and that they want some restoration of the old guard and including in a land dispute that they are on the wrong side of regarding Ukraine. And so they are in a lot of ways fighting a nationalistic crusade for what they perceive to be their own rights and their own pride and doing so with aggressive interventions into other countries, the United States is not militarily engaged in it, but is certainly financing their enemy in a large way.

And so although we do not have a significant economic tethering to Russia, Europe does, and we have a significant economic tethering to, to Europe. So, by domino effect, there's more relevance there. I mentioned Iran because we're well aware, we've been an adversarial relationship with them going back to the late 1970s. And there's a significant context in the Shia Muslim Iranian revolutionary guard component of the country. But the fact of the matter is that they entered into a treaty with the Obama administration in 2015 and then the, the Trump administration ripped that treaty up. And then the country right now is in, has no appetite to reenter it. And, and even in the, by an administration where a lot of the players are who constructed the initial deal in 2015, they're not going back in, they're a nuisance.

We don't need to sell them a lot of things. We don't need to buy anything from them, but they do have a lot of oil and the, their ability in theory, to be able to put oil into the world markets, which right now they don't have that ability would be relevant in that isolated case. And then of course, where they want to fit in in other endeavors with Russia or China as a buyer or seller of things becomes more relevant. That's sort of generally the role that a lot of autocratic middle Eastern countries will play is sort of a nuisance as it pertains to a larger conflict. And then this brings us to Saudi Arabia, which is by far of the four, the one that's actually historically been the most friendly. I would call it a transactional friendship that the United States had with Saudi Arabia from 1946 to approximately 2010.

And there were disruptions along the way, the nine 11 moment and the various elements of the 1970s there's been tensions between the us Saudi, but it was always about oil. It was always about our need to buy it from them and their need to be safe and free and democratic to provided. And there was this mutual alignment and the us fracking revolution more even the nine 11 is really what produced a final rift that then was exacerbated the murder of that journalist and the COVID moment when they flooded the world with oil. And then now leading up to Biden administration's recent visit kind of begging them to help cooperate with increasing production to bring oil prices down. So, what do I bring these four countries up? Well, I'm gonna focus most on Russia and China. But my point being that there are four potent countries that each have different economic interest and a diff a different economic connection to the United States.

And yet I think that we right now need to really evaluate what is taking place president G of China and Putin of Russia met last week. And there was largely this sort of Western response that, okay, you know, China's not telling Russia everything's okay. And yet there was plenty of ascent coming out, China, plenty of consensus, acknowledging look, Russia. We may say that we don't agree with everything you're doing, but we certainly understand why you feel cornered by the west and why you feel that the positioning of the us and NATO forced you into a very tough position with Ukraine. So, this week, vitamin Putin gave a speech a couple days ago by far the most aggressive in escalating talk of the nuclear threat and, and implicit threat to go to a nuclear option if it was necessary. My view is that as far as I know, or have the ability to know it is legitimate and accurate, the Ukraine has made great advances in that conflict and that there has been continued defeat and continued dis disappointment for Russia in their efforts.

And yet I am not sure that that's necessarily the best thing for markets per se, to have Putin even more cornered. In other words, though, I guess the only thing that could be worse than him actually prevailing as an imperialist authoritarian would be him being fully defeated as an imperialist authoritarian, and deciding to go in, in a more cornered dog kind of route. I think that it is telling that he met with PJI and then just two days later was comfortable with that level of rhetoric regarding nuclear confrontation with the west. And I'm not saying China said, yeah, yeah, you have our green light. Let's go nuclear here. What I'm saying is whatever China is saying, rhetorically and whatever China's doing substantively, what they're not doing is scaring Putin away from talking like a madman. And I think that they have an Alliance right now that is not rooted in the exact same thing.

China does not like the west and Russia does not like the west, but they are not for the same reason, but they have a pragmatic Alliance formed right now that if it were to essentially China mitigating the impact of sanctions by becoming a buyer or seller, depending on what we're talking about in commerce with Russia, it, it mitigates the impact of sanctions that the rest of the west has, has promulgated against Russia for the purpose of damaging them in this Ukrainian effort. So, China becomes a sort of closet cousin of Russia in the war against Ukraine and China has I think been totally willing to be branded that way. What does this mean in terms of the investment aspect? Look, I think that it very likely means a elongation of the war in Ukraine. I can't say if it's three months, six months, nine months, but I don't believe that there is a scenario in which that thing has to end.

And I don't see pressure right now by which there is an effort to get back to the negotiating table or, or generate a cease fire that can hold or come to some, you know, compromise on some of the land disputes, a question. And then if anything that puts on a elongation of the war extends a war premium, that is primarily gonna be felt I think, in commodity markets. And then that's why I find it interesting that we more or less have a war premium that could put commodity inflation and extended capacity at the same time that I believe you're gonna start seeing downward pressure on inflation with the rent and housing element. And so if I could pause from the Russia China discussion or bring it back to the fed, this begs the question of what the Fed's response would be. Do they see higher wheat prices that come about in 23 and higher oil prices that come about in 23, if those things materialize as a adult, a result of Russia, Ukraine, and believe that therefore they need greater monetary tightening still to, to fight it.

There are some who I respect a great deal who thinks, so I don't think so. I think that the fed would've cover at that point to say, first of all, there's other disinflationary pressures we're, we're gonna bank on. And second of all that they would bank on the, the material substance of the matter that there's nothing they can do with monetary policy about war driven inflation. However it does create competing narratives for investor positioning in a global macro sense, the state of the us economy. Then we talk about interest rates and you say, well, rates go higher if inflation's going higher. And the fed is raising rates to combat inflation, but if you have an elongated war premium that will traditionally mean a flight to safety, which bids up a bonds and puts down bond yields. So, there's a tension in there that is not gonna be easily solved, known, or resolved.

I would suggest to you that most people taking one side of it are not doing so, cuz they've evaluated all and decided that's what'll play out it's cuz they're only evaluating one side. And if you have a one sided argument or data point becomes easier to draw conclusion, but um, conclusions in financial markets and investing real capital come from intersecting with competing narratives. And that's what I think you're gonna have going into 23, a weakening economy, not a too hot economy potential for extended war premium, which is likely boosting up energy and commodities and then a fight to safety. That's pushing down bond yields and a monetary policy that by then may have already run its course. So, Russia is sort of this wild card in it. And we have a a reasonable level of belief that, that they don't have to go away anytime soon on the Ukrainian front with China.

I don't believe that they feel Putin is right and I don't think they care about Russia's interest in Ukraine. But I do think that they understand enemy of our enemy is our friend and they have a beef with the us and Russia's a beef with the us and they can maximize that shared enemy to their own purpose. And that's what I think they will do. And I think that that will drive home a far bigger movement, that of one that is already playing out anyways, partially and initially because of protectionism because of COVID be because of a desire to re industrialize much United States, but ultimately now from a national security standpoint and the Alliance that you see in the other countries who will leverage the other side of this against the west, I think that the west then now intensifies efforts for their own onshoring re regionalization in manufacturing in national security, in domestic goods, in commodity production in a lot of these elements that to take some control back of their own supply chain.

This can't happen in three months and it cannot happen in three years, but seeing these forces play out, forces me to look at it as a financial guy and say it's highly capital intensive. You cannot regionalize manufacturing after a couple decades of much more globalization without spending in an order amount of money and doing that at a time in which interest rates are higher and where liquidity is gonna be more constrained. I think you have to think about how the, the need for very strong and robust capital markets and anyone who doesn't believe capital can be waged as a war, as a weapon in a war is insane. And I think anyone who would advocate for domestic policy reasoning reasons, the weakening of us capital markets is missing the broader foreign policy argument against doing so there will need to be great access to and innovation in capital markets to re regionalize much of the global economic interest in the United States to enhance commodity production, to intensify, supply chain efficiency and independence.

And there is going to be a thematic reality here that, that deals with certain aspects that of certain sectors in different ways. And I don't wanna get into all the detail of it. Now I'm more trying to provide thematic overlay to what we believe is gonna happen. So, just by way of quick conclusion I think Saudi is gonna have a short courtship, but nevertheless, be in a courtship with China right now. Denominating some oil purchases in Chinese Yuan. Not listening to the us when it comes to what they want of Saudi around oil production. And they will operate against the us to the extendeds in Saudi's best interest to do so. And they will operate with China to the extendeds in Saudi's best interest to do so, but that really has very low likelihood of staying long term that it will be shortlived because their mutual alignment of interest is likely to be short lived and Saudi will maintain a self their, their role as a self-interested actor in this.

I suspect that I've commented already, by the way, on where I think the Russia war effort will, will go and what it will mean for some of these other economic issues we're debating. But I think that this China Russia Alliance is likely here for some time and it's going to have a big impact on all these other elements we're discussing. And it behooves us, regardless of what people's own opinions are about Taiwan, about national security, about self-interest about military spending. There is going to be greater defense spending in the years ahead. I'm very confident of that, and there's gonna be a regionalization of a lot of the spending that takes place in our industrial economy. And so I think that that, that could lead to some problems in the short term, and it could lead to an explosion of growth and opportunity later.

As you see a lot of CapEx take place towards the purpose of greater domestic productive investment a couple years ahead, it's not something I want to time, but it is something I want to execute. It is something I wanna implement is understanding the, the foreign policy ramifications, how this impacts our portfolio decisions. The number one biggest takeaway, if you just kind of wanna, what does all this mean to me, moment is quality. And I say it all the time, but this is another in a time of monetary policy uncertainty and high valuations, and very low regard for multiple expansion and, and risk asset speculation. I would just simply say that quality in one's portfolio matters the recurrence of cash flows, the depth of balance sheet and defensiveness of a business model. Those are the things in both the capital and operational sense that matter when you're in a vulnerable time.

And I think frankly that those will be the companies that are best positioned to benefit from a lot of these changes. So, we are seeing a bit of a global macro shift. We intend to be properly positioned. We may even look in the, in the alternative space for a way that it can be best capitalized upon, but that's, that's our Dividend Cafe for the day Alliance between China and Russia, the, the ongoing nuisance where Iran and Saudi fit in nations that are not necessarily that interested in what's best for the west what's best for the United States. That's been around for a long time. That's not new. However, what is new is the way in which you're shaping up that can impact global macro-economic conditions. I hope you've picked up a few things here. I know it was a lot to chew on, but these are topics near and dear to my heart. I'm gonna keep extrapolating practical takeaways from this in the days, weeks, months to come. If you have any questions, reach out to us questions@thebosongroup.com and in the meantime, have a wonderful weekend. The beat goes on. It's been a, a rough period of time here in markets lately. That's part of being in markets. I'll have more to say about that next week. Thanks as always for watching and listening to the Dividend Cafe.