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Well, hello and welcome to this week's Dividend Cafe. I am really excited to bring you this topic because I had intended to do it last week and with all of my travel and things going on, I didn't get to pour in the way I want to do. We did a Dividend Cafe last week about dividend growth, which is the investing religion here at the Bahnsen Group. And hopefully that was a good refresher. But there's a topic that's been sort of lingering out there that is very macro economic. It's top down, kind of globally relevant across a number of different economic categories, what the ramifications may mean, but it's also microeconomically important, meaning there's sort of bottom up local and individual ramifications that I think are very important. And those types of topics are what I love covering. It's what I basically spend hours of every day of my life studying for many, many years.

And trying to bring that to the pages of Dividend Cafe and represent it in a client portfolio, find application to these things can be very hard. We're not ones who tend to go jump on big thematic changes because we believe that oftentimes thematic changes in the macro-economic context are overblown, they're incorrectly assessed, and then oftentimes, even when they are correctly assessed, they are challenging to apply into an investment thesis. And I've talked about that a lot. It's a big part of the way we do things and don't do things at our firm, but this is an example of something that we believe is going to have some investment utility. And I wanted to kind of just set the table for that a little bit today and give you an understanding of the way we're thinking about this. First, let me just back up and say that CapEx capital expenditures, the way it is referred, labeled in the GDP formula, the portion of gross domestic product that comes from this is called non-residential fixed and investment.

And it's one of the categories that contributes to the way they measure total economic output in a particular country. And I think it is the part that has been most lacking since the financial crisis. Inventories go up and down. Government spending largely goes up. Consumer spending is very, very difficult to take away in American culture, and yet the business investment necessary to drive productivity gains has been lacking for some time. This is not the subject of this week's Dividend Cafe, but it's very correlated because I believe that when we talk about onshoring of American manufacturing potential drift towards reshoring, near shoring, which is basically still pulling some of the manufacturing that might be in China, but maybe not back to Arizona or Ohio or Michigan or something like that, but maybe to Mexico or Canada or something close. So there's a number of different subcategories, and I resisted as much as I could, the temptation to get in the weeds and just wanted to focus on the broader migration towards changes in American manufacturing and supply chain management that could end up having an impact to capital expenditures and just the overall economic story. Now, what's interesting about this is that eight years ago you were starting to see a kind of political movement about limiting trade with China. It was the very early stages of what became the President Trump campaign, but he largely did run as an economic nationalist. And his argument was almost always framed around a sort of protectionist theme. Let's protect American workers by not letting jobs go over overseas and instead have these jobs be in America. And that was something that Pat Buchanan had talked about many, many years earlier that Ross Perot, when he ran as a third party candidate back in the early 1990s had said, and even the left, particularly Bernie Sanders had tried to throw that out against the right over the years. Mitt Romney, if you recall, when he ran for president, had been criticized for his private equity firm, had moved some jobs offshore and so forth.

So this general subject about economic nationalism was starting to get headway, and yet it was really framed around kind of a protectionist theme. And the politics of it sort of changed, and it was very, I think, paradigmatic of a shift that really it moved from kind of a leftwing issue to in some cases sort of a right wing issue. Look, what really kind of moved the needle here was the covid moment because I don't believe that there was enough traction to totally change the way in which a lot of the globalization of certain economic activity had gone, the benefits that existed for that, but also some of the downside, the way in which that risk and reward was being allocated. There were people that were mad about from protectionist standpoint, I don't think protectionism is a very economically way of thinking, and I don't think it ever has been, but it will have varying degrees of populist popularity, if you will.

And yet what really I think pushed this conversation about China manufacturing supply chain was not protectionism. It was varying degrees of fear around the national, the supply chain connections of that to national security interest connections of all that to a sort of human rights and culture story around the communist Chinese, the Chinese Communist Party, the CCP invasion of privacy, data privacy, all of these things obviously conflicting value systems. And I think the culture war and the economics began to intersect in the past several years and then having a moment where you find out, well, we don't necessarily have the ability to get the hand sanitizer or Clorox wipes that we want because we're dealing with this lockdown, the global shutdown out of the covid moment, and we can't just go run it off of a manufacturing plant in Oklahoma because we're dependent on Shanghai and it can't get over here for various parts of a breakdown in the supply chain.

Now, that's a little bit lower magnitude example, but you look at something like semiconductors where it became pivotal important, the role in which some of the parts enhancement coming out of Taiwan into China finished goods. There's a great deal of connectivity that was probably, it's fair to say, not really understood, not really appreciated or foreseen pre covid. So of course a lot of these things you think might be able to get worked out in a more fraternal relationship. I mean, particularly the stuff about the culture war, and you had that tension with the NBA thing, if you recall. And there are a whole lot of things that have gone on that are just really not good, but when there's kind of a mutual economic interest and a general fraternal, people have a way of being able to get along when there's something in it for both of 'em.

And I think a great example I've written about in Dividend Cafe several times is the US relationship with Saudi Arabia for decades was one of convenience. It was a fraternal, reasonably friendly relationship despite a lot of conflicting cultural aims, religious aims, value system differentials, but driven by a sort of we, it's best for us to get along. The fraternal relationship with China is clearly broken down in a lot of ways. I think that right now, just from a public sentiment standpoint, you see a significant change even apart from households in America. 45% of companies in the American Chamber of Commerce in China say that China's in their top three countries for investment. That number was 60% just two years ago, so it's dropped sub 20% from 60 to 45 in just two years. You see what China's done with Saudi Arabia looking to denominate more oil and gas purchases from China, but also Qatar, other Middle Eastern countries in Yuan denomination transactions. So trying to denominate outside of petro dollars using Chinese currency. The US has tried to ban a significant amount of exports or at least put controls on exports, particularly around technology, but also broker deals to get various European countries, even Japan, to do the same. You had 15% of American companies in 2020, not very long ago, say that they were either pulling out of China or taking steps to pull out of China. That number is now 24%. And so that doesn't mean they've done it. And yet again, you see almost a quarter of

American companies saying that they're making movements towards removing some of their activity out of China. And the data alone, there's a chart at dividendcafe.com today, but just seven, eight years ago, over 20% of our imports came from China. That number is down to 13.4%. So again, these are still imported goods. This is not being replaced with on shored domestic production, but just that much of our imports has shifted to another neighboring country somewhere on the globe.

All of that is happening. The China cost competitiveness is definitely on the decline. Wages to utilize manufacturing services in China are now more expensive than they are in Mexico. There used to be a significant cost savings with offshoring to China. So the game is changing in a lot of ways. And what is I think interesting is that President Trump used these really blunt tariffs to try to accomplish certain things, and they're still on to this day. The Biden administration hasn't taken them off. Most of the Canadian tariffs and the threats, the European tariffs all kind of went away. But the goal there, the policy aim negotiated over the course of almost a full year. You remember before covid all that talk in 2019 about level one of the trade deal, and it was going to be China buying more soybeans and some LNG liquefied natural gas from us and exchange for the US continuing purchases of certain categories there.

And it was riddled with exceptions and exemptions and carve-outs, but that was still focused on trying to get an even playing field, trying to increase what China would buy from the us. The movement right now is not about that. The movement is not about we're going to keep buying the same from China, but then we want China to buy more from us, which was always sort of President Trump's argument. It is more right now about basically having less reliance on China period in terms of the supply chain, more investment restrictions, more export controls, trying to not merely alter the ratio of who's buying what from who. But really at this point, I think trying to diminish the reliance on China for our various supply purposes, there's also other talks taking place. You know, look at the popularity, particularly the American teenagers of things like TikTok and who knows where that ends up going.

That is driven largely by data privacy concerns, maybe some national security issues, China gaining access to information that people are uncomfortable with. That whole thing can be on the table. But again, when you look to a significant change of where American manufacturers taking place, and it sometimes is not just a matter of we contract with somebody in China to build something and they build it soup to nuts. Oftentimes things are largely done in the US or largely done another country, but some parts of the finishing or processing process is going through China and there is just so many, so much complexity in the supply chain, and there is clearly right now an incremental, not sudden, but nevertheless real erosion of some of that taking place. And I think it has profound economic ramifications. It isn't going to happen smoothly, quickly, easily. A politician who were to come in and say, if I'm in office, I'm just going to pass a law that we're done with all this, it can't happen that quickly.

And that would certainly be highly disruptive economically. You got to understand, and this is fascinating, I did not know this until my research this week. In 2002, the only country on earth who China was their biggest trading partner was Japan. Now 20 years later, out of the top 40 sized countries on Earth, 33 of them, including the US, the largest trading partner is China. So there's a global dependency in much of the way that goods are manufactured and shipped and traded around the globe that is not going to be undone easily or quickly. Even the US, by the way, is really slow walking on the stuff. The bark is pretty high right now, but you look at things like this, export controls that they're putting on, and then when the details get announced, it's all technology. It's not energy, it's not healthcare, pharmaceuticals, it's just in tech.

And then it gets punted to further out down the line recognizing the complexity of a slow, oh, excuse me, of a sudden accelerated move. But what I want to do is present a few different macroeconomic takeaways and then a couple investment takeaways for your consideration here. All of these are listed out at Dividend Cafe this week as well, whether or not you agree with why it's happening, whether or not I agree with why it's happening. And even apart from I think whether or not should be happening, there is a change underway and various people at different opinions about both the should it and will it and how will it type of thing. But I'm only here to say that it is happening right now that there is some degree of a change in America's relationship with China as it pertains to manufacturing supply chain, et cetera.

And I think that that changing US China economic relationship will alter our reliance on China and will increase onshore activity and nearshore activity in the years ahead. Number two, this will present challenges in the cost structure for multinationals for a period. There will be potential for volatility if China retaliates. So this is not all a positive. There's challenges that will come out of that, but number three, it will present opportunity as desperately needed. Capital expenditures theoretically come back to United States, potentially allow for a boost to productivity and various other peripheral and economic benefits. There's a chart at Dividend Cafe this week about the increase in manufacturing jobs. It's slowed as of late, but again, the manufacturing job announcements has picked up substantially here in concert with some of this downtick of supply chain reliance in China, factory construction is rising in the United States now. It's rising from a very low base, but spending in factory construction's up a stunning 77% over the last 12 months as factories are being built.

Next comes machinery that is needed to fill the factories digital. There's a whole lot of complexity and specificity that could entail, but the point is a factory's not built to be four walls built to house machinery. And once you have a factory and then once you have machinery in the factory, then you need workers in inside of it. And so this could very well be a boost to and an underappreciated catalyst for economic activity in the years to come from the factory build to the capital expenditures, machinery, hiring inventory, build out things of that nature. There is an issue here though that I want to close with as far as macro considerations, and it's a chicken or egg dilemma. What is kind of feeding the other, which is will we have the labor force needed to meet this moment? This is something near and dear to my heart.

It's a subject I've written about a lot. I think about constantly I want to analyze. There is a school of thought that says we've lost our labor force because we've lost our factories. And there is another concern here that perhaps we've lost some of our factories and machinery and mechanical manufacturing industrial jobs because we lost the laborers to go in. I want you to look at the chart of the week about the labor participation force, and I just isolated men to make a point there because it can get into different dynamics that are a little bit different when you factor in isolating just women or looking at the whole labor force. But as far as just the labor participation force for males, it's worth wondering if there is a domino effect here that needs to be understood and that perhaps we may have a problem getting the CapEx and manufacturing we need if we have factories but no laborers to go in them that something will continue to want to study.

So from an investment outlook, I'll leave you a few concluding thoughts here. Number one is that there is no point coming where a simple, clean, quiet undramatic break from the economic connectivity we have with China takes place. The pain points are too sensitive. There will be escalations, there will be tensions along the way, and that will enhance volatility globally throughout this process, particularly for multinational companies. But number two, betting on who will be the most punished in a reframing and reworking of the US China relationship is not so easy. There will be carve outs and exceptions. There will be incentives, special deals, and that's the norm, not the exception. That's the way these things have always gone, including even in things like Trump's tariff deal. One company or sector might look like it's going to be a real victim of some of these changing guards and then they could all of a sudden be excluded or carved in or something and underneath the surface in a way that exempts the pain from their situation entirely.

It's the nature of the beast here. I'd be very careful about believing that one could pick winners or losers immediately out it. And that ties into number three as well. The passage of the CHIPS act looked like a boondoggle opportunity for American semiconductor companies, but it does look that the strings attached to getting those manufacturing subsidies and the tax credits and various other forms of corporate welfare may neuter the efficacy. The semiconductor space is very hard to invest in without guessing who will benefit from corporate welfare. Basically, investment decisions are best made without relying on crony support. And I believe that where there's less revenue exposure and less supplier exposure to China, that theoretically will make a lot more sense, but it's very hard to kind of gauge those things. There's 200 billion of projects for us. Chip manufacturing underway now, supposed to go up to 350 billion.

There's 35,000 jobs that have been created. I would focus more on the macro than the micro. I don't think that it's hard to see that there's a broad economic impact, but speculating on which companies benefit and which suffer is not the way to go about looking at things like onshoring of chip manufacturing. And I point out the companies that have invested the most in onshoring chip manufacturing in the US from prior offshore activities. Those are the companies that have performed the worst in this period of time. Number four, in the industrial sector, the material sector ought to benefit the most from increased CapEx, this thesis about greater investment in US manufacturing, but demand is going to need to increase. And my thesis about downward pressure and economic growth as a result of indebted excessive indebtedness, will our ability to increase productivity drive a higher demand?

And I think additionally, that question about labor is an important one, but certainly enhancing capacity is a solid way to start. Efficiencies will need to be improved. There will be successes and failures along the way. This is not a macro story just by all the industrials or by all the materials. It isn't like that selection and execution will matter, and it's entirely possible that large capital investment in the next phase stalls along the way, particularly stays slow while fed. Tightening is still on the table. There's no timing mechanism When I refer to materials and industrials benefiting in this CapEx cycle, and for our purposes as bottom-up dividend growth investors, our goal is to marry a bottom-up security selection that meets our criteria to this macro sector oriented thesis. Number five, government subsidies and interventions will not make it more attractive, rather more convoluted, the picking of winners and losers will distort price, discovery and alter.

We should not run to government handouts as an investment strategy, probably run away from it. It is just very difficult to attach an investment thesis to that kind of activity. And then finally, I make a comment on the defense sector, which is connected to industrials, the broader CapEx theme. But specifically when we think about defense and military spending, China increased their military spending by 7.2% last year. I talk about a kind of frame fraternal relationship with China, and you look at just the need to prep for what could potentially happen down the line in escalating tensions with Taiwan or the need to supply missiles or play a role to Taiwan, similar to a role we play to Ukraine, things like that. It's hard to picture the rug getting pulled out from under the defense sector right now. And I think that ties into all of this theme.

So I mentioned the chart of the week showing that male participation force. I think it's anecdotally interesting, but really at the end of the day, I hope a lot of this information is useful to you. There's a macro theme. There's the way we're packaging it internally that we want to just simply take the fact that we see opportunity that could come in materials industrials, but make sure that we're applying it with dividend growth mindset bottom up. And recognizing that it is not just a easy, all of these manufacturers are about to go up or all of any company engaged in moving stuff from offshore to onshore is going to benefit. It could very well be quite the opposite. There is a lot of opportunity in CapEx being improved in the United States, but it is not a smooth and easy ride. And I believe that if we rely on government incentives, subsidies to do it, it will become less economically meaningful.

So I'm going to continue talking about this theme, continue updating you on some of our thoughts around it. It's a moving part. It is geopolitical, all geopolitics is always a moving part, but I think that there is a theme playing out here for potentially years to come that could be quite economically significant. It was a multi-decade issue of economic significance to see so much offshoring of various manufacturing and even if it's partial, partial onshoring of some of that manufacturing is going to be economically significant as well. Okay, that's all I got for you in the Dividend Cafe. I will be back in New York City here this weekend and will be working there all next week, including bringing you next week's Dividend Cafe from New York before returning to California for a week. So that's the scoop here in this incredibly busy summer. A lot of fun things happening in the portfolio. We're knee deep in earning season. I'll look forward to a big fun DC Today with you on Monday. Thanks for listening. Thanks for watching. And thank you for reading the Dividend Cafe.

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