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Well, hello and welcome to another episode of the Dividend Cafe. I am David Bahnsen. I am the Chief Investment Officer of the Bahnsen Group, and I am fresh off of literally 23 meetings that my co-CIO Brian Szytel, our director of Investment Solutions, Kenny Molina, and myself have participated in here in New York City. And so as I'm sitting here recording, we just got done minutes ago with the final meeting of the week, and it's been an invigorating week and one I plan to be recapping a lot of different things for clients in the days to come. But in the meantime. There is a Dividend Cafe message for you today about China and it's devoted to the subject of China because China has really been a dominant story in markets over the last couple weeks.

And you say, how dominant has it been? Let me jump right into this. China has been massively underperforming the S&P 500 this year. It's the bulk of its stock market is still down a significant amount from its highs. Some of its leading companies are still down 50 percent from their all time highs.

And yet there has been a massive move in the last two weeks to where the Chinese stock market is past the S&P 500 year to date. So it was about two weeks ago, over 10 percent less than where the S&P was. And in a few days had gone up into the kind of 26 percent range or so year to date.

And some of those numbers have moved. It's not really. I'm not, I don't need to be exact right now as to where the S&P 500 is and where Shanghai is and all these exact points. It was just a violent rally in the Chinese stock market that took place. And my friend, Louis Gave, who's the chief economist at GaveKal Research coined it this way, which I thought was sort of funny, but it isn't really funny.

It's just that both Louis and I are economic nerds. So we think it's funny, but Louis said, basically the approach of institutional investors for quite some time has been ABC, anything but China. And then all of a sudden, ABC became all in by China. And so I stole it from Louis to make the point of a very significant sentiment shift.

It was a dramatic opposition to Chinese exposure that's been going on for some time. a real sustained period of underperformance for a number of different reasons we're going to get into. And then all of a sudden it's pedal to the metal. So the question is why, what happened? And there was a specific catalyst in the last week of September when the Chinese Politburo's essentially an emergency meeting came out and really threw a kind of kitchen sink in policy.

At trying to address some of the challenges in their economy. What are the challenges? Let's start with that before we go into what exactly it is that they've done. Growth expectations have essentially collapsed in China. You know, their GDP. Growth is significantly lower than it has been. It's still higher than countries like the United States, but this is a country with a lot of reasons that they've gotten accustomed to five, six, 7 percent annual real growth, and now they're looking at potentially 4 percent growth.

That's a dramatic decline, but far worse than that, because again, they export so much, you're still going to get positive GDP growth, but. They have 90 million uninhabited homes that have been built. They have 25 percent unemployment for their young adult population. These are brutal statistics, even as the overall aggregates of the country appear to be going forward.

Industrial production, flatlined export growth, which is the lifeblood of the economy. Has flatlined if not even contracted. And then that ha that property sector is a big deal and it's a big deal too, because it feeds public finance. Their public revenues are so incredibly dependent on property taxes and transaction taxes around property activity.

And as that market is frozen up and fallen it's creating a chain reaction. Um, I could go on and on about the real specific issues with their commercial banks connected to the property sector, connected to then industrial activity in the economy, connected to consumer appetite. To employment, to, to all of the things you'd expect to have an interconnectedness in a domestic economy.

And it's all bad. And what they basically said that they were going to do was first of all, I'll give you a list of policy decisions. They lowered their seven day reverse repo rate, which would be pretty equivalent to our federal funds rate by 20 basis points in the middle of meetings. But they telegraphed a significant downward trajectory of where they want to bring their rate level and it was not expected.

So they're changing expectations in monetary policy. They lowered the reserve requirement for banks by 50 basis points. So half percent cut, essentially freeing up a lot of regulatory capital that now can be lent out. Which is most certainly what they expect these banks to do. This is, I'm putting in quotes because it was in quotes, they are guiding banks to refinance existing mortgages to lower rates.

I don't think guiding means the same thing in CCP, the Chinese Communist Party, that it does for a lot of us. I think when these banks are guided to do it. I think they're going to do it. They're targeting 50 basis points of additional reductions in mortgage rates. They are lowering the statutory requirement for a down payment from 25%.

Of the purchase price to 15%. They are issuing about 2 trillion of Chinese Yuan of additional public debt. That's at least been indicated. 1 trillion is the amount that would be needed to address the current budget shortfall above and beyond 1 million or 1 trillion is stimulative. And they're doing all this because of the chain reaction of economic distress from labor to manufacturing to all the categories we already talked about.

So here's a few quotes that are in things I've already said today that are part of the media narrative that are part of the literal research coverage. Word for word quotes. Tell me if any of these sound familiar. Property prices became unsustainable. State public funds became dependent on the housing sector. Unemployment has risen as the aftermath of this bubble burst has played out. The government's looking to support the banking system to provide a lifeline after balance sheet deterioration, referring to banks. Support is needed for the middle class. Encouragement for banks to lend. Lower cost of capital. Growth is sacrificed when an asset bubble burst.

Does any of this sound familiar? Cut and paste sequence of events, cut and paste economic circumstances, very similar cause, very similar effect. U. S. housing bubble 2008, Japanese property bubble 1990. Things I've been writing about talking about the way in which an asset bubble burst and the deflationary pressures that come from that and the policy responses that come from those deflationary pressures.

This is global economics in the adult lifetime of David Bahnsen and therefore a whole lot of you. We've seen this before. There are differences. There were differences in Japan and the U. S. I talk about that all the time, too. There were not exactly similar cultural circumstances. There were not there were very different age demographics.

There's differences in all three with culture, with homogeny, with government, with population, but the economic dominoes are what I'm saying are the same. So you have these challenging circumstances. They're doing all this rally. Why did their stock market rally so much in response? It was changing expectations about where they're headed with fiscal and monetary policy.

And I think it happened despite the other signal it gave off, which is clearly desperation from their policymakers. Let me put it this way. I want to be diplomatic and I say this, Investors generally operate off of self interest. And there has been this track record. I talk about where there has been a boost to asset prices sometimes, even when the policy efficacy for what they're trying to solve for is questionable.

The act, the Labor market impact, real wages, you know, health of middle class asset prices sometimes do benefit even as governmental instability rises and real wages do not. So yeah, stocks and real estate can increase and you get a hedge funder coming on. I saw David Tepper on CNBC pounding the table.

We're now going in on Chinese equities. So sure you can get a trade out of this. I don't have any doubt that's true. But the problem is that going back to when I was leaving high school, Chinese economic growth has been massive and the stock market has not returned a thing. And when you look at them acting, talking, indicating, teasing, Bernanke, Abe, Japan, Fed like policy and direction, I really believe that you are doing this in a society that has no free markets or very constrained free markets and no property rights.

And it is a very different milieu environment, landscape than some of the others. And that has profound impact in terms of the long term expectation. China's deflationary mess may be far worse than we know. They may reflate, they may obviously obfuscate. I don't know exactly how it plays out there.

But what I would say is that with higher government intervention and money supply contracting right now, they're in a real deflationary spiral. This is no joke, and we've seen it before. And I believe that they will go all in on exporting their deflation to the world, which could very well be effective for them.

But nevertheless is a macroeconomic story. It does not cause me to say I want to go buy Chinese video game stocks and that exporting of deflation. You know, there are some who say, well, all this fiscal monetary accommodation, Is inflationary. It's not counter deflationary. I think that goes against the testimony of history.

It is counter deflationary until it isn't. There's a sugar high, there's a short term bump. There's hedge funders talking on tv. All that's real. All that just happened I in the last week or two. Sustainable fundamental buyable. I don't believe so. And I think that there are self-reinforcing demographics there.

Obviously governmental distortions. That are problematic here and would, could be solved by freedom. That's not on the table. I would expect them to be exporting their deflation. I would expect the long term fundamental thesis of China to not match the short term trading opportunity that some may be attracted to in this period of policy maker shift.

I would expect that if President Trump's elected, which you just heard me say last week, that former President Trump and current Vice President Kamala Harris in their race for the President 2024, I considered a 50 50 proposition. So I'm by no means making a prediction because that isn't my prediction.

I think it's a toss up. But if Trump were elected, I think he goes in to a lot of the China negotiations that are going to be a big part of his platform and agenda with a lot of leverage. I would expect President Xi to be buying a lot of liquefied natural gas from the United States. I don't think that they're in a situation To bluff and not blink in some of these trade negotiations So that's something i'd be thinking about in the context of the election and finally I would suggest that our negligible exposure of chinese equities Does not mean that we don't believe we're impacted by china or that we don't believe the world's impacted by china I believe that there's a macroeconomic reality As net negative for them But some of the actions are net positive for the world.

I believe that's only true marginally. I don't think it's a something that you can go create an entire investment thesis around, but I believe it changes some trade dynamics and potential, opportunity in terms of where China interacts with other trading partners. I think it's an economic story, not a market story.

And when I say it's not a market story, I say that despite the fact that I'm a dividend growth guy, we are dividend growth investors at the bonds and group and China's stock market has had 14 percent dividend growth. But when the government's forcing the dividend growth to try to use capital return to stimulate investment, that's not necessarily what we want to see.

Ultimately we want rule of law, we want property rights, but also we believe that a deflationary spiral met with fiscal and monetary counterpunch often begets more deflationary spiral. So we have seen it before and we are very much on the side of fundamental value. Not being viable in China right now.

I hope that the way I've tried to break this down is giving you a little understanding of what exactly has transpired, how China got here, where they are now, why they're doing what they're doing. You will hear more. I do not think China's done trying to throw a sink at stimulative stimulative measures.

But I want to explain why to us seeing the Chinese stock market run up doesn't cause us to hit the trading desk and the buy button. We want to be more prudent. We want to stay consistent with our philosophy. To that end, we work. Thank you for bearing with me as I've gone through some kind of wonky stuff and done it quickly, but the China story is an important one.

As always, I encourage you to go to dividendcafe.com to read more. Thank you for listening. Thank you for watching and thank you for reading the Dividend Cafe