Weekly Market Flash

Geopolitics, China and the Chamber of Commerce

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A couple weeks ago an article appeared in the Financial Times newspaper about something called a nuclear-capable hypersonic missile, a piece of defense equipment that China apparently tested back in August, the first of its kind. The FT article was not a pleasant read. Hypersonic means that the vehicle travels at around five times the speed of sound, which is slower than the speed of an intercontinental ballistic missile, but fast enough to orbit the Earth on its own after first being launched into space on a rocket. The hypersonic vehicle in question circumnavigated the planet and eventually landed about thirty miles from its target, but not before evading all the missile defense systems the US has set up to destroy incoming warheads (to be absolutely clear, this was a test – there were no weapons of any kind attached to the missile). The chairman of the US joint chiefs of staff, Army General Mark Milley, called the hypersonic test something close to a "Sputnik moment," evoking the Soviet Union's successful first launch of a satellite in the 1950s, in the early years of the Cold War. It gives new weight to a Pentagon report that came out earlier this week saying that China plans to quadruple its nuclear weapons stockpile by 2030.

Geopolitics is Geoeconomics

The geopolitical tension between the US and China transcends the quotidian smallness of our partisan political conversation, with the current administration more or less picking up where the previous one left off. Now, there is a conventional way of thinking about geopolitics in the context of the effect it has on markets, which is to say "none whatsoever." It is true that markets have a storied history of ignoring even the tensest of flashpoints between nations (oddly enough, even at the height of the Cuban Missile Crisis in October 1962, the stock market started a rally that would see it gain almost 40 percent in the next twelve months – go figure).

But what happens between the world's largest two nations matters for markets. About half the world's oil tankers pass through the South China Sea, which China has more or less claimed for itself via the famous "nine dash line" map, a major source of tension with its Asian trading partners as well as with the US. Taiwan, one of Asia's most developed nations and home to the world's most advanced semiconductor manufacturer – Taiwan Semiconductor Manufacturing Company – is under growing threat from China with near-daily military incursions and incessant hostile rhetoric from Beijing's leaders. China is the world's largest consumer of most major industrial and energy commodities. Not to mention, of course, the strategic epicenter of global supply chain networks whose importance to consumers around the world was made crystal-clear when the pandemic hit.

Simply put, markets cannot just forever shrug off rising geopolitical tensions and in particular China's growing military threat to the economically vibrant Asia Pacific Region. And here's the other side of the equation: the markets in question are largely made up of entities – multinational enterprises – the fortunes of which are very much embedded in China.

The View from the Chamber of Commerce

What would US companies do if the tensions between their home country and China were to spill over into something worse? It's a question that would affect the market leaders of almost every industry sector in the S&P 500, from consumer discretionary to healthcare to communications services and information technology. Many of these market leaders derive a plurality or even a majority of their revenue from China. The growth numbers they report to their shareholders and to the securities analysts who cover them on quarterly earnings calls depend in no small part on the continuation of business as usual with China. The growth has never been entirely frictionless – there are many examples, well-documented in the business press, of companies reluctantly agreeing to comply with edicts from Beijing that run counter to their own values and instincts. Such is the complexity of doing business in a multifaceted world.

For a long time the hope has been that the importance of the economic relationship between China and its partners around the world would override counterproductive nationalistic impulses. Indeed, from the days of David Ricardo and Adam Smith in the eighteenth century, trade between nations has been seen as the most productive path to the creation of wealth for the benefit of all. In the aftermath of the Second World War, the Bretton Woods framework aimed to enshrine this belief for once and all. With the collapse of the Soviet Union and then the admission of China to the World Trade Organization, confidence ran high that the permanence of this aspiration was finally in sight.

None of which, unfortunately, will give much comfort to the senior managers of those multinational enterprises who have to think about how they would react to waking up one morning to news of an outright military attack by China on Taiwan. That is not an abstract risk, but something with a reasonable probability of happening sometime between now and the middle of this decade. It will affect their employees, their strategic partners, their customers and – yes – their investors (in other words, us). It's a risk we have to take seriously.

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