





Pīng pāng hé tóu zī zài zhōng guó

When 19-year-old Glenn Cowan and his US teammates arrived in Nagoya, Japan, for the World Table Tennis Championship in March 1971, most people thought that players from a country where ping-pong was largely a recreational sport confined to suburban basements would have little chance against world-class players from powerhouse countries like China.¹ And they were right. The 23rd-ranked US team made little noise inside Aichi Stadium, but unbeknownst to them, their impact would be felt well beyond the world of table tennis. On April 5, Cowan –the team’s top player and straight out of hippie central casting – stepped onto a shuttle bus and found himself in the presence of the Chinese national team, the only other passengers on board. The doors closed and the bus left, and Cowan and the team sat there in silence until China’s top player, three-time world champion Zhuang Zedong, approached from the back of the bus, a silk-screen portrait of the Huangshan mountains in hand. He presented it to Cowan as a gift, a truly extraordinary gesture given the tense relations between the two countries and the pressure the Chinese Communist Party (“CCP”) was imposing on its citizens during the ongoing Cultural Revolution. And yet, here was the great Zhuang looking past all of that, exemplifying the unifying power of sports in one spontaneous gesture. “I grew up with the slogan ‘Down with the American imperialism!’,” Zhuang would say later. “And during the Cultural Revolution, the rope of class struggle was tightened unprecedentedly, and I was asking myself, ‘Is it okay to have anything to do with your number-one enemy?’”²

Cowan would later return the favor, presenting Zhuang a t-shirt with a peace symbol and the Beatles song lyric “Let It Be.” When Communist Party Chairman Mao Zedong heard what had happened, he praised his countryman as not just a good table-tennis player, but a good diplomat as well. Chairman Mao invited the US players to visit China, and a few weeks later the US table-tennis team would be the first American delegation to set foot in China since 1949. “Ping-pong diplomacy,” as it was called, put in motion a series of events that opened up diplomatic channels where few had existed for decades, culminating in Richard Nixon’s arrival the following year, the first time a US president had visited mainland China while in office. Table tennis helped accomplish what 15 years of secret diplomatic negotiations could not, sowing the seeds of reconciliation and showing the world the power of sport to overcome barriers and alter the course of history.

It’s an inspiring, oft-told story of a happy coincidence that changed the trajectory of international relations between two global superpowers forever. The only problem is that the details don’t quite hold up under scrutiny, neglecting the realities of the time and the economic, social, political, and physical pressure the CCP was imposing on its citizens, a dynamic that continues today, albeit to a different degree. As detailed in Nicholas Griffin’s *Ping Pong Diplomacy: The Secret History of the Game That Changed the World*, the actions leading

¹ The terms “ping-pong” and “table tennis” are used interchangeably here. “Table tennis” was born from a trademark dispute in the sport’s early days.

² “Obituary: Zhuang Zedong, The accidental architect of ‘ping-pong diplomacy’” The Independent, Feb 12, 2013



up to the events of 50 years ago were almost certainly planned, and serve as an important reminder of the influence the Party imposes as a means toward achieving its goals. China is a stunning, vibrant country with a deep well of bright, innovative, creative minds making important contributions throughout the world's second-largest economy, but operating under a cloud of political uncertainty that shows no signs of abating. It's not impossible to invest in a system without complete trust and confidence in the political infrastructure and rule-making authorities, but it does make it far more challenging. To be fair, China most definitely does not stand alone in this regard. There are other emerging markets that fall into this category, and even developed markets where leadership hardly inspires confidence or trust in the stability of the policy-making system. But China deserves particular attention because of its size and importance on the world stage. The country has come a long way since using ping-pong as a tool for strengthening its reputation, but the CCP remains a powerful, unilateral, not necessarily shareholder-friendly force for shaping the contours of growth and progress, which means investors have to be particularly careful when considering how to invest in an area that remains tethered to a system of tight control.

Communism (and Ping Pong) in China

Ping-pong was created by the British Army in the 1880s, but it was a man named Ivor Montagu who was responsible for codifying its rules and bringing it to the masses. Montagu was born into one of Britain's wealthiest families, but was seduced by both communism and ping-pong in his teen years and ended up promoting the game as a sport of competition for the working class. The game made its way into communist-controlled China in the 1930s, growing in popularity with the publication of *Red Star over China* in 1936, the American journalist Edgar Snow's account of his time embedded with the Chinese Red Army, where he wrote about the origins of the CCP and conducted interviews with the mysterious Party leader, Mao Zedong. The Communists were engaged in civil war against the ruling Nationalists, led by Chiang-Kai Shek, but not much was known about Mao and the CCP. The book ended up having a massive impact on the growth of communism in China, and also introduced the masses to ping-pong, a popular game among members of the Red Army.

In 1949, the Communists drove the Nationalists off the mainland into Taiwan and established the People's Republic of China ("PRC") with Mao as Chief of State and Zhou Enlai (who would go on to play a key role in the events of 1971) as Premier and Foreign Minister. However, the Nationalists still maintained their representation in the United Nations, despite the efforts of the PRC's main ally, the Soviet Union, which also held a seat. This would become a point of contention for years, as the US and other nations would continue to recognize the Republic of China and not the PRC, whose support of North Korea in the Korean War led the US Commerce Department to impose a trade embargo that would last for decades. The US did not mince words either. In a visit to Taiwan in June 1960, President Eisenhower said, "The United States does not recognize the claim of the warlike and tyrannical Communist regime in Beijing to speak for all the Chinese people. In the United Nations we support the



Republic of China, a founding member, as the only rightful representative of China in that organization.”

The PRC craved recognition, respectability, and a voice in global affairs, and would turn to ping-pong as one mechanism for accomplishing these goals after seeing how Japan used the sport to help rehabilitate its post-war image and reputation during the Table Tennis World Championships in England in 1954 and Holland in 1955. Local spectators still harboring bitterness and resentment warmed to the Japanese team’s humility and sportsmanship during the championships, and by 1956 the tournament was being held in Tokyo, with the Japanese team now the most dominant in the world. By 1958, China had withdrawn from both the International Olympic Committee (“IOC”) and the Fédération Internationale de Football Association (“FIFA”), putting all of its athletic resources into building a world-class ping-pong program. In 1959, the intensive commitment paid dividends, as Rong Guotuan claimed the first Chinese championship in any sport. Interest in ping-pong exploded, and Ivor Montagu, by now a friend to China, offered the country the chance to host the next world championship in 1961.³ It would allow China to not only position itself as a friendlier nation, as Japan had done a few years earlier, but it could show off the achievements of the Great Leap Forward, initiated in 1958 by Mao to transform the country from a largely agrarian economy to an industrial powerhouse on par with the most developed nations.

Control Over The People

China’s actions over the next few years displayed the CCP’s willingness and ability to mold a perception vastly at odds with reality at the expense of its people. The Great Leap Forward was devastating for the country’s population, with discredited agricultural techniques imported from the Soviets contributing to a massive famine that claimed tens of millions of lives at the same time the Party was building a world-class gymnasium and the largest ping-pong stadium in the world in advance of hosting the Table Tennis Championships in 1961. In that regard it was highly successful. Led by a local Beijing man named Zhuang Zedong, China defeated the five-time defending champion Japan for the championship. The best Chinese players became celebrities, while also becoming friendly with leaders of the Party, not appreciating how tenuous these relationships truly were. China would win the next two team championships in 1963 and 1965, but would not appear in the subsequent championships in 1967 and 1969, which coincided with Mao’s next socioeconomic experiment, the Cultural Revolution.

Like the Great Leap Forward, the movement was progressive in name only, with young people – the so-called “Red Guards” – directed to challenge authority figures and destroy the “Four Olds” of culture, habits, customs, and ideas. It reflected Mao’s idea of “continuous revolution,” but it ending up fertilizing the seeds of self-destruction, with the Red Guards often using violence as a means of carrying out Mao’s directive, with encouragement, support, and guidance from his wife, Jiang Qing. “The Cultural Revolution upended China, causing

³ Post-war, the World Table Tennis Championships were held annually from 1947-1957, then every two years through 1997, then barring the back to back tournaments of 2000 and 2001, every two years again starting in 2004.



chaos and misery. The mob ruled the streets in a hysterical orgy of violence, [with] hundreds of thousands killed or driven to suicide.”⁴ Given their status in the country and avoidance of the rigors of the Great Leap Forward, the top ping-pong players naturally thought they would be immune from the impact of the Cultural Revolution. But they miscalculated. Under Jiang’s new “Clean Up the Ranks” directive, the entire sports system was effectively dismantled under accusations of players and officials being “spies, traitors, and capitalist roaders.” Success was effectively criminalized, with players who had celebrated victory at prior championships accused of impurity of thought. The country’s most celebrated player, Zhuang Zedong, was subjected to torture and accused of colluding with the enemy to commit treason and of having “bourgeois inclinations.” By the tumultuous summer of 1968, Zhuang had been beaten and jailed as a counterrevolutionary, and almost 500 other players and officials were exiled to the province of Shanxi in the northern region of China for reeducation through compulsory labor in a farming community. It was a trying time for China, which, along with the Soviet Union, was also helping to fight a war against the Americans in Vietnam.

Despite their shared commitment to communism, tensions between China and the Soviet Union were actually escalating during this time, and fighting broke out along their shared border. Mao and Zhou Enlai decided that China’s best foreign-policy option was to engage with the US, which was experiencing its own internal strife and chaos. Martin Luther King Jr. and Robert Kennedy had both been assassinated within a few months of each other in 1968, and the increasingly unpopular Vietnam War was causing massive social and political upheaval. Talks had actually been held between the US and China in Warsaw, Poland, over the last 15 years – 134 meetings in all – but according to Secretary of State Henry Kissinger, they were notable only because “they represented the longest continual talks that could not point to a single important achievement.” Significant animosity existed between the citizens of both countries as well, as communism was viewed as repressive by many Americans and capitalism as excessive by many Chinese. Zhou decided a different approach was warranted, and the Table Tennis Championships of 1971 presented a perfect opportunity.

Zhuang Zedong has always maintained that the encounter with Cowan on the shuttle bus was not premeditated in any way, and that his actions that day were influenced by Confucian teachings of openness and reconciliation. However, for us to believe that, we’d have to believe that Zhuang was able to set aside the treatment he had received only a few years prior to confidently reach out to an enemy without fear of Party retribution. We’d also have to believe that he happened to have a large silk-screen portrait on him, despite the fact that most senior players were allowed to carry only tiny souvenirs to exchange with players from other teams. A group of photographers also just happened to be waiting for them as they got off the bus at Aichi Stadium. The circumstantial evidence supports the notion that the Party had planned for this as an attempt to kickstart diplomacy, and it worked. US perceptions about the Chinese began to change significantly, and later that year UN General Assembly Resolution 2758 was passed, recognizing the PRC as “the only legitimate representative of China to the United Nations.” Shortly afterward, Nixon would visit the mainland trailed by extensive

⁴ “Mao the Man, Mao the God” Foreign Policy, Sep 8, 2016



media coverage, opening up the country to the rest of the world.

The Risks of Investing in China

So what does ping-pong have to do with investing in China? The story of the Party's embrace of ping-pong as a tool for serving an agenda dovetails perfectly with how the CCP appears to be viewing the role of companies in the private sector – as tools for serving the Party's economic, social, and national-security agenda. The days of the Great Leap Forward and Cultural Revolution are thankfully behind China, but the Party's hold on the social and economic apparatus of the country is clear, and this fuels the concerns that go along with investing in the region. While there are other governing bodies within China, the only one that truly matters is the CCP.

It may help to better explain how the political system operates in China. The CCP dominates the state and society, with its power resting on four pillars of control: 1) China's military, police, and other security forces; 2) personnel appointments across all political institutions, the military, state-owned corporations, and public institutions; 3) the media; and 4) the judiciary and internal security apparatus. There is an elected body called the National People's Congress ("NPC"), which technically oversees the State Council, as well as the presidency, the Supreme People's Court, the public prosecutors' office, and the military, and has the ability to initiate and shape legislation. In practice, however, the NPC is controlled by the CCP and exercises little oversight of any of the institutions officially under its supervision. Interestingly enough, the Party's leadership role is referenced five times in the preamble to the PRC's 1982 constitution, but is not mentioned in any of the articles of the constitution, leading to ambiguity around the legal basis for the Party's vast powers. But make no mistake – the Party remains above the law, leadership politics is a black box, and civil society and the right to free speech and association are severely constrained.⁵

This all-powerful Party structure has been the single biggest factor underpinning the recent trepidation of investing in the area. China has experienced a significant amount of economic growth over the last number of years, but it hasn't been accompanied by a lot of regulation, which means that the Party has had a lot of catching up to do. A report this summer from Goldman Sachs showed that Chinese regulators had taken more than 50 actual or reported actions spanning antitrust, finance, data security, and social equality. "Among the moves were scuttling Ant Group Co.'s blockbuster listing; fining sister company Alibaba a record \$2.8 billion for antitrust failings; and blocking a Tencent-backed merger... The pace intensified in July, which saw the opening of a cybersecurity review into Didi Global days after the ride-hailing firm went public in New York, and an abrupt declaration that after-school tutoring should become a not-for-profit industry."⁶

The overhaul of ed-tech in China really underscores the power that the CCP has to literally transform an entire industry. Whether or not ed-tech ultimately becomes not-for-profit has

⁵ "Understanding China's Political System" Congressional Research Service, Mar 2013

⁶ "China's Corporate Crackdown Is Just Getting Started. Signs Point to More Tumult Ahead" Wall Street Journal, Aug 5, 2021



yet to be determined, but the Party clearly thought that, as structured, the industry was doing as much (if not more) harm than good, and new policies were required. “The most impactful policies, introduced in July, include a ban on any for-profit tutoring services focused on the country’s core public school curriculum, oriented around the make-or-break high school and university entrance exams. Limits were also set on the times during which students could attend classes, restricting class schedules to no later than 9pm on weekdays, and allowing only extracurricular courses on weekends. The regulations have been catastrophic for leading Chinese ed-tech companies... As much as 50% to 80% of such firms’ revenue came from tutoring — activities that have now been banned. Their executives are faced with the unpleasant task of turning around billion-dollar Titans before they sink.”⁷ This is a complicated subject, with CCP decision-making impacted by factors ranging from the intense pressure placed on parents by aggressive tutoring-services ad campaigns to the potential shortage of technical skilled labor for a growing economy dealing with a birth-rate slowdown. The Party’s objectives may be to ease the strain on struggling parents and increase the appeal of vocational training, but it comes at a cost to shareholders who may have mistakenly assumed that free-market principles would apply. In the wake of the Party announcing these changes, the entire sector sold off dramatically at a cost of tens of billions of dollars for investors.

It’s important to note that some of these orders seem like really positive social policy decisions that address societal problems (problems which aren’t unique to China). After-school tuition costs rising significantly. Kids spending too much time on screens. Delivery drivers not receiving basic benefits like insurance coverage and a minimum wage. Runaway health-care and housing costs for consumers. Questionable use of personal data by companies. A persistent wealth gap between rich and poor. If you’re a potential beneficiary, like the average Chinese citizen, the Party orders may be welcome. But if you’re an investor accustomed to the idea of shareholders being prioritized, the associated uncertainty can be maddening. And so the question that managers need to ask themselves when assessing a company is this: Do the Party’s goals – or society’s “best interests” – potentially conflict with a company’s product or service? If the answer is anything other than “no,” the risks of a Party order impacting the company’s prospects need to be considered.

The Issue of Social Suppression

In addition to the risks associated with Party goals, investors with social concerns have to be mindful of other issues. The CCP has never hesitated to silence the voices of critics or those it deems to have a less savory influence on its citizens. Alibaba co-founder Jack Ma has been an outspoken critic of the CCP, a stance which played a role in the shutdown of the IPO for his financial technology company, Ant Group. “Chinese President Xi Jinping personally made the decision to halt the initial public offering of Ant Group, which would have been the world’s biggest, after controlling shareholder Jack Ma infuriated government leaders, according to Chinese officials with knowledge of the matter. The rebuke was the culmination of years of tense relations between China’s most celebrated entrepreneur and a government

⁷ “The Casualties of China’s Education Crackdown” TechCrunch, Sep 22, 2021



uneasy about his influence and the rapid growth of the digital-payments behemoth he controlled. Mr. Xi, for his part, has displayed a diminishing tolerance for big private businesses that have amassed capital and influence—and are perceived to have challenged both his rule and the stability craved by factions in the country’s newly assertive Communist Party.”⁸

The Party has also exercised its unilateral authority to “cancel” people from the internet. Zhao Wei is a billionaire actress and among the country’s most widely recognized faces in film and television. On August 26th, without any comment or stated reason, all entries related to Zhao on major Chinese social-media platforms were removed, her name was scrubbed from the credits of films and TV shows, and all content featuring her — including film, TV, chat-show appearances, and more — was removed from major streaming sites like Tencent Video and iQiyi. This came two weeks after popular actor Zhang Zhehan similarly had all of his accounts and works banned and scrubbed from the internet after pictures surfaced of him visiting Japan’s Yasukuni Shrine to those killed in war, considered especially offensive given the history of Japanese aggression against the Chinese on the mainland.⁹

And then there is the case of the Uighur people and the reported treatment of this Muslim population in the Xinjiang province, located in the northwest region of China. According to the United Nations Committee on the Elimination of Racial Discrimination, there is credible evidence that up to one million Uighurs and other Muslim minorities are being held in “re-education” detention centers in Xinjiang. The Party denies any mistreatment, claiming that these camps are “vocational training centers” which help stamp out extremism by providing people with new job skills. However, a 2018 report by Amnesty International found that arbitrary detention of Uighur Muslims across the province was widespread, while the exile group World Uyghur Congress claims that detainees are held without charge and forced to undergo attempted indoctrination by shouting Chinese Communist Party slogans. Even more disturbing, the Party has faced accusations that it has forced Uighur women to be sterilized or fitted with contraceptive devices to control population growth. Despite Chinese denials, in March 2021, the US, Britain, Canada, and European Union all agreed on new sanctions against Chinese officials, companies, and institutions deemed responsible for human-rights abuses against the Uighurs.¹⁰

Invest in China, But Proceed Carefully

During their visit to China following Nagoya, the US table-tennis team was given an audience with Zhou Enlai, the primary architect behind Glenn Cowan’s “chance encounter” with the Chinese team. Cowan asked the Chinese premier what he thought of the hippie movement in the United States. Zhou said that he didn’t know too much about it, but “youth wants to seek the truth and out of this search, various forms of change are bound to come forth. When we were young, it was the same, too.” In this spirit, it’s tempting to believe that reform is coming, and that the Party’s influence on capital markets will fade as the economy continues to grow and a younger, reform-minded demographic pushes back against CCP

⁸ “China Blocked Jack Ma’s Ant IPO After Investigation Revealed Likely Beneficiaries” Wall Street Journal, Feb 16, 2021

⁹ “China Removes Actress Zhao Wei From Streaming Sites and Social Media” Hollywood Reporter, Aug 27, 2001

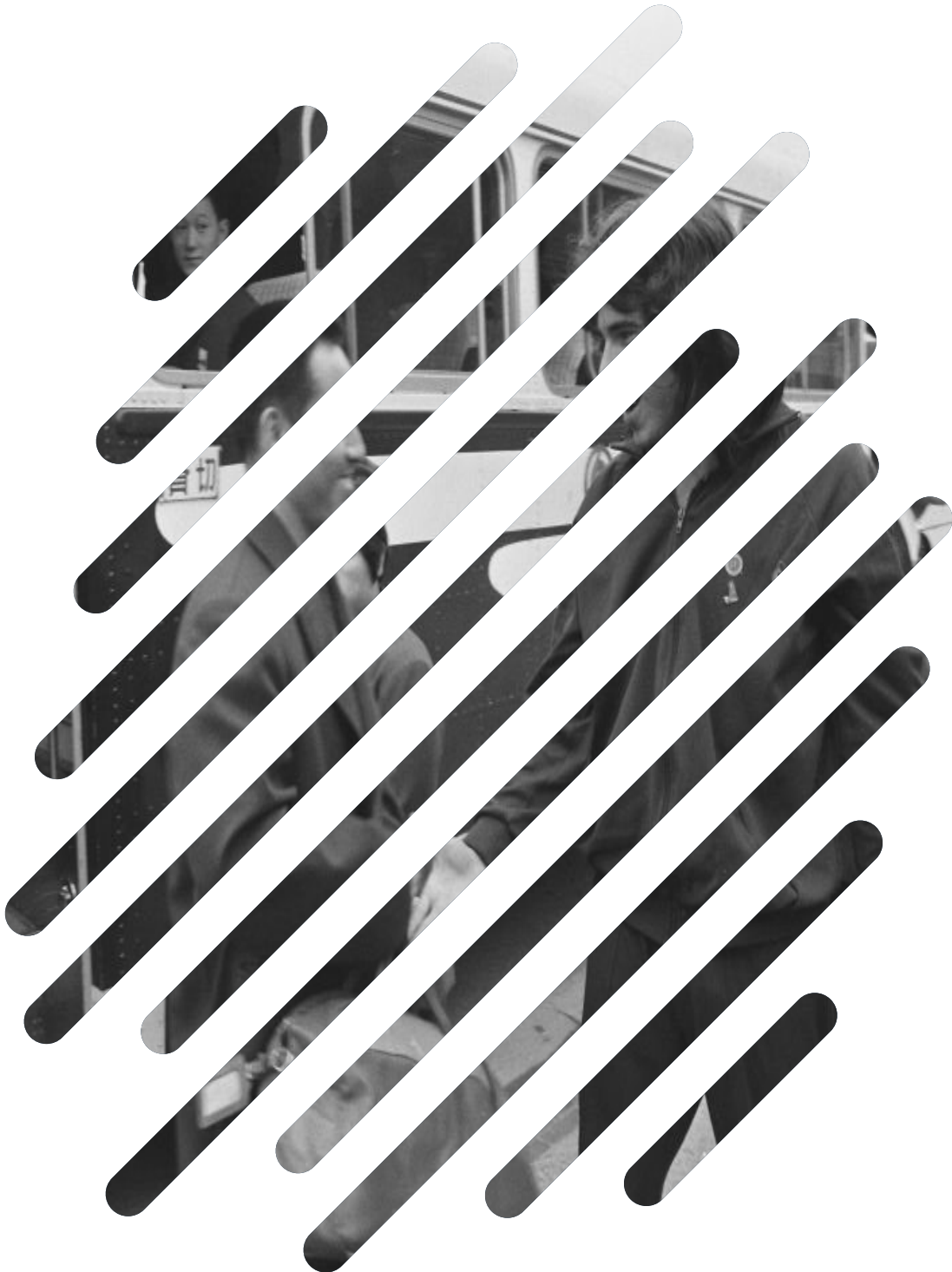
¹⁰ “Who are the Uighur people and why do they face oppression by China?” The Independent, Mar 26, 2021



influence. But despite Zhou's remarks, this seems highly unlikely anytime soon, if ever.

It's important to note that all countries – developing and developed – are imperfect. It's easy to identify problems in every area of the world that highlight the risks of investing in those regions. The reason China deserves additional focus is because the political structure runs the risk of masking just how investable it is. The sheer magnitude of the economy and number of opportunities for further growth make it a place difficult for investors to ignore. With that in mind, it is essential to find managers with deep expertise, a strong information network, comprehensive cultural understanding, and an unwavering focus on the risks specific to the country. In that respect, investing in China is quite familiar in the sense that myopic, shallow, and one-dimensional assessments can be disastrous, while the opposite provides a strong probability of reaping the available rewards. If investors were to dismiss every country where they took issue with an aspect of the social or political decision-making apparatus, the only suitable portfolio might be one invested solely in cash.

Despite the controls imposed by the CCP, China is a very different place today than it was 50 years ago. The effects of ping-pong diplomacy reaped significant rewards for the country, but Party-controlled actions often come with casualties. In the aftermath of these events, Zhuang Zedong became minister of sport and physical culture and a member of the Central Committee of the CCP. He allied himself with the "Gang of Four" political faction, where he ended up doing the types of things done to him in the earlier days of the Cultural Revolution, like organizing mass meetings at which denunciations, beatings, and self-criticism were common. After Chairman Mao's death in 1976, the Gang of Four was toppled, and Zhuang was arrested and placed in solitary confinement for four years and then exiled to Shanxi before being allowed to return to Beijing for the remainder of his life, during which time he expressed regret for the actions that led to his punishment. Zhuang's story of glorious ups and devastating downs reflects the attributes of what turned out to be a highly complicated life. Investors in China should take note, because these are also the attributes of investing in a highly complicated region.



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