

PERCEPTION

SEEING IS BELIEVING, BUT OUR BLIND SPOTS MAY MASK A BIGGER PICTURE.



Perception

Perception makes us who and what we are. It shapes ideas and beliefs, influencing every facet of our lives, impacting both logic and reason. It is a way of seeing, interpreting, and acting on the information and facts that comprise our world. Different perceptions can emerge from the same set of facts; as exemplified by the parable of the blind men and the elephant (where a group of blind men who have never come across an elephant before try to describe what the animal is like by touching it, leading to different descriptions based on the part of

the elephant touched), variant perspectives may each reflect inherent, if opposed and occasionally limited, truths. Unfortunately, friction is common between those with different viewpoints, although good judgment requires the willingness to consider other views. This is an especially important characteristic of good investors, who are constantly interpreting information on both a micro and macro level, from the details of corporate financial statements to the competitive qualities of entire countries.



Title of image: China in the dark, a play on the parable "Blind men and an elephant," circa 500 BCE.



A World with Some Curvature

One of the more respected observers and writers of domestic and international affairs in the world, Thomas Friedman has earned two Pulitzers for International Reporting, a Pulitzer for Commentary, and a National Book Award for Nonfiction.

When Friedman wrote his best-selling book *The Earth is Flat* in 2005, his goal was to emphasize and highlight what he viewed as a leveling of the playing field in global commerce, driven by a variety of factors that included technological advances and supply chains that deemphasized historical borders, placing more focus on the pace of innovation. He talked about how this interconnectedness would make the world a safer place, as countries sharing economic interests were much less likely to enter into conflicts with each other.

Friedman used to be a major admirer of the Chinese government and its ability to promote Western styles of capitalism in an autocratic society. It was a position he maintained for some time, but over the last year, that stance has shifted, and he no longer believes the above is occurring in

step with China. Friedman's opinion piece published in the *Times* on November 1 – “How China Lost America” – calls the “end to four decades of steady integration of China's economy with the West” the most important thing that happened this year, selecting it from a list of candidates that included Britain's post-Brexit economic difficulties and Russia's invasion of Ukraine. Friedman does not render the US blameless in the “erosion of this relationship,” but puts much more of the blame on China.

Friedman's interpretation reflects a popular viewpoint of the American public, and China's reputation in the US has certainly not improved in recent years—according to the Pew Research Center, more than 80% have an unfavorable view of China¹—and that trend doesn't seem likely to reverse anytime soon. This view is well-made and very worth considering, but it should be balanced with a consideration of another, less widely appreciated angle: the case for China.



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¹ “Negative Views of China Tied to Critical Views of Its Policies on Human Rights” Pew Research Center, Jun 2022



Sailing Past the Edge of a Flat World

There's an old Chinese saying that translates to: "Listen to both sides and you will be enlightened; heed only one side and you will be benighted." It's good advice to apply to the analysis of any situation, but in particular with politics, where schisms have a natural tendency to widen because of each side's all-to-common inability to listen to the other.

One major criticism of China is its defensive and ostensibly selfish focus on itself, leading to such things as unfair trade practices (e.g., China reneging on a promise to sign a World Trade Organization side agreement on government purchases, which would have limited China's ability to discriminate against foreign suppliers, instead steering its state buying power to state-owned and local subsidized industries) and the flaunting of international agreements. However, while this can be acknowledged with a "yes," it is not impervious to a "but..."

The 24-member Politburo² is a group of top officials who oversee the Chinese Communist Party (CCP), headed by the general secretary. In recent years, it has seen an increase in the number of men with advanced degrees and overseas backgrounds, whereas foreign-educated returnees previously generally served in lower-levels of leadership in decades past³. Travel and higher education tend to broaden mindsets, and people with this kind of background in turn tend to be more pragmatic and economic-development oriented, with a better understanding and direct experience of the benefits of globalization; an increase in their presence could bode well for a broader, sustained, collective political shift towards such a mindset, should Prime Minister Xi Jinping feel inclined or pressured to listen.



² Power within the Chinese politburo is further centralized in the Politburo Standing Committee, a group of seven individuals from among the larger politburo.

³ <https://www.chinausfocus.com/2022-CPC-congress/the-anticipated-strong-representation-of-foreign-educated-returnees-in-xis-third-term>

In this respect, although Xi has expressed his desire to scale back China's economic policy of "opening-up," particularly in opposition to the West, and has effectively been able to overturn the Chinese policy on term limits, the opposition around him has not been absent. Outgoing Premier Li Keqiang has publicly asserted over the last several months that China's outward-facing economic programs are a "door of opportunity that China cannot and will not close." While he was not included on the 20th Central Committee of the Chinese Communist Party, indicating his political retirement, his views likely reflect those of other CCP officials and interest groups opposed to the Prime Minister's policies who are unwilling to risk their careers at the moment by publicly criticizing the general secretary⁴. However, with the growing presence of such actors, Xi's consolidation of central power may necessitate greater official cooperation should these voices assert themselves in force or gain greater public or political influence.

Furthermore, China's reputation for hyper-nationalism does not fully reflect the country's active engagement with foreign officials beyond its tentative or erstwhile Western partners. China's emphasis on its "Belt and Road Initiative" policy is very active, and will continue to demand its attention given how much time and effort has been spent courting and negotiating with the 147 countries that have signed Memorandums of Understandings with China to be part of this initiative⁵. Xi has indicated multiple times that China will leverage its own new development path to share new opportunities with the world to achieve a 'win-win' situation. Not only is China aiming to boost "common prosperity" domestically, but it has also stated an intention to facilitate this across the world. Modernization and cooperation isn't synonymous with Westernization; losing America doesn't mean losing other partners.

On that note, after decades of skyrocketing economic development—and benefiting greatly from joining the WTO—China has also noticed the potential threats from globalization caused by a heavy reliance on exports (of manufactured goods) and imports (of high-tech-related products). China, like the US, does not wish to be dependent on other nations regarding the health of its domestic economy. Like any country with the resources and capabilities to alter this dynamic, China is making great efforts toward improving its manufacturing industry and supply chain. The government has indicated publicly multiple times that Chinese manufacturing needs to follow the German manufacturing model, which used to be criticized as 'cheap' but has become the exemplar of good quality. The obvious purpose of this trend is to enhance the competitiveness of Chinese products on the world stage, which sends a clear signal the government has no plan to give up exports. (Of course, exports may be impacted if it does not address the issue of restricting the competitiveness of imports.)

All of this considered, whatever its shape, the world cannot be considered flat anymore. Countries—all countries, including the US—have shown they will prioritize their own well-being and prosperity over reciprocal relationships. This leads to a new dimension to globalization, where every nation needs more-precise positioning and a competitive advantage to effectively work with particular interests across specific groups of countries over defined timeframes. China sees the urgency of leveraging its large market to build a robust cycle of domestic demand, but this does not necessarily equate to a de-integrated world and does not mean forsaking foreign markets.

⁴ <https://www.rand.org/blog/2022/10/xi-jinping-is-weaker-than-you-think.html>

⁵ Formerly known as "One Belt One Road," the Belt and Road Initiative is a strategy that seeks to connect Asia with Africa and Europe via land and maritime networks with the aim of improving regional integration, increasing trade and stimulating economic growth. The name is in reference to the concept of the Silk Road established during the Han Dynasty 2,000 years ago – an ancient network of trade routes that connected China to the Mediterranean via Eurasia for centuries. The initiative defines five major priorities: policy coordination, infrastructure connectivity, unimpeded trade, financial integration, and connecting people.



Reconciling and Learning from Different Perceptions

This is not to say that we endorse China's policies. Instead, we are simply highlighting that perception is fluid based on the recognition of new information, and this is a good thing. Opinions and interpretations should always be subject to fresh data and perspectives, never set fully in stone, and always open to discussion, especially with those who may have a more intimate or fundamental understanding of the nuances of any situation.

Herein lies the very essence of Crewcial, our investment philosophy, and research effort. Each year, we log millions of miles and meet thousands of distinct and, at times, great investors, with each interaction contributing to the overall quality of our thinking and advice. We maximize the value of these interactions through the questions we ask and the way we listen to the answers, with the latter enhanced by the wide variety of backgrounds and perspectives of our team members.

For example, the counterpoints to Friedman expressed here were substantially formulated by a woman born and raised in China and educated in the United States, who serves as one of Crewcial's senior research analysts pursuing a global opportunity set on behalf of our clients.

Making room for variant perception—the ability to look outside your existing paradigm of beliefs and expectations—allows one to approach any issue more comprehensively to formulate more targeted solutions to what may have previously seemed like insoluble problems.

In a nutshell, this is the key to investing. Facts are facts, but they're always subject to context and interpretation. Listening to and surrounding oneself with different opinions—based on life experiences, age, education, ethnicity, gender, etc.—is the best way to see every side of any picture; and more information to act upon leads to smarter, better-informed decisions, investment-related and otherwise. Specifically, in our role as advisors, we're tasked with determining the importance of Chinese equities in an investment portfolio given the myriad political and economic dynamics in play, and the impact this can have on Chinese or China-domiciled companies and the many US companies operating across Asia. Ultimately, we still believe China cannot and should not be ignored from an investment standpoint.

In the end, it is always beneficial to try to consider matters from a different angle. Knowledge is gained when both sides are willing to not only listen, but possibly adjust their thinking based on the listening.

Most things offer more than meets the eye.





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