

# Letter from Yunnan

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**I**n addition to a permanent staff in Beijing and Shanghai, a number of us based in Westport take regular trips to China. The goal is to deepen our understanding. In particular, we find getting out of the biggest cities provides useful perspective. Below are the notes from our most recent trip.

The flaccid, recently severed pig's head stared out dully from atop a metal tray. It was being lugged up a narrow, steep village alley by two young men. Behind them trailed a procession of male village elders, friends of the deceased. I had stumbled into a funeral among the Bai, an ethnic minority in western China, neighboring Laos. The Bai practice animal sacrifice in temples segregated by gender. I followed the pig and the men into the temple. A mourner with weather-beaten farmer's skin smiled and offered me a cigarette. He and the others sat down and waited for the shaman to arrive.

I had seen the other parts of this pig, or one just like it, earlier in the market. This was no Westport farmers market with artisanal cheese. Chickens and fish were slaughtered on site. Feathers piled up, soaked in blood. Fish writhed in tanks, waiting to be gutted. The Bai women wore brightly colored headgear. Differences in headgear plumage distinguished the fisherwoman from the farmer. The women took payment for the meat, fish, and vegetables over their cell phones, courtesy of Tencent and Alibaba. The buyers scanned the sellers' unique codes—even out here, the phones operate at 4G.

"5G is coming soon," said one woman, a bit apologetically. I thought about how often I've lost cell phone service on the Merritt Parkway in Connecticut.

If the Bai want to spend their hard-earned renminbi, they can jump on a high-speed train from their village to Yunnan's capital, Kunming. A few years ago, the trip required an overnight train; now it takes two smooth, quiet hours. Soon enough, another high-speed train will allow a jaunt to Hanoi, Bangkok, and Singapore, courtesy of Belt and Road. Out here, China's transformation seems nothing short of magic, which of course makes one wonder how the magic trick works and what's in store for the future.

## Chinese Building Blocks

In the West, rule of law unfolded over 800 years (the Magna Carta to present), industrialization over 250 years, and the computer age over about 40 years. Apple's first personal computer was unveiled during the 1984 Super Bowl. For the Bai and many other Chinese, China's roughly 300-year economic drawdown (call it 1700-1978) ended with a shockingly abrupt wealth boom. Particularly for those on the periphery of China, the big, obvious shifts have occurred only in the very recent past. As a result, new interacts with old; electronic payments coincide with animal sacrifice.

Oversimplifying the ingredients that made this possible is dangerous, because it misses so much. But oversimplification is also synthesis. The United States has an evangelical strain in matters of faith, culture, and foreign policy. It started with the Puritans. China, reduced to the same type of oversimplification, is Confucian hardware with Soviet software. Beijing's mid-level bureaucrat administering the five-year plan descends both from generations of able civil servants and from Moscow's Gosplan.

The Confucian ethic is in the country's very fiber. You cannot eat rice without grueling, year-round, communal work. You cannot become educated without going through the arduous process of learning Chinese characters, handed down from one generation to the next. The English alphabet has 26 letters. A Chinese high school graduate knows about 4,000 to 5,000 characters. A scholar needs to master 7,000 to 8,000. The Soviet software relates to the language and political culture (politburo, party, plenum), the economic planning process, and the attitude toward civil rights.

The other variables that seem so evident in Yunnan and the other places I saw on this most recent trip are scale and technology.

## Scale: Setting Their Own Rules

There may be big things going on in Laos, but they don't tilt the global economy like China does. The second biggest economy in the world has 1.4 billion people and 29 cities with a population of more than 3 million. While average Chinese households are obviously poorer than their US equivalents, there are more of them, and household spending is now about the same as the US in dollar terms. This scale is driving the economic ups and downs everywhere else. For instance, the current global manufacturing slowdown emanated from China. Secularly, this scale will only increase going forward. China has a 55% urbanization rate versus 80% for the States. China has 16 cars for every 100 people, while developed world countries are closer to 60 or 70.

At this scale, China can play a bit by its own rules, or at least it gets to play by them more than any other country except perhaps the US. I got a sense of how this scale works sitting at the edge of a rooftop pool in central Hong Kong, the water glittering in the sunlight. I was talking with a senior Tencent executive. While winter had already descended on Beijing, Hong Kong, a few hours' flight to the south, was bright and warm.

An example of scale: Tencent is the creator of WeChat, as well as many popular video games and other business lines. WeChat is far more integrated into the daily lives of Chinese people than any equivalent app I can think of in America. If a company wins a battle like that, developing the dominant app in a certain sector, the cash flows thrown off are, not surprisingly, meaningful. That's what scale means. Together with its other lines of business, Tencent is generating billions of dollars in profits and aggressively reinvesting all of them. The job of the executive I was speaking with was to make acquisitions globally to further bolster Tencent's cash flow, rivaling the acquisition arms of Alphabet and other Western competitors.

## Technology: Different Constraints

The railroad transformed every country it was a part of in the late 19th and early 20th centuries, creating corridors of modernity that cut through agricultural communities. The combination of high-speed internet and rail is likely doing the same thing now in China, creating a cascade of space-shrinking changes that are occurring so quickly they are difficult to document, down to the functioning of a Bai village market. China can build a train line in part because property rights are weaker than in developed countries and administrative decision making is less cumbersome. It now takes more time to take the train from Westport to New York City than it did 50 years ago. To get a high-speed Metro North train installed between Westport and New York City would need the sign-off of the Connecticut and New York legislatures and federal regulators, as well as funds from the US Congress.

The same lack of obstacles applies to technology. The lack of primacy that China places on privacy means that it is much easier to form electronic marketplaces where the buyer and seller can be definitively known. It also allows the government to administer policies that would not be accepted in the US.

When reporting on China, Western media focuses on the "surveillance state." There are indeed cameras on every corner. In a meeting I had with a state-owned company, they used facial recognition, not key cards. Facial recognition is also used at passport control. Yet, I suspect many in China see this technology as a civilizing influence.

A case in point is traffic. Traffic in many cities used to be chaotic due to widespread rule breaking. Bicycles and scooters still do this. Up early one morning in Beijing, I saw parents dodging cyclists as they tried to get what looked like terrified first and second graders into school. Since China has mastered the ability to take a picture of a car running a red light, match that image to a license plate and a driver, and then tie this into registration renewal, I'm told there has been a marked shift to better automobile driving. This shift is welcome, which is why I suspect most people don't seem to resent the monitoring.

Technology is also changing customer service. Trust in day-to-day interactions is low, perhaps due to the legacy of poverty and the need to elbow your way through life. However, Alibaba, Tencent, and others have set up transaction platforms that force buyers and sellers to play by the rules. Trust in these online platforms is high. My guide in Yunnan stayed up late on 11/11 (known as "Singles Day"), a sort of Black Friday for the Chinese, and did all of her shopping online, saying she wouldn't deign to shop in one of her local stores because she worried about quality.

Of course, some barriers exist in China that don't in the US, like censorship. I didn't realize how much I used Wikipedia until I couldn't. As my high-speed train raced through farmland, I looked out at peasants crouched in the fields, digging. It was a Sunday. Inside the car, no one read a book. They scrolled through their phones. How does censorship change perception here? The medium is the message, as the media theorist Marshall McLuhan said, by which I think he meant that our perceptions are influenced by how information is delivered (i.e., TV versus radio). Non-censored phones lack coherent, curated information, which appears to coincide with diminished trust and rising anger. Reading chaotic, emotional ideas may make people become more that way themselves. I wondered how China's more curated information impacts the national mood.

## The Services Boom

I sat in the back of a Beijing conference hall on the grounds of the State Guesthouse, one of the few foreigners present. Away from Beijing's bustle, the Guesthouse grounds offer a reprieve of gardens, trees, and streams. Key economic thinkers from the Academy of Social Sciences, the State-Owned Assets Supervision and Administration Commission, the State Information Center, and other key cells in the Beijing economic elite offered their views. They were all quite short-term bearish. It seemed 5% growth was a full-on recession to them.

Many of them noted "high inflation," which at present is being caused by rising pork prices, even as core prices are low. There is also stress in the banking system, particularly the smaller regional banks that are in the crosshairs of the China Banking and Insurance Regulatory Commission (CBIRC), though our research suggests the worst may now be over for the small banks. Over the course of my visit, various pieces of Chinese data, like credit and retail sales, continued to come in weak, though nothing seemed to signal much more than mid-single-digit growth, as opposed to a sharp fall.

Based on the speakers, there seemed to be a twinge of doubt setting in, as the key forces we have described in previous *Observations*—debt, balance of payments pressures, inflation, and the desire for financial stability—are limiting both the willingness to stimulate and, by extension, the confidence that China's economic miracle will continue. Likely the lessons Beijing takes from the Soviet Union (too little growth), the 2008 global credit crisis (too much debt), and Hong Kong (too unequal growth) are now defining the way they walk their policy tightrope.

However, unless the central government expressly forbids it, growth seems to burst forth, helter-skelter. And it isn't only the Tencents of the world. If you are in the right place at the right time, be it electric cars or a new service-sector job, growth is breakneck.

The CEO sitting across from me had a look—shocks of dark black hair suspended by gel, a hip blue and white blazer over a snug-fitting, crisp, white shirt. He was bemoaning his company's slowing growth, down to 40% from the previous 100%. His company organizes around 40,000 quick-response errand runners in 80 Chinese cities to service the increasingly demanding tastes of Chinese consumers. His company is sort of like Seamless expanded to include everything that needs a quick delivery time: food, birth control, medicine, getting rental bicycles into position. Services in China are 50% of GDP. In the US they are 80%. Reaching US levels will add roughly \$4 trillion of spending, and speaking to the CEO and walking past a floor of his employees tapping away at computers, it wasn't hard to imagine that growth occurring.

In the process, the CEO is creating tens of thousands of jobs (the delivery contractors) for those who would otherwise be on a farm or in a factory. Having watched the peasants in the fields, riding a delivery scooter seemed preferable. The CEO's company is probably the type of entity Beijing wants to support, even if support for it isn't explicit. This is important. A lot of the economy isn't planned, it just isn't forbidden. His company was launched by a mix of foreign and local venture money, not SOE bank loans, and is soon to IPO in the States. (He was shocked to learn that sentiment toward China is now so negative in the US.)

A wall in his modest office was covered with diagrams and notes that he said change daily. Most of his staff, like those I've met elsewhere, work a 9-9-6, or 9 a.m. to 9 p.m., six days a week. Given the explosion of services that make life easier across Chinese cities, I heard from a few people about a return back from the manufacturing coast, hard hit by the trade war, to these second-, third-, and fourth-tier, more interior cities that are now so much more comfortable to live in. Now Chinese people get to have their plot of land, fresh vegetables, and better air, plus high-speed internet, delivery services, and high-speed rail.

Education is another example of a booming service, satisfying a mix of traditional Confucian values and the desire for wealth. Only 5% of Chinese people have a college education. Chinese parents, most often still with one child even though they are now permitted two, pour resources into additional lessons for their kids in the hope of doing well on the *gaokao* (the brutal Chinese entrance examination that determines college acceptance) or gaining admission to a foreign college.

Financial services seem ripe for the same type of boom, though people can recognize a good meal or piano teacher easier than they can recognize good money management. Investors seem conflicted between a desire for very high returns and an aversion to loss. Chinese households and SOEs hold tens of trillions of dollars of assets that are mostly saved in cash, bonds, real estate, and junky investment products like wealth management products (which guaranteed a rate of return that couldn't actually be guaranteed, which is why these products are gradually being phased out). If they are lucky, they might have some gold. China is also massively underinsured. Only a small percentage of households have private insurance. The people I spoke to in Yunnan didn't own insurance products, and even those with a university education seemed to barely grasp the concept. The only way they knew how to save was to buy apartments and rent them out.

## Tensions and Wealth Gaps

“It's a long down cycle.”

The person I was speaking with was referring to the cycles conceptualized by Nikolai Kondratiev, whose 1925 book, *The Major Economic Cycles*, has both never been academically accepted and is widely quoted. While these cycles typically refer to an economy, this was alluding to worsening geopolitical tensions and conflict.

The Party is betting on a rather slim management cadre to negotiate China's challenges. Given how erratic US leadership looks to Beijing, many in China are increasingly confident that their system has higher odds of success than any other. There are roughly 80 million Party members. Assuming a minority of them do most of the work, a reasonable rule of thumb for any bureaucracy, it means just a few million people need to manage the economic challenges we have described in prior *Observations*. Now they clearly need to deal with a trade war as well and hit ambitious growth targets that stretch out for years as they strive to become what Beijing has described as a “moderately prosperous society.”

The wealth divisions are real. One wise person told me he thinks there are in fact “three Chinas.” The rich in Beijing and Shanghai, a middle tier of those who have more of a lower-middle-class life but are free from basic wants, and then the very poor. The wealthy, non-party elite in Beijing seem almost apolitical and to desire healthy children and grandchildren, interesting work, stylish, well-designed apartments, and foreign travel. Their core aspirations are basically the same as those of high achievers everywhere. They seem to have much more in common with elites in New York City than with Chinese peasants.

At the same time, I was shown a photograph of school kids in rural China sitting in what looked like a mud hut. The photo was making the rounds on WeChat. Despite the progress, that type of dire poverty still exists. Viewed from this perspective, comparisons of China to East Germany seem like a stretch. Yes, there is state control over political protest, but state oversight of commerce and consumption, including foreign travel, isn't much in evidence. In fact, there is a desire to grow as fast as possible without triggering a financial crisis—hardly the East German model.

## Next Steps

The question originally posed by Russian author Nikolai Chernyshevsky in his 1863 book, *What Is to Be Done?*, is still relevant in China today. Chernyshevsky was asking about how to bring millions of Russian peasants into modernity, and his book is now seen as a harbinger of the 1917 Russian Revolution and Soviet ideology. A few centuries later, China is still wrestling with this question.

Despite or perhaps because of the enormous uncertainty, on the flight back I felt incredibly privileged to be able to be a small part of Bridgewater's mission in China. The first few times I came to China, jetlagged and

baffled by the language, I didn't get it. Now, thanks to repeated trips and the fact that I am surrounded by so many incredible people who have helped me understand, I've been able to, at times, pierce the surface just a bit. Underneath, I see a world that is multidimensional, rapidly changing, contradictory, and filled with fascinating characters.

I used the word mission intentionally. Missionaries have long had a role in China. When Ray reluctantly let me join him on a trip to China more than ten years ago, he seemed like he was on a mission. US soldiers, the Flying Tigers, who worked with Chinese forces during World War II, were on another type of mission. The educational institutions the missionaries helped create have left a permanent mark on China. Bridgewater has tried to do the same in China for decades, mostly without any thought of making money, but for the sheer pleasure of the relationship and the joy of helping. Now that China is opening to non-Chinese investment managers, we are trying to do that in a broader and more business-like way.

The question is whether we will have the cleverness to also adapt. Some institutions have done so beautifully. For instance, Johns Hopkins created an institute many years ago in Nanjing that today is a beacon of excellence and improved understanding between China and the US. There are others, however, who made efforts that seemed successful at the time but have since been almost forgotten. In Yunnan, the province this story started in, I saw a beautiful early-20th-century house.

"What's that?" I asked.

"That? Oh, that's the house left from the French. They built a railroad up here for the minerals when they ruled Vietnam."

There is no sign of those French now, though clearly the Chinese did latch on to the idea of railroads and, 100 years on, can build better ones themselves.

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