Hong Kong, North Korea, and the Unintended Consequences of Large Crowds

Every month brings a new crop of interesting international headlines (and some of them occasionally have nothing to do with the Trump administration). June was no exception.

For starters, two million people hit the streets in Hong Kong to protest a newly proposed law that would allow mainland China to extradite fugitives from Hong Kong to be prosecuted in China. For context, the population of Hong Kong is 7.4 million. Hong Kong, which was a British colony for over a century and a half, was "handed over" to the Chinese government in 1997, with the agreement that China would allow Hong Kong to maintain its political and economic systems ("One country, two systems") for fifty years, that is, until 2047.

(Two million people in the streets all at the same time makes us wonder, How many porta-potties would you need for such an occasion and where should they be strategically placed? 20,000 porta-potties? That's one for every 100 attendees. Are there that many porta-potties in Hong Kong total? What did the protesters do when there were none? Starbucks?)

As a result, Hong Kong conducts its governmental affairs more democratically (a culture inherited from its British predecessors) than does China, whose communist government is not democratic in any manner. And it's no secret that China would like for Hong Kong's government to be just a tad less democratic (OK, maybe a lot less democratic) over time and eventually fall completely under the rule of mainland (communist) China. Hence the newly proposed extradition law.

Citizens of Hong Kong view this legislative change as the most egregious thus far in what is feared to be a slippery slope ending in the loss of the democratic freedoms they have historically enjoyed. Getting arrested wouldn't be a horribly unusual problem in Hong Kong, which has a criminal justice system that is as transparent as one could reasonably expect (few criminal justice systems are completely transparent). China, however, has an opaque system such that if one was arrested in Hong Kong and extradited to China, a "fair trial" would not be a realistic expectation.

The protests, which began civilly and orderly (considering there were two million people without adequate "facilities"), continued for the ensuing days and actually became less orderly over time, with the demonstrators even attacking government buildings at one point. These images speak for themselves:

BCWM
PROVIDING PEACE OF MIND

Portfolio Management
Richard W. Boyer, CFP®, CFA
Laura Carley, CFP®, CFA
Cory Bloodgood, CFA

BCWM, LLC
14221 Metcalf Avenue
Suite 201
Overland Park, KS 66223

Phone: 913-685-2300
Email: info@bcwm.com

Source: AP Photo/Kin Cheung


Source: Getty Images

The extradition law has been temporarily tabled, although the Chinese government will probably never cease trying to absorb Hong Kong completely.

Speaking of China, President Trump and China's president, Xi Jinping, both attended the annual G20 summit, which was held at the end of June in Osaka, Japan. (G20 is the "Group of 20" — the largest economically developed nations on the planet.) Leaders from all over the world attend this conference annually and the countries represented account for 80% of the world's economic activity. Needless to say, the U.S.-China trade war was *the* topic of focus. When the two largest powers in the world don't get along, everyone pays attention.

By the time the G20 summit was over, the trade war and tariff threats had cooled somewhat. President Trump appears to be less critical of Huawei (the Chinese technology company that has been labeled a threat to U.S. national security), and he even said the trade talks were “back on track.” Perhaps most importantly, the United States is delaying proposed tariffs on $300 billion of Chinese goods.

As expected, this trade war is long from over. But we are always mindful that there will be a presidential election in 16 months and economies that are humming are much better for incumbent candidates than economies that have stalled. It’s our bet that Trump won’t intentionally destroy global trade . . . at least not for 17 months.

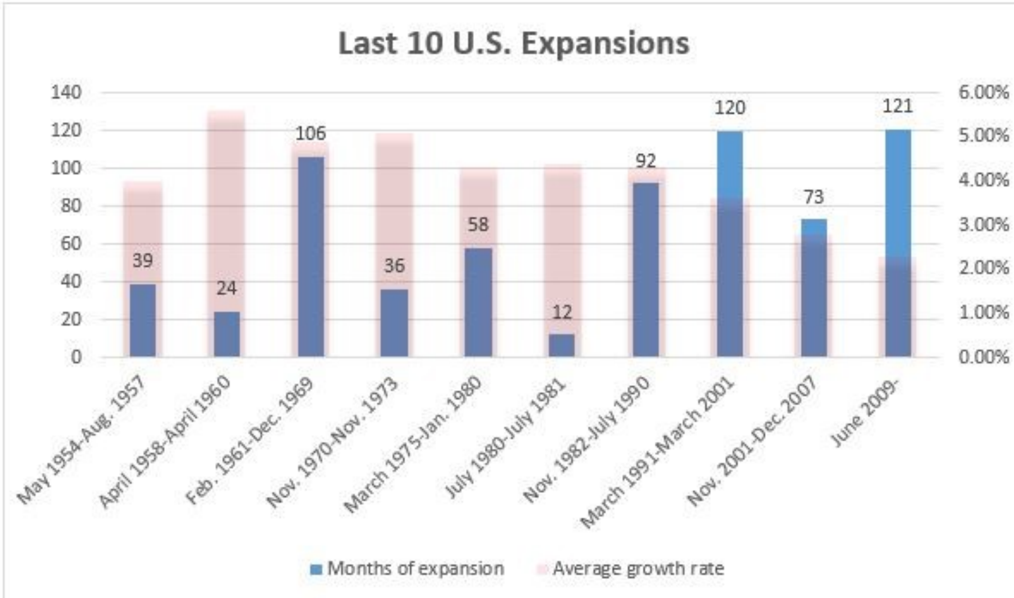
What was quite unexpected was that Trump had an impromptu meeting with North Korean leader Kim Jong-un in the DMZ. DMZ stands for Demilitarized Zone and is the buffer created between North Korea and South Korea at the end of the Korean War, in 1953. The president didn’t stop at the DMZ; he actually crossed the border, becoming the first serving U.S. President in our lifetime to step foot in North Korea.

Say what you will about Trump (and there is usually plenty to say on both sides), we feel it is significant to note that meeting with the dictator of North Korea *in* North Korea (barely) could possibly be a constructive step between two nations that haven’t agreed on much for the past sixty-six years. Maybe not, but nothing else has been successful thus far. And it just seems to us that others have been awarded the Nobel Peace Prize for a lot less.

Last month marked the 121st consecutive month of the economic expansion that began at the 2009 nadir of the sub-prime mortgage crisis. We went from what appeared to be “financial Armageddon” in 2009 to the longest stretch of economic growth in U.S. history.

But just because it is the expansion with the most longevity doesn’t make it the most impressive. The graph below illustrates the last 10 U.S. economic expansions, the blue bars showing the length of each in months.

However, the pink bars show the average annual growth rate of each expansion, revealing the “quality” of each. While some expansions were shorter in duration, the current one is clearly the wimpiest of them all. By far. (It’s interesting to note that, since 2000, each stretch of economic growth has become increasingly wimpier.)



Source: NBER & U.S. Bureau of Economic Analysis

While no one knows how much longer this expansion can continue, we feel confident its wimpiness will linger through its duration. Why? Because other developed nations (our trading partners) are already feeling an economic pinch, which will enhance the likelihood of a global economic slowdown. And because global debt is much larger than it has ever been.

But don't confuse economic activity with stock market activity. Stock markets are fickle and hard to figure out. They can go up when times are bad (when you expect them to decline) . . . and they can decline when conventional wisdom would seem to indicate that they should be going higher.

The dilemma for investors going forward is . . . if there is a global economic slowdown, will that make the stock market go lower or higher?

Most investors would expect the answer to be "lower," because a slowdown will translate into depressed corporate earnings and therefore lower stock prices. Pretty simple, huh?

Not quite. A global economic slowdown will likely also translate into lower interest rates. The 10-year bonds of Germany, France, and Japan are already trading at *negative* interest rates. Which means the U.S. 10-year Treasury bond (currently at 2.09%) will likely trend lower. (An environment of lower interest rates has been our stance for a long time).

When the rate at which investors can earn "risk-free" declines, the propensity for investors to take risk increases. In other words, lower interest rates typically mean higher stock prices as investors take their money out of bonds and re-invest it in stocks.

Here is the scary part: Someday, when interest rates have become ridiculously low (like Japan, Germany, and France today) and stock prices have rallied 10 years or more, there may come a period of several years where getting a good return in either stocks *or* bonds may become a real challenge.

For now, U.S. stock markets remain near all-time highs and we are skeptical whether they can go much higher very soon. And as interest rates have hit their lowest levels in the last three years, bonds prices have appreciated nicely. We do, however, still think low interest rates (and possibly lower interest rates) are here to stay.