Here’s How You Should Approach Investing in China

The China Household Finance Survey run by Gan Li at Chengdu’s Southwestern University of Finance and Economics, recently found that one fifth—that’s 20%—of Chinese homes do not have occupants. Instead these homes are owned as investments in what could be one of the world’s most distorted markets ever.

Back in February of 2012, I wrote about China’s “ghost cities,” and the dangers of investing in a command economy. Government subsidies, capital controls, and excessive regulations distort the Chinese economy, making analysis of normal economic signals difficult.

With Chinese shares already down over 20% (in yuan terms) in 2018, and Trump administration tariffs threatening to take a bigger bite out of the Chinese economy in the future, I urge all investors to read my analysis on investing in China here.

> ***China***
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> *I have long advised against direct investment in China. Among the many reasons I am bearish on China is the country’s vastly distorted economy. China is a command style economy run by an unelected political party—the Communist Party of China (CPC). The CPC’s policies have resulted in a grand misallocation of capital. A mercantilist currency policy, perverse incentives for provincial government officials, and crude monetary policy tools have helped inflate a fixed asset and real estate bubble that puts the U.S. real estate bubble to shame.*
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> ***A Quality Problem***
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> *It should be obvious to most that things are not as they seem in China. China has reported GDP growth of 9% or more in every*

quarter over the last two years, but the Shanghai Composite Stock Index has plunged more than 30% during that time. If China's economy were truly booming, Chinese shares would most likely be trending up. China suffers not from a quantity of economic growth problem, but a quality growth problem. China's GDP statistics are being propped up by unproductive fixed asset investment. The real estate sector is the most obvious example. To prop up GDP growth rates the Chinese are building entire cities, but they are virtually empty. For more on these ghost cities, be sure to check out the China's Empty Cities video at www.youngresearch.com. It is perplexing that the world has allowed a command style economy run by an unelected political party to become such an important player in the global economy. China is now the world's second largest economy and America's second-largest trading partner. If China heads into the tank, the world economy will suffer.

No Profit Motive

China doesn't play by the same rules or have the same motives as the world's other large economies. China has consistently manipulated its currency to gain export market share and it has subsidized favored industries through its financial system to the detriment of non-Chinese companies. Take the rare earths industry as an example. China now has an effective monopoly on rare earths production. Not because of the country's low labor costs or a lack of reserves in other countries, but because Chinese rare earths companies were provided with subsidized loans. Rare earths companies ramped up production in the '80s and '90s and drove prices down to unprofitable levels. The Chinese government was more interested in maintaining stability through high employment then, as they are today. Low prices pushed rare earths producers in the U.S., Australia, and elsewhere out of business. With the support of subsidized loans, China's rare earths companies were the only companies able to remain in *business at such low prices. Now the U.S. relies on China (at least temporarily) for a supply of metals vital to the defense industry and other high-technology industries. Sound like a smart strategy to you?*