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INVESTMENT OUTLOOK

September 2020

THE GOLD RENMINBI

When we wrote last month about the decline in the US dollar, the obvious question was: What is the alternative: Euro, Yen, Swiss Franc, Pound? As China is now the second largest economy, and the No. 1 global trading power, it is worth considering if an alternative exists in the Yuan, or “Renminbi” (people’s money). The Chinese authorities clearly see the risk of continuing to depend on the US dollar to pay for all their imports, especially oil: also, as a medium of exchange, or store of value, for their massive reserves of US\$3 Trillion (the largest in the world). It is estimated that currently 60% is held in US dollars and nearly 4% in gold, with the balance in Euros, Yen, etc.

China has been actively buying gold since 2015, building their gold reserves from as low as 1% to around 3.4% today of total forex reserves today. This is much lower than developed countries like the US at over 8,133 tonnes, 80% of its reserves, and even Germany at 3,363 tonnes, 75% of its reserves. China currently holds 1950 tonnes in gold reserves officially, an increase of over 90% since 2015. Unofficially, analysts have estimated that China holds closer to 5,000 tonnes.

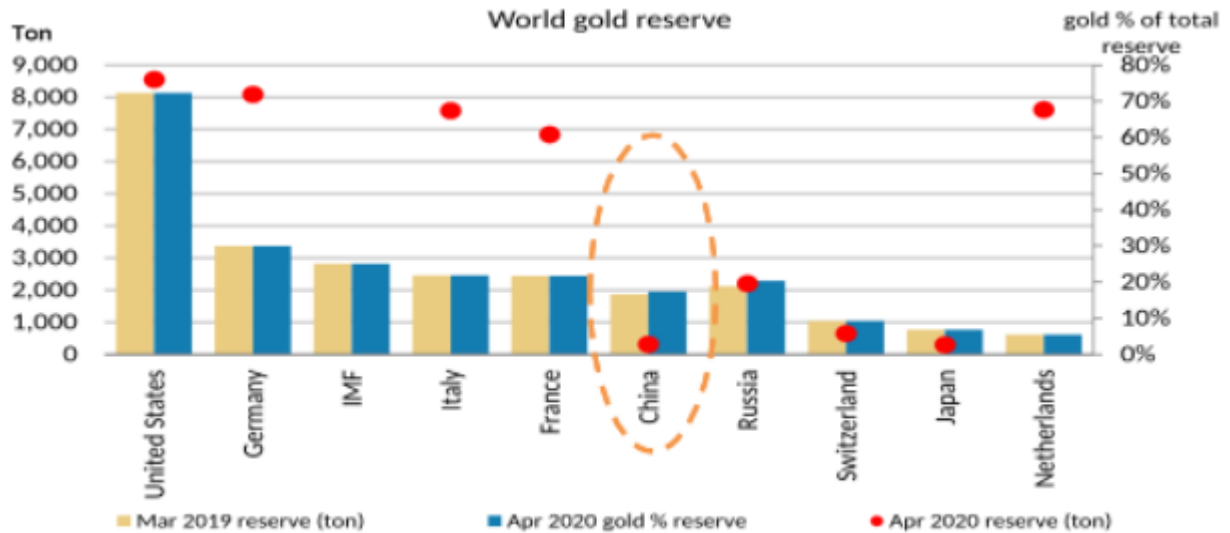
The top 10 countries hold close to 50% of global official gold reserves, while the IMF itself holds 2,814 tonnes as well. But China has already begun, 2 or 3 years ago, to offer Saudi Arabia and other major oil producers (Russia, Iran, etc.), payment for its oil shipments, in

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“Petro Yuan” or Renminbi backed by gold, with an implicit guarantee against devaluation, instead of US dollars. Given the centuries-old preference among both Arab traders and



Source: CEIC, WCC, Bloomberg, Morgan Stanley Research.

Chinese businessmen for the precious metal, instead of “Fiat” paper money, this makes sense for both sides. In addition, the attraction for Arab investors and other international institutions to buy Chinese RMB bonds at 2.9% on 10-year paper, instead of 0.6% in US dollar 10-year Treasuries, is evident. (It is also interesting to note the historical perspective, that while the Western world effectively abandoned its gold standard in 1931, the Chinese continued on its silver standard for some years longer.)

With the real risk that the Trump Administration, or perhaps its Democrat successor, could further “weaponize the dollar” by imposing more severe sanctions (as they have already done on top Hong Kong and Chinese officials), and effectively shutting China out of the US dollar financing system, it makes sense for China to explore alternatives – a gold-backed RMB, or even a digital RMB, which (backed by China’s massive reserve) could overtake Bitcoin (if supply was similarly limited).



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But readers may question why we are so interested in gold, and its role in the global monetary system. Given that Asia – headed by China and Japan, but including South Korea and Taiwan – runs a large trade and current account surplus with the West (and, indeed, with emerging nations), the question of whether the US Dollar continues to dominate the global financial system becomes even more pressing. If China can succeed in making the RMB internationally acceptable by having a link to gold, it would dominate the Asian financial system (and Hong Kong may become the leading forex centre).

The long cycle of disinflation, which has been in place since 1982, has seen interest rates fall from 15% to nearly zero. This has now finished. The bond bull market is over. The “Ice Age” of deflation is giving way to “The Great Melt” of massive monetary stimulus, and frenzied fiscal pump-priming, in an attempt to paper over the current pandemic-induced slump. Inflation of 4% by the end of 2021 is now anticipated by many experts.

With that monetary background, we may be in for extreme volatility in currencies and markets. If the gold renminbi comes to pass (or, indeed a gold ruble), then the demand for gold will soar (and, in fact, both Russia and China have been steadily purchasing gold for their central bank reserves now for several years); and demand for the dollar will slump. The era of US dollar domination of the world’s financial system may end by 2025/2030.

In addition, it is worth noting that China has become the first major country to launch a “Digital Yuan” or Chinese cryptocurrency, backed by The Peoples’ Bank of China, and likely to replace much of the existing digital on-line payment systems of WeChat (Tencent) and AliPay (Alibaba), which account for RMB 2 Trillion (US\$300 Billion) in payments currently.

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Reviewing 2020 investment performance so far, it is striking that China is one of the few major markets showing a gain of 11% (in Shenzhen, it is 32%), which has helped our Bamboo Asia Fund, LP to an estimated 20% gain year-to-date. (For clarification, this is the fund managed by Robert Lloyd George and Lloyd George Management (HK) Limited; Management of Quaero Capital Funds (Lux) - Bamboo has been moved back, last month, to Quaero Capital LLP to manage.) Only the NASDAQ, with a 26% rise, powered by Apple, Microsoft, Facebook, Google, and Tesla, has outperformed. Both South Korea (+6%) and Taiwan (+5.4%) show positive trends, whereas South East Asia (Singapore -21%, Thailand -16%, Indonesia -16%) has lagged behind badly. To some extent, these numbers reflect the economic realities – that the ASEAN economies are still in lockdown, deprived of tourist income and business investment – but it is also true to say that China, South Korea, and Taiwan, as well as NASDAQ, reflect the weight of technology in their indices. It is hard to overemphasize the rapid acceleration of technological trends such as online purchases (and now cryptocurrency payment systems).

The commodity group has also seen some wide disparities. While oil has seen a 30% fall, due to wide cutbacks in commercial aviation, shipping and transport, gold is up 28% and silver an astonishing 50%. We would also highlight the recent strength of lumber (+100% this year), and, particularly, iron ore (+45%), whereas copper and aluminum are relatively flat. The economic prospects for 2021 are still very uncertain. And we do not believe it is helpful to make forecasts for the Asian economies since so much now depends on the course of the virus – will it continue for another 6 months, one year, or longer? Will we have a successful vaccine by the beginning of 2021? Who will prevail in the presidential election of November 3rd? Our hope is for a calming down of US/China trade tensions next year, and a return to normalcy after an unusual and feverish year in 2020.



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Central banks' balance-sheets, \$trn



Source: Wind, IMF, The Economist.

One of the key messages we are getting out of China these days is “KEEP IT AT HOME” – the tourist dollars (\$70 billion last year), the students studying in the US, UK, and Australia, and the manufacturing (especially technology). Xi Jin Ping calls this “Dual Circulation,” (it is not clear why); but it means China, in the next 3 years, becomes much more self-sufficient, and turns inward instead of looking out to the world. It also means a stronger RMB, (China’s money supply has grown much less than Europe or US in 2020), and perhaps a shift to a more convertible, global reserve currency.

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Hong Kong

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