SAFANAD

CNBC Fast Money: Why You Should Not Buy Chinese Stocks Today

Dr. John Rutledge

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Summary

After 50 years of investing, I have decided it's time to share my secret strategy with you, the thing that will keep you in the game when things go bad. The secret strategy is to avoid SLS—Sudden Loss Syndrome—that happens when you put your money in something that can go "POOF!" and disappear when some guy decides he doesn't like you. Today, that somebody is Xi Jinping. As I told the FastMoney crew, don't be tricked by the China stock market head fake. Keep your money someplace where they have judges in long black robes to

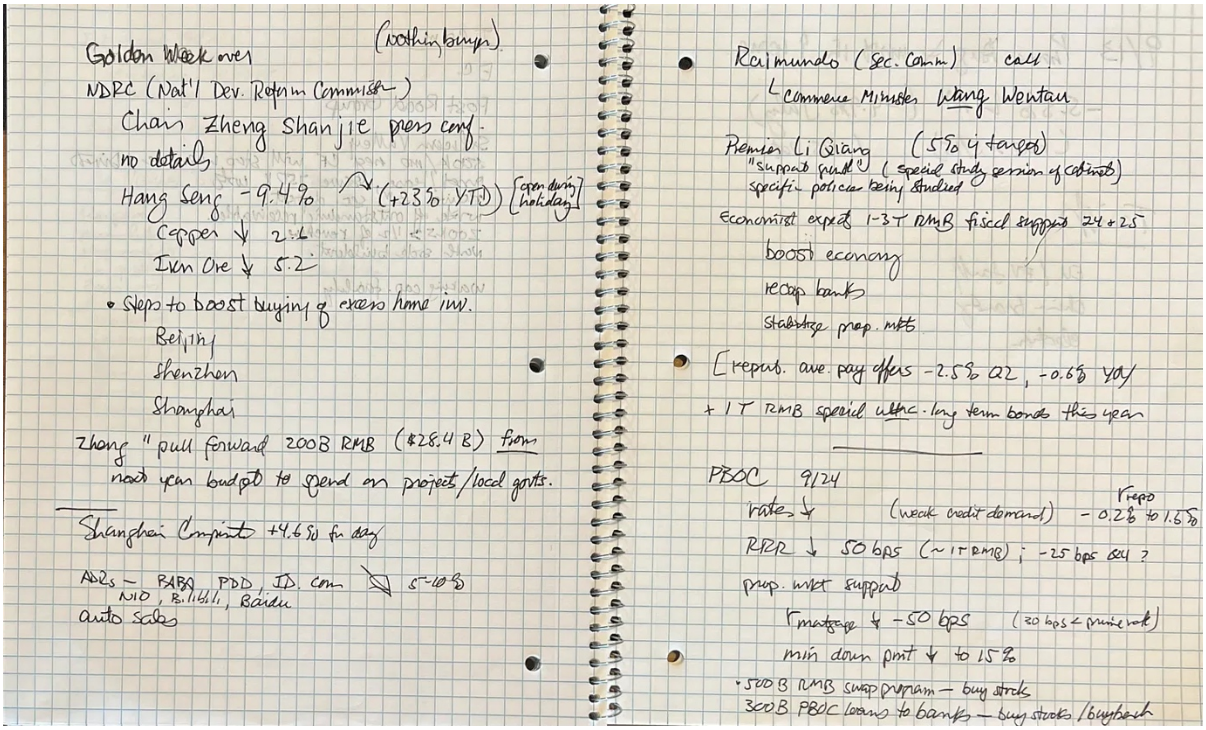
(usually) uphold the law. You can see a video of the interview by clicking here. And I have copied the talking points, below, that I wrote to brief the anchors before the show.

Retail investors shouldn't touch China stocks, warns Safanad's John Rutledge

John Rutledge, Safanad chief investment strategist, joins 'Closing Bell Overtime' to talk China's market pullback and how U.S. investors should navigate it. TUE, OCT 8 2024 6:16 PM EDT

Talking Points

I always prepare briefing notes before a show so the producer (Stephanie in this case) can brief the anchor (today it was Melissa) before the show. The schedule today was a little tight, so I just talked her through the main arguments over the phone. Here are the notes I put together to prepare for the hit.



Golden Week over (nothing burger)
NDRC (Nat'l Dev. Reform Commission)
Chair Zheng Shanjie press conf.
no details
Hang Seng -9.4% (+23% YTD) [open during holiday]
Copper ↓ 2.1
Iron Ore ↓ 5.2
• Steps to boost buying of excess home inv.
Beijing
Shenzhen
Shanghai
Zheng "pull forward 200B RMB ($28.4 B) from next year budget to spend on projects/local govts.
Shanghai Composite +4.6% for day
ADRs – BABA, PDD, JD.com, NIO, Bilibili, Baidu ↓ 5–10%
auto sales

Raimundo (Sec. Comm) call
Commerce Minister Wang Wentau
Premier Li Qiang (5% g target)
"support growth" (special study session of cabinet)
specific policies being studied
Economists expect 1-3T RMB fiscal support 24+25
boost economy
recap banks
stabilize prop. mkts
[reports. ave. pay offers -2.5% Q2, -0.6% yoy
+ 1T RMB special ultra-long term bonds this year

PBOC 9/24
rates ↓ (weak credit demand) r_{repo} -0.2% to 1.5%
RRR ↓ 50 bps (~1T RMB); -25 bps Q4 ?
prop. mkt support
$r_{mortgage}$ ↓ -50 bps (30 bps < prime rate)
min down pmt ↓ to 15%
• 500B RMB swap program – buy stocks
300B PBOC loans to banks – buy stocks/buyback

If you fight your way through the bad penmanship, you will see that the Chinese economy is still in the crapper (technical term), and that investors have concluded that the recently-announced government stimulus measures add up to a nothing-burger. That's largely because property prices are still falling. Home prices in August took their biggest drop (-5.3%) in 9 years.

That's reason enough for investors to stay clear of the Chinese stock market, but it's not why I advised viewers to put their smart phones down and back away slowly from the BUY button. The reason is SLS.

Sudden Loss Syndrome (SLS) is what happens when you put your money into anything that can be wiped out in an instant by the wave of a single person's hand. The person I am referring to, of course, is Xi Jinping, China's supreme ruler and one and only policy maker. And, in spite of the assumptions you used in Finance class, Xi Jinping is NOT normally distributed.

Risk is not the backward-looking standard deviation of a stock's price history. It is an investment that does not pay you back your capital and the stream of profits you expected when you bought it.

It's only fair to tell you that I learned about SLS the hard way, by owning assets that suddenly went "POOF" when an autocrat woke up in a bad mood one day and decided I couldn't own them. In today's case, there are two such risks: 1) the big risk that Xi Jinping wakes up crabby and announces that foreigners can no longer own Chinese assets, and 2) the smaller but still meaningful risk that whoever wins the U.S. election in 3 weeks decides that Americans can no longer own Chinese assets.

When you own a portfolio of stocks, you are making a bet that you can collect a stream of cash flow that goes far into the future. In the first year, for example, the only thing you will collect is the dividend, if there is one. If the dividend yield is 2%, then, what makes it worth paying the other 98% of the price to buy it? Future cash, of course. But you have to actually own it and have the legal right to collect the dividends for that to be worth owning. That means the duration of the cash flow stream is the key variable when figuring out what to pay for the stock.

JR notes for briefing the anchors before the show.

PS: When I posted this piece on substack (drjohnrutledge@substack.com . Subscriptions are free) one of my readers sent me a comment saying that Americans (like me) are quick to moralize about rule of law and property rights in other places but the U.S. record is not so good either. While I agree that the U.S. has much to account for, I want to point out that I was not moralizing at all, neither about Xi Jinping nor in recommending not to own Chinese stocks. I was just pointing out two simple facts. One is that a decision made by a single individual is inherently more volatile than one representing the average of many people, i.e., the law of large numbers doesn't work for small numbers, especially not for the number 1. The second is that the value of a stock depends on what happens for many years into the future, i.e., you have to feel comfortable that you are going to be able to collect future cash flow. You don't need moralizing to reach the conclusion that Chinese stocks today are a very risky bet.