WHY CHINA'S CRISIS THREATENS YOUR WEALTH

Many US investors say, "why should I be interested in what is happening in China? I would never intend to invest there."

Over three years ago, I wrote an e-book, The Coming China Crisis. Surprisingly, a number of our clients asked, "why would I be interested in China?" When you look at how the global markets are intertwined as I do, with China accounting for more than 50% of global economic growth, I was surprised to hear that. Perhaps now people are more enlightened.

The fact is that so many of investors favorite US firms – like Apple, GM, GE, Tesla, Uber, Morgan Stanley, Goldman Sachs, and many others – depend so much on their business in China. Whether you know it or not, most of your investments are dependent on what happens in China.

Take Apple: the stock lost over 30% from the top in 2015. China was the great hope on this stock for Apple enthusiasts. Now China sales actually declined. Additionally, the Chinese government has blocked two of Apple's businesses in China, such as iBooks.

IBM has had major problems in China, with squads of police raiding its various offices, carrying out filing cabinets, and other records. It is quietly said that the central government has an agenda to reduce the role of foreign firms in China. And that is extremely important for US companies having large expansion goals for China. YUM Brands, Starbux, GM, Apple, come to mind.

Furthermore, a credit and economic crisis in China could cause a plunge in the Chinese yuan. The repercussions would be severe throughout the Asian emerging countries. We may even see another default by one of these countries. And that would produce contagion throughout the global markets.

The bursting of the stock market bubble in China in June-July 2015 led to the US market plunge in August of that year. The global markets are now well correlated.

In my book, THE COMING CHINA CRISIS, published about 4 years ago, I predicted that instead of China being the poster child for prosperity, and surpassing US economic growth, it would hit the "Great Wall Of Communism."

China's economic growth of the prior 20 years was primarily due to two things:

1. Cheap labor, attracting very large money flows from abroad for manufacturing and investing.

2. Getting 100 years of technological development, knowhow, patents, and intellectual property of all types from western firms, virtually free. That was worth trillions of dollars. It allowed the "Great Leap Forward."

But now the "great leap" has resulted in a 'Great Leap into Quicksand and Mud.' A dictatorship, especially one built on communistic principles, is antagonistic to free market capitalism.

The Chinese people are great entrepreneurs and are very hard workers. But communism stops progress at this point in the long-term economic development cycle. This is the time that creative entrepreneurs should take over from the government. But policies of the government at all levels in China, along with extraordinary corruption, are worse than throwing sand into the ball bearings of the economy.

China's economy continues to remain in a recessionary state, in spite of the false GDP number showing 6.7% growth. On May 2, 2016 the PMI for manufacturing was released. It was 49.4 for the month of April, which is below the 50 neutral level. **This is the 14th consecutive month below 50. That shows contraction, i.e. recession.**

Yet, the head of the IMF, and other chief economists of leading western financial firms, always cite the China GDP number as if it were fact. Can they explain how the manufacturing can be in contraction for 14 months, and GDP growing at a booming 6.7%?

A credit crisis doesn't suddenly start one day. It festers, builds, spreads, until finally there is an "event" signaling that the 'critical mass' has been reached.

I have said for the past two years in our Wellington Letter that the critical mass in China's credit cycle was perhaps reached in June 2014. That's when overnight interest rates tripled from around 8% to 25%. At the time, I wrote that the government had temporarily lost control. I believe that is when the worsening China problems surfaced.

To regain control, the central government pulled out all the stops and started reflating with incredible credit creation. That set off a fantastic stock market bubble. The rise in the A-shares ETF on the Shanghai and Shenzhen exchanges surged higher from $21 to $55 at its peak in just 12 months.

And then the stock bubble burst, in June 2015. The Shanghai index collapsed 61% as a result. About

$6 TRILLION of wealth, equivalent to about 50% of annual GDP, was wiped out.

The government prohibited most selling of stocks by financial firms, prohibited short selling, and arrested those who did. They even arrested the top executives of the biggest financial firms. That doesn't do much to encourage investors to buy.

Reporters were arrested for revealing truthful stories about the financial crisis. The government injected approximately $500 billion into financial firms so they would buy stocks to support the market. It was a disaster.

After the stock market crash of 2015 faded, similar speculation was repeated over the first four months of 2016 in the commodity markets. Wealth management companies are off-balance sheet entities owned by the banks. The entice investors with promises of returns higher than available in savings accounts.

Over the years, these speculated in everything from stocks, real estate, and derivatives among other riskier asset classes. Each of these investment sectors experienced their own bubble, which then collapsed.

In early 2016 the commodity futures were targeted and another huge bubble resulted. The China commodity bubble caused a rise in all global commodity stocks. Commodity prices soared to obscene highs. That also caused the strange rally in US firms exposed to commodities, such as steel, etc. The volume in China cotton trading was enough cotton to supply every person on earth with a pair of jeans.

Now the bubble is deflating. When you are the market, instead of just trading it, where do you go to find buyers?

The government with its policy of throwing hundreds of billions of dollars at every such crisis created the bubbles. The credit creation has been unprecedented.

However, that may now change. China's President Xi Jinping has declared in an article in People's Daily that such credit creation must stop because it if isn't, it will result in something much worse down the road. Is he becoming an advocated of Austrian Economics? He even said it would be painful to stop now, but apparently he is willing to take the consequences.

If he is serious, watch out below, in all the global markets. It will be a shocker.

(I will be issuing a special 35 page report on the China crisis very soon).

Wishing you successful investing,

Bert Dohmen,
Founder Dohmen Capital Research, Inc.