

Investors face a stark choice: are they on the side of the US or of China?

The world is dividing as Washington and Beijing battle for economic and geopolitical supremacy

By DIANA CHOYLEVA

Western companies with substantial business in China, such as Apple, may find it hard to keep riding two horses in a **confrontational, bifurcating world**.

The technological revolution epitomized by startling advances in artificial intelligence opens up rich opportunities for investors, but it also confronts them with a stark choice: are they on the side of the US or of China?

For the world is dividing as Washington and Beijing battle for **economic and geopolitical supremacy** with the weapons of choice being cutting-edge technologies such as AI and quantum computing.

The US and China are so far ahead in this high-tech arms race that others have no realistic chance of carving out their own independent sphere of influence.

The EU has ambitions and money but is politically fragmented. India is one country and has scale but is behind in economic development. As such, given that both China and the US are happy to use economic coercion and sanctions to press their technological advantage, countries, companies and investors will be under growing pressure to choose whose technology they want to use and cannot do without.

The choice US allies had to make over Huawei's telecommunication equipment and whether to join US efforts to deny China advanced semiconductors are just stepping stones in a long and all-encompassing confrontation.

Hankering for the evolution of a multipolar order is now, sadly, just wishful thinking. Decoupling will be costly, as will its close cousin de-risking. But any divorce, even the most amicable one, is costly.

Both Washington and Beijing have made it explicit that national security concerns trump economics. Even Treasury secretary Janet Yellen, a relative China dove, has said protecting national security will be the US priority in its relations with China, regardless of the economic expense.

Hence the bans that Washington has imposed on exports of high-end chips are now to be followed by curbs on outbound investments in some technologies with significant national security implications. For his part, Chinese leader Xi Jinping vowed last month to push forward what he called the “profound unity” of economic development and national security. Xi’s comments are a clear indication that China will take steps to boost growth, including encouraging more foreign direct investment, only if they do not jeopardise national security, in other words the authority of the Chinese Communist party.

The party had already sent out the same message by launching raids earlier this year on the Chinese offices of US consultancies Bain, Capvision and Mintz. Beijing also banned the sale of some products from US memory chipmaker Micron.

This sharpening of strategic competition between the world’s two biggest economies requires a fundamental rethink of investment approaches.

Valuation models based on past performance will be unable to capture the *tectonic shifts* that are now taking place. Indeed, no model can factor in unpredictable, politically motivated actions that can upend the prospects of individual firms or entire sectors in an instant.

Complicating matters further, it is unclear which countries will end up in the two spheres of influence. The US is successfully strengthening its military links in the Indo-Pacific, but traditional allies such as South Korea and the Philippines are all too aware of the gravitational economic pull of their near neighbour China. Or take India, which is a partner of the US in the Quad diplomatic alliance but is also a member of the Brics, a grouping dominated by China.

The Brics group hitherto has punched below its weight but more than a dozen countries are interested in joining the club, something that would bring them closer into China’s orbit. Some of them, including energy producers Saudi Arabia and the UAE, have traditionally been firmly in the US camp.

Western companies with substantial business in China, such as Apple, BASF, HSBC, Tesla and Volkswagen, may also find it hard to keep riding two horses in a confrontational, bifurcating world.

Manufacturing supply chains and global finance are highly integrated so excluding China from your portfolio is not just simply a matter of avoiding its stock market or firms. Against this background, a successful decoupling strategy for equity investors is likely to involve being long those firms that are less exposed to the bifurcation and going short the ones that are stuck in the middle with, say, revenues derived from the US but costs incurred in China.

The geopolitical outlook is changing as fast as technology is progressing. Pension funds and other institutional owners of assets need to move with the times and rethink from first principles the remits they give to their fund managers.