

MORGAN CREEK

CAPITAL MANAGEMENT

ALTERNATIVE THINKING ABOUT INVESTMENTS

New Asia Perspectives



Welcome to Morgan Creek's *New Asia Perspectives*, an open forum where we share our proprietary research together with curated articles of interest. We seek to offer a variant interpretation of important political and economic events through an Asian lens by leveraging our team's "on the ground" insights and decades-long experience in covering the region. We disseminate our research through newsletters, webinars and periodic whitepapers. Feel free to forward our research to colleagues you think might be interested and please share any interesting research you come across as well. To offer comments, share research, or learn more about our team and investment offerings, please email chinateam@morgancreekcip.com.

Best Regards,

A handwritten signature in black ink that reads "Mark W. Yusko". The signature is written in a cursive, slightly slanted style.

Mark W. Yusko
CEO & CIO

NOTES FROM THE BUND¹

This is our fourth newsletter discussing the South China Sea tensions and conflicts from a local perspective. In the prior three newsletters, we outlined reasons why we believe:

- The region is so highly contested and why China is vociferous over its claim.
- The West might be misled in its assessment of China's objectives in the region.
- China's inclination to find a peaceful, win-win solution for claimants is rooted in its core philosophy.

In this last installment, we will discuss why we believe the narrowing gap in military capabilities between China and the West might be advantageous for a continual, albeit tenuous peace (i.e. maintenance of the status quo) as outright victory for either party is unclear and the costs of conflict excessively high.

Notwithstanding the reasons we highlighted in the last newsletter why we believe China is unlikely to initiate a physical confrontation, strategically it also makes sense for China to refrain from any armed engagement. Even with a transitioning economy and slowing growth, China's projected GDP growth (4-5%) is still double that of the

US (2%) If these numbers hold for the next two or three decades², China has a chance to become the largest economy in the world. Even if it does not, the economic (and corresponding military gap) should continue to narrow. Time is a friend, and the China has never been known over its long history to lack patience.

Amid heightening tensions, both the US and China have simulated war games in the past year,³ and while the ultimate outcome in these exercises are not clear – the cost is. Whoever the “winner” might be, it would almost certainly be a pyrrhic victory.

The margins for victory for either side may be lower than generally expected for a few reasons. The US undeniably continues to possess the strongest and most advanced military in the world. However:

- **In naval warfare, size matters more than technology.** According to Tangredi, a professor at the US Naval War College and a former US Navy Captain, a scrutiny of history reveals that a larger navy almost always beats a smaller one with superior quality ships.⁴ China’s navy fleet surpassed the US in 2020 and currently has 340 warships to 300.⁵ This gap is expected to continue to increase – China is expected to grow to 400 warships in the next two years, while the Pentagon’s goal is 350 ships by 2045.⁶
- **Potentially more critical than size and technology is industrial capacity.** Attrition in battle is unavoidable, and the ability to replace destroyed units is of paramount importance. As an example, Japan’s navy at the onset of the Pacific war was larger and more effective than that of the US.⁷ However, it was ultimately defeated because it was outproduced and overwhelmed. In 1944 alone, the US built more planes than the Japanese did from 1939 to 1945.⁸ The situation has since reversed. Although the West has outspent Russia in the Ukraine war (\$178 billion⁹ to \$132 billion¹⁰), Russia is producing more ammunition than the US and Europe combined.¹¹ The situation is expected to be even more unbalanced in the event of conflict with China, the undisputed factory of the world, where 4 out of every 10 ships in the world are built.¹²
- **For China, the South China Sea is a core national issue; for the US, it may be important, but it is peripheral.** While not exactly congruous, this is at least partially a reason why a technologically inferior China was able to fight the US to a standstill in the Korean War in 1950; the Chinese wanted a buffer state in the Korean Peninsula. They likewise view the South China Sea serving in a similar capacity and will have a different level of tolerance for the inevitable casualties.

Because outright victory appears highly uncertain for either country in the event of a physical confrontation, we believe both will continue to preserve the status quo in the region, which is a good outcome in and of itself. In the meantime, to set guardrails to prevent miscalculations from spiraling into war, the US and China agreed to reestablish high level talks between their militaries. Furthermore, China and ASEAN continue their discussion for a binding code of conduct on the South China Sea. However, given the robust trade linkages between these Asian nations, we remain optimistic an acceptable solution can be found.

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Asia Markets Mixed Ahead of Central Bank Decisions, U.S. and China Inflation

Data this Week: Asia-Pacific markets were largely up ahead of central bank decisions this week, with investors also awaiting inflation numbers from the U.S. and China. The Bank of Korea, the Reserve Bank of New Zealand, the Bank of Thailand and the central bank of the Philippines have their monetary policy meetings scheduled this week. S&P Global expects all four banks to hold their rates steady, but also added in its note that “the Bank of Korea may be amongst [banks] which [are] close to lowering rates and the rhetoric will be in focus.” [Read More.](#)

Japan Firms' Plans for CO2 Export, Storage in Southeast Asia on Rise:

More Japanese companies are seeking to export carbon dioxide emissions to Southeast Asian nations and elsewhere for underground storage as a way to tackle climate change, with over a dozen projects in the works, a tally by Kyodo News showed Sunday. The move comes as the Japanese government promotes carbon capture and storage, known as CCS, and sets a goal of putting the technology into practical use by 2030. [Read More.](#)

U.S. and China in High-level Talks to Deport More Chinese Nationals, Mayorkas

Says: The U.S. is conducting high-level discussions with China aimed at increasing the number of Chinese nationals deported from the United States, Homeland Security Secretary Alejandro Mayorkas said in an exclusive interview with NBC News. Such an agreement would be a breakthrough in U.S.-China relations and American immigration policy. China has long been uncooperative with U.S. efforts to deport Chinese citizens back to their country, according to American officials. [Read More.](#)

Taiwan Quake to Hit Some Chip Output, Disrupt Supply Chain, Analysts Say:

Taiwan's biggest earthquake in at least 25 years is likely to tighten supply of tech components such as display panels and semiconductors, analysts said, as manufacturers in the global tech powerhouse restore operations at affected facilities. The powerful 7.2-magnitude earthquake struck Taiwan's eastern coast near Hualien County on Wednesday morning, killing nine people and injuring more than 1,000. [Read More.](#)

Nvidia Plans to Build a \$200 Million AI Center in Indonesia Amid Push into

Southeast Asia: Nvidia is planning to build a \$200 million artificial intelligence center in Indonesia in partnership with local telco giant Indosat Ooredoo Hutchison, as the U.S. tech darling continues its push into Southeast Asia. According to Indonesia's Communication and Information Technology Minister, Budi Arie Setiadi, the new facility will be based in the city of Surakarta in the Central Java province and will bolster local telecommunications infrastructure, human resources, and digital talent. [Read More.](#)

China Central Bank to set up \$70 Billion Tech Re-lending Program:

China's central bank will set up a 500 billion yuan (\$70 billion) re-lending program to support the country's science and technology sectors, according to a statement released on Sunday. The program will offer loans via 21 banks to small and midsize technology companies at an interest rate of 1.75%. The one-year loans can be extended twice, for up to a year each time, the statement said. China's policymakers look to boost liquidity and increase confidence in the world's second-biggest economy amid headwinds from a property crisis and frictions with major trading partners. [Read More.](#)

Asia Spot LNG Holds at 6-week Top Amid Sustained Demand: Asian spot liquefied natural gas (LNG) was unchanged this week, keeping at a six-week high over

\$9 per million British thermal units (mmBtu) for a third consecutive week, as demand from buyers continued shoring up prices. The average LNG price for May delivery into northeast Asia held at \$9.50/mmBtu, the same as the previous week, which was its highest level since February 9, industry sources estimated. [Read More.](#)

China Could Drive Africa's Renewable Energy Revolution, Report Says: China has a unique opportunity to drive forward an energy revolution in Africa, but it must first reverse nearly two decades of neglect of green power investments there, research from Boston University showed on Tuesday. Beijing has emerged as the continent's biggest bilateral trading partner since the start of the century and has financed billions of dollars' worth of large-scale infrastructure projects. [Read More.](#)

¹The Bund is a historic waterfront area in central Shanghai, where Morgan Creek's office is located. From the 1860s to the 1930s, it was the rich and powerful center of the foreign establishment in Shanghai, operating as a legally protected treaty port. The picture above is part of the historical waterfront.

² Source: China can overtake US as world's biggest economy by 2035: Former IMF deputy chief; <https://www.straitstimes.com/>; May 25, 2023

³ Source: The Pentagon is freaking out about a potential war with China; <https://www.politico.com/>; Jan. 2023

⁴ Source: Bigger fleets win; <https://www.usni.org/>; Jun. 9, 2023

⁵ Source: 2022 China Military Power Report; [U.S. Department of Defense](https://www.defense.gov/); Nov. 29, 2022

⁶ Source: Chief of Naval Operations Navigation Plan 2022; [U.S. Department of Defense](https://www.defense.gov/); Jul. 26, 2022

⁷ Source: How Japan developed carrier aviation; <https://www.usni.org/>; Apr. 2018

⁸ Source: War production; <https://www.pbs.org/>; Jan. 12, 2023

⁹ Source: Fact sheet: US assistance to Ukraine; <https://www.understandingwar.org/>; Feb. 8, 2024

¹⁰ Source: The cost of the Ukraine war for Russia; <https://www.rand.org/>; Dec. 18, 2023

¹¹ Source: Russia is manufacturing 7 times as much ammo as the west, officials say; <https://www.businessinsider.com/>; Sep. 13, 2023

¹² Source: Most influential countries in the maritime industry <https://www.merchantnavydecoded.com/>; Sep. 11, 2023

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