Godesburg's Haven Investment Letter

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FIVE LARGE-CAP STOCKS THAT MIGHT NOT SURVIVE A CHINA-TAIWAN WAR

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5 Large-Cap Stocks That Might Not Survive A China-Taiwan War

By Garrett Baldwin
Godesburg's Haven Investment Letter

If you've flipped through a newspaper or scrolled through a news website lately, you've seen some ominous headlines about Taiwan and China.

"Taiwan says China can blockade its key harbours, warns of 'grave' threat"
-Reuters

"The moment of truth over Taiwan is getting closer"
-Financial Times

"China-Taiwan military tensions 'worst in 40 years'"
-BBC News

"Taiwan says China will be capable of 'full scale' invasion by 2025"
-NBC News

Some might think of these stories as pure foreign policy news with little relevance to the markets.

But the smart money is paying close attention.

That's because a full-scale ground war involving the world's most populous country would *absolutely* move the markets.

More specifically, it would pit China against one of the most important links in the world's electronics supply chain.

In this report, we're examining five large, well-known, publicly-traded companies for which a war between China and Taiwan would be an existential threat.

Some may, in fact, be in your portfolio right now.

First, however, we should look at why China and Taiwan are at the brink of war - and how likely a full-scale confrontation is…

The Chinese Civil War Never Ended

You may notice that we avoid referring to Taiwan as a country in this report - and there's a reason for that.

Neither the People's Republic of China (PRC; the mainland government) nor the Republic of China (ROC; the official name of Taiwan's government) are fond of that term for the island.

As you may know, the communist government of mainland China was established at the end of a brutal 22-year civil war between the Chinese Communist Party (CCP) and the Kuomintang (KMT), the nationalist ruling party of the ROC, which governed mainland China in the early 20th century.

In 1949, the CCP conquered all of the ROC's mainland territory and proclaimed the present-day PRC in its place.

This while the remnants of the KMT retreated to the island province of Taiwan, which was still under ROC control.

More than six decades have passed since then with minimal armed hostilities on either side. But the ROC and the PRC have never signed a peace treaty.

Source:
https://www.google.com/maps/place/Taiwan/@27.1741325,103.5534923,5.19z/data=!4m5!3m4!1s0x346ef3065c07572f:0xe711f004bf9c5469!8m2!3d23.69781!4d120.960515

And despite only controlling Taiwan and some surrounding islands, the ROC still calls itself the Republic of China - it still sees itself as the legitimate government of the mainland portion, as well.

This is the origin of the tense ambiguity surrounding Taiwan's political status.

Taiwan has historically been reluctant to call itself a separate country because the ROC sees itself as the rightful government-in-exile of all of China - and the PRC refuses to call Taiwan a separate country because it views it as a breakaway province.

But in the last decade, Taiwan has started to act more and more like it considers itself an independent country - and the PRC has made clear that full-scale independence would mean full-scale war.

The PRC And Taiwan Are On The Brink Of Violence Again

In 2000, the KMT - which had ruled Taiwan as a one-party state under martial law until the late 1980s - lost a national election for the first time in Taiwan's history.

After a series of coalition governments between various minority parties in the 2000s and 2010s, the KMT's longtime rival, the Democratic Progressive Party (DPP), won a parliamentary majority in 2016.

Its leader, Tsai Ing-Wen, has been the president of Taiwan since then - and has set off a paradigm shift in Chinese geopolitics.

Source: ttps://www.bloomberg.com/news/articles/2016-01-16/taiwan-s-chu-concedes-defeat-in-president-election-to-dpp-s-tsai

As the KMT sees itself as the legitimate government of China, it opposes the concept of Taiwanese independence, and opposes spending substantial resources on defending the island against potential PRC aggression.

Instead, the KMT favors friendly relations with the PRC (but not surrender) with a vague hope of one day reuniting Taiwan with the mainland under favorable (i.e. non-CCP) terms.

The DPP is different.

It sees Taiwan as a *de facto* independent country, and favors the development of a Taiwanese national identity - as well as major anti-PRC military spending and stronger ties with the U.S. and Japan (rather than unification-minded ties with the PRC).

Tsai Ing-Wen hasn't quite drafted a formal declaration of independence for Taiwan yet - but her rhetoric has come pretty close.

She has repeatedly pointed out that in practical terms, Taiwan is *already* an independent country, and that unification is off-the-table.

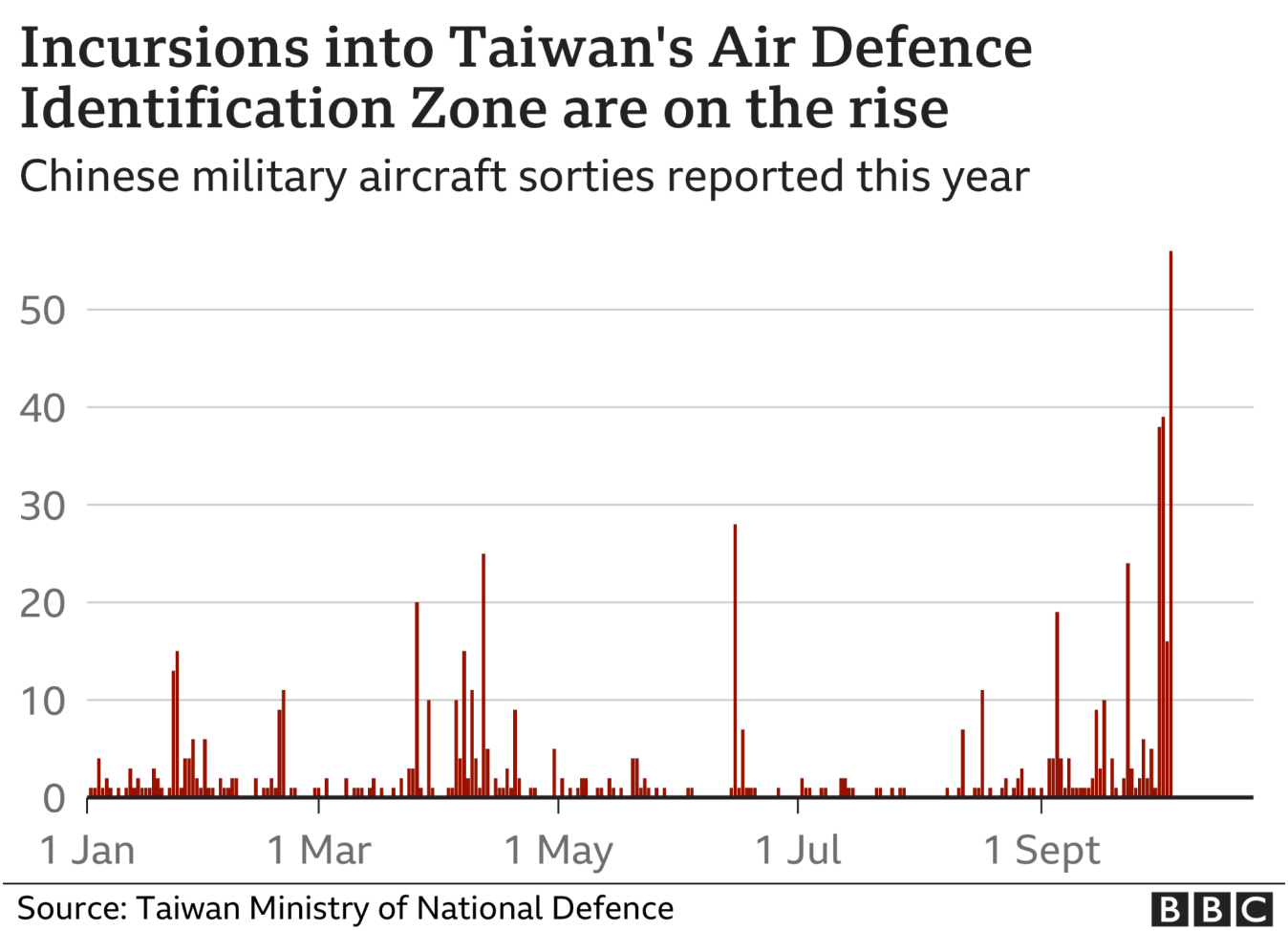
She has also vowed to defend the island (seeking foreign help, if necessary) in the event of PRC aggression.

Beijing is not happy about her being in charge of the island.

Since Tsai's election, the PRC has repeatedly said that Taiwanese independence would mean war - and has made insinuations that Tsai's rhetoric is already crossing that line.

The PRC's military has started to conduct drills and air missions in recent years which sure look a lot like preparations for an imminent invasion of Taiwan.

This year, it has sent record numbers of fighters and bombers into Taiwanese airspace…



Source: https://www.bbc.com/news/world-asia-58794094

The U.S. military, for its part, thinks this buildup in tensions is more than just empty threats and saber-rattling.

In early October, news broke that the U.S. military has secretly been deploying forces in Taiwan for more than a year, conducting covert training exercises with the Taiwanese military in preparation for a potential PRC invasion.

The White House has flip-flopped on the issue in a concerning way.

In early October, President Biden repeatedly said during a town hall that the U.S. would come to Taiwan's defense in response to a PRC attack.

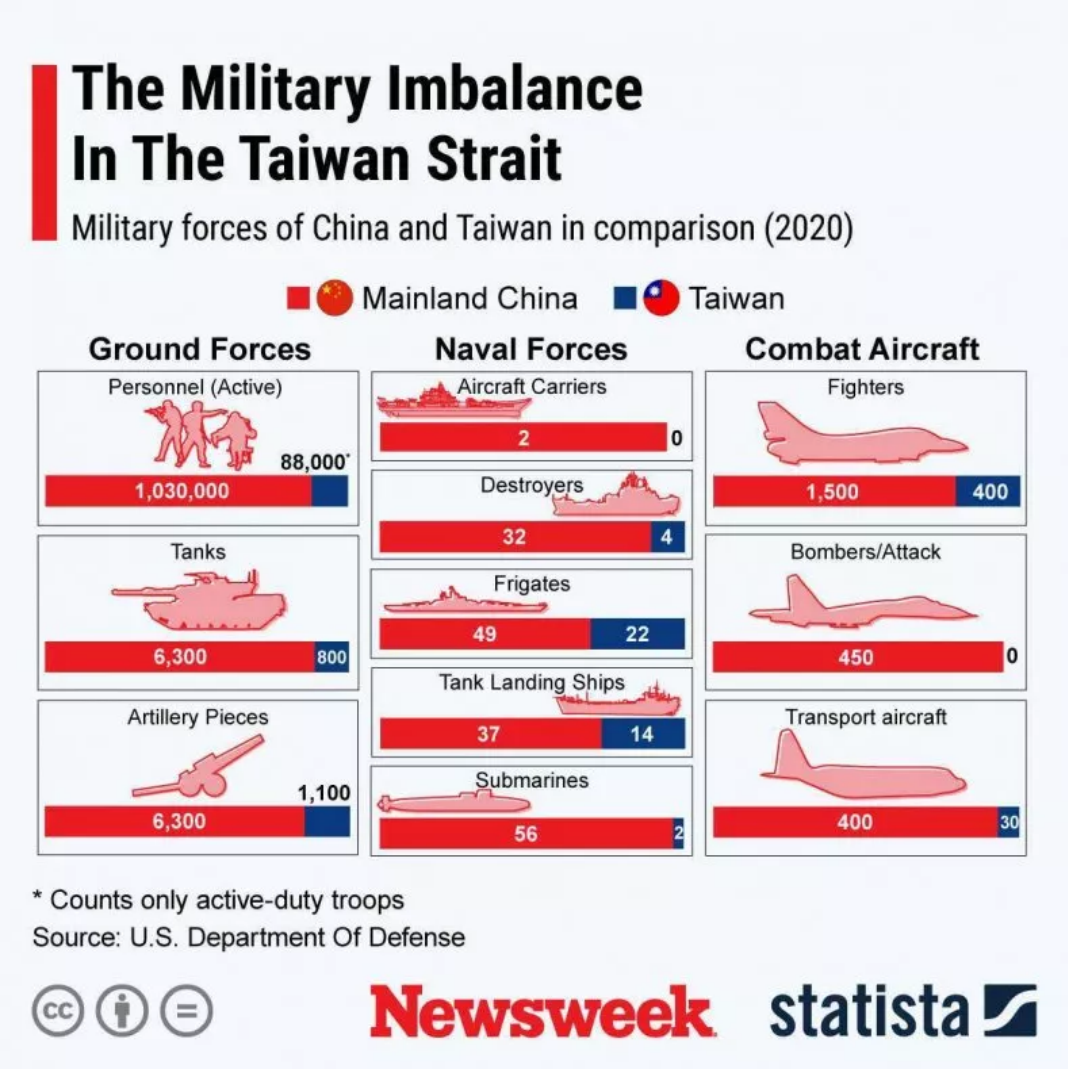
Beijing responded by saying that there is "no room" for compromise or concessions over the issue of Taiwan… *and then the U.S. backtracked.*

A few days after Biden's comments, a White House spokesperson appeared to contradict the president...

"We will uphold our commitment under the [Taiwan Relations] Act, we will continue to support Taiwan's ***self***-defense, and we will continue to oppose any unilateral changes to the status quo," they said (emphasis added).

That might sound like cowardice - but it's also a realistic perspective of the situation on the ground.

A China-Taiwan war would pit one of the world's largest militaries against one of the world's smallest. Even with substantial U.S. aid, a Taiwanese victory would be unlikely. Without it, it would be nigh impossible.



Source: https://www.newsweek.com/taiwan-defend-itself-us-reversal-china-stronger-1641741

Taiwan itself has been candid about its abysmal chances fending off the PRC. The ROC government has said that the communists will likely have the military capability to conquer the island by the end of the decade.

With all this in mind, investors should prepare their portfolios for the possibility of a new major land war in the far East - one which would likely involve Chinese military strikes against key Taiwanese industrial centers, and widespread seizure of Taiwanese business assets in the mainland.

The five companies profiled below could lose most or all of their assets and operations in such a scenario - and should thus be handled with caution…

Hon Hai Precision Engineering Co. (OTC: HNHPF)

Hon Hai Precision Engineering Co., formerly known as Foxconn, is a Taiwanese electronics contract manufacturer founded in 1974 and based in New Taipei City.

Hon Hai is somewhat infamous as Apple's longtime iPhone manufacturing partner. It has largely stopped using its once-common name, Foxconn, since a series of highly-publicized employee suicides at its Shenzhen iPhone factory caused by poor labor conditions in the early 2010s.

The geography buffs reading this report might be scratching their heads at that last sentence, because Shenzhen is in mainland China, not Taiwan.

Indeed, the company is *headquartered* in Taiwan, but its largest *manufacturing facilities* are in the PRC.

In the event of war, the PRC would almost certainly seize those facilities, thereby disrupting Hon Hai's crucial iPhone manufacturing business.

With all this in mind, it's easy to see why Hon Hai shares have anxiously traded sideways this year as military tensions between China and Taiwan have increased…

There are a couple of caveats to consider about Hon Hai's plight, though. The company does have some manufacturing facilities in the U.S. and India which it could theoretically continue to operate in the event of a PRC invasion of Taiwan.

It also has a reasonable debt-to-equity ratio of 55.53%, meaning that it could conceivably fend off its creditors for at least a little while in the event of a wartime revenue disruption.

It's also worth remembering that Hon Hai shares trade over-the-counter (OTC) in the U.S..

There's almost no options market around them, and OTC liquidity issues mean that shorting them might be difficult.

Taiwan Semiconductor Manufacturing Co. (NYSE: TSM)

Founded in 1987 and based in the Taiwanese city of Hsinchu, Taiwan Semiconductor Manufacturing Co. (TSMC) is the world's largest contract manufacturer of semiconductor chips.

Like Hon Hai, TSMC's manufacturing operations are overwhelmingly located in Taiwan and the PRC, where they would be extremely vulnerable to PRC aggression.

And like Hon Hai, shares have stagnated as the probability of such aggression has grown this year…

However, also like Hon Hai, TSMC's operations might not be completely doomed, even in the event of a worst-case scenario between China and Taiwan.

The company has invested billions of dollars in new foundry projects in the U.S. in the last five years.

It could survive in some form through those foundries if it gets them up and running before a PRC invasion.

The company has a low debt-to-equity ratio of 22.29%. This could allow it to buy itself some time with creditors if it had to move all operations to its under-construction U.S. facilities.

What's more, during the current global semiconductor chip shortage, the PRC might be reluctant to knock the world's largest chipmaker completely offline.

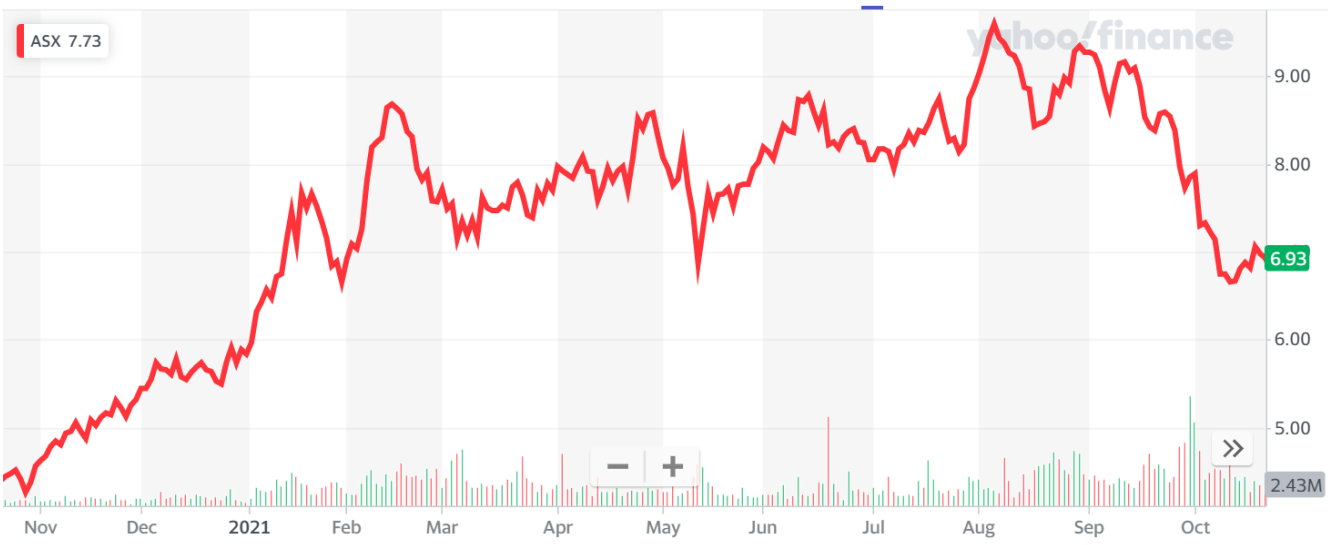
Nonetheless, some form of nationalization or expropriation would be a real possibility in the event of a PRC invasion of Taiwan.

That would not bode well for shareholders.

ASE Group (NYSE: ASX)

Founded in 1984 and based in Kaohsiung, Taiwan, ASE Group is another of the world's largest semiconductor manufacturing and testing firms.

It faces similar vulnerabilities to TSMC in the event of a China-Taiwan war. Most of its manufacturing facilities are in Taiwan or mainland China, with only small operations in other countries like South Korea, Japan and Malaysia.



Like TSMC, ASE could hypothetically survive through these peripheral non-Chinese operations in the event of war.

But its prognosis would likely be worse than TSMC's for several reasons.

For one, ASE has a heavy debt burden - accounting for 77.60% of its equity value - meaning that it could become insolvent pretty quickly if it suddenly lost a lot of assets or revenue due to a PRC invasion.

For another, ASE is not quite as much of a crucial bottleneck in the global semiconductor supply as TSMC is.

It has less than half of TSMC's market share. That might make the PRC military more disposed to bomb ASE facilities than TSMC facilities in the event of a large-scale attack on Taiwan.

Chunghwa Telecom (NYSE: CHT)

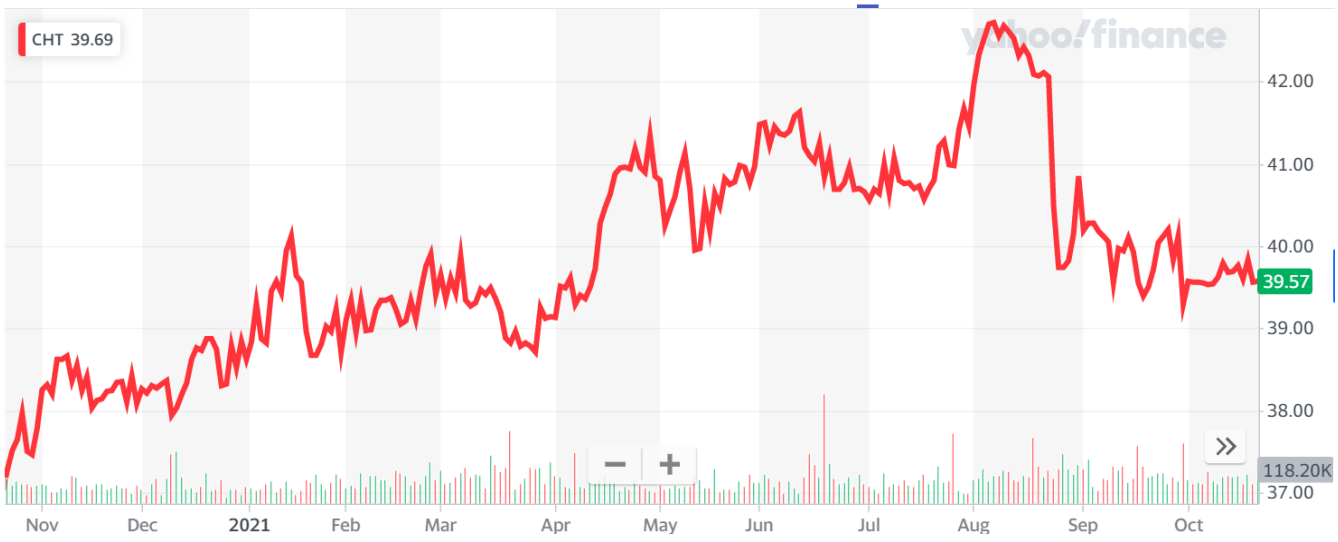
Founded in 1996 and based in Taipei, Taiwan, Chunghwa Telecom is the largest telecommunications company in Taiwan, and has a near-monopoly on the country's local telephone and broadband internet services market.

Chunghwa is somewhat unique among companies on this watchlist in that its entire business - headquarters, operations, customers and all - are located in Taiwan.

On the one hand, that could be a grim indication of its wartime fate... it would have nowhere to flee to in the event of a PRC invasion.

On the other hand, given its near-monopoly status, a PRC occupation government might allow Chunghwa to continue operating in a largely-unchanged form, perhaps just under a new corporate structure with new, CCP-approved leadership.

To that end, shares have had a bumpy ride this year - but they have managed some small gains despite the worsening geopolitical situation in Taiwan, unlike the other companies profiled in this report.



The company also has very little debt. Is debt-to-equity ratio is just 10.19% at the time of writing.

It might not immediately face bankruptcy in the event of a PRC invasion - but a wartime corporate shakeup by communists still wouldn't be good for shareholders, even if the PRC tries to let the company continue operating.

United Microelectronics Corporation (NYSE: UMC)

Founded in 1980 and based in Hsinchu, United Microelectronics is Taiwan's oldest semiconductor company - and one of TSMC's major rivals in the chip manufacturing game.

Like the other semiconductor manufacturers profiled on this watchlist, United Microelectronics does most of its manufacturing in Taiwan and mainland China - and would thus have a lot to lose from a war between the two.

Shares have traded mostly sideways this year as tensions have risen, although they've eked out some small gains.

In addition to its mainland Chinese and Taiwanese facilities, United Microelectronics has a small foundry in Singapore, and another in Japan.

Its semiconductor chip market share is larger than that of ASE, but smaller than that of TSMC - so it's hard to say whether the PRC military would see its plants as acceptable soft targets in the event of airstrikes on Taiwan.

The company has a relatively-low debt-to-equity ratio of 31.62%, so it would likely have a bit of runway with creditors if it had to shift its operations to its Singaporean and Japanese facilities in the event of war.

Its long-term survival in such a scenario seems unlikely.

Is The West In A New Cold War With China?

The watchlist above contains five large-cap stocks which are widely held and traded in the West which would be unlikely to survive the war which seems to be brewing between China and Taiwan.

And they're not the only Western stocks which face threats from an increasingly-emboldened China.

In the last few years, China's tech industry has started to beat Silicon Valley at its own game - and publicly-traded Western companies are rapidly losing market share to their upstart Eastern rivals.

We'll be writing more about this incipient "tech cold war" in upcoming issues of *Haven Investment Letter*.

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