

Have the China Watchers Never Heard of a Decoy?

By Adrian Douglas

What amazes me is how financial journalism is at the level of 6th grade in terms of analytical thinking! Even so called market analysts are not much better. GATA put out a dispatch today citing this article:

China keeps buying US bonds despite concerns

<http://news.smh.com.au/breaking-news-world/china-keeps-buying-us-bonds-despite-concerns-20090517-b757.html>

This article is a prime example. The article is cheer leading the fact that China was recently expressing grave concerns about their massive bond holdings but have added more purchases. The simpletons in the Press and financial world don't have a clue. What are these sleuths looking for? A 500 billion dollar sell order posted with a New York broker on some rainy Monday morning? Have they never heard of a decoy?

The US Treasury reports each month on foreign holdings of US Treasuries. The Chinese would have no more than 30 days to dispose of almost one Trillion dollars in Treasury debt before it would be public knowledge they are selling. Do these China watchers seriously think that the China's diversification strategy is going to involve unloading US debt on the debt market?

You don't have to dispose of an asset to realize its cash value. Didn't these people learn anything from the mortgage crisis? For bankers the best collateral in the world is US Treasury debt. That is likely to change soon but if we deal with the facts of today the Chinese are holding what bankers perceive is the most liquid and highest quality collateral. Do you think that this characteristic of US Debt has escaped the notice of the Chinese? I would bet that the Chinese have been busy using their Treasury debt as collateral against FIXED interest rate loans. They will have used this money to buy up real assets. We know they have bought 454 tons of gold. They are currently importing 70% more copper than they consume. They are busy filling up a Strategic Petroleum Reserve. They have been going around the world making deals for raw materials and making acquisitions of small enough companies that they fly under the radar (they learned their lesson from trying to buy Unocal). The interest rate on these fixed rate loans will be partially offset by the interest paid on their bonds. When the bonds go tapioca they have two options. They can sell some of the assets they bought but at prices much higher than what they paid and so pay off the loans with worthless dollars or simply default and lose their collateral of worthless US bonds. Just to obfuscate what they are doing they make some complaints about

US debt one day and then buy some a few weeks later. These journalists should read the biography of Jesse Livermore to know how you fool even the best traders.

The Chinese have a 300B\$ Sovereign Wealth Fund; if that is properly positioned in commodities that alone will hedge the entire bond portfolio.

The notion that the Chinese have accumulated this massive US Debt portfolio and are only now wondering what to do about it is so naïve it doesn't warrant consideration. I have dealt with Chinese in business and they are the sharpest knives in the drawer. My guess is that the Chinese have already diversified most of their dollar holdings.

Now like magicians they keep the China Watchers eyes fixed on the hat because we all know that is truly where the magician has hidden the rabbit.

The Chinese have no interest in collapsing the US Treasury market, but if people think that the Chinese strategy to protect themselves against such an eventuality is to sit tight, buy more and keep their fingers crossed every thing will work out fine, then they shouldn't go out in public alone!

The Chinese have vault loads of intrinsically worthless Treasury Bonds that they have no doubt used as collateral to buy intrinsically valuable assets. The Western central bankers in contrast had vault loads of gold that they have loaned or sold to buy intrinsically worthless interest bearing Government debt!

I bet Confucius would have had something to say about that!

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May 17, 2009

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