

## The Tonge Telegraph

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#### China, and so on...

The world's fastest-growing economy has had some outsized influence on world stock markets. In late February, the Chinese stock markets dropped about 9% one day and set off a five-day worldwide stock market rout that wiped out more than \$3.3 trillion of stock market value. China's influence on world markets is disproportionate when you consider that foreigners were until recently allowed to participate up to a total of only \$10 billion.

Now, \$10 billion is a lot of money, but Exxon earns that much in one quarter of business activity. In short, the amount of money Exxon earns in one quarter was equal to the total amount of securities available for foreign purchase in the Chinese stock market. Last week, the Chinese government agreed to triple the value of securities available for foreign ownership.

That may offer some stability, but I'm not sure it will go very far in reducing the current problem. China's economy is the world's fourth largest; however, its markets account for just 4% of global market value. Yet when something is perceived to be going wrong, markets all around the world have over-reacted. The fact is that the world economy is not particularly exposed to disruptions in the Chinese market. (World markets responded much less irrationally to last week's plunge in China.) We are more interested in, and sensitive to, the economic expansion in China. As long as the Chinese economy stays strong, which most commentators predict it will, a decline in their stock market is not going to have a crippling effect on the rest of the world. The psychological effect is an entirely different matter (as in: "We have nothing to fear but fear itself.").

Still, the word "bubble" may still be an accurate description of what's going on in China's market. It has currently all the attributes of a bubble. (We usually don't know what a bubble was until it has passed.) Most stock market bubbles are caused by the same circumstances: too much demand and too little stock. This is part of what happened in our Internet bubble, when companies sold 5 or 7% of their stock to the public at a time when the public appetite could have consumed over 80% of existing shares. This imbalance between supply and demand drives markets into a frenzy. China's markets are experiencing just such an imbalance between supply and demand. Stay tuned, and be patient as we see how the whitewater river of capitalism erodes thousands of years of empire and a half century of communism.

Housekeeping items: Lisa has decided to move on, and I have hired Brenda Dufour to replace her. Brenda has an extensive résumé, including tax work, Internet work, and computer experience. (No, we are not going to start doing taxes.) She's already made a significant difference in how some of our systems are running. Brenda is new to the securities industry but is a quick study and is doing a great job learning some of the processes at Schwab. Please call and introduce yourself to Brenda when you get a chance.