

Magellan – In The Know: Episode 56

The big issues for investors coming out of Washington



Announcement (00:00):

The information contained in this podcast is for general information purposes and does not constitute investment advice. You should seek investment advice tailored to your circumstances before making an investment decision.

Host (00:14):

This is In The Know, a monthly investment podcast brought to you by Magellan Asset Management.

Michael Allen (00:20):

I think people believe that we're still, if we play all of our cards right in a position to continue to win artificial intelligence, but it's not a sure thing, and as I see Huawei and other Chinese entities investing and trying to catch up and us not necessarily ever sure where they truly are, DeepSeek surprised a lot of people. Then it turned out that it wasn't as momentous as we thought, but I think we're in a real foot race with the Chinese. We may have a little bit of a lead, but I don't think we'll hold it forever.

Host (00:54):

That's **Michael Allen**, a former senior White House national security official dipping beneath the surface and offering his perspective on the big issues for investors coming out of Washington. Welcome to Magellan In The Know. With the global tariff shock beginning to subside, it's a good time to draw on the thoughts of a long-term Washington Insider and explore the logic and methodology underpinning President Trump's approach. First, here's a warm welcome from Arvid Streimann.

Arvid Streimann (01:32):

Welcome to Magellan's In The Know, my name is Arvid Streimann, the Head of Global Equities and Portfolio Manager here at Magellan. So we're in for a treat today because today we've got joining us Michael Allen, who's a leading expert on national security issues and amongst other things, Michael's worked in the White House, the House Permanent Select Committee on Intelligence and the private sector. And right now Michael is Managing Director of Beacon Global Strategies, which is a leading consultancy based out of Washington D.C. and it's helping its clients manage geopolitical and national security risks. And we know both of those are rising over time and they're pretty elevated right now. So welcome, Michael. Thanks for coming on.

Michael Allen (02:10):

Thanks so much for having me.

Arvid Streimann (02:12):

Well, Michael, let's start with a little bit about you. Can you please share a little bit about your background and in particular what you were doing in the White House?

Michael Allen (02:20):

Yeah, of course. So when I grew up, I was always interested in working in politics and really wanted to work in foreign policy, national security. And when George Bush won the presidency in 2000, I started working for him at the State Department and after September 11th, 2001 was able to start at a new office within the White House called the Office of Homeland Security, and it was set up to mirror the office at the White House called the National Security Council, which coordinates all the familiar national security bureaucracies. But this one was meant to work with some of those departments and agencies, but also ones that had not been involved in the National Security Mission, so customs and the Treasury Department and other places that were adapting a counterterrorism mission.

(03:16):

So I started there in that capacity and worked with what we call Homeland Security and later in the National Security Council for seven years at the White House. So I stayed until the end on January 20th, 2009. I worked a lot on legislative affairs, so worked in the Congress on behalf of President Bush and also worked on North Korean nuclear issues and Iranian nuclear issues and all sorts of counter-proliferation type activities that were, well, they were big then and they're still big today.

Arvid Streimann (03:50):

Well, they certainly are, and we've got another Republican that's sitting in the White House right now under Donald Trump, and it's been fascinating to watch his first a hundred days. Of course, they're now up, he's announced some very large tariffs on many countries, including his allies like Australia, but also his adversaries like China. What do you reckon he's actually trying to do here?

Michael Allen (04:10):

Well, first and foremost, as you probably noticed during the campaign, the president really likes tariffs. He says constantly, it's one of his favourite words, if you will. He talks about the revenue that he believes the United States can get by having large tariffs on other countries. He's discussed that it helps nurture us domestic industry that has long since gone overseas, especially to China. And so he's constantly talking about the manufacturing promise that tariffs might bring the United States. And finally, in his mind, he is solving or lessening the US's trade deficit with other countries bilaterally around the world. He's bothered by that metric. He wants it to be more of a surplus in favour of the United States in terms of our exports.

(05:05):

So, the President usually justifies many of his actions with regard to tariffs in one of those three categories, but he does have also just sort of a longstanding deeper concern about China in general. I think he understands innately as a businessman that their free trade, their so-called accession into the free trade agreement within the World Trade Organisation has been sort of an affront to the United States. He believes that the centre of our country think the industrial Midwest has been hollowed out as businesses moved to not just China, but also to Mexico. So he's got a really strong sense that in his words, the United States has been poorly served by his predecessors and ripped off by China in particular. And so I think he thinks he's getting some of that money, some of those jobs back and some of that energy within the US economy.

Arvid Streimann (06:07):

Yeah, it sounds as though from what you're saying is he's most worried about the jobs and the wealth creation. Is he also worried about America's military power, or at least its relative military power compared to China?

Michael Allen (06:20):

I think so, although I wish he were talking about it a little bit more here. He definitely has embraced a sort of Ronald Reagan defence spending philosophy, which is usually described by Reagan and now by Trump as peace through strength. Reagan of course, had an extraordinary defence buildup. I think the United States gross spending as a percentage of gross domestic product was a lot higher than it is today. Trump has proposed more defence spending, but not on the order of what we saw in the Cold War. So those of us in the United States who think of ourselves as hawks and believe that a lot of the China threat to be anchored in their extraordinary military and growing military capabilities are a little bit worried that the United States is very far behind, mostly because of the sorry, state of our defence industrial base. And so we're trying to catch up and I hope the Congress will add even more in defence spending to what the President has proposed.

Arvid Streimann (07:24):

Okay, interesting. So we might get back onto China and a little bit of Taiwan in a moment, but let's get back to the tariffs. I think everyone is watching to see these trade deals as they roll through. I think we've seen the UK already. How big do you think these trade deals will be? I know that they're being done in a very compressed timetable, so they're not quite as fully formed as they otherwise would be. How big do you think that they'll be ultimately and how big do you think they actually need to be to get Donald Trump off people's backs?

Michael Allen (07:51):

Well, I think the President is moving very, very fast, but what we're doing here I think is striking agreements to agree or maybe at best trade principles, principles of an agreement, not the actual text. And so as you correctly identified, we started with the United Kingdom. There was an enormous China announcement, to hear the President tell us there's many dozens of companies that have come to the United States seeking help from the tariffs that he has imposed and then suspended their implementation for 90 days.

(08:30):

I do think the President's created a unique opportunity for the United States to raise and settle certain issues that we have, not just with tariffs, but even non-tariff barriers and sometimes things as complicated as currency manipulation and digital service taxes. A lot of people are upset at the way we got there and worry that we've needlessly angered some of our best allies and that we should have kept our eye on China and not tariffed our friends, and those are some fair points, I think. But I think the other side of the coin is that this is an opportunity for the United States and other countries to revisit some of our arrangements and hopefully in the end, ironically enough, come back with freer and fairer trade.

Arvid Streimann (09:15):

Yeah, okay. And sitting as someone on the other side of the world, there's a lot of discussion over here about how hard Donald Trump went against China and then how quickly he undid a lot of what he was saying. Do you think that that showed an element of weakness on behalf of the American negotiating team or strength on behalf of China? It's really interesting because this could play out in other theatres down the track.

Michael Allen (09:40):

Well, myself, I was just at a China conference **Hosted** by the US Chamber of Commerce, and that topic was a big one today, and that was, did the United States win this first skirmish of the trade war with China or did we lose? A lot of people I think tried to argue that the United States fared well in

the end because we were able to swiftly come to an "agreement." But I think the best reflection of what's just happened is that both countries realised that tariffs at the rates that we had them, and in the case of the United States, it was 145% on China, just was not a good way to proceed given the interdependence of these two economies.

(10:23):

So the President signalled going into last weekend that it would be open to major scale reductions and then to hear him tell it, they heard so much positivity in their meetings in Switzerland, he felt like he could reduce them all the way back down to 30%. There are others, but at least the ones that he was talking about are 30%, 10% base, 20% so-called fentanyl tariffs. The President felt like he made enough progress. And I think that's a reflection honestly of the state of the markets and a lot of the United States businessmen warning that we're serious when we say we need uncertainty and without it when our supply chains are so interdependent with China, we're just not going to be able to make the investments or make the purchases that we need to move forward. And so I think that had a lot to do with the President's move on Monday morning.

Arvid Streimann (11:19):

Well, it's hard to decouple when you're so coupled together, isn't it economically.

Michael Allen (11:23):

That's right.

Arvid Streimann (11:24):

Given what's happened, do you think it's unlikely that these tariffs on China will rise again to the same extent? Do you think that we've, or at least Donald Trump has tried this game, didn't quite work, so forget he's going to move on to something else? Do you think there's a chance of a repeat of this?

Michael Allen (11:37):

I think I agree with you that he will not go that high again, our negotiations with the Chinese would really need to go off the rails for the President to sort of touch the red-hot stove again. I believe he will look for progress and hope for progress in a variety of different areas. By the way, we usually talk in terms of will the Chinese make more purchases of US exports or will they make real commitments to reform what we call their mercantilistic economy? I think they would make more purchases than anything else, and they might make some other concessions, but the President's going to have to make a judgement on whether he feels like he's made progress with Xi Jinping. I think this will be wrapped up in a phone call soon and maybe even a meeting in the fall. And while I think it's possible that we're not going to be able to come to substantive real enforceable implementable agreements on behalf of the part of the Chinese in structural areas, the President I don't think wants to go back to as high as we just had those tariffs.

Arvid Streimann (12:44):

And do you think that the phone call, the deal, whatever it is that's negotiated between these two international leaders, do you think that Donald Trump, based on what happened in his phase one trade agreement, is going to have a bigger ask or do you think that he just wants anything?

Michael Allen (13:01):

I think he might ask for more in terms of purchases. Even today we saw some of the announcements out of the Middle East. They were Boeing purchases, aeroplane purchases. They were good for hundreds of millions of dollars. That was part of it last time with the Chinese. I think maybe agricultural products can be ramped up rather easily by the Chinese, although the counter argument to that is that in the Chinese own way of decoupling, they feel like they are too reliant on the United States for agricultural purchases. But if for an interim deal to get out of the box that we're in with the Chinese, I could see them ramping up agricultural purchases even as they're looking to a midterm strategy of reducing their dependence in that critical area with the United States.

Arvid Streimann (13:49):

Yeah, I think agriculture is a pretty easy give, isn't it?

Michael Allen (13:51):

Yeah.

Arvid Streimann (13:52):

Let's move on to domestic politics and one of the big swing factors for the US outlook is the economic outlook is the budget. There's a lot of stuff happening right now. Now Trump wants to cut spending but also extend the personal income tax cuts, which of course he did in his first administration when they're about to expire. What do you think will be the key features of the budget when it's finally agreed to?

Michael Allen (14:15):

Well, certainly we will extend the US Congress through its so-called reconciliation legislative package will re-extend the vast majority of the tax cuts from last time. So the question is how much farther does the Congress go? And I think what we've learned as the House of Representatives put out their first version of the legislation within the last few days is that, we're not going to be able to go much broader and much deeper on those traditional areas in terms of personal income taxes and the rest because the president made new commitments when he was on the campaign trail to not tax wages to lessen the burden of senior citizens as it pertained to social security benefits. And so they had to find a creative way to address that also.

(15:13):

So when you tack on these two and then there's some others additional tax relief for what they would call the middle class or the working class in the United States we're running out of money to put it all together in a bill that could actually pass because I don't think we came up with the amount of spending cuts that some of the most hardcore Republicans wanted to see as we got tax relief. So there's a big fight going on even as we speak about how much the match will be between spending cuts and tax decreases.

(15:51):

And while at the end of the day, if you ask me my bottom line, I still think it's too big to fail. Something will come through the Congress this summer that it's going to be really hard and difficult to get there given just the enormous fiscal challenges that we have here and the spending increases we want to do, by the way, on defence and immigration, while at the same time cutting even more taxes and not cutting as much in spending as Elon Musk seemed to promise during the early days of the Doge here, which you'll recall of course was his effort trump's effort to reorganise the executive branch, especially in search of savings.

Arvid Streimann (16:33):

So when we're thinking about the outlook for the equity market and how much that might rise, 'cause this is a big topic for us, one of the things that we look at is how expansionary the budget will be. And the way to we think about that is the budget deficit going to increase relative to the previous projections or is it going to decrease? And I know over in America there's a big debate about debt sustainability, which is deficit sustainability. And so making those deficits higher is tough politically. Do you think that the deficit will increase or decrease when this budget goes through 'cause that goes through to the stimulus which goes into the economy?

Michael Allen (17:14):

To be honest with you, I think what it will be is it will come out with a slightly higher deficit, this go around and an increase to the debt, which is almost crazy given where a lot of Republicans are. But when you begin to look at where the spending is here in the United States, the vast majority of it is not subject to the annual discretionary budget exercise that the Congress is doing. It's generally speaking, healthcare costs and what we call Medicare. No one wants to touch Medicare and understandably so because of seniors and other reasons here in the United States. And so as long as US politicians are unwilling to cut Medicare or for that matter substantially reform Medicaid, so think mostly healthcare funding for the poor and other vulnerable populations, that's where the money is.

(18:06):

And I think that's politically unpalatable. President Trump said he didn't want to cut these areas in big ways, and so I think that the United States is going to continue to kick the can down the road until we honestly hit some sort of fiscal crisis or economic crisis. I think it's unforeseeable when it's going to happen, but it's going to happen at some point. And then the Congress will be forced to really reform Medicare, Medicaid, maybe social security, but that's not coming yet. And I think they'll get away in the end with this enormous tax cut this year with select spending increases and cuts that may be semi-substantive this year. But I bet in the out years won't be as much as advertised.

Arvid Streimann (18:54):

Yeah, I tend to agree with you. It seems very tough anywhere around the world to cut down on the government spending because you're taking money out of voters pockets and unfortunately for politicians, voters vote. So it doesn't really happen. So I wonder what will happen in the longer term. I kind of wonder whether the Fed might have to start soaking up some of that government bond issuance to fund the deficit down the track, but that's a bit of a balancing act. We'll see, I guess

Michael Allen (19:19):

You're right. I think that is definitely part of it. And unfortunately here in the United States especially of late, we don't really tackle big problems until there's a crisis. I mean, remember TARP, the Troubled Assets Relief programme after the financial crisis in 2008, 2009. So unfortunately that's sort of our template we spend when we're or fix things when our back is against the wall. Maybe that's definitely a hallmark of democracy, but it doesn't make a lot of the experts feel good about it here in Washington.

Arvid Streimann (19:52):

Yeah. And what you're describing there, I would also say happened during COVID where when the might of the US economy was trying to find a cure for or at least a vaccine, it happened pretty quickly, which was lucky for the global economy.

Michael Allen ([20:05](#)):

Yeah. That was another example where we were willing to spend as much as it takes to fund alternative vaccine ideas and concepts and let some fail because we were also funding alternatives, which turned out better. So it was a great example of the United States doing something when it sets its mind to it, but it was also in sort of a mistake-free political system where you weren't going to get penalised if you spent hundreds of millions of dollars on a vaccine that didn't work out because everyone understood we're trying three or four things at the same time and it's going to be expensive, but we're doing it to save lives.

([20:44](#)):

We can do things when our backs are against the wall or if it's a national emergency or the stock markets have collapsed, I'm afraid, ultimately, and it's almost unpredictable when this is going to happen. Some of the anti-debt groups here in Washington try to predict when these types of crises are going to happen. But you're right, I think it comes at us by way of the bond market. The fed will be involved, but some future crisis to be named later as we say.

Arvid Streimann ([21:10](#)):

Yep, I agree completely. Now, let's just stay on politics. We've been talking about the budget and of course it's easier than usual because the Republicans of which Donald Trump is part of the party control, both chambers of Congress, so the House of Representatives and the Senate, that's because the Democrats did quite badly in the most recent general election. And so the Republicans have what we'd call the sweep. Now, do you think that the Democrats can recover fast enough to take back either the House of Representatives or the Senate in the next elections, which is the midterms just in over a year's time? And the reason why we're asking this question is because if they do manage to do that, then it's going to be much harder for Trump and his fellow Republicans to pass new laws.

Michael Allen ([21:53](#)):

So you're exactly right. Everyone assumes that the House of Representatives will go democratic in this midterm election, and therefore Trump and the Republicans feel like we've only got this year and next to pass something. Next year is the midterm election year, so it's now or never. And we're going to have to go through, and it's a complicated process here in the United States called reconciliation, which gives us the opportunity, especially in the Senate, to pass an enormous 10-year budget by 50 votes instead of 60, which is usually what's required to break a filibuster here.

([22:32](#)):

In other words, to cut off debate so they have time. But when you really analyse the calendar and try to forecast how the election will go, most people say, "You know what? The Republicans are going to have to make these many of these tax cuts permanent or at least extend them this calendar year." And so as I talk to people who really, really follow it hour by hour, I think most people are in the cynical camp of it's too big to fail. We can't necessarily articulate how it's going to pass, but it has to pass or Trump and the Republicans will have just taken such a black eye. It's nearly inconceivable. So most of us assume base case this gets done, but it's going to be really, really hard and a real legislative scramble.

Arvid Streimann ([23:24](#)):

Yeah. And on the Democrat side, they didn't do as well as they'd hoped in the general election, particularly when it came to the race for the White House. It seems to me as though there's been no clear leader emerge on the Democrat side, when do you think that that might happen?

Michael Allen ([23:37](#)):

So we go through this all the time. When there's a party that loses big, we, one, go through a period where that party tries to figure out why they lost and they have been doing that. I think they're not really in a place where they have reached consensus yet. In fact, this week we're still arguing and debating about whether Biden had some serious mental capacity issues because there's a new book coming out, the third in a series of books about this very topic. What that says is the Democrats are still debating, did we lose because of inflation? Did we lose because Kamala Harris didn't have enough time after Joe Biden pulled out to run a real campaign?

([24:20](#)):

I don't know that they have settled on why they lost, which helps explain why a real leader has not emerged. But also this is just the curse of American politics. When you lose big both houses of Congress and you lose the Presidency, you really don't have a new leader until there's a new nominee of the Democratic Party. So there's going to be some confusion until they have a primary process that begins to anoint a new leader for their party that settles some of their own internal quandaries and debates, and so this is just part of the process of being in the wilderness and trying to make a comeback.

Arvid Streimann ([25:00](#)):

And that likely to occur before the midterm elections, which is just over a year away or after that.

Michael Allen ([25:06](#)):

I don't think they'll have a recognisable leader before the midterm elections. There are a lot of people out there auditioning for it, if you will, trying to get attention, trying to make regular speeches and punch through, but it's hard enough in a normal year, and then you put Donald Trump as the incumbent, the man who can make news at the drop of a hat and just totally dominates the American political conversation every day. It's hard for them to break through, so they're not going to be able to do it, I think until after the midterm. And then we begin to see, "Wow, is it a governor? Is it the governor of California who's making soundings? Is it going to be a senator that we're more familiar with?" These issues, I think people are out there trying to get noticed right now, trying to get traction, but I think it's after the midterm.

Arvid Streimann ([25:59](#)):

Yeah, it's interesting that Donald Trump, he's not just dominating the news cycle over there. He sort of has a very big impact over here as well.

Michael Allen ([26:06](#)):

It's amazing.

Arvid Streimann ([26:07](#)):

Let's move to semiconductors. Now, the US and China, they're obviously in a high stakes, I'd call it a high stakes arms race in semiconductors, and at the moment the US is leading and China's trying to play catch up. I would say that the US is making it harder for China to get their hands on

technology and the US is trying to slow them down, obviously. Do you think that the US will actually prevent China from catching up to where they are when it comes to semiconductor technology?

Michael Allen ([26:33](#)):

So that was another topic today at this conference that I just mentioned. I think most people believe that the Chinese will eventually catch us. It's a question of how soon will they catch us and how effective are our export controls? I think generally, and I know that the very prominent CEO of NVIDIA disagrees, but by and large, I think we're going to be able to hold them at bay while we move into this critical phase of artificial intelligence where we need to be able to build the data centres to dominate the race for the software, which is in essence the algorithms. I think people feel good about it.

([27:16](#)):

By the way, we always look at this think tank from Australia, ASPI, who has this terrific ranking of where we stand vis-a-vis other nations, and we always look at it to see where we are on AI matters. I think people believe that we're still, if we play all of our cards right in a position to continue to win artificial intelligence, but it's not a sure thing. And as I see Huawei and other Chinese entities investing and trying to catch up and us not necessarily ever sure where they truly are, DeepSeek surprised a lot of people. Then it turned out that it wasn't as momentous as we thought, but I think we're in a real foot race with the Chinese. We may have a little bit of a lead, but I don't think we'll hold it forever.

Arvid Streimann ([28:07](#)):

Okay. And how do you think that plays out over time in that scenario that you just described that let's say the Wall Street Journal, we wake up one day and it's got an article on the front page saying, "The Chinese have caught us and maybe even they're overtaking us." What do you think that the American reaction to that is?

Michael Allen ([28:23](#)):

So this is sort of similar to what I mentioned about what the United States does when it's back against the wall. There's an overused phrase here, a Sputnik moment where the United States rallied in education, technology spending, government spend just about every category after the Russians seemed to get a satellite in orbit quicker than we would. I think we would go into a similar mode and mindset where the country would come together and move towards certain solutions that we think are absolutely important.

([29:01](#)):

I think we would rally and you would see the best of the United States trying to fight back and either keep the lead or catch back up. I should say. We have spent a little early and adopted an industrial policy called the CHIPS Act here in the United States where we do subsidise semiconductor manufacturing to come back to the United States. That's a good example of where we actually spent some money early in order to keep a lead or to correct a supply chain type issue, if you will. So I think we are focused on this, and if we began to lose, I do think you would see the United States storm back.

Arvid Streimann ([29:38](#)):

Yeah, that would be interesting to watch. Now, do you think that the US economic machine and political machine requires a Sputnik moment, which is when you actually know that they're ahead? Or do you think that it needs a bomber gap moment, which is when you think you're behind? And

just for people's reference, a bomber gap is something which happened during the Cold War where the Americans thought that the Soviets had a lot more bombers than they actually did, and they turned out that they didn't, and that really got the Americans building bombers.

Michael Allen (30:07):

I think the far preferable, obviously, is the bomber gap moment. I think the CHIPS Act is a early down payment on the idea that we can act early in order to correct a huge deficit, if you will, in the United States. I think it's all about how many people are aware of these types of issues. And I rank that very high. I think even your average member of Congress that while they care about other issues that their constituents care about, also understand innately that we need to win the artificial intelligence race.

(30:39):

So I think people understand it. The second most necessary part of that is, well, then what would we do? What would we spend on, give me something to vote on. That's the part that's less clear right now of is there anything Congress could do? Is there anything the executive branch could do here or is it just a Google, Facebook, Microsoft, et cetera? Is it just about their spend to keep us in the race? We're going to have to make the policy case over time of here's how we keep the lead. And some of that's ongoing, but I think we need a lot more education of policymakers here in the United States.

Arvid Streimann (31:14):

Yeah. When I think about that particular scenario, that Wall Street Journal article scenario, I suspect that the government will be throwing around a lot of money in a very short time, and I suspect there's some companies that would benefit from that.

Michael Allen (31:26):

I think you're right. I think a lot of people and, you know, big tech has had a rough time in the United States in recent years as parents are trying to figure out what screen time does to their children and a hundred other things that you've read about. But by comparison, they've had a good couple of years 'cause everyone understands that, "Wow, the spend on whether we win artificial intelligence in the tech race, unlike in the Cold War, is primarily a private sector spend, an R&D adventure. So we need to be more respectful of these companies, even if we're irritated with some of the details because they're the ones that are spending tens of billions, hundreds of billions of dollars in some cases to try and win the AI race."

(32:08):

And so some members of Congress, while they're upset with big tech, are also saying, "Well, you might also be the golden goose, and so let's not kill the golden goose, as we say, and especially when we think about China's behaviour of late and the crackdown that they did on their own tech community and how that really hurt themselves more than anything else."

Arvid Streimann (32:28):

Yep, sure did. And maybe, we'll, as we're looking to wrap up here, talk a little bit about East Asia and Taiwan in particular. How worried do you think that investors should be about a Chinese takeover of Taiwan?

Michael Allen (32:41):

So I do think it is something to watch and be worried about in the medium to almost long-term, let's call it. I don't think they're going to do it now. There's been a lot of debate in the United States and of course in Australia and elsewhere about when the PRC, the PLA will the Chinese military have the ability to successfully mount a cross-straits invasion. And when you hear in the United States, us talk about the so-called Davidson window, that was after our INDOPACOM commander who said he thought that, and others in the intelligence community in the United States thought it was 2027 when Xi Jinping expected his military to be ready to do it. Now, that's quite different from a political decision to actually mount this very chancey, very risky cross-strait invasion. And so I think that we need to get past 2027.

(33:41):

I usually hear the people who follow this hour to hour say things like, "It's the late 2020s, especially if Xi Jinping is beginning on yet another term in office that we need to worry more." And so he aspires to do it. He's made that clear. And so I think it's something we need to be very worried about, but we have a vote. We can make it so exponentially much harder to do by arming Taiwan, by working with our allies like Australia, Japan, and of course South Korea and the Philippines. They're setting the theatre, as we say, with more US naval assets, getting the permission system set up for our allies, with our allies so that they give us access to bases and agree to help us out.

(34:31):

If the balloon goes up against the Chinese, were they to invade, there's plenty of things we can do. We have an enormous to-do list. So I still think we might be able to deter them in the medium term, but for now everyone's focused on can the United States military get into a higher gear? Can we improve our defence industrial base, especially as it pertains to the Navy, submarines in particular, so that we might be ready? So we got a ways to go, but I think people are seized of the issue.

Arvid Streimann (35:03):

Okay. So it sounds like both sides are looking to increase their military posture in East Asia.

Michael Allen (35:09):

I think that's right. I think the Chinese are just juggernaut right now, and we have a long way to go. Ironically, the Ukraine War helped us because it made us realise just how acutely needy we were in terms of munitions and another bunch of other weapons systems we could get into. So we've started to ramp up the defence industrial base, but we've just uncovered that even if we wanted to spend a hundred billion dollars tomorrow on parts of our defence industrial base, it's just not that easy. You have to create the welders and the education system to support new workers in addition to dozens of other supply chain issues. So it's incredibly complicated. Lots of people are working on it, but it's to say the least difficult.

Arvid Streimann (35:53):

Yeah. And at the same time, Australia is apparently going to buy some high-end submarines off you guys, so throw that into the mix.

Michael Allen (35:59):

Well, that's a great... Yeah, I think that's got broad support, more or less here in Washington D.C. and so we value our friendship and partnership with Australia, and we've got to make good on all of these commitments.

Arvid Streimann (36:11):

Okay. So very, very last question. The people that are listening to this podcast, when they're not sitting in Washington D.C. they're reading the local press in Australia, okay, watching the TV. What are the two or three things that they might see on the TV with regards to China and Taiwan that if they saw it, they should go, "Okay, this is now happening. China's making a move," what would those two to three things be?

Michael Allen (36:34):

So I think you would begin, and I'm sort of as a national security guy, focused on some of the more tangible things, which I believe we would begin to see through our intelligence assets. I think we'd begin to see the, let's call it the correct military, parts of the military, move into a position closer to Taiwan. I think you would begin to see the movement of ships that could bring the troops across on our platform X, formerly known as Twitter. People are marvelling at a new Chinese invention, if you will, "the roll on roll off," I'd call them ships that can expand into an enormous bridge.

(37:14):

And you could have any number of military vehicles begin to use that instead of taking one of the hard to conquer ports. And so I think there would be a relatively long buildup of tangible, certainly visible military actions that the Chinese would need to undertake to get into a position to do this. We always think of D-Day here in America. This is immensely more complicated than D-Day. I think that we'll see it coming, but we've got a long way to go to where we feel like, you know what? We have set the theatre so much that the Chinese aren't going to do anything.

Arvid Streimann (37:52):

And let's just say that happens. You start to see the buildup. All the tanks are lined up that they've got these fancy new ships and you guys see it, you Americans see it, and you've got to make a decision. Do we fight or do we not fight? And so there's a potential here that all the Chinese have to do is to line up the ships. And if the Americans say, "We're not going to fight," then they just sort of float into the Taiwanese harbours and take it without any fight at all. Or in the other scenario, if you guys decide to fight, then that's an uglier scenario, and who knows who might win there. Do you think that the American public would support this? Where I'm going is, I ultimately need public support to go to war. Do you think the American public cares enough about this?

Michael Allen (38:33):

I don't think the American people care enough right now. I think that our politicians, our very senior statesmen, need to make a longer, more sustained case why Taiwan is important to the United States. The argument is complicated. I mean, it's a bit linear, but it has something to do with if the Chinese were able to take this crown jewel in the first island chain, they could begin to project their power outward and that they over time might seek to displace the United States, Australia, Japan, Korea, from this key economic crossroads. And over time, our freedom, prosperity, and security would come into some question, and it might usher in a decline in the West, which not only is of interest to people who want to see Western democracies win, but more importantly, I think it would be a real negative to our economies. And so that took too long to explain.

(39:33):

It might not even have been that persuasive, but we've got to break this down into a place where the American people understand that losing Taiwan would be really, if not existential, which is some people here have debated, it would be catastrophic to at least US interest, national security and economic, and then therefore we better spend what it takes to make sure that Xi Jinping when he gets up every morning and looks in the mirror, says, "You know what? I'm not ready to do this yet." The Americans have successfully planted so much doubt in my mind through their alliance system

and through the military, especially Navy purchases that they've been able to make. And I have enough of a doubt about whether they would come to Taiwan's aid in my mind. I'm ambivalent about it, so I'm not going to go for it. That's what we need to sow into his decision making process. We need to make him conflicted about this like he is now. And so keep him conflicted so that he doesn't eventually do it. I think that's the big question and you've put your finger on it.

Arvid Streimann (40:39):

Yeah. Okay, great. Well, we're certainly going to be watching this as investors because it'll have a material impact on markets if it was to actually happen. Even the standoff phase.

Michael Allen (40:48):

That's right. Yeah, I can imagine. So it's a rising issue. I think it's just going to remain a big issue. Most people are focusing on Russia, Ukraine, and the Middle East, but over time, Asia begins to climb the list in terms of national security issues here in Washington.

Arvid Streimann (41:04):

Yeah. So come to the end of the podcast. So I want to thank you again, Michael, for coming along. I thought we really enjoyed that chat, so we enjoy our chats every time we have them. So thanks for joining us.

Michael Allen (41:15):

Well, thanks so much for the invitation. I really enjoyed it, and anytime I would love to do it again.

Host (41:21):

That was Michael Allen in conversation with Magellan's Head of Global Equities and Portfolio Manager, Arvid Streimann. We trust you've enjoyed this episode. For more information on previous episodes, visit magellangroup.com.au/podcast where you can also sign up to receive our regular investment insights programme. Thanks for listening.

Important Information: Units in the funds referred to in this podcast are issued by Magellan Asset Management Limited ABN 31 120 593 946, AFS Licence No. 304 301 ('**Magellan**'). This material has been delivered to you by Magellan and has been prepared for general information purposes only and must not be construed as investment advice or as an investment recommendation. This material does not take into account your investment objectives, financial situation or particular needs. This material does not constitute an offer or inducement to engage in an investment activity nor does it form part of any offer documentation, offer or invitation to purchase, sell or subscribe for interests in any type of investment product or service. You should obtain and consider the relevant Product Disclosure Statement ('**PDS**') and Target Market Determination ('**TMD**') and consider obtaining professional investment advice tailored to your specific circumstances before making a decision about whether to acquire, or continue to hold, the relevant financial product. A copy of the relevant PDS and TMD relating to a Magellan financial product may be obtained by calling +61 2 9235 4888 or by visiting www.magellangroup.com.au.

The opinions expressed in this material are as of the date of publication and are subject to change. The information and opinions contained in this material are not guaranteed as to accuracy or completeness. Past performance is not necessarily indicative of future results and no person guarantees the future performance of any financial product or service, the amount or timing of any return from it, that asset allocations will be met, that it will be able to implement its investment strategy or that its investment objectives will be achieved. This material may contain 'forward looking' statements and no guarantee is made that any forecasts or predictions made will materialize. This material and the information contained within it may not be reproduced, or disclosed, in whole or in part, without the prior written consent of Magellan.