

January 18, 2022

What Would a U.S.-China War Look Like?

(Note: As we shift to a bi-weekly publication schedule for this report in 2022, we introduce the accompanying Geopolitical Podcast, now available on our [website](#) and most podcast platforms: [Apple](#) / [Spotify](#) / [Google](#))

We've written extensively about the worsening geopolitical tensions between the United States and China, which have already affected investors. For example, the Trump administration's tariffs on Chinese imports have skewed economic developments in each country. Businesses in each country have suffered, while others have benefitted.

Looking ahead, the risks are even bigger. It's important to stress that a U.S.-China war is not inevitable. On each side, the top leadership probably wants to avoid war. However, as each country flexes its muscles and pushes back against the other, there is a growing risk of miscalculation or mistake that leads to shooting and bloodshed. Even if the conflict became "World War III," it would not necessarily look the same as World War II. A conflict between today's two greatest powers would exemplify a new, unique form of modern warfare in terms of the domains in which it would be fought, the weapons utilized, the tactics and strategies employed, the alliances facing each other, and the goals pursued by each side. This report describes the likely lead-up to such a war and how it might be fought. As always, we wrap up with a discussion of the likely ramifications for investors.

The Lead-Up to War

If war eventually breaks out between the U.S. and China, the events and trends we are experiencing today would constitute the lead-up to that war. The present is prelude to any conceivable future. What we don't know is how long this prelude will last. Discernible trends in global politics, economics, technology, demographics, and military development suggest the most dangerous period will be the latter years of this decade, when China's overall national strength will probably have grown enough, relative to U.S. power, that Chinese leaders will feel emboldened to pursue their most cherished geopolitical goals.

China

Based on President Xi Jinping's public commitments and consistent rhetoric, we believe China in the coming years will keep building its military, economic, and diplomatic powers with the goal of eventually replacing the U.S. as global hegemon.

Xi's Vision and Goals. Since becoming China's leader nine years ago, Xi has eliminated all potential political rivals and consolidated his control over both the Communist Party of China (CPC) and the government. Xi's stated vision and goals for China are a key source of his power. Backed up by the nationalist teachings of Wang Huning, his "idea man," Xi is a true believer in China's greatness and his right to govern it. Xi's rhetoric amounts to a commitment he cannot easily abandon. In the coming years, we expect Xi to keep pressing for the following goals, all of which will create friction with the U.S.:

- The Great Rejuvenation of the Chinese Nation.*** Xi has stated many times that his primary goal is to achieve “the great rejuvenation of the Chinese nation.” By this, Xi means that he wants to restore China to the global position it enjoyed for most of its 5,000-year history, i.e., as the world’s most dominant state, most advanced culture, and largest economy.¹ Xi’s next interim goal is for China to become a “great modern socialist nation” by 2035, by which he means China will transition to healthier, more equal economic growth; become a leader in technological innovation; and transform its military into a “modern” fighting force. Under Xi, China is to achieve rejuvenation by 2049, at which point he sees China as “a global leader in terms of comprehensive national strength and international influence,” with a “world class military.”
 - China at the Center of Global Politics.*** Xi believes China’s rejuvenation will require changing the global governance system to make it supportive of Chinese development goals and interests and less obstructive of China’s authoritarian political system. Xi’s vision is to create a global “community with a shared future for mankind,” a tortured phrase that essentially means a global system of political economy in which China’s massive economic heft gives it sway over myriad countries that depend on it for their exports and capital.² Such sway would peel countries out of their U.S. security relationships, leaving the U.S. isolated and weaker.
 - Reunification with Taiwan.*** A key part of Xi’s rejuvenation is for China to regain its “lost” territories. China has already tightened its control over Hong Kong, but Taiwan remains elusive. Indeed, China’s clampdown on Hong Kong has made many Taiwanese wary of China and desperate for stronger ties with the U.S. [Xi has declared any Taiwanese move toward independence a red line, and he has threatened to retake Taiwan by force if necessary.](#)
 - East Rising, West Falling.*** [A final key belief for Xi is that China is developing and strengthening while the U.S. and its democratic allies are stagnating, fracturing, and weakening.](#) If China can maintain its current advantage in economic growth and military development, it would eventually match the U.S. or even surpass it in terms of “comprehensive national strength.” That would seemingly argue for China to maintain peace at all costs, since the country would ultimately develop the preponderant power needed to achieve its goals without bloodshed. However, much depends on Xi’s patience.
- Chinese Military Development.*** Driven by Xi’s vision of national rejuvenation, military modernization, and unification with Taiwan, China will almost certainly continue to pour resources into the People’s Liberation Army (PLA) in the coming years.
- Defense Budget.*** [The Stockholm International Peace Research Institute \(SIPRI\) estimates that total Chinese military spending, converted to U.S. dollars at market rates, grew at an inflation-adjusted rate of 6.6% per year in the decade ended in 2020.](#) In the same

¹ For a discussion of China’s national goals and strategies, see [Military and Security Developments Involving the People’s Republic of China](#). U.S. Department of Defense, November 2021.

² A deeper discussion of this concept can be found in Doshi, Rush. (2021). *The Long Game: China’s Grand Strategy to Displace American Order*. New York, NY: Oxford University Press.

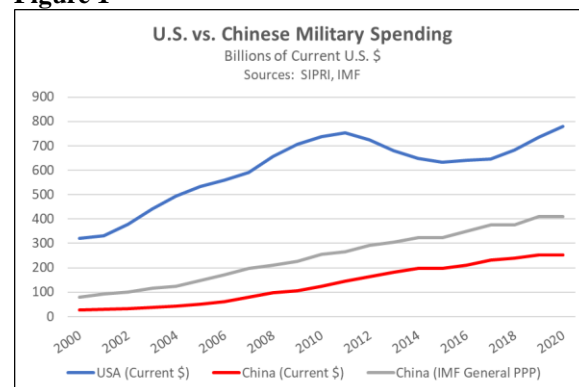
period, U.S. military spending *fell* at an average rate of 1.2%. According to SIPRI, China’s nominal defense spending in 2020 totaled \$252.3 billion, far less than the U.S. at \$778.2 billion. However, it’s important to keep in mind that China’s currency literally gets “more bang for the buck” because of subsidized prices and other economic differences. Data from the International Monetary Fund suggest China’s 2020 defense spending would equate to about \$403.7 billion in purchasing power parity terms (see Figure 1). That’s still only about half the U.S. figure, but it’s a lot when you consider that China can focus its military spending mostly within its own borders, while the U.S. has to spread its spending over an expensive, global set of military bases and international operations.

- **Weapon Systems.** China is focused not only on weapons acquisition and increased training and operations, but it is also making great strides in research, development, testing, and deployment of key military technologies, including offensive cyber and space weapons, [artificial intelligence](#) (AI), autonomous weapons, [hypersonic weapons](#), and [nuclear missiles](#). As a result, China will continue to grow not only the quantity of military assets it can throw at the U.S., but also the quality of those assets.

Espionage and Influence Campaigns. [The U.S. and its allies have become more aggressive at identifying and expelling China’s spies and agents of influence](#), but given that disinformation and public influence campaigns are a core part of China’s military doctrine, we expect the country to continue its efforts at spying, intellectual property theft, and utilizing agents of influence to bolster public perceptions of China or undermine

opposition to it. The U.S. will be a key focus for this effort, but China will also target key allies, such as Japan. It will also continue to focus this effort on Taiwan to neutralize its defensive capabilities and undermine the population’s will to resist unification with China.

Figure 1



Testing and Probing. President Xi is a man in a hurry. Rather than have China hide its strengths and bide its time so it can develop economically, as previous Chinese leaders had counseled, Xi has told his government to actively push back against the U.S. and its allies. Especially regarding Taiwan, he has adopted a policy of nearly continuous testing and probing of the island’s defenses. [In 2021, China frequently sent military planes into Taiwan’s air defense identification zone, forcing Taiwan’s air force to scramble and warn them off.](#) This effort probably aims to train Chinese air crews and expose weaknesses in Taiwan’s defense. It also probably aims to wear down and confuse the Taiwanese military to soften it up in the event of conflict. Naturally, the risk is that an air crew on either side could get an itchy finger or spark a collision that could increase tensions and lead to shooting.

United States

On the U.S. side, we also expect recent trends to continue in the coming years. However, many of the U.S. initiatives to counter China are little noticed or

understood by Americans. Ironically, U.S. efforts to strengthen its defenses and prepare for a fight with China will carry the risk of even greater tensions and the potential for accidental conflict.

Rebuilding U.S. Alliances. Given China’s enormous population and economy, and given the U.S.’s historic success at building alliance systems, we think the U.S. will continue to prioritize rebuilding its alliances in the Indo-Pacific region, even if political constraints probably preclude any new, formal defense treaties. [The Biden administration’s key defensive grouping will likely be the “Quad,” consisting of the U.S., Japan, Australia, and India.](#) Japanese and Australian officials have shown alarm at Chinese geopolitical designs and have already taken strong stances against China.

- **Japan.** [In 2021, a range of Japanese politicians, including former Prime Minister Abe, began to argue publicly that any Chinese aggression against Taiwan would gravely threaten Japan’s security and constitute a national emergency allowing for military action under the country’s pacifist constitution.](#) Newly elected Prime Minister Fumio Kishida [has even called for Japan to develop its own missiles capable of preemptive strikes against Chinese military bases.](#) Since controlling Taiwan would allow China to cut off Japan’s vital sea lanes, we expect Japan to continue boosting its defense cooperation with the U.S.
- **Australia.** Prime Minister Morrison has taken a tough, nationalist stand against China, [especially after his call for an investigation into China’s role in the coronavirus pandemic prompted a range of retaliatory trade restrictions by China.](#) Chinese spying in Australia has also made the government more concerned

over its vulnerability. In mid-2021, these concerns [prompted Australia to scrap a multi-billion-dollar deal to buy diesel submarines from France and instead buy nuclear-powered subs from the U.S. and the U.K.](#) In the coming years, we expect Australia to keep boosting its cooperation with the U.S.

Military Budget and Strategy. Because of the wind-down of its long wars in Iraq and Afghanistan, the U.S. defense budget so far reflects none of the increases one might expect from a growing geopolitical conflict with China. [However, Congress looks set to boost U.S. military spending 5% next year.](#) The new resources will help bolster belated modernization efforts in many of the same areas that China is targeting. [For example, U.S. Air Force General John Hyten, former vice chairman of the Joint Chiefs of Staff, claims China has conducted hundreds of tests of hypersonic weapons over the last five years, while the U.S. has only conducted nine.](#) Perhaps more importantly, the Department of Defense has started to dramatically shift its strategy to focus on the “near peer” competition from China. Even though many congressmen continue to push for more purchases of decades-old weapons such as the A-10 ground attack aircraft, the armed forces are having some success at fielding new cyber weapons and autonomous vehicles, such as a [jet refueling drone](#) and [drone supply ships.](#)

FONOPs and Other Assertiveness. To counter unrecognized Chinese territorial claims, the U.S. [continues to conduct “freedom of navigation operations” \(FONOPs\) in the seas near China.](#) We expect such operations to continue, even if they create increased friction with China.

War Itself

To reiterate, we believe U.S. and Chinese leaders want to avoid a shooting war. On

each side, such a war would entail enormous risks. In the U.S., voters have tired of the burdens required to maintain the country's global hegemony, especially after the long, costly conflicts in Afghanistan and Iraq. Even in authoritarian China, Xi would lose credibility if his shift from “hide and bide” to “build and assert” leads to a lost war. Besides, China's prior one-child policy means most Chinese soldiers, sailors, and airmen have no siblings. In a war with mass casualties, millions of Chinese parents would be at risk of seeing their only child killed. That alone could make Chinese leaders reluctant to go to war.

Despite the mutual desire to avoid war, we think there is a high risk of conflict, mostly because of Xi's aggressive efforts to build Chinese dominance in the Indo-Pacific region and beyond. Xi's efforts to assert Chinese power, along with continued U.S. pushback against those efforts, set the stage for accidental conflict or miscalculation at any time. Because of Xi's focus on reestablishing Chinese control over Taiwan, that is probably the most likely place for a miscalculation or accident to occur. [Indeed, *The Economist* last year called Taiwan “the most dangerous place on earth.”](#)

The War Begins. As we've written before, we doubt that Xi plans an outright invasion of Taiwan for at least the next several years. Such an invasion would be extremely risky. [However, there are less provocative steps that Xi could take to continue wearing down Taiwan's military and establish de facto control over the island.](#) He could order the PLA to occupy or blockade one of the many Taiwanese islands that lay just a few miles from the mainland (see Figure 2). Since many of those islands are lightly populated and within easy range of China's mainland-based military units, Xi might gamble that the U.S. and its allies would be unwilling to

fight for them. Another option would be a blockade or quarantine of Taiwan itself, on the assumption that the U.S. and its allies wouldn't be willing to fight without an outright invasion of Taiwan. The problem is that Xi may underestimate the political pressure U.S. leaders would face if they didn't take action. Similarly, since Chinese aircraft carrying out probing sorties near Taiwan and U.S. Navy ships carrying out FONOPs are heavily armed, there is always the chance that a pilot or sailor could open fire in panic or in hopes of creating a name for himself. A seemingly minor shooting incident could escalate into full-scale war.

Figure 2



Taiwan's Kinmen Island, literally swimming distance from China's port city of Xiamen. (Source: The Atlantic)

War in Space and Cyberspace. One novel aspect of a major U.S.-China war is that it would probably involve the world's first real conflicts in space and cyberspace. To set the stage for an aggressive move like seizing or blockading Taiwanese territory, the PLA may first use its newly developed laser, electronic, or kinetic space weapons to blind or destroy U.S. reconnaissance satellites. It might also try to preemptively take out the global positioning satellite system (GPS) that the U.S. military uses for navigation and targeting. Similarly, it may try to disable U.S. communications satellites. The more intense the conflict, the greater the probability that China would launch such a

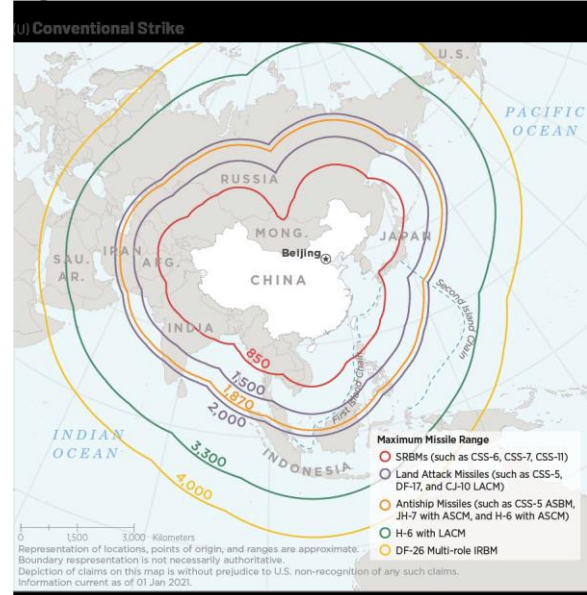
space war. Even without a major escalation, China would likely launch a concerted cyber attack against U.S. military and civilian targets, including in the U.S. itself. Besides directly impeding military or economic activities, such attacks could aim to undermine the U.S. population's will to fight. To that end, China could also use its cyber warfare skills to send targeted propaganda designed to cast China as a winner that can't be resisted or as a victim that should be mollified.

A New Kind of Island Hopping. Since a U.S.-China war would most likely be fought in the waters around Taiwan, it would primarily involve naval and air forces. Ground units would probably have only a minor role. Assuming the U.S. and its allies would be seeking to roll back Chinese aggression against Taiwan or some other territory in the region, the war would turn on whether China's military strategy of "anti-access/area denial" (A2/AD) can keep allied air and naval forces from attacking the PLA's landing units or resupplying Taiwanese defenders.

- **Chinese A2/AD.** Because of its major investment in A2/AD capabilities, China would have a big homefield advantage in any conflict near its shores. Importantly, its land-, air-, and ship-launched missiles have greater range than the carrier-based strike aircraft and other conventional air and missile systems fielded by the U.S. and its allies (see Figure 3). Like a boxer with arms longer than his opponent's, China could theoretically land punishing blows on allied ships and land bases in the region with relatively little risk of being hit in return. In addition, China's navy is now the world's largest, and most of it would be in the region to target allied forces. Not only does China have a large submarine force to menace allied ships, but it also

has submarines capable of launching nuclear missiles against the U.S. homeland. Faced with these threats, U.S. and allied forces could find it challenging to get within striking range of the Chinese aggressors.

Figure 3



China's key aircraft and missile ranges. (Source: U.S. Department of Defense)

- **The U.S. and Its Allies: Distributed Firepower and Archipelagic Defense.** Faced with China's robust ability to deny access to the conflict zone, the U.S. and allied militaries are now revamping their doctrines and warfighting concepts. The resulting strategy is still in flux, but we see a number of elements that could characterize warfare for much of the rest of the century. The following are some examples of those new elements:
 - **Distributed Firepower.** Military theory has long taught the value of concentrated firepower (picture those paintings of 18th-century riflemen firing in tightly packed formations). Large, heavy, expensive capital assets like aircraft carriers are the modern expression of that idea, but

such platforms are also vulnerable to modern missiles and other precision weapons. [The U.S. and allied militaries are therefore adopting “distributed firepower,” in which small, light, inexpensive weapons like drone aircraft and submarines fire from widely dispersed positions.](#) Because those weapons are widely dispersed, they may be harder for the enemy to target. Unlike a carrier, any that is hit and destroyed is only a minor part of the overall force.

→ **Networked Forces.** Distributed firepower dispenses with *concentration*, but it still requires *coordination*. A distributed force requires that all units are networked and operating in concert. For instance, the small but lethal drones mentioned above must be aware of each other, communicate, and operate in concert. Such networking also allows these assets to confuse and overwhelm the enemy’s defenses by “swarming.” The need for networked forces suggests the U.S. and its allies will keep investing in satellites, communications systems, supercomputing, and AI.

→ **Archipelagic Defense.** It will take years to reorient the U.S. military from big, capital assets like aircraft carriers and bombers to small, light, networked weapons. Meanwhile, with the risk that heavy U.S. assets like carriers couldn’t be brought to bear on a U.S.-China conflict without undue risk, the U.S. military is marrying distributed firepower with some traditional maritime assets. Its “[archipelagic defense](#)” strategy treats the various islands in the Indo-Pacific region as small, temporary bases [from which to](#)

[create A2/AD against China itself or stage hit-and-run attacks against Chinese forces assaulting Taiwan.](#) Japan has already [agreed to allow the U.S. to set up small, temporary bases on its southernmost islands in the event of war.](#) In addition, small Marine squads would be inserted across the many islands in the region to fire missiles at Chinese ships and shore batteries utilizing the concept of distributed firepower and networks for coordination. [To support this effort, the Marines are dramatically changing their weapons mix and training to become dedicated ship killers rather than territory seizers.](#) In fact, some Marine units assigned to the region [have had their artillery replaced by the military’s new anti-ship missile.](#)

Figure 4



Major islands near Taiwan (Source: WordPress.com)

Ramifications

Because of China’s growing preponderance of conventional weaponry in the waters off

its coast, it's impossible to guess what the outcome of a U.S.-China shooting war would be. All the same, we can say with certainty that a war between the U.S. and China would have a major negative impact on risk assets, while boosting the value of safe-haven assets such as gold and U.S. Treasury bonds. That is especially true given how difficult it would be for the U.S. and its allies to overcome China's A2/AD defenses and roll back a Chinese seizure of Taiwan. Facing China's advantage in conventional weapons in the region, and potentially facing the loss of a major asset like a big ship, the U.S. might be tempted to turn to its big advantage in nuclear weapons. Until China reaches something approaching nuclear parity with the U.S., that will remain the ultimate risk.

Still, the allies' evolving threat perceptions and military doctrines may hold

opportunities for investors. At the highest level, continually rising tensions between the U.S. and China will likely prompt continued defense budget increases. That would likely argue for taking a fresh look at U.S. and allied industrial firms and defense contractors. While the transition away from big, heavy legacy weapon systems would hurt some major contractors, the investment in new, smaller, lighter systems might offset that pain. Contractors or suppliers focused on software, communications, space, and other advanced technologies might see especially good opportunities. Historically, war and the preparation for war have created fortunes. The evolving competition between the U.S. and China could do the same.

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