US-China Trade Truce

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The White House announced that the planned 15th October tariff increase from 25% to 30% on USD 250bn of imports has been suspended in return for additional Chinese purchases of USD 40-50bn of US agricultural commodities, RMB transparency provisions and greater China market access for US financial services firms.

Our take – A preliminary truce

While this is a step in the right direction towards remediating trade tensions, we strongly caution market participants from reading too much into this preliminary truce.

Firstly, the details of the agreement haven't been hammered out yet and won't be for another month. Secondly, additional tariff increases are not off the table and can still expected – although it's more likely now that future increases will be delayed until 2020.

The Chinese local media has sounded more cautious and has characterized the actions over the weekend as "progress" being made. The word "deal" has not been used in media reports – Beijing clearly wants to keep expectations low.

President Trump has characterized the recent trade agreement as "Phase 1" out of 2 or possibly 3 phases. The US has said that Phase 1 could be signed by President Xi and President Trump as early as mid-November, during the G20 summit in Santiago, Chile.

Trump remarked that progress was made on thornier issues such as forced technology transfer and intellectual property – although it appears that these issues and the enforcement mechanism will be dealt with in later phases.

Future tariff increase will be predicated on how negotiations pan out in Phase 2. The negotiations in Phase 2 will certainly be more challenging and complicated than the issues addressed in Phase 1. I don't expect an easy outcome anytime soon – which means the threat of looming future tariffs remains around the corner.

Outlook

We have long argued that China has the upper hand in the trade dispute since Beijing can play the "long-game." China also doesn't have to worry about elections and the Chinese Communist Party controls monetary, fiscal and industrial policies.

President Trump on the other hand, faces an increasingly competitive reelection bid in 2020 and battling an impeachment inquiry, will most likely capitulate if US economic data and indicators deteriorate.

Tariff hikes and trade uncertainty has started to take a toll on the US and global economy.

Although US hard economic data in September remain buoyant such as the unemployment rate and retail sales, the soft data – often seen as future economic indicators – has weakened in areas such as corporate sentiment.

The Institute for Supply Management (ISM) recently reported that trade uncertainty is one of the reasons that has pushed the services PMI down to levels not seen since 2016. Trade uncertainty has also caused US manufacturing activity to contract to its lowest level in 10 years.[1]

[1] https://www.instituteforsupplymanagement.org/ISMReport/NonMfgROB.cfm?SSO=1

Investment Implications

The fog of trade uncertainty has thinned but it is far from having lifted.

We continue to recommend that investors remain diversified for the rest of the year and heading into 2020 – a year expected to be fraught with geopolitical and trade volatility.

Even though I don't expect a genuine trade deal anytime soon, the overall US-China environment has improved.

I continue to like China A-shares at these levels as valuations remain attractive, expectations for economic and earnings growth appear achievable and recent structural changes such as the elimination of foreign stake limited of Chinese security firms should bode well for investors with a long-term horizon.

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