

Market Bulletin

May 8, 2019

Do President Trump's trade threats spell doom for markets?

Market excitement about a resolution to the long-running U.S.-China trade dispute built ahead of (what were rumored to be) the final round of negotiations this week. However, comments from President Trump midday Sunday helped to dash that optimism. He threatened to raise tariffs further if negotiators do not speed up their progress toward a resolution. Chinese officials promptly threatened to delay and shorten their visit for these negotiations, or to cancel their trip altogether. Since these threats, China has agreed to a shortened meeting for deliberations later this week and the U.S. administration plans to move forward with raising tariffs this Friday.

This rise in tensions, in an already-fragile relationship, were not well received by markets, especially since many investors were expecting a resolution in the near future. China's onshore equity market (measured by the CSI 300) started Monday -3.5% down from its last trading session on April 30 (China's major bourses were closed last Wednesday through Friday for the Labor Day holiday) and slid a further -2.3% in Monday's session before stabilizing Tuesday. S&P 500 futures dropped 1.4% ahead of Monday's open and the index had fallen -2.1% by Tuesday's close.

This episode highlights that trade tensions are not truly resolved until a deal is signed, sealed and delivered. Until an agreement is finalized, investors will have to contend with large swings in sentiment based on the commentary of officials and rumors about closed-door deliberations.



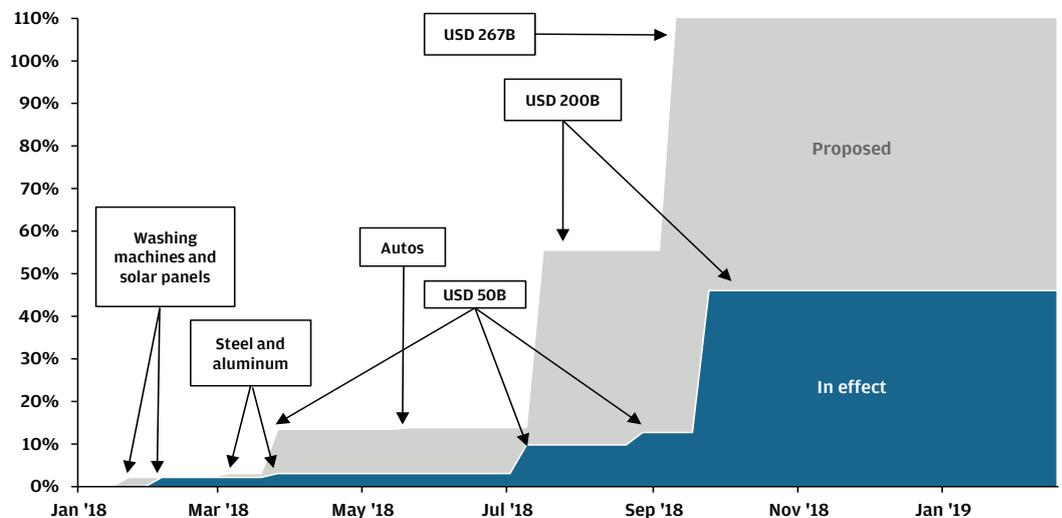
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EXHIBIT 1: U.S. TRADE THREATS OFTEN EXCEED ACTIONS

% OF CHINESE EXPORTS TO THE U.S., 2018 VALUES



Source: Bloomberg, Goldman Sachs, Politico, Twitter, U.S. Commerce Department, U.S. ITC, USTR, Wall Street Journal, J.P. Morgan Asset Management.
Guide to the Markets - Asia - On the Bench. Data reflect most recently available as of 05/07/19.

Currently, the U.S. charges tariffs of 10% and 25% on \$50 billion and \$200 billion of Chinese imports, respectively. In retaliation, China imposed tariffs ranging from 5% to 25% on almost all U.S. imports (roughly \$120 billion). These tariffs have had a cooling effect on trade between the U.S. and China, particularly in the agricultural sector, as China is one of the largest purchasers of U.S. farm output. Additionally, the products currently facing tariffs are predominately intermediate goods, which has raised producer costs across various industries.

As part of Sunday's comments, President Trump echoed threats made last year, threatening to raise the existing 10% tariff to 25% and to apply tariffs of 25% to all remaining imports from China (roughly \$293 billion, using 2018 import values). Other U.S. officials have since confirmed that they plan to implement the 'raising the tariff rate from 10% to 25%' portion of these threats this Friday. Applying new tariffs to all U.S. imports from China will take much longer, as new tariffs require a lengthy administrative process.

U.S. and Chinese policymakers have held several rounds of talks since the November 2018 G20 summit, when President Trump and Chinese President Xi Jinping last met to discuss trade. These talks have covered a wide range of topics, theoretically in the lead up to a broader trade deal between China and U.S. All policymakers insist they have made progress on a variety of issues, but some have noted that enforcement—or how the U.S. will ensure China complies with the agreement—remains a contentious issue. Notably, in the last round of talks, the U.S. apparently softened its language around cyber-theft, a key Chinese demand, smoothing the way for a final deal in the near future. However, the same round of talks ended acrimoniously after the U.S. side is rumored to have perceived China as backing away from commitments it made around removing State subsidies for certain industries, leading to the U.S. accusing China of renegeing on their deal, resulting in these latest threats.

Investment implications

In our view, reaching a deal by this Friday was too optimistic a timeline, especially given that a number of difficult issues reportedly remain under discussion. At the same time, progress does appear to have been achieved, and regardless of Sunday's comments, it is possible that the teams could have something ready for the heads of state to sign in June.

While many wonder about the motivation behind these latest threats, investors should remember that these leaders each have to deal with domestic political pressures and there is an advantage to be seen to be driving a hard bargain. We should all be wary of over-interpreting officials' commentary. However, the potential for more tariffs or that this trade dispute may drag on even longer is not a welcome development. Investors may want to buckle up for a volatile week.

We still expect negotiations to eventually result in a larger trade deal. At this point, the substance of such a deal is an open question, but harsher rhetoric catering to a domestic audience is unsurprising as policymakers get closer to a deal. Presidents Xi and Trump are likely to meet again in late June at another G20 Summit, which could be a natural venue for signing a trade deal. In the meantime, markets will react to rumors and rhetoric until we have something of substance to consider.

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Material ID: 0903c02a825be70e