Philequity Corner (October 14, 2019)
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A Truce!

Fund managers and traders were all glued to their TVs and mobile phones as they monitored developments heading into the October 10-11 meetings between the US and China. Conflicting news caused the market to go on a rollercoaster ride, with short term traders getting whipsawed as they tried to trade each new event.

Scary headlines

As the start of US-China negotiations drew closer, investors scanned the headlines of major business websites and TV channels. Unfortunately, what greeted them was a series of scary headlines which indicated that a trade deal was becoming less and less likely. A series of rapid fire developments in the past 2 weeks, from capital controls to human rights violations to satirical cartoons to the NBA, buffeted traders and bystanders alike.

Shock and awe

Throughout the week, opposing news from different sources on both sides of the fence greeted investors morning and night. This caused stocks to seesaw between gains and losses, leaving many investors in a daze. Though there are too many to list in this article, below are some of the most significant news articles which moved markets:

October 8 – US blacklists 28 Chinese surveillance firms and public security bureau, bans visas of officials involved in mass detentions, reiterates potential capital controls such as delisting of US-listed Chinese companies
Trump administration announced that it is blacklisting 28 Chinese surveillance firms and public security bureaus over human rights violations against Uighur Muslims in the Xinjiang region. This was released on October 8 while midlevel technical staff were having meetings and a mere 2 days before the start of high level negotiations. At the same time, they reiterated a previously reported discussion regarding capital controls (see *A fight for love and glory,* 7 October 2019). This could either be a poorly timed action or a deliberate act to create shock and awe that will pressure the Chinese.

October 8 - Later in the day, China indicates that it is ready to discuss a partial deal, but it expects no further tariff threats
Offsetting the scary headline above was news that China was offering a partial deal. Instead of a trade deal covering all topics, China offered to talk primarily about reducing the trade deficit with the US through the purchase of more agricultural products. However, this was contingent on the suspension of any tariff increase. China also refused to budge on Trump's main demands regarding intellectual property violations, technology transfers and industrial policy reforms.

October 9 – A major daily reports that the Chinese contingent led by Vice Premier Liu He is leaving 1 day early as midlevel talks held earlier in the week fail to bear fruit

This report from the South China Morning Post spooked markets, sending the Dow Jones index down more than 300 points as traders had to grapple with the possibility of tariffs being raised this week.

October 10 – "Big day of negotiations with China. They want to make a deal, but do I? I meet with the Vice Premier tomorrow at The White House." – Trump's twitter

With US equity indices dropping sharply, Trump felt compelled to react as he sees the stock market as a major barometer of his success. He tweeted that the trade negotiations will last 2 days, with Vice Premier actually coming to the White House on October 11. This, plus his suggestion that China is offering a deal, caused the market to erase its losses earlier in the week.

NBA gets dragged into the US-China trade war, cultural war

Even the NBA got dragged into the trade war when Houston GM Daryl Morey tweeted that he was supporting the HK pro-democracy movement. Though this October 4 tweet has since been deleted, the backlash was quick and decisive. In a matter of days, Houston Rockets merchandise had been removed from Chinese e-commerce websites and all of its Chinese sponsors had backed out. Despite Houston's star player James Harden trying to defuse the situation by saying "We love China", China remained adamant. It became clear that this trade war also transformed into a cultural and ideological war. In fact, Trump even admonished 2 NBA coaches for siding with China instead of him.

Very substantial phase one deal

Finally, the day of reckoning had come. Fortunately for investors, Trump had good news. He said the US and China had come to a "very substantial phase one deal". To be written over the next three weeks, it will address intellectual property and financial services concerns, along with purchases of $40-50 billion worth of agricultural products by China. Calling it a "tremendous deal" for farmers, he added that once Phase 1 is signed, Phase 2 will "start almost immediately." In exchange, Trump is suspending the October 15 increase in tariffs of 25% to 30%. However, he left the December 15 tariffs on the table as the subject of negotiations in the future. When asked what changed since April, Trump said that this deal is "bigger". When the same question was posed to Vice Premier Liu He, he simply leaned back and said "cooperation".

Is a trade truce enough?

Fortunately, rationality prevailed. Friday's truce marks the first significant de-escalation of the US-China trade war, which officially started on July 6, 2018, 12:00AM, Eastern time (see *It's Official– Trade War Begins*, 9 July 2018). The Dow Jones index rose more than 300 points last Friday. This was a big relief because the repercussions of an escalation in the trade war amidst a slowing global economy could be catastrophic. Even though this is just a partial deal and the details still have to be ironed out, this is at least a step in the right direction that caused markets to recover. However, the devil is in the details. Seeing how the trade war developed in the past year, it may either re-escalate or improve from here. Let us hope that the US and China follow through with a mutually beneficial

Phase One agreement that eventually leads to more de-escalation in the future. A successful Phase Two agreement that addresses major concerns of both sides may lead to a more lasting recovery for the global economy and normalization of financial markets.

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