



Philequity Corner (December 16, 2019)

By Wilson Sy

Signed, sealed, delivered

After more than a year of trade tensions and tariff wars, Trump signed-off on the phase one trade deal between the US and China. The agreement suspends a 15% tariff on \$160b of Chinese imports which were scheduled to take effect yesterday. The phase one deal prevents another escalation in the trade war which would have worsened an ongoing global economic slowdown. Moreover, the imposition of another round of tariffs would have caused the stock market to drop sharply.

They want it, and so do we!

Last Thursday, Trump tweeted, *“They want it, and so do we!”*, driving US indices to fresh all-time highs. Below is Trump’s tweet which summarized key details of the phase one deal.

“We have agreed to a very large Phase One Deal with China. They have agreed to many structural changes and massive purchases of Agricultural Product, Energy, and Manufactured Goods, plus much more. The 25% Tariffs will remain as is, with 7 1/2% put on much of the remainder. The Penalty Tariffs set for December 15th will not be charged because of the fact that we made the deal. We will begin negotiations on the Phase Two Deal immediately, rather than waiting until after the 2020 Election. This is an amazing deal for all.”

The phase one deal includes a commitment by China to stop intellectual property theft. Both sides have also pledged to refrain from purposely manipulating their respective currencies. Lastly, the US has agreed to scrap current tariffs in phases, contingent on China’s adherence to the deal terms.

No escalation

The most important portion of the phase one deal is the suspension of the 15% tariff on \$160b of Chinese imports. The tariff was supposed to be applied to consumer goods such as electronics, toys, clothing, and power tools. This gave rise to fears that the tariff may dampen US consumer spending and stoke inflation. There was also concern that it may hamper the US economy and worsen the ongoing slowdown felt in many major economies. Instead, the tariff cancellation is an important catalyst in restoring investor confidence and stimulating business spending.

Christmas gifts to the whole world

The phase one deal is the best Christmas gift for investors. The interim agreement stops another tariff escalation which would have been disastrous for the stock market. Aside from the phase one deal, there are other positive developments which came as early Christmas gifts. The better-than-expected jobs report highlights the underlying strength of the US economy. Meanwhile, the Fed’s forward guidance suggests that it will not hike rates in 2020, providing further support to the American economy. Boris Johnson and the conservative party’s election win, and the formation of a UK majority remove the chance of a gridlock in Brexit negotiations. This paves the way for discussions with Europe to finalize a trade deal and avoid a hard Brexit scenario.

PSEi weighed by revocation of water concession extension

The Metropolitan Waterworks and Sewerage System (MWSS) last week announced that it has revoked the contract extension of the two water concessionaires up to 2037. With the revocation, the concessions are now scheduled to end on 2022. It will be critical for the water concessionaires to determine how they will recoup their investments and pay down their debts if the concessions will not be extended beyond 2022.

The debacle has material consequences on the viability and survival of Maynilad Water Services Inc and Manila Water Corp (MWC), thus resulting in the steep declines of parent companies Metro Pacific Investments Corp (MPI), DMC Holdings, Inc (DMC), and Ayala Corp (AC). Since three of the four affected stocks are index constituents, their sharp drops have dragged the performance of the PSEi.

Singing and dancing while signing-off on trade deal

Trump appeared victorious and satisfied with the phase one deal as he was able to secure key concessions from China. He was probably singing Stevie Wonder's classic soul hit entitled "Signed, sealed, delivered" when he signed-off on the agreement. Below, we provide you with a few stanzas from the popular groove.

*I've done a lot of foolish things
That I really didn't mean, didn't I?
Seen a lot of things in this old world
When I touch them, they mean nothing, girl
Oo, baby, here I am, signed, sealed, delivered, I'm yours!
Oowee baby, you set my soul on fire
That's why I know you're my heart's only desire*

*Here I am baby
Signed, sealed, delivered, I'm yours
(You got my future in your hands)*

Signed, sealed, but will they deliver?

US indices ended flat last Friday as investors sold into news of the phase one deal. The general terms of the deal were signed-off by Trump but the legal text and the details have yet to be finalized. The phase one deal is targeted for signing by Trump and Xi in January next year. It remains to be seen whether both countries will deliver on the terms that they have agreed on. As we have seen in the past, Trump and Xi are capable of springing surprises that can spook the stock market.

Nonetheless, markets heaved a sigh of relief as another dangerous escalation to the trade war has been averted. This escalation would have caused the stock market to fall precipitously. Though many things can still happen and the details have yet to be ironed-out, the phase one deal is a step in the right direction. We believe that the agreement is still a win for the global economy and capital markets.

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