



Philequity Corner (April 9, 2018)

By Wilson Sy

Tit-for-tat

Last week, markets experienced another period of heightened volatility due to tit-for-tat tariff pronouncements from the US and China. The Dow swung wildly throughout last week on concerns regarding the escalating trade conflict between the two biggest economies in the world.

Tweeter-in-chief

Instead of referring to Trump as commander-in-chief, fund managers now jokingly call him the tweeter-in-chief due to his incessant tweeting. Trump's tweets usually cause a lot of noise as he routinely attacks specific individuals, sectors, organizations or even countries. Below, we show some examples of Trump's recent controversial tweets regarding the trade battle with China.

1. *"When a country (USA) is losing many billions of dollars on trade with virtually every country it does business with, trade wars are good, and easy to win."*
2. *"We are not in a trade war with China, that war was lost many years ago by the foolish, or incompetent, people who represented the U.S. Now we have a Trade Deficit of \$500 Billion a year, with Intellectual Property Theft of another \$300 Billion. We cannot let this continue!"*

"We have no alternative but to fight back"

In an interview with CNBC last Tuesday, Cui Tiankai, China's ambassador to the US, directly responded to Trump's proposed protectionist policies. Below, we list pertinent quotes from Mr. Cui.

1. *"We have done the utmost to avoid this kind of situation, but if the other side makes the wrong choice, then we have no alternative but to fight back."*
2. *"We are always ready to continue and intensify our dialogue and communication with the U.S. side on any possible economic or trade issues, but we need reciprocity. Our goodwill has to be met by the same degree of goodwill."*
3. *"Such protectionism will not protect anybody. It will not protect American workers or American farmers. It will not protect American businesses or American consumers. It will hurt everybody including the U.S. economy itself."*
4. *"In today's global economy, almost everything is interconnected... so when people take some protectionist measure, it will hurt people's confidence in the overall prospects for the economy. It may hurt finance, it may hurt trade, it may hurt economic performance, it may hurt consumer confidence — everything."*

"It is only polite to reciprocate"

Instead of using the word 'retaliate', China wisely used the word 'reciprocate' to respond to Trump's trade provocations. Though it does not favor a trade war with the US, China stated that "it is only polite to reciprocate." China's reciprocal tariffs include an initial list on \$3b worth of US products and an additional list on \$50b of American goods, including soy beans, cars and chemicals. These developments escalated the trade conflict between the world's two biggest economies, thus causing global markets to gyrate wildly last week.

President Xi vs. President Trump

Many are wondering who will win a trade war between the US and China. To properly analyze who will win the ongoing tit-for-tat, one must study the two leaders and main protagonists in this battle – President Xi and President Trump. It is important to understand their strengths and weaknesses and the sources of their power. On the one hand, Trump has to navigate through a four-year term and mid-term elections that will determine the fate of his Republican allies. Moreover, Trump has to deal with other contentious issues such as opposition to his policies within the US government, a potential impeachment and the Stormy Daniels scandal. On the other hand, Xi Jinping is China's president for life and has absolute control over the Chinese bureaucracy and economy. In addition, China's reciprocal actions and statements have been well-calibrated, thus showing that the Chinese government is firmly in control. In contrast, the actions of the US have been based on Trump's spur-of-the-moment responses and random rants in Twitter.

China's ace up its sleeve

Many have commented that the tit-for-tat battle that Trump is waging may end up hurting the US economy more. It appears that China has many tools to hurt the US. Most importantly, China has an ace up its sleeve which it has not used yet. China is the biggest buyer and holder of US Treasuries. Thus, any moves by China to drastically reduce its Treasury purchases or sell down its current holdings may have disastrous effects on the US economy and global financial markets.

Timely pivot to China

Considering recent global developments, it appears that the Duterte government's pivot to China is timely. Before, the Philippines was identified as a staunch US ally and was antagonistic against China. Our country has recently re-established friendly ties with the biggest country in Asia as the government seeks to tap China as a potential partner for many infrastructure projects. In this light, the Philippines is currently in a more neutral position in terms of geopolitics.

Win-win or lose-lose

We agree with the assessment of many economists that a trade war will be a lose-lose scenario for everyone, including the Philippines. This can be seen with how global markets react to the prospects of a trade war. At present, there are questions about how far the tit-for-tat between the US and China will go, which sectors will be affected and how economic growth will be undermined. The fear of the unknown has weighed down on recent stock market performance as uncertainty creates volatility. We thus hope that a win-win solution can be crafted and the trade provocations do not escalate further. Otherwise, everybody loses in a trade war. This has been clearly manifested in the heightened volatility and recent weakness of global stock markets.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 689-8080 or email ask@philequity.net.