



## **INVESTMENT NOTES - May 21<sup>st</sup>, 2019**

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We apologize for the absence of investment notes last week. We were travelling to London to participate in the Templeton Round Table where some of the smartest investors in the world voice their best ideas and outlook for the market. We wanted to share that with you....

But first- China....President Trump keeps stating that if the Fed dropped US interest rates, the trade war with China would be over. Why does he believe that? China is at much greater risk in a trade war than the US since America imports about \$560B from China annually while China imports \$180B from the US. Therefore the US can place tariffs on Chinese goods by a far greater amount than China can in retaliation. Is this the right way to look at this risk?

Near term, US consumers will pay higher costs for imported Chinese goods until they find substitutes. Demand for Chinese goods will fall potentially bankrupting Chinese exporters. One needs to wonder however, if this is the Chinese government's plan as 90% of Chinese exports are manufactured by private Chinese companies. Since Xi has come into power, the Chinese government has reversed its policy to promote private enterprise and has encouraged lending to and investment in, SOEs or state owned enterprises. Xi seems to think the private sector had grown too large.

US companies which have been manufacturing in China will re-locate, some of them back to America where supply lines are shorter and Opportunity Zones offer low cost/low tax/ investment opportunities. Plus there is plenty of labor in low tax states such as Texas and Florida. Craftsman, the tool manufacturer, has already decided to move back. For a number of companies, leaving Chinese production and supply chains intact, will be financially unreasonable, if they come to the view the current trade policy will remain.

This will lead to the US 'winning' the trade war. Tariffs increased US corporate costs and dampened demand but the tax cuts of 2018 and perhaps low interest rates will restore cash flow. It is interesting that the trade war didn't get started until the tax law was passed.

China knows this, that is why they have been busy with the New Silk Road initiatives and trade talks with other nations such as Pakistan and Italy. Beijing received a hint of what was going to happen when ZTE nearly went bankrupt and Xi appealed to President Trump to help. China will not let Chinese companies go bankrupt and billions of dollars in investment and jobs leave China in a vacuum. More will be done to reverse US trade policy but the damage can be reversed if it is 1.5 years but not if it is 6 years. Are the Chinese willing to gamble on Trump leaving office?

Politicians in the US are united on China trade policy. The New York Times is even endorsing Trump's approach in Thomas Friedman's latest article. There is one exception, Joe Biden has said that China is the US' friend, not our enemy- by doing this Biden has set himself apart. Will China back Joe Biden's election bid? The bigger the stake a foreign country has in how America behaves, the more likely it is they will use every kind of influence available to them.

Next week: the long view of the smartest investment managers in the room....