

## ASI 2019 - UNDERSTANDING THE US-CHINA TRADE RELATIONS AND ITS IMPACTS TO INVESTMENT

September 2019

For professional investors or advisers only

# Trade friction resurfaces

## Amount of trade tariff

Category list	Phase I	Phase II		Phase III
	6 Jul & 23 Aug 18	24 Sep 18	10 May & 1 Jun19	Est in Q3
<b>Amount of goods (USD mn)</b>	50,000	250,000	250,000	500,000
<b>Incremental amount of goods (USD mn)</b>	50,000	200,000	0	300,000
<b>Additional tariff rate (%)</b>	25%	10%	25%	10%
<b>Additional tariff (USD mn) - Incremental</b>	12,500	20,000	30,000	30,000
<b>Additional tariff (USD mn) - Total</b>	12,500	32,500	62,500	92,500
	<b>US Export to China – Tariff Scenario</b>			
<b>Amount of goods (USD mn)</b>	50,000	110,000	110,000	130,000
<b>Incremental amount of goods (USD mn)</b>	50,000	60,000	0	20,000
<b>Additional tariff rate (%)</b>	25%	7.50%	10-25%	25%
<b>Additional tariff (USD mn) - Incremental</b>	12,500	4,500	6,300 <sup>1</sup>	5,000
<b>Additional tariff (USD mn) - Total</b>	12,500	17,000	23,300	28,300

## China exports

	US\$50bn	US\$200bn	US\$300bn	Total
<b>Exports to US, % GDP</b>	0.41	1.63	2.45	4.5
<b>Total export share</b>	2.19	8.77	13.1	24.1
<b>25% Tariff, % GDP</b>	0.10	0.41	0.61	1.1

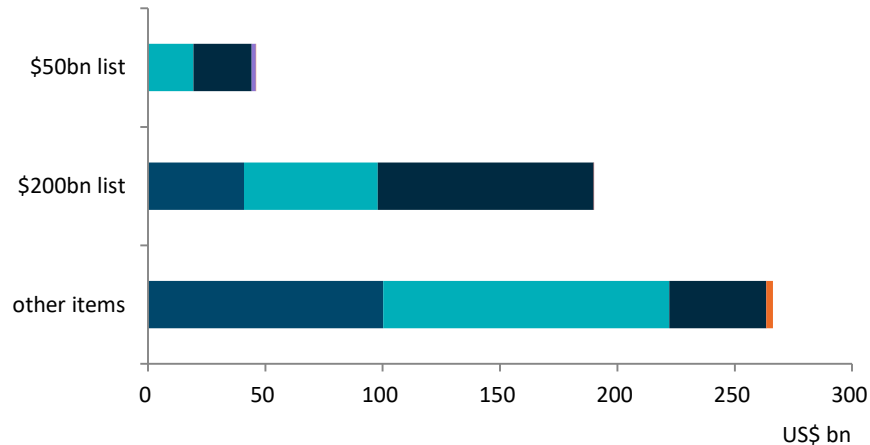
• Source: National source, JP Morgan, Schroders, August 2019

• 1. Using the rate of 18% (average of 10%, 20% and 25%) minus the existing rate of 7.5% to arrive the additional tariff

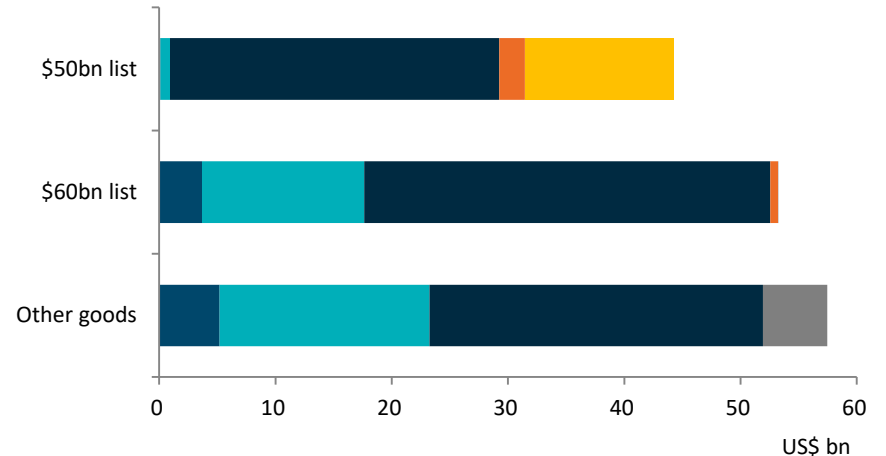
# U.S. imports from China vs. China imports from the U.S.

The latest round of tariff will have more impact to the US consumers

U.S. imports from China – consumer goods represent a big portion



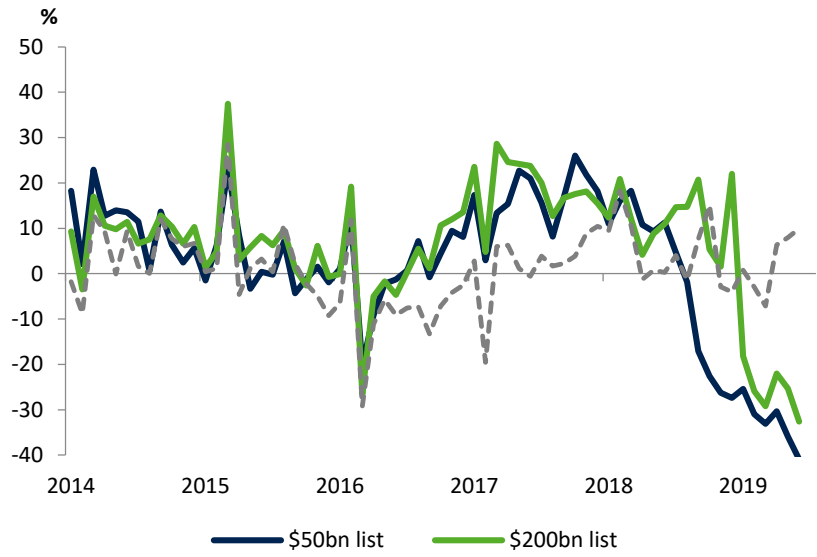
China imports from the U.S. – percentage of consumer goods is relatively insignificant



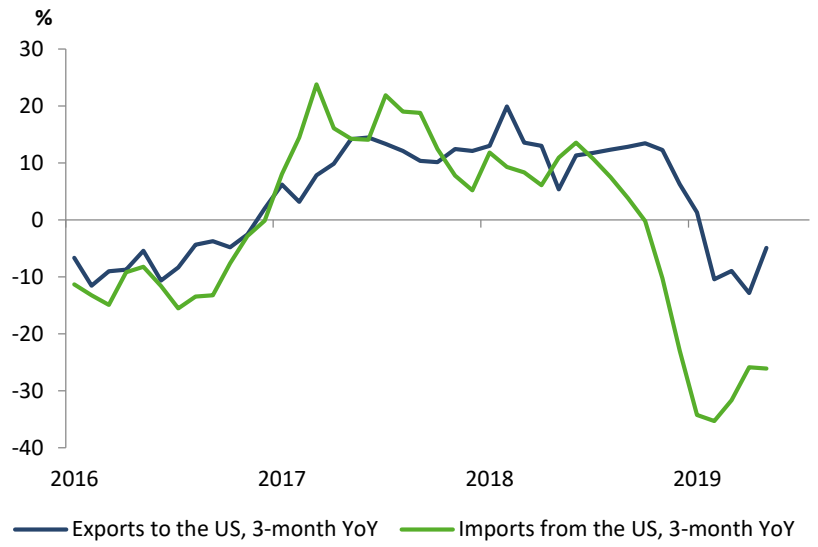
# The effect of additional tariff kicking in

China's import from the U.S. fell faster

US's import of Chinese goods that subjects to additional tariff dropped drastically in Q1 2019



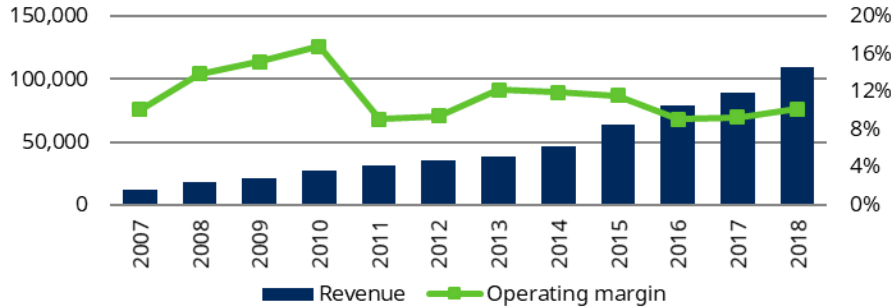
China's import from the US is falling at a much faster rate



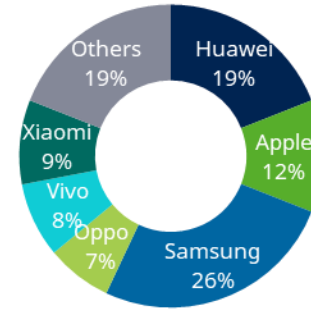
Source: US Census, USTR, CICC research, June 2019 (May 2019 for chart on RHS)

# Huawei ban – disruptive for technology supply chain

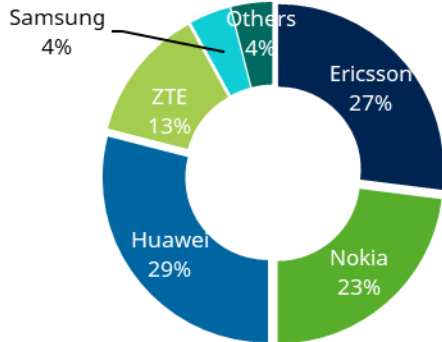
Huawei has grown sales 7x to over US\$100bn over the past decade



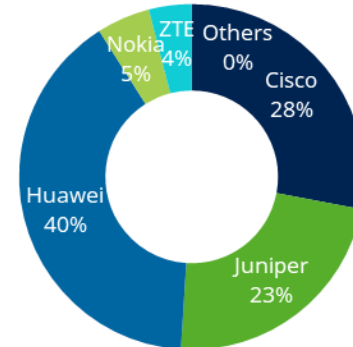
Huawei at 19% smartphone share in 1Q19



Huawei at 29% wireless radio share in '18



Huawei had 40% core routing share in '18



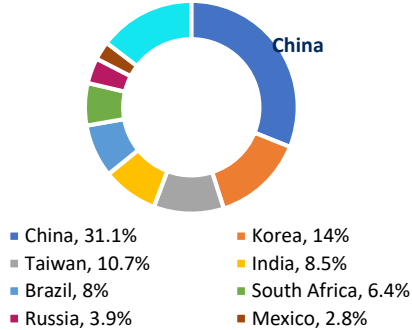
# Government policy responses

A combination of anti-cyclical and structural policy responses to counter the challenges

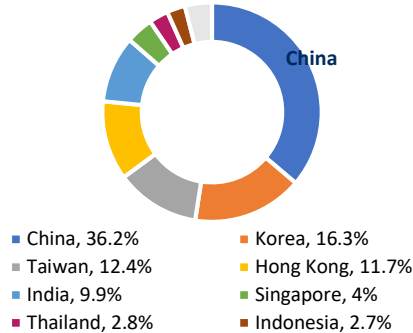
Near-term anti -cyclical policy responses	Long-term structural changes needed
<p>Accommodative monetary policies</p> <ul style="list-style-type: none"> <li>• RRR cut</li> <li>• Interest rate reform (LPR)</li> <li>• Favourable lending policy for SME</li> </ul>	<p>Further opening up of the domestic markets</p> <ul style="list-style-type: none"> <li>• Open up of domestic markets to foreign players (e.g. auto)</li> <li>• Financial market reform and development (e.g. relaxation of foreign ownership in financial institutions, Stock Connect, Bond Connect, RQFII etc.)</li> </ul>
<p>Supportive fiscal policies</p> <ul style="list-style-type: none"> <li>• Value-added tax and personal income tax, and social security payment cut (Rmb2tr package)</li> </ul>	<p>Moving up the value chain</p> <ul style="list-style-type: none"> <li>• Increase R&amp;D spending (e.g. IT , Pharm)</li> <li>• Encourage development of high-tech, higher value product industries</li> <li>• Potential relocation of lower value added industries offshore and diversification of supply chain</li> </ul>
<p>Fixed asset investment boost</p> <ul style="list-style-type: none"> <li>• Infrastructure investment and 5G investment</li> <li>• Financed by local government bonds - special purpose bonds (Rmb2.15tr) / general purpose bond ( RMB 930bn in 2019)</li> </ul>	<p>Urbanization</p> <ul style="list-style-type: none"> <li>• Hukou relaxation</li> <li>• Development of city zone structure (Greater Bay zone)</li> </ul>
<p>Currency flexibility</p> <ul style="list-style-type: none"> <li>• Currency depreciation?</li> </ul>	<p>SOE reform</p> <ul style="list-style-type: none"> <li>• Mixed share ownership scheme</li> <li>• More management share ownership schemes to align with interests of management with minorities</li> </ul>

# China is punching below its weight

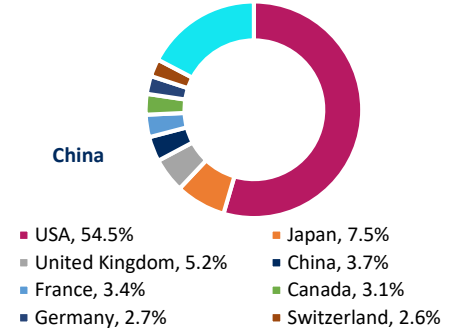
MSCI EM index  
country weights



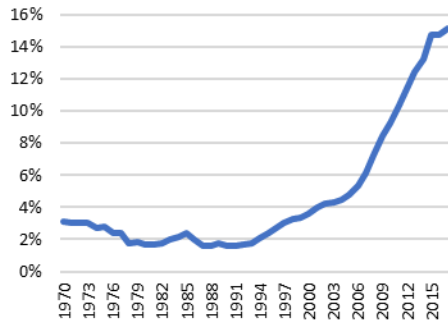
MSCI AC Asia x Japan index  
country weights



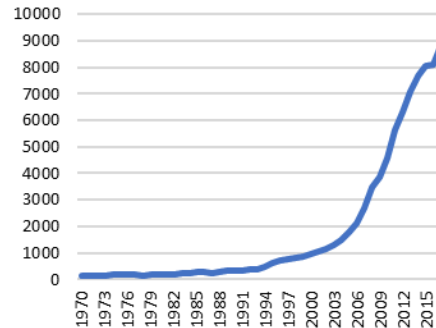
MSCI AC World index  
country weights



China GDP (% world)



China GDP per Capita



China Market Cap (% GDP)

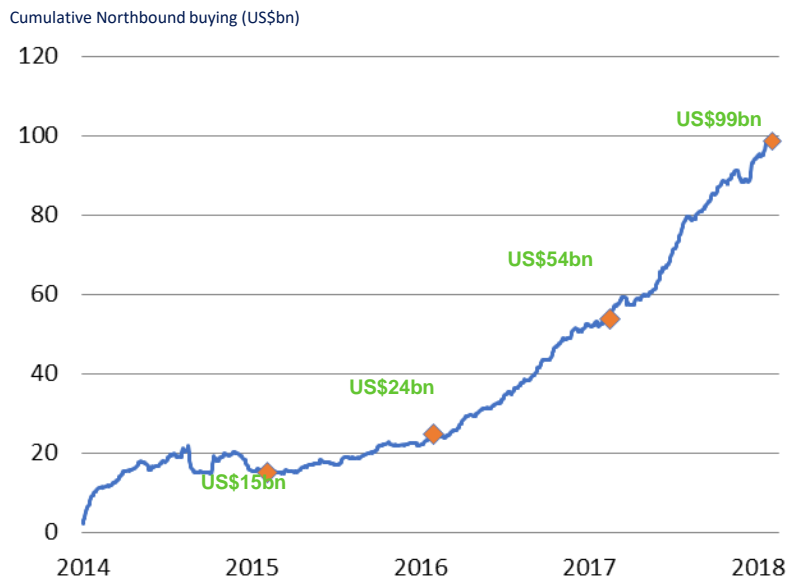


Source: MSCI. Percentage weightings as at 31 January 2019. Refinitiv, World Bank WDI, at December 2017

# But this is about to change

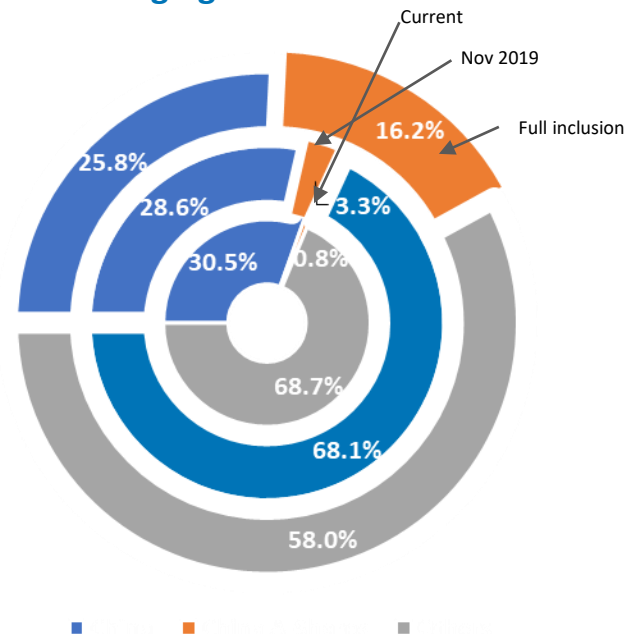
Continued interest into A-share market with inclusion into globally followed indices

## Northbound flow into China A shares<sup>1</sup>



<sup>1</sup>Source: Bloomberg, Goldman Sachs, January 2019

## MSCI Global Emerging Markets Index \*



Source: Schroders and MSCI, Data as at 22 January 2019.

\*At 5%, 20% and full inclusion of China A shares into the respective indices



# China A – can provide diversification benefits

A stand-alone China A-Share allocation can result in a more efficient EM portfolio

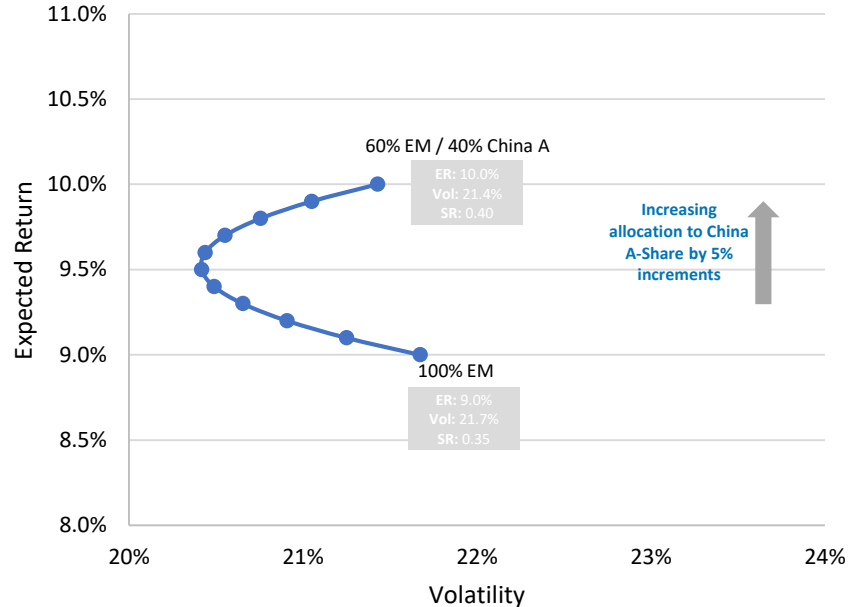
Monthly correlations: Jan 2001 – Jan 2019

	MSCI World	MSCI EM	MSCI ACWI	MSCI Emerging Asia	MSCI Asia ex-Japan	MSCI EM ex-China	MSCI China	MSCI China A-Share
MSCI World	1.00							
MSCI EM	0.85	1.00						
MSCI ACWI	1.00	0.88	1.00					
MSCI Emerging Asia	0.80	0.97	0.83	1.00				
MSCI Asia ex-Japan	0.82	0.97	0.85	0.99	1.00			
MSCI EM ex-China	0.85	0.99	0.88	0.95	0.95	1.00		
MSCI China	0.70	0.83	0.73	0.84	0.85	0.77	1.00	
MSCI China A-Share	0.35	0.43	0.37	0.45	0.46	0.38	0.56	1.00

EM = Emerging markets, ER = Expected return, Vol = Volatility, SR = Sharpe Ratio.

Source: Bloomberg, Schroders. Based on returns for an unhedged USD investor. Volatility and correlations expressed using monthly returns from 31 January 2001 – 31 January 2019. Start date limited to inception of the MSCI China A-Share index (31 December 2000). Expected returns based on 10-year return forecasts by Schroders Multi-Asset Quantitative Research team, please see Assumptions in the appendix for more details.

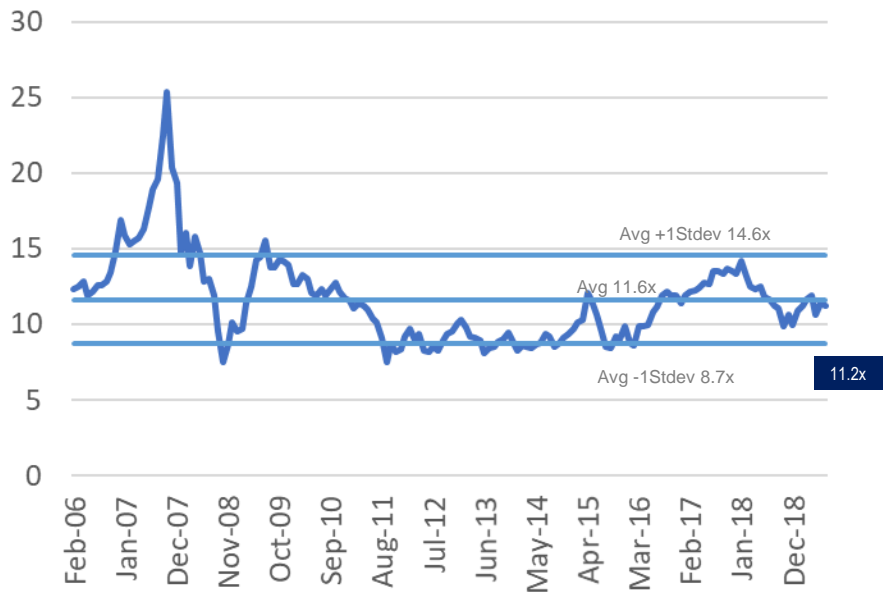
Risk / return impact of including China A-Share



# China Valuations

China A shares still trading below long term average

MSCI China Forward PE (x)



MSCI China A Onshore Forward PE (x)



Source: Factset, as at 31 July 2019

# Key concerns about China

1. **Sino-US conflicts** – not purely just trade conflicts, but ideological confrontation
2. **High debt situation in China** – repairing China balance sheet will take time
3. **Structural reforms** – more resources allocating to private instead of public, liberalization of industries, SOE reforms
4. **Demographics** – can productivity gains offset deteriorating demographics?
5. **Managing stable currencies** – balancing the impossible trinity

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