

State of the Markets: Macro Commentary

90 Days...

Sounds like a Hollywood summer blockbuster...just need Tom Cruise. So, can China and the US will agree on changes in Chinese economic policy that will lead to the end of the China/US economic war in the next 90 days. OK. I guess that could happen. Clearly the markets give some non-zero probability to that event given the market move today. I however believe that probability is zero. That is a silly time scale to have China change an economic policy almost 40 years in the making. Not happening. Not on in 90 days, 9 months or 9 year. China will continue to move their command and control economy on a path to move up the food chain in economic development to bring their economy to a par with advanced economies. China's path is, of course, reasonable, the real question is not the ultimate goal but rather the timing of their achieving that goal. There's the rub. The "made in China 2025" pushes their economic agents both public and private to achieve those goals in a nano second in economic development terms. The clock is ticking and there is now only 7 years left to get their companies to produce the technology to replace 70% of the technology that is current imported, e.g. planes, trains, automatable, chips, robotics, and AI. Given this time frame, can they do it without forced technology transfer, stealing of technology, or massive state support of state entities? Seems unlikely in reality but does reality really matter in terms of markets? On a fundamental basis, I believe it does because it drives outcomes, and think that is the reality that markets will reprice to. First let's look at the first embers of "concession" by the Chinese.

China is going to buy more soybeans.

Not a concession despite the hype. China needs US soybeans. They buy $\frac{3}{4}$ of all the exported soybeans in the world, and the US comprises $\frac{1}{3}$ rd of the export market. So, doing the algebra leads one to the conclusion that the non-us world cannot meet that demand. Argentina seems to have understood that dynamic and is buying us soybeans to sell to the Chinese. Capitalism at work.

China is going to reduce tariffs on US exports of cars into China. In addition, eliminating the foreign ownership restriction on manufacturing of autos.

Again, not a real concession. They don't need US cars they have taken advanced economy auto production processes and will start selling Chinese cars into the US market in the next few years. Also, it's not going to help US auto companies that are producing cars already in China. I call US auto companies "dead man walking": what Japanese auto companies could not do, the Chinese companies will do. Only a matter of time, but not a real concession.

What else could they offer?

China will allow Visa and Mastercard into China electronic payment market

Oh, ya. They already agreed to that when they were allowed into WTO in 2001. But, agreeing is not doing, as will become clear with any Chinese agreements. So, what did China do? China created barriers that prevent

Visa/Mastercard from entering the Chinese market until the Chinese state-owned company, UnionPay, became the dominate provider and only provider. The US entered a dispute with the WTO in 2010, that the US won in 2012 but by then it was too late.

China is allowing majority foreign ownership of financial institutions

Having access to the banking markets in China is similar to catching a falling knife given the likely path of NPLs in the next few years. More importantly, the profitability of non-china financial institutions is not majority ownership it is having access to the lending market. This market is largely determined by who you know (princelings) rather than the credit quality of the loan.

China will allow Google and Facebook unfettered access into China

I know, low lying fruit....

China will start buying super computers from US producers

Too late again since US produces already sold their Chinese production to Chinese companies since Chinese state run or government agencies would not buy US produced supercomputers. So, US market share from $\frac{3}{4}$ of the market to zero.

Ultimately, the real question for markets: does it matter if Trump declares victory and goes on to his next oppression? I think it does. I argue three points that market is missing in this scenario.

One. The economic die is cast.

Trump declaring victory does not change the slowing path of the world economy in the near term. Pretty much whatever the Chinese do in terms of stimulus world growth will slow and that will weight on policy makers and asset markets.

Two, there is a bipartisan view on China behavior that goes beyond Trump view.

Even with Trump declaring victory may not change US policy towards china, and, in fact, could escalate the rhetoric.

Three, Xi and Trump are not Tom Cruise so don't look for a happy ending at the end of the 90 days.

Copyright (c) SOM Macro Strategies. 2018 All rights reserved. The information contained herein has been obtained from sources believed to be reliable, but is not necessarily complete and its accuracy cannot be guaranteed. No representation or warranty, express or implied, is made as to the fairness, accuracy, completeness, or correctness of the information and opinions contained herein. The views and the other information provided are subject to change without notice. This report has been created without regard to the specific investment objectives, financial situation, or particular needs of any specific recipient and are not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not necessarily a guide to future results. Company fundamentals and earnings may be mentioned occasionally, but should not be construed as a recommendation to buy, sell, or hold the company's stock. SOM Macro Strategies accepts no liability for any damage caused by any virus transmitted by this company's emails, website, blog and Apps.