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EXCUSES… AND EXECUTIVE ORDERS

With the Presidents Trump – Xi first meeting completed, many investors in Asia are breathing a sigh of relief; although there were no major break-throughs neither was there anything that could be interpreted as overt hostility.

Indeed, as many anticipated, President Xi came bearing gifts in the form of better US access to both the financial markets and US beef exports.

In reality, these were easy concessions to make; China had already been in advanced discussions with the Obama administration about raising the ceiling on foreign ownership of various financial institutions and was already willing to ease its 2003 ban on US beef imports.

With no apparent talk about currency manipulation, peace has broken out, at least while the 100-day assessment period is in play.

Against this backdrop, there could be some important (but overlooked?) implications for China in President Trump's 31 March, executive order assessing the causes of the US trade deficits.

While the order seems focused on preparing the grounds for renegotiating the North American Free Trade Agreement (with both Canada and Mexico), it could also be the template by which further trade pressure is exerted on China – if the Trump administration chooses to do so.

Overall, the order mimics the cries heard during Mr. Trump's election campaign; "reciprocity", "unfair disadvantage" and the concept of a "level playing field" emerge in various guises.

It is possible that Mr. Trump could use the resulting report to justify his use of executive authority; under Section 301 of the 1974 US Trade Law, for example, he could impose retaliatory tariffs or import restrictions in response to foreign trade practices deemed to hurt US commerce without seeking Congressional support[1].

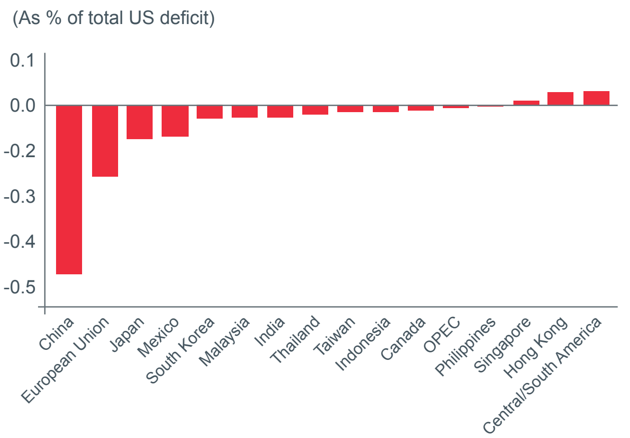
Should trade war tensions rise after the 100 days are up, the impact on China could be less than many fear; China's exports to the US account for around 6% of GDP while some 85% of listed company sales are internal - although individual sectors (e.g. office and data processing machinery, and telecoms) would undoubtedly be hit.

From an Asian investor's point of view, it is worth noting that China's 14% rally this year has pushed the prospective price earnings ratio up to 12½X – its highest level since 2010 and a level it has tried to break (unsuccessfully) two times since 2015. Though high, this value has reached 15¼X (and higher) in the past.

If traders were to look for excuses to "lock in" some trading profits, Mr. Trump's executive order and its associated trade fears could fit the bill just nicely.

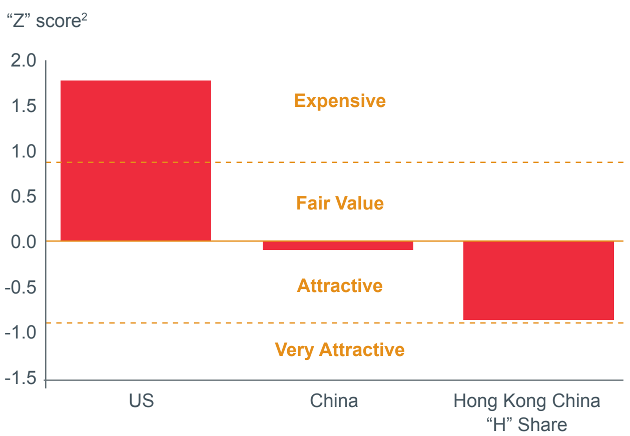
But as Figure 2 below illustrates, China still looks attractive. As long as there is obvious value to be found, it will likely take more than trade war fears to crimp China's rally.

Fig 1. Trade war fears will not fade easily. China accounted for nearly half of the US' trade deficit in 2016.



Source: IMF Trade Statistics from Datastream as at 10 April 2017

Fig 2. Good to fair value still to be found in China



Source: Eastspring Investments, MSCI and IBES from Datastream, 10 April 2017.

1 Whether Mr. Trump would do this is debatable; the Republican-led Congress appears to have less stomach for approving broad-based tariffs on the scale threatened by Mr. Trump and given his lack of success in the health care bill, he may decide he needs friends. 2 The "Z" valuation is a composite measure giving equal weighting to the variation of the historical price to book ratio from its long-term trend and the variation of the prospective price earnings multiple from its long-term trend over a 12-year period. The two outer dotted lines represent the limits within which around 70% of all world values lie.

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