U.S.-China Trade: Risks and Opportunities for Investors

Manager Call with Canterbury Consulting and Matthews Asia's Andy Rothman

On September 4, 2019, Andy Rothman, China Investment Strategist at Matthews Asia, presented his outlook on China. He discussed the potential risks of the Hong Kong protests, the U.S.-China trade dispute, and the health of the Chinese economy. Despite negative public sentiment, Andy was confident that the U.S. and China would reach a trade resolution given each side's incentives. The following notes summarize the comments made by Andy Rothman. The views are those of Mr. Rothman and do not necessarily reflect the views of Canterbury Consulting.

Hong Kong Turmoil

- Street protests are a common occurrence in Hong Kong as a means for the people to communicate with their government.
- Half of the protesters are in their twenties, but there are many older participants as well.
- Leaders of the Communist Party in Beijing recently made a concession to withdraw the controversial extradition bill.
- This recent move signals that Carrie Lam, Hong Kong's Chief Executive, is aware of broader political, economic, and social issues, and that they will be addressed effectively.

U.S.-China Relations

- A deal will likely be reached in the near future as U.S. President Donald Trump and Xi Jinping, the General Secretary of the Communist Part of China, are each motivated for different reasons.
    - President Trump understands that a deal improves his re-election prospects.
    - Xi knows that China is dependent on the U.S. for its supply of semiconductors.
- Tariffs do not give the U.S. leverage over China because China is not export-led. In 2018, net exports from China declined while domestic consumption accounted for 76.2% of China's GDP growth.
- China's tariffs have come down since they joined the World Trade Organization, and U.S. companies such as General Motors and Intel have increased their exports to China.
- The problem of intellectual property rights (IPR) is not large in context. Only 13% of U.S. firms say weak IPR protection is a serious hindrance to business.
- Chinese currency strength and weakness is directionally determined by the U.S. dollar, but the Chinese government will not intervene to prevent the currency from fluctuating more than 5% in a calendar year.

China's Economy

- U.S. leaders hold a mistaken belief that China's economy is weak. However, over the past 10 years (2008 – 2018), the real growth rate of per capital disposable income in China was 120%, compared to 17% for the U.S.
- China's lack of significant credit or infrastructure stimulus is a sign that tariffs are having minimal impact on the economy.
- Services and consumption's share of GDP has outpaced manufacturing and consumption for the eighth consecutive year as China continues its transition into a consumer-driven economy.

- 86% of urban employment is now in small, privately-owned entrepreneurial companies as opposed to state-controlled enterprises.
- China's household savings are now more than the combined GDP of Brazil, India, Russia, and Italy.
- Real retail sales rose 6.9% in China in 2018, vs. 2.4% in the U.S.
- A residential property bubble is not a significant risk because of high down payment requirements. Also, the homes with the largest price increases are the ones in Tier 1 cities, which only account for 2% of new home sales.
- China's debt problem is not a serious issue. The rise of debt was due to investment stimulus in response to the collapse of exports during the Great Financial Crisis, and since then the government has been slowly unwinding the debt.

Q&A

- Given your optimism around China, how has this affected investment positioning at Matthews?
    - Approximately one third of firm AUM is invested in Chinese companies, primarily those focused on the domestic economy.
- How should investors react to the volatility in global markets arising from these headline risks?
    - Turn off Twitter and CNBC, and apply the same long-term framework to investing globally as you do to investing in U.S. companies.
- What are your thoughts on Chinese equity valuations?
    - Active management is essential in order to control valuations. The forward P/E of Matthews' China holdings was recently 15x, which was cheaper than the S&P 500.
- What risks are you legitimately concerned about in China?
    - The biggest risk is a government policy or implementation mistake such as the surprise currency devaluation of 2015. The good news is the Chinese government tends to learn from its mistakes and has not overreacted to the recent tariff dispute.

Andy Rothman

Investment Strategist, Matthews Asia

Andy Rothman is an Investment Strategist at Matthews Asia. He is principally responsible for developing research focused on China's ongoing economic and political developments while also complementing the broader investment team with in-depth analysis on Asia. In addition, Andy plays a key role in communicating to clients and the media the firm's perspectives and latest insights into China and the greater Asia region. Prior to joining Matthews Asia in 2014, Andy spent 14 years as CLSA's China macroeconomic strategist where he conducted analysis into China and delivered his insights to their clients. Previously, Andy spent 17 years in the U.S. Foreign Service, with a diplomatic career focused on China, including as head of the macroeconomics and domestic policy office of the U.S. Embassy in Beijing. In total, Andy has lived and worked in China for more than 20 years. He earned an M.A. in public administration from the Lyndon B. Johnson School of Public Affairs and a B.A. from Colgate University. He is a proficient Mandarin speaker.

About Canterbury

Canterbury Consulting is an independent investment advisory firm based in Newport Beach, CA, overseeing $20.2 billion in assets as of December 31, 2018. Canterbury provides consulting services to tax-exempt organizations — including community foundations, educational endowments, religious organizations, arts and cultural foundations, health care organizations as well as individuals and family offices. Founded in 1988, the firm designs and manages custom investment programs aligned with each client's specific goals. Canterbury acts as the investment office for its diverse clientele and provides objective investment advice, asset allocation, manager selection, risk management, implementation, and performance measurement. Canterbury strives to deliver performance and service that exceeds client needs and expectations.