

What should investors do as USA-China tensions build over trade war, Hong Kong and COVID-19

The US-China trade war of 2018-20 followed by the COVID-19 global lockdowns in February-April 2020 have left many investors feeling jaded, as stockmarkets gyrated up and down. President Trump and Xi Jinping continue to battle with not much really being resolved. This time they are fighting over an investigation into COVID-19 and what will happen in Hong Kong. Hong Kong is the perfect example of the two super powers pulling in opposite directions.

Today I look at some events that are likely to soon happen and how investors can navigate these tricky times.

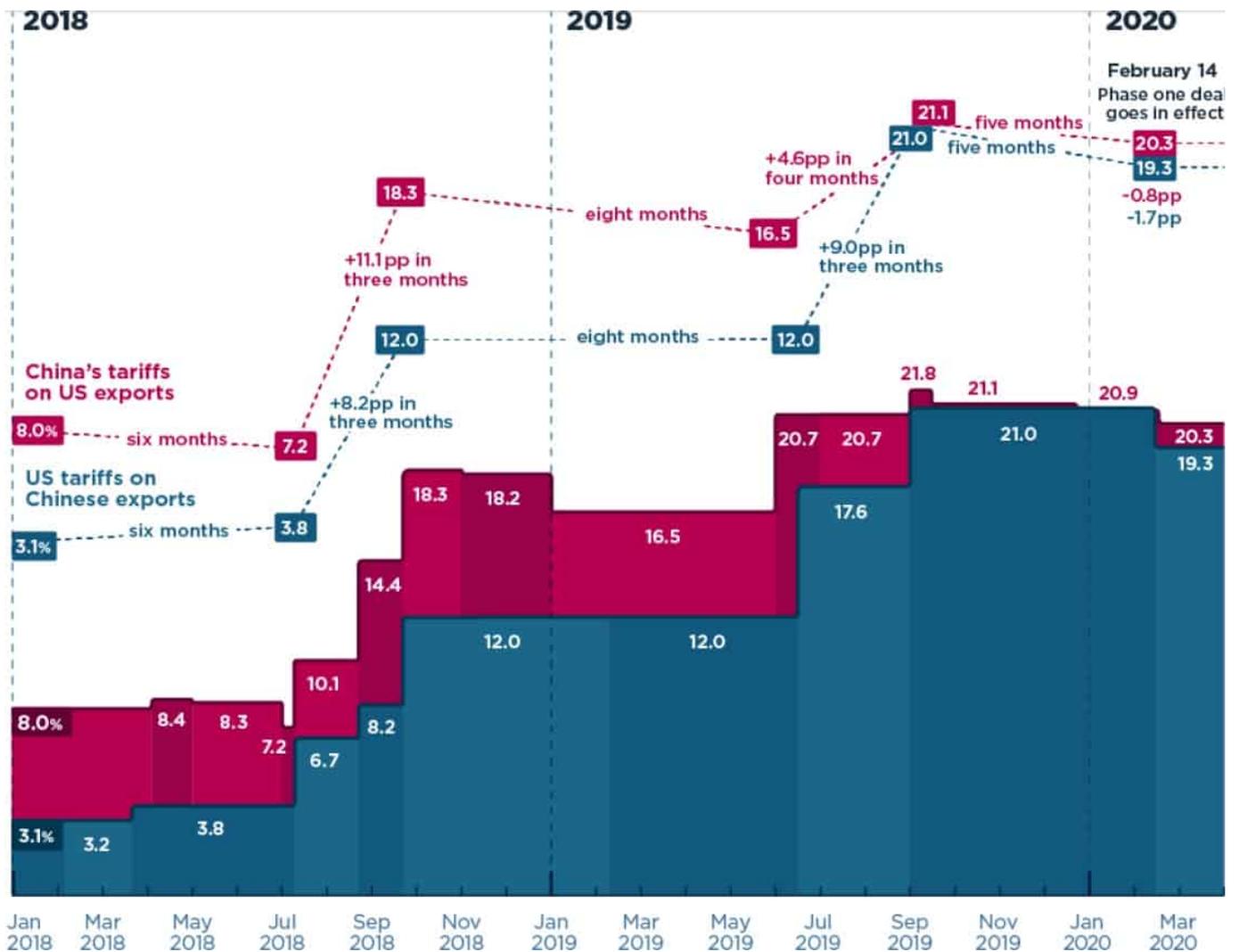
Protests in Hong Kong as US-China tensions rise again



From 2018 to 2020 both the US and China businesses suffered a steady increase in tariffs due to the US-China trade war. The biggest losers from the trade war were manufacturers of global goods, especially those traded between the US and China such as US agriculture. Globally the auto industry was hit hard, as was the electronics industry, as poor sentiment caused consumers to reduce their purchases. The main winners in the trade war period were cash, bonds, gold, rhodium, and palladium. In the US the best performing sectors were utilities, healthcare, and tech.

Then in 2020 we finally got a US-China trade 'deal'. Unfortunately many tariffs remain and the COVID-19 crisis has meant China has not been able to stay on track with its side of the deal, notably US agricultural purchases.

A history of US-China tariffs from 2018 to Feb. 2020



Source

Fast forward to today and given the US and China appear unable to settle their differences the following events are possible to occur next:

- The US may add additional tariffs on China if China goes ahead with “any decision impinging on Hong Kong’s autonomy and freedoms”.
- The US may raise existing tariffs on China if China fails to meet its current obligations.
- The US may look to boycott more Chinese companies, as they did with Huawei technologies.
- The US may force Chinese listing companies to delist from US exchanges. Last week the US Senate passed a new Bill (Holding Foreign Companies Accountable Act), effectively stating that Chinese companies must play by

American rules or be banned from U.S. exchanges. This requires Chinese companies being fully accountable both for their financials and their share registry (cannot be CCP controlled). Luckin Coffee (NASDAQ: LK) and Baidu (NASDAQ: BIDU) already have indicated they plan to delist.

- The US will work to secure critical materials and safer supply chains with their allies. This has already started with uranium, and is proposed with rare earths and other key battery materials (Onshoring Rare Earths Act – the “ORE Act”) .
- China may retaliate with tariffs on more US goods, or boycott US companies and their products.

Reference for ideas: United States Strategic Approach to The People’s Republic of China

The playbook for investors

Reduce exposure

- Reducing or selling completely exposure to US listed Chinese companies. It would also be wise to do the same for any Hong Kong listed stocks. The same could be said for any Chinese or Hong Kong foreign exchange exposure, property, infrastructure or bonds etc.
- Reduce or sell US companies with considerable exposure to China earnings. Some examples would include Foxconn, Apple, Qualcomm, and Starbucks.

Increase exposure

- US stocks in sectors with minimal China exposure – US utilities, US healthcare & aged care, US food and consumables, some US tech (Alphabet Google, Facebook, Amazon, and Netflix).
- Countries which will benefit from increased US trade or US supply chain shifts away from China – USA, Canada, Mexico, Australia, Vietnam, and maybe India.

- Critical materials companies including uranium. The recent US 'ORE Act' lists 6 key critical materials – rare earths, scandium, cobalt, graphite, lithium and manganese. Investors should look for quality sources of these materials in the US or in US allied countries.
- Gold stocks and physical gold ETFs (SPDR Gold Trust ETF (GLD) or iShares Gold Trust ETF (IAU)).
- Other valuable metals related stocks – Silver, rhodium, platinum, and palladium.

Closing remarks

The trade war and now COVID-19 has finally served a purpose to wake up the US to get their manufacturing and supply chains back under control, and away from China's control. This will mean we can expect to see further moves to secure critical materials by the US. Already we have seen the US uranium reserve announcements, and now the 'Ore Act' to secure the US for rare earths and critical battery metals supply.

In these rapidly changing times investors need to stay nimble and look forward to what will likely unfold next. The next battlegrounds between the US and China will involve the biggest trends of the 2020's – Securing critical material supply chains, 5G, electric vehicles, solar & wind energy, energy storage, and of course the top tech trends (AI, cloud, streaming, eSports, social media, and mobile payments).

Finally a worst case scenario is we may be in for a full blown US-China cold war. In that case investors will do well to add some cash and gold stocks to their portfolio. But don't forget some exposure to the key critical materials (and companies that produce them) as they will be the foundation for the 2020's as we move into a cleaner and more automated/connected world.

Hong Kong's student protests scare Beijing

✘ Some have described it a “Little Tiananmen” but the leaders of ‘Occupy Central’ have a clearer notion of what they want to achieve than their Chinese cousins in 1989. This is because, unlike the citizens of the People’s Republic of China, the inhabitants of Honk Kong know what freedom, democracy, and rule of Law mean. This means that they are prepared to endure any sacrifice to convince Beijing to listen to their demands. Predictably, nobody in Beijing is going to listen, much less go along with them. The protests intensified over the past weekend and they have waned somewhat on Monday; however, the movement will not be dissolved by mere the police’s tear gas. Furthermore, should the protests continue, intensify and lead to the police being forced to using arms, there is no telling what ripple effects it could have in the heart of the Chinese mainland, where social conditions and, paradoxically, the emergence of middle class in the urban areas, might well respond in tune with Hong Kong’s students. Beijing is facing a significant challenge and it will have to address it with finesse.

In 1997, Hong Kong changed status from being a British colony to a Special Administrative Region; the architects of the transformation were UK Prime Minister Margaret Thatcher and Chinese Premier Deng Xiaoping. The former colony has always lived with the idea of being special, free and independent. Hong Kong and China have always had a special relationship but the city’s streets have always feared the possibility of a sudden invasion from the mainland. Many Hong Kong residents actually fled in 1997 because they were convinced that Beijing would impose its own political customs to the island, crushing

freedom and independence, including through violence if necessary. Well, looking at what's going on in the streets of Hong Kong today, with police charging the barricades constructed by the students and their professors, one might call it a delayed reaction. The city-state cannot help but fear the worst, because the situation has the potential for exacerbating out of hand.

Hong Kong will become to all intents and purposes Chinese in 2047; however, the students have taken to the streets now because they fear that China is fully ready to take over now. They have read the signs, which include Beijing's lifting of freedom of the press to the imposition of higher education curricula and the appointment of the gubernatorial candidates, who would be allowed to campaign to run the Island. In other words, the Communist Party will choose who can and cannot run for power in Hong Kong. The 'democratic candidates' will be chosen by the Executive Committee of China, effectively rendering the entire electoral process, pointless. Surely, Beijing has imposed too much too soon even if Hong Kong has lived under the illusion that it could remain "special".

Universal history has taught that when the dialogue degenerates into struggle, it is difficult to keep the situation under control and under reason. The fear is that, with neither side willing to give in, this very difficult confrontation could escalate and do so suddenly. China, however, is acting rationally because it worries that the democratic wind from Hong Kong could easily reach the island of Macao – just a few dozen kilometers away – and then hit the Mainland, threatening the power of the Communist Party itself. The students, for their part, have excellent timing. President Obama and western nations have spoken about democracy and freedom at length throughout the duration of the UN General Assembly over the past week and throughout the Ukrainian crisis that has intensified since last January. Beijing clearly fears the inevitable moral support for the protesters

in Hong Kong from the British, the former colonial rulers, and from Washington. The Chinese government has, in fact warned the United States and other foreign nations, not to interfere in Hong Kong's internal affairs of Hong Kong, stressing that it is a Chinese internal matter. Ignoring the appeals of the Hong Kong and Chinese Government, thousands of people have stayed in the streets to protest. Braving the risk of bursts of tear gas and batons, thousands of protesters continued their protests over the weekend.

The protesters have chosen the umbrella as their symbol, given its ability to protect from the scorching sun and from tear gas such that in social media, the Hong Kong protest has already earned the title of the umbrella revolution". The student protesters also remind observers of 'Occupy Wall Street', the protest movement that began in the United States on September 17, 2011 in an effort to block New York's financial centre. In fact, the students have blocked the financial center of Hong Kong. 'Occupy Central', the name of the Hong Kong protest, has a founder, Benny Tai Yiu-ting, Associate Professor of Law at the University of Hong Kong, who started the civil disobedience movement in January of 2013. Tai Yiu-ting has been careful to keep the protest focused on Hong Kong rather than try to appeal to the West and its regional allies; however, Taiwan has already expressed its support to the people of Hong Kong. Some Taiwanese students have exhibited signs that read "Today, Hong Kong, Taiwan tomorrow", expressing the hope, therefore, that the island of Formosa can finally get rid of Beijing.

The protests in Hong Kong come at a time of tension in the East China Sea with Japan and the South China Sea with Vietnam and other regional powers. However, the repercussions will be more economic than geopolitical at first. Hong Kong serves as the financial link between China and the world. Should the protests turn into a sustained political movement the resulting turmoil will have deep economic repercussions. While

the students have expressed concern over freedom, democracy and human rights, Hong Kong's business leaders, care more about stability and their wealth. They have accused the students of damaging Hong Kong, threatening its wealth. The financial markets have reacted in tune with the business leaders' concerns, as shares took a bearish turn. Ironically, Beijing, which has celebrated China's 'conquest' of Wall Street as Alibaba (NYSE: BABA), amid concerns of lower economic growth, scored the largest ever IPO, will side with the business elite rather than the idealistic students. Karl Marx is surely rolling in the grave. The students can leverage the economic concerns on both sides because a compromise may be the only solution that would ensure business stability and China's long term full absorption of Hong Kong, averting a wider national and international crisis – and its inevitable economic effects.