

At the Trade War Frontline: Observations From My Trip to China

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The “spat” with China (or trade war, depending upon your perspective) is a central issue touching millions of people around the globe in a myriad of ways. To some it appears to be about unfair competition and reciprocity, while to others, including myself, it is about geo-political influence and control of major technologies that will shape the future of the world. With US-China tensions at a level that I have never experienced as an Asia emerging markets specialist for over 25 years, I thought it was especially important at this time to make one of my regularly scheduled research trips to China. There, I met over 30 company managements, and spent time talking with many of my long-established personal contacts in the region. I came away from the trip less optimistic on the outlook for Chinese equities and would like to share some of my observations.

Technology and Innovation

I’ve long believed that China sees its place in the world as a leader in technology, in addition to other arenas. With this issue being so important to the Chinese, they are, unsurprisingly, promoting many homegrown companies in areas such as automation, robotics, batteries, and 5G. My meetings confirmed that domestic competition in this space vs. international firms has only gotten fiercer, chasing after market share and driving down profitability for all. It is apparent to a visitor like me that foreign companies will struggle to maintain their margins in the face of China’s relentless drive to be the world’s dominant high tech leader. For all players globally, it will be increasing difficult to make money.

Dependence on US chips

Interestingly, the greatest concern I picked up in China regarding the trade war doesn’t concern the mountain of goods that are exported annually to the US and the potential loss of factory jobs. Rather, it is the dependence on the US as a source of logic chips that is most worrisome. China does not have a domestic replacement option for products from Intel, ARM, Qualcomm etc. If this trade war escalates, or there is some sort of embargo on chips, China’s high technology aspirations will be dealt a major blow. China is looking to reduce its reliance on the US for these goods by creating strong domestic competitors. This potentially has significant longer term implications, shifting the dynamics of the global technology industry.

Consumption

The rapid development of China as a modern, post-agrarian society is evident everywhere. I’ve long expected that the development of a middle income class will have ripple effects throughout the Chinese economy. Examples include members of this cohort seeking out new experiences like attending the cinema and traveling both domestically and internationally. Expected standards of service rise for healthcare and the need for insurance increases as Chinese consumers’ material world expands. My meetings confirmed this view and that we are reaching a J curve effect where leading providers will have pricing power as demand increases. Spending by the Chinese on domestic services, in particular, can only grow in parallel with incomes, which are unlikely to be significantly dented by the trade war.

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