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MARKET COMMENTS/POTPOURRI

"SUBSTANTIAL PHASE ONE DEAL". . .REALLY?

It still needs to get "papered". . .but we have a deal!

As Friday commentary went into the late afternoon and evening—and spilled into the early weekend talk shows, especially on financial television—opinions flew around often wildly concerning **yesterday's alleged "deal" reached between the U.S. and China**. Ever the one for hyperbole, President Trump at one point referred to the "warmer" environment between negotiators this past week as a "love fest."

So eager—at least for the cameras, reporters *and investors* yesterday—to extol what he called a "substantial Phase One deal," Trump went out of his way to congratulate China on its recent 70th birthday bash and more. Aside from the economic and market discussion in yesterday's aftermath, that and similar comments (more in a bit) drew the ire of many upset that—to score this "deal"—Trump *would* do as past presidents have and look away from China's past *and present* human rights record.

As to the reported key items both sides claim to have agreed to, some were already operational or in the works. Most of all, China—in the midst of a food crisis which, among other things, has pushed consumer inflation to its highest level in a while—was already buying increased amounts of food from the U.S. This week they reportedly agreed to buy a lot more; as much as $40-$50 billion annualized. Likewise, the U.S. position had *already* softened somewhat on dealings with Huawei, waivers having been granted in areas *not* having to do with anything the American government deems would compromise national security.

The "deal" Trump said would take three to five weeks to "paper"—maybe in time for he and Chinese President Xi to sign at the Asia Pacific Economic Conference, scheduled for November 16-17 in Santiago, Chile—**was *not* so characterized in China**. China's official Xinhua news agency late yesterday referred only to "substantial progress achieved" in a range of negotiation areas. But to be fair, even Trump—and Treasury Secretary Mnuchin at one point yesterday, as everyone discussed this in the Oval Office—both suggested the possibility that the "deal" might not come off.

"What a pretty pig…or did you say super model?"

Still, I'll give this effort somewhat more credit than one particular commentator I read, who quipped that this whole charade was about "putting lipstick on a pig and calling it a supermodel." I would more throw in with Double Line Capital's Jeffrey Gundlach, who in less cynical fashion simply views the provisional deal as "more cosmetic than real." Indeed it is; yet there are at least a couple areas that caused my eyebrows to raise, **and suggested to me, at least, that Trump still has the stronger hand on his side of the table and yesterday pretty much protected it.**

Now, the whole story is almost guaranteed to change over the several weeks it will take to commit to writing; maybe in numerous ways. But here are a few key points on what is in front of us now:

* **Liu He's title –** Having previously had the added title stripped from him, Vice Premier Liu He (in the above photo with Mnuchin) *did* have restored to him for these negotiations the added title of "Special Envoy," ostensibly directly representing and speaking for President Xi. All else being equal, this means there is *relatively* less chance of happening this time around what we saw in the Spring, when Xi and/or party officials otherwise deep-sixed a good chunk of what Liu had reportedly committed to, prompting Trump to *properly* walk away and ratchet up the pressure on China back then.

* **Tariffs –** *Only* the planned bump up in *some* tariffs scheduled for next week have been suspended (as opposed to removed.) No other promise on the president's part was made; by all appearances, a significant "win" for him *on the merchandise trade area* if it all holds.

* **Piecemeal format** -- One reason some are critical is because this whole idea of two or three "phases" *and more* to settle all the various issues with China is NOT what Trump promised. Yet it was *never* realistic that one big, grand deal could be reached. Further, as both political and practical matters for each side, something manageable if it was going to happen at all needed to be done *now*.

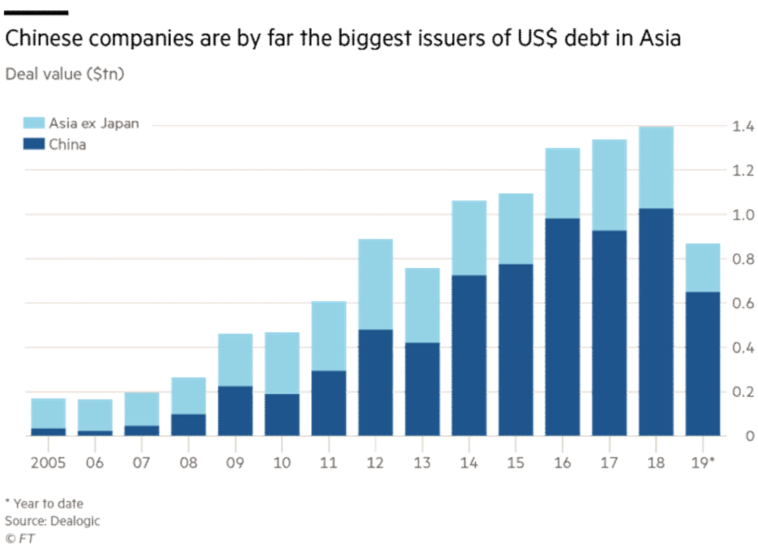
So personally, if this is how things realistically have to progress anyway, this *series* of deals (assuming they come) is no negative issue to me, **as long as Trump with each step makes sure things are enforceable and stands ready to pull the plug *again* if China wavers in being accountable**.

* **"Separate issue" regarding U.S. funds investing in Chinese stocks, etc.** -- To me, one of the more significant nods the Trump team gave to China—especially after the recent noise on this—was in putting off for now anything to do with the listing of Chinese stocks on U.S. exchanges and the corollary issue of U.S.-based pension funds especially investing in them. This, said Trump, is an issue "separate"

from the strictly trade-oriented ones (and, of course, he's right.) Nothing specific was said that I heard of as to how/when the subject will be addressed. I suspect that China hawks such as Kyle Bass, Gordon Chang, Steve Bannon and others will keep this issue alive.

* **So far Huawei is NOT part of deal** -- According to Trade Rep. Bob Lighthizer, the Chinese tech giant likewise is a bigger issue in and of itself. That the Administration is taking its time here—and again keeping its stronger hand and making no concessions of significance—should keep the security/foreign policy hawks at bay as well.

* **AND HERE'S THE BIGGIE (?) – Currency, markets and banking issues** -- I don't want to get too far ahead of myself here or simply employ mere wishful thinking. But after yesterday, I have to acknowledge the *possibility* that somebody at long last has educated Trump on currency issues from the perspective of America being the owner of the globe's reserve currency and what that means for financial markets; *most acutely, for a VERY stressed China*.



What is *to me* the most important aspect of yesterday's purported deal was at the same time the least expected. Trump gushed not only for farmers, **but for U.S. banks and other financial institutions that could have a much greater presence *in China*.** As part of China's slow pace of recent years in "opening" its markets, etc., it has been seeking to create a greater market and presence for its own currency, the yuan. This, as you know, has led to all manner of predictions that—at least in its own part of the world—the yuan will seize the U.S. dollar's long-time role as a trade and reserve currency.

Given that—as you already know—Chinese companies of many varieties have massive external debts denominated in dollars, some of us have been growing ever more concerned about the stability (or lack thereof) of those obligations. And that has been doubly true of late when—thanks to a weakening economy and capital flight; NOT to any "manipulation" lower on its part—Chinese officials have had to deal with a *weaker* domestic currency.

Up to now, Trump's amateurish and *very* ignorant insistence that China is "manipulating" its currency downward has ignored not only the facts, but not taken account of China's core desire THAT IT WANTS A STRONGER CURRENCY. For him, a weaker dollar has had a limited meaning for *Trump the mercantilist*: it will allow us to export more to China (and others.) As I have said, he has previously ignored the reasons *why* the strong dollar has come about (*especially* against China's yuan) and **how it has arguably been a greater stress *to China* (and other emerging markets with trillions in dollar-denominated debt) than to the U.S.**

So—though, as Mnuchin said, there remains a bit more work to do—some "fundamental understanding of the issues" regarding currency matters has none the less been reached. Here again, I do not want to overstate things: but it strikes me that the part of yesterday's "deal" that was least expected could turn out *by far* to be the most pivotal (and, I'll add, demonstrate that on this issue Wall Street would have decidedly scored a major "win" against the Deep State in this whole New Cold War.)

Could everything—good and bad alike—still come to nothing? Of course. **Already, Trump and his crew are taking heat from *all sides* politically for sweeping human rights abuses and Hong Kong under the rug again, simply to be able to declare some kind of "victory" on the part of the beleaguered president.** All Trump had to say, in fact—in truly *infuriating* some people—was that Hong Kong "will take care of itself" and in any case benefit *bigly* from this deal right along with China.

Apparently not embracing that same "warm" feeling yesterday, Secretary of State Mike Pompeo likened China's behavior toward its ethnic minorities as having been taken straight from the pages of Orwell's 1984; see https://uk.reuters.com/article/uk-usa-china-muslims-pompeo-idUKKBN1WQ29D. The extent to which these issues flare up anew (or not) may *by themselves* screw up yesterday's love fest; time will tell.

But that aside I'll conclude, for now, by repeating that especially if these banking/currency matters—and the dollar/yuan relationship—*really are* being looked at in the right light and ARE put to paper, this deal may later be embraced legitimately as more of a super model after all.

**** The above is excerpted from the second regular issue of *The National Investor* for October.**

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