Penn State Asset Management Group

Phase One Deal Report

January 24, CY2020

Phase One Deal Report

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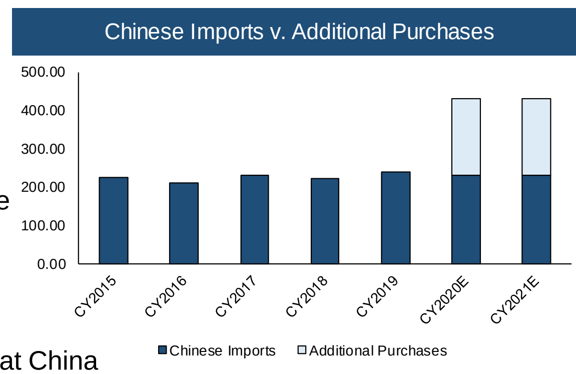
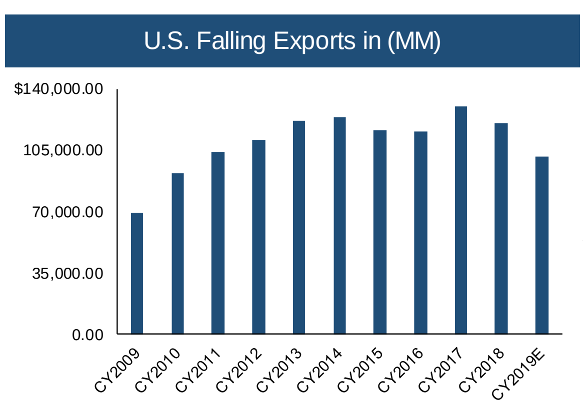
After 18.00 months of rising tensions and increasing tariffs, the U.S. and China have implemented the first pause in their on-going trade war. President Donald Trump, and China's Vice Premier Liu He signed the "Phase One Deal" on Wednesday, January 15, CY2020. The deal calls for China to purchase $200.00 bn worth of U.S. goods and services over the next two years, and in exchange, the U.S. cancelled new tariffs on approximately $156.00 bn worth of Chinese made phones, laptops, toys, and clothing. Additionally, the tariff rate was cut from 15.00% to 7.50% on an existing $120.00 bn of Chinese goods that was imposed September 1 CY2019. However, tariff of 25.00% on $250.00 bn worth of Chinese goods that was implemented prior to September CY2019 will remain and will be used as leverage for President Trump in future negotiations. If either party fails to meet the set standards of the agreement, the opposing side reserves the right to reinstate forgone tariffs. Future negotiations are not set to begin until after the CY2020 election.



Phase one of the deal is a positive step for both economies, but issues still remain. To meet the purchase requirements, China will need to reduce imports from other countries. Such a significant change in spending policy impacts China's potential to fulfill their yearly U.S. import targets. For this reason, the deal states that both parties will continue to collaborate to ensure that China does not backtrack. In other words, this means that if China falls short of their requirements, the U.S. will not immediately reimpose tariffs as long as there is meaningful effort and cooperation from China. Additionally, the main concerns of the war are not addressed including both Chinese subsidies to domestic companies and behavior of Chinese state-owned firms; it seems that the deal may be a rushed agreement from President Trump in efforts to prove that he can negotiate with China. As the CY2020 election is closing in, President Trump needs his voters trust and faith that the U.S. will reach a fruitful deal with China.



One of the largest impacts of the trade deal is the promised $32.00 bn of increased purchases by China of U.S. agriculture products by December 31, CY2021. It is important to note that the purchases exceed the CY2017 baseline of U.S. exports to China, which equates to approximately $23.80 bn in regards to U.S. agriculture products. In CY2020 China is required to increase agriculture imports by no less than $12.50 bn and by no less than $19.50 bn in CY2021. China will increase imports of soybeans most significantly. When news of the agreement emerged last December, soybean prices surged. Additional agricultural products to be included are: meats, cereals, cotton, seafood, various oilseeds, and other commodities. The new demand and higher prices created by the deal will benefit U.S. farmers, as farmers were some of

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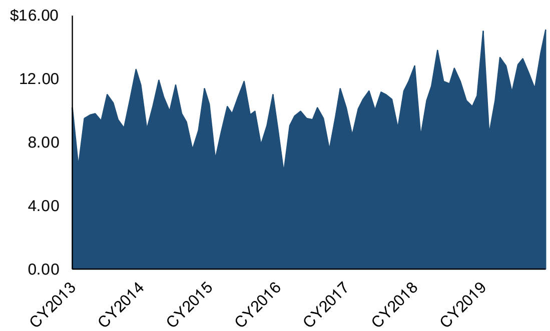
the most affected by the trade war. As a result, there will be a substantial increase in the supply of these products, which in turn, weigh on the prices of these commodities.

Other sectors of the U.S. economy that China is required to support are manufacturing, energy products, and services. More specifically, China is required to increase their purchases of U.S.-manufactured products by \$77.70 bn, \$52.40 bn of U.S. energy products, and \$37.90 bn of U.S. services over the next two years. The two parties foresee the increases continuing past the specified expiration of the deal and into future years. According to the deal, the U.S. must ensure the availability of the products for purchase by China. To meet new demand, there will be a surge of supply for the specific products within each sector. The boost in the manufacturing sector may offset the sluggish growth seen by the sector throughout CY2019. Expected leading manufactured products to be sold are industrial machinery, aircrafts, and pharmaceutical products. New demand will be easily attainable considering the large preexisting supply of oil and natural gas in the U.S. In regard to the services sector, the most significant portion of the deal is involves U.S. intellectual property and the ability to charge Chinese businesses for the use of such information.

China Agricultural Import Commodity Value in (bn)



In the short run, these sectors will experience growth and potential job gains. This may be seen in manufacturing facilities as they will require additional workers to reach the required output quota. However, as businesses increase their supply to meet demand, they begin to subject themselves to various risks. If China fails to purchase the required amounts of goods, then producers will be left with a surplus. This will deflate prices of commodities that go unpurchased. As the deal proceeds, market participants should look to both parties and track their fulfilment of promises.

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