

Market Comment

The market may underestimate the possibility of a potential trade war

Stock market hasn't priced in the increasing possibility of a trade war

On March 1, 2018, President Trump proposed that the US would impose 25% import tariffs on steel and 10% on aluminum. It is hardly surprising that the tariffs will come after Trump was elected to be president. Today, Gary Cohen, Trump's top economic advisor and an advocate for free trade has resigned. This may leave an imbalance in the administration with an unopposed group of officials supporting trade tariffs which may lead to potential escalation of trade tension and an all-out trade war. Although a trade war may end up in a lose-lose situation for China and the US, we are concerned that the stock market may have underestimated such possibility. HSI is on 11.7x 12mth fwd PE, vs an 8.9x-14.4x range in last 5 years; and HSCEI is on 9.9x 12mth fwd PE vs a 5.6x-10.7x range in past 5 years. Market consensus still forecasting an 26% EPS growth in 2018 and 14% EPS growth in 2019 for HSI. We believe the EPS estimation has not fully implied the impact of the trade war.

Intellectual property related sanctions could be the next move

According to Bloomberg, Trump is considering clamping down on Chinese investment in the US and proposing broad range of Chinese imports to punish alleged improper transfer of intellectual property – a Section 301 Action in coming weeks.

Implication on the US economy and China economy?

The lack of a compatible supply chain in the US and current full employment rate is likely to lead to higher inflation rather than higher output, and hurt US manufacturers that used to depend on supply chain around the world.

For China economy, impact on steel and aluminum is manageable as steel exported to the US is only 1.6% of total steel export and aluminum exported to the US is 16% of total exported aluminum. Following sectors are potentially subject to higher tariff: telecom equipment (60% China exports account for total US imports in telecom equipment section), household equipment (53%), Toys and baby carriages (91%), lighting (64%) and footwear (56%).

Other trading partners could take actions as well

Trump also mentioned tariff for European car in the US. We believe if the tariff is settled, Germany would be the biggest victim of European car tariff. European Union (EU) is preparing counter tariff on US products, fighting back to US steel tariff. According to Bloomberg, EU is highly likely to lift tariff to 25% for consumer, agricultural and steel products, if Trump would apply its tariff threat.

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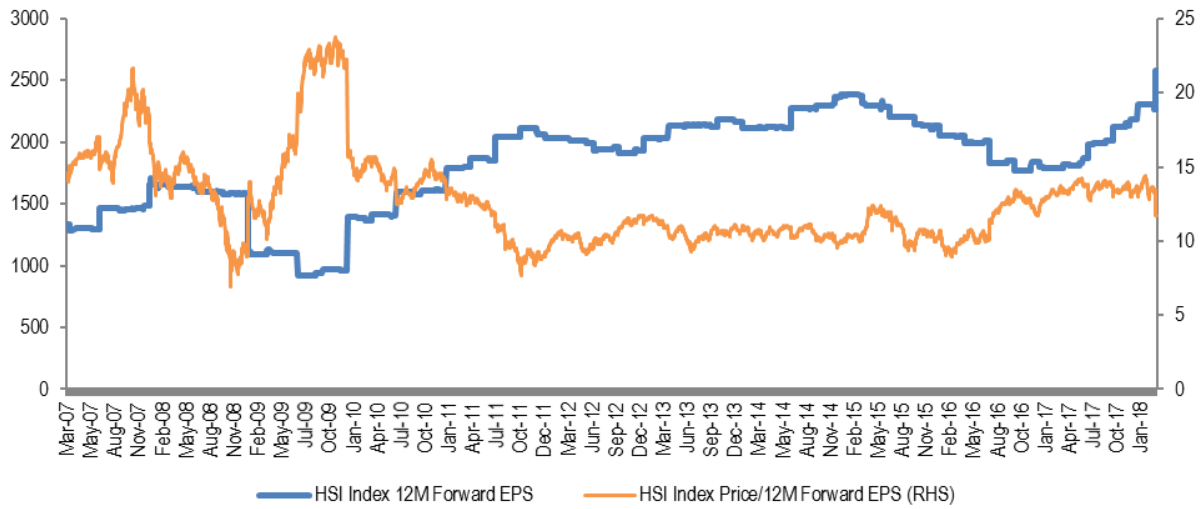
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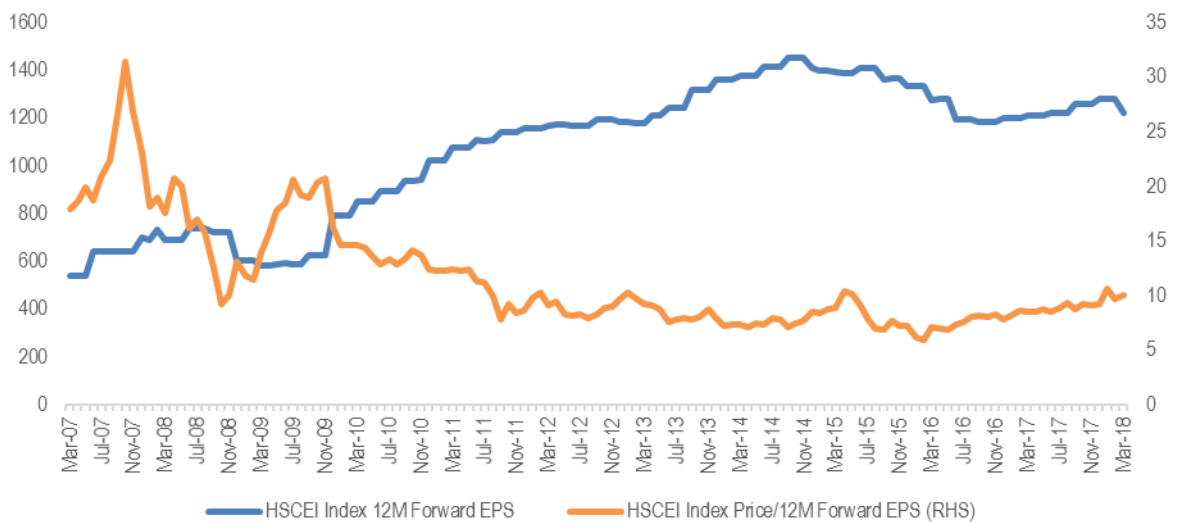
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Figure 1: HSI 12M Forward EPS vs HSI 12M Forward P/E



Source: Bloomberg, AMTD Research

Figure 2: HSCEI 12M Forward EPS vs HSCEI 12M Forward P/E



Source: Bloomberg, AMTD Research

GENERAL DISCLOSURES

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