ARGO ASSOCIATES

# Briefing 16 October 2018

*Beyond the trade war – what does the new superpower rivalry mean for businesses in Asia?*

Two superpowers face each other warily across a vast ocean. One has been accustomed to dominating global trade and controlling the seas; the other is now powerful enough to challenge a status quo that has existed for decades. The two powers have clashed before and the challenger seeks to push its rival out of its regional sphere of influence. Meanwhile business leaders in the established power complain of unfair trade practices, protectionism and theft of technology.

Sounds familiar? This was the situation in the Caribbean at the end of the nineteenth century as the United States sought to push Great Britain out of the region and its businesses began competing with their formerly dominant rivals. History never repeats itself exactly but historical parallels and challenges can be illuminating. As Henry Kissinger has written: "Inevitably, the rising power impinges on some spheres heretofore treated as the exclusive preserve of the established power…Significant groups [in the U.S.] view China, by analogy to the Soviet Union in the Cold War, as determined to achieve military as well as economic dominance in all surrounding regions and hence, ultimately, hegemony."

The United States and Britain managed their rivalry and avoided open conflict, but since then – to quote Kissinger again – the U.S. does not "have experience interacting on a sustained basis with a country of comparable size, reach, and economic performance embracing a distinctly different model of domestic order." Instead of such sustained engagement with a comparable power, America's political establishment – who mostly rose to prominence when the U.S.S.R. was a threat – easily default to Cold War policies.

What lessons does this offer us as we enter a new era in which China is branded a strategic competitor by the U.S. and the rivalry has moved beyond the military to the economic sphere? We consider a few possibilities for how the rivalry will play out and the implications for Chinese, American and other companies and investors.

## It will all be over by Christmas …

Much as the First World War was going to be a short skirmish, some commentators believe that after the U.S. midterm elections, the Trump administration will come to a deal with China that will bring the ongoing trade war to an end. The administration may indeed come to a limited deal that could reduce tensions in the short-term; however, the U.S. objectives are long-term and are shared by the left of the Democrats as well as by the protectionist Trumpian wing of the Republican party. This is not really about trade – it is about global dominance and who gets to write the economic rules for the 21$^{st}$ century. It is an attempt to circumscribe how models of state-controlled capitalism such as China's can fit into the current global economy. It is also about disentangling the American supply chain from China and preventing China from accessing U.S. technology.

The recent U.S. National Defence Strategy paper states that China is trying to "shape a world antithetical to US values and interests". According to this thinking the U.S. previously promoted the rise of China, believing that the country would gradually become more liberal, both politically and economically; the current administration believes that this hope was (and is) misplaced. For them the U.S. is engaged in a long-term conflict with China in which only one country can come out on top.

## Are iPhones going to be made in Ohio?

One of the hopes of the China hawks in the U.S. is that American companies will repatriate their supply chains, but – at least in the short-term – this is highly unlikely. It is not just a question of cost – the infrastructure of tech supply chains is highly complex, requiring the assembly of parts from many countries (with a high percentage of those parts being made by specialist manufacturers around Asia). It would take years to create this infrastructure in the U.S. and would be uneconomical to do so. In addition, China is also a huge domestic market (although in Apple's case – with only 7 million iPhones sold in Q2 2018 in China – its market share is declining). However, there is another option for manufacturers in China – relocate elsewhere in Asia …

## Who is going to benefit from this new Cold War?

The prime candidate within Asia is Vietnam. It has a booming economy, a workforce that is skilled but still relatively cheap (compared to China), and a stable political system; on the downside, infrastructure needs to be upgraded and corruption remains an issue. In addition, Vietnam has a close political relationship to the U.S., as one of the countries that feels most threatened by China's growing power.

Vietnam has already seen a boom in FDI (from Samsung in particular, which was responsible for a quarter of Vietnam's total exports in 2017) and the economy grew at over 7% in 2018 Q2. The country is already the top ASEAN exporter to the U.S. But even for Vietnam there are risks: a trade war could lead to an overall drop in global demand that could hit Vietnam's export economy. Equally, tariffs on Chinese goods could also affect those Vietnamese exports to China that are used as inputs in Chinese exports.

In the medium to long-term Vietnam could benefit from antagonism between China and the U.S. but in the short term it might lose out. Even if a significant amount of investment moves from China to Vietnam (including by Chinese companies themselves) it will take years for this process to play out.

## What's going to happen to US-China investment?

Cross-border investment between the U.S. and China is (unsurprisingly) in steep decline. According to the research firm Rhodium Group Chinese investment in the U.S. fell by over 90% in the first five months of 2018 to just USD 1.8 billion. A number of Chinese investors who have previously focused on the U.S. market now say that it is almost impossible to do significant deals. Even non-Chinese companies are having difficulties. Take the Singaporean company Broadcom's attempts to buy the chipmaker Qualcomm in the United States: the deal was hurriedly investigated by the US Committee on Foreign Investment in the United States (CFIUS), which claimed in March that there were national-security concerns that "relate to the risks associated with Broadcom's relationships with third party foreign entities". The suggestion was that the deal could have benefitted Chinese companies such as Huawei in the race for 5G dominance.

The implication is that companies in Asian countries other than China must choose between China and the U.S. in terms of commercial partners and investors. This is replicating at a commercial level what already happens at a geo-political level where Asian countries are being pushed towards alignment with either China or the U.S. Most have China as their largest trading partner but want the U.S. in the region to act as a balance to China. This policy requires a certain diplomatic ambiguity which may be difficult to retain in the future.

## What about regional investment?

The effect of a decrease of US-China investment will be an increase in intraregional investment, as more investors in Asia focus on their own region. Even within global companies and funds there will be more defined regional silos. Already large global PE funds are segregating their Chinese operations from their U.S operations and are no longer buying companies in China with the aim of helping them to expand into the U.S. market. Chinese investors who are blocked from the U.S. market may concentrate increasingly on Southeast Asia, where there will be stiff competition from Japanese and Korean companies. As U.S. investors find it increasingly difficult to invest into tech in China, more investment may come from Korea and Japan (it was recently announced that Softbank's South Korean venture unit had launched a $300m venture fund targeting China). If the U.S.'s strategic rivalry with China pushes Asia to become increasingly economically integrated ironically it may help to diminish U.S. influence in the region.

# About Argo Associates

Argo Associates is structured around a single overriding purpose: providing our clients with the information and intelligence that will allow them to navigate acquisitions, investments, disputes, or frauds in a clear-sighted and rational way, minimizing risk and maximizing opportunities.

Information gathered may clarify the profile and background of key business people and managers; it could illuminate the operations of a company or demonstrate a history of fraud or mismanagement; or it could help our clients to assess the political situation in a given jurisdiction and how it may affect their investments or business operations.

Headquartered in Hong Kong, Argo Associates assists clients across Asia and – through international partners – globally.

## Intelligence Gathering

"Intelligence" is central to making sense of the world and to decision-making. Argo Associates has developed a network of well-placed human sources across Asia and – through our partners outside Asia – globally. This network provides insights beyond what is available publicly – into leadership, operations, strategy, corruption, red flags, political connections and so on - and is supplemented by extensive research and analysis of publicly available sources – corporate filings, litigation filings, regulatory communications, media articles, social media postings and so on. In a world in which information is increasingly commoditized, high-level intelligence and analysis provides the insights that give our clients an edge over their competitors.

## Fraud, Corruption and Disputes

Our intelligence-gathering techniques and in-depth research and analysis have also helped our clients uncover frauds within their operations or in those of a portfolio company or recent acquisition. Our professionals have provided numerous reports for arbitration or legal proceedings to recover the proceeds of fraud. We have also assisted clients in tracing assets globally when bringing a high-value claim against a company or individual. In high-profile disputes we have assisted a number of top law firms in gathering information, evidence and intelligence in support of their clients' cases.

## Political Risk

Our political risk work has developed naturally out of our intelligence and investigative capabilities. We see political risk as an important part of the evaluation of many investments, mergers and acquisitions, as well as a key element of commercial disputes in many markets. We have helped our clients look at political risk in a new way, not just in terms of the broad outline of potential political developments in various countries, but with a focus on the impact on their businesses. For example, will growing frictions between two countries lead to tariffs that could impact the specific sector in which a portfolio company operates? Or, how will rising protectionism in a country alter the possibility of a fair result in an ongoing commercial dispute? Frequently, politics is local as much as national and we understand the importance of drilling beneath the widely-circulated opinions to a real understanding of what is happening.

## Jason Wright, Managing Director of Argo Associates

Prior to founding Argo, Jason was a Managing Director in Hong Kong for Kroll, the company that created the modern investigations and intelligence sector. Before moving to Asia in 2011 he worked for Kroll in Italy for five years and then briefly in London.

While assisting clients on numerous transactions, investigations and disputes in Asia and Europe, particularly for private equity funds, banks, hedge funds and special situations investors, Jason has also specialized in the analysis of political risk, whether that has involved examining the role of local politicians, regulators and other stakeholders, or broader geopolitical concerns.

Although he has managed projects across the whole Asia-Pacific region he has been particularly focused on China, Korea, and Southeast Asia, especially Indonesia, Vietnam, Malaysia and Thailand.

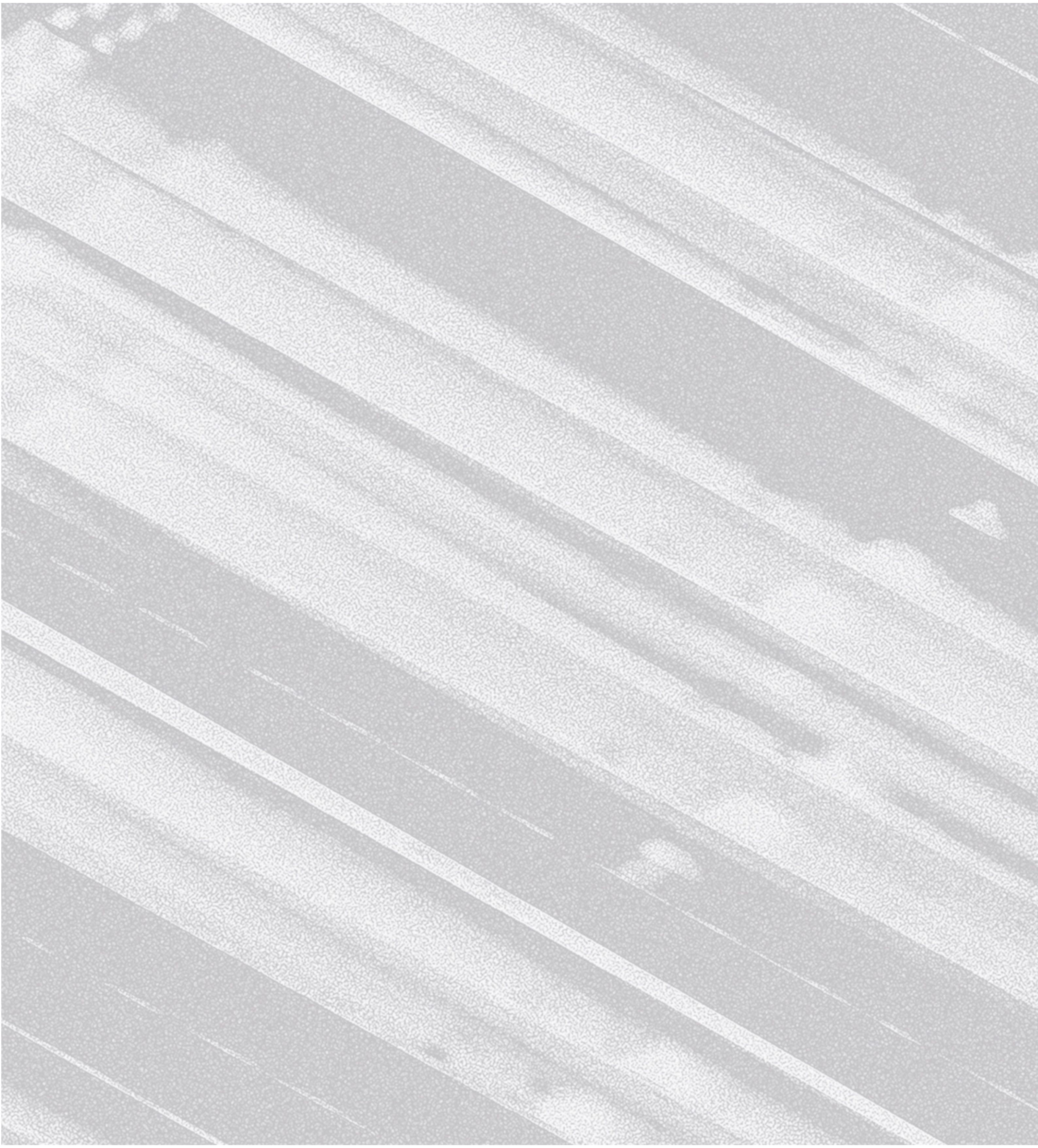
Jason is a scholar of St. Catherine's College, Oxford, having been awarded a Master of Arts (Oxon) in English Language and Literature, as well as a Master in State Management and Humanitarian Studies from La Sapienza University in Rome, Italy.

## Yulingbo Mao, Head of Greater China

Before joining Argo, Yulingbo worked in the Business and Client Intelligence Unit of Deutsche Bank where she advised the deal teams and the management board on existing and potential high-risk clients and major transactions. Prior to that, she was a case manager in a number of leading international corporate intelligence and investigation companies.

Yulingbo specialises in enhanced due diligence, business intelligence, asset searches, fraud investigations and other types of complex investigative projects. She has assisted numerous financial services, legal, regulatory and corporate clients in making informed decisions related to potential and existing investments, mergers and acquisitions, IPOs and de-listings, senior management and board appointments, market entry, internal investigations and disputes and litigation.

Yulingbo has worked on projects of varying scale across Asia Pacific with a focus on greater China. She is a native Mandarin Chinese speaker with fluency in English and Cantonese. She holds a Master of Finance from the Hong Kong Polytechnic University.



**www.argoassociates.com**
info@argoassociates.com
+852 3905 1892

**Argo Associates Limited**
Suite 401, Printing House
6 Duddell Street, Central
Hong Kong