



Phase One Devil in the Details

- Media coverage of U.S-China trade dynamics does little more than scratch the surface
- A Bloomberg headline sets the risk-on tone today: [U.S., China Signal Progress Toward Initial Trump-Xi Trade Deal](#).
- In fact, **there has been no discernible progress** since Liu He left the Oval Office on October 11th. Given the thin list of deliverables targeted for Phase One, why not?
- NEC Director Kudlow provided some detail on the state of play [on Bloomberg TV on Friday](#):

*Kudlow: "The deal is not completed. The deal is not done. **There are issues to go on enforcement** – that's going to be very, very important. There will be issues on forced technology transfer – very, very important – those may slip into phase two. But I can tell you we've come a long way. **President Trump himself has indicated a desire to complete this Phase One deal.** President Xi has indicated likewise.*

Jonathan Ferro (BBG TV): What is holding us back in Phase One. What is left to be agreed?

*Kudlow: "I can't be too specific, as you might imagine. I'm going to let our brilliant negotiators do their brilliant negotiating. But as I said before, I went through the different chapters: Agriculture chapter looks good, financial services looks good, currency looks good, intellectual property theft much improved. Still much more work on forced tech transfer. And **enforcement is very, very important – very, very, very important. And that's what they'll be working on.** I don't want to go any further below that surface. All I'll say is we've come further than we were last May, when we thought we had 90% of the deal."*

- **Enforcement remains an intractable problem:** Lighthizer won't sanction any deal without a unilateral enforcement mechanism. China can't possibly accept one.
- Could the U.S. punt enforcement to Phase two?
- Bloomberg TV reported (second hand) two slightly different interpretations of weekend remarks from Wilbur Ross on the issue:

Bloomberg's Haslinda Amin, who conducted the Ross interview, said on BBG TV this morning:



*"I asked Secretary Ross if the U.S. would [suspend tariffs on December 15th]. He was non-committal. He said it **would depend on the legislation – and the enforcement mechanism, without which he said 'you just have a pile of paper.'**"*

- That seems clear enough: Phase One depends on enforcement. However, Bloomberg muddies the water with a somewhat different interpretation in its [print version of the story](#):

*Ross remained non-committal on whether the Trump administration would suspend the December tariff hike. He also said **further phases of the deal** would depend on things involving legislation on the part of China and an enforcement mechanism*

- So, did he link enforcement to Phase One or to "further phases?" That's only the **critical determinant of whether Phase One gets done**. Ugh.
- The problem with punting enforcement to Phase Two is that Phase One already suffers from a big credibility problem. [From today's SCMP](#):

Tim Stratford, chairman of American Chamber of Commerce in China, said he believed the "phase one" deal currently under discussion could prevent a further "downward spiral" in the dispute but feared the US did not have enough leverage to push Beijing into restructuring its state-led economic model.

"It seems to fit the political goals of the president," Stratford said. "But it's not addressing the systemic trade issues that the business community would be concerned about on a long-term basis."

- Everyone thinks Trump can "sell anything as a win." But a **Phase one deal without enforcement is like a pig without lipstick**.
- [Signals from China](#) continue suggest a hardline stance on their "three core concerns." **They haven't moved at all** since previous talks broke down in May:

"For China, removing all the additional tariffs is a core concern that has not changed and will never change; even if there is a first phase deal, this core concern should be reflected," [Taoran Notes](#), a blog affiliated with state-run Economic Daily, wrote Saturday. China's insistence on a "realistic" value for U.S. purchases and a "balanced" text of the agreement remains...

- While consensus is that the President is ready to sign a wet napkin labelled "Phase One Trade Deal," that was not apparent from his tone yesterday:

Q: Any progress on the meeting place with China? Have you spoken to China?

*THE PRESIDENT: Yeah, there's progress. And there's — first, I want to get the deal. I mean, the meeting place, to me, is going to be pretty easy. But first, we'll see if we get the deal. And **if we get the deal, the meeting place will come very easily.** It'll be someplace in the U.S.*

- Odds of Phase One completion declines the longer we go without a deal. It's no better than even money at this point. Gun to my head, I'd bet the 'Don't Come' right now.
- No imminent ramifications for the risk rally, but as we approach mid-month, the odds of a Presidential tweet bomb about China's renegeing (again) will rise appreciably.
- I'm running long U.S. equity risk and looking to re-set my hedge via puts on the Hang Seng Index (my Dec expiry puts having now traded deep out-of-the-money).
- Targeting 27,800-28,000 to buy more HSI puts:

