FISCHER STRALEM

300 Madison Avenue, New York, NY 10017

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Dear Client:

As you well know, in the decades prior to the global pandemic, the fourth quarter was the time of year which found us in China evaluating the business backdrop for investment opportunities in U.S. large cap companies. While our travel wings have been clipped by a myriad of impediments in the past few years, we still do our best to stay abreast of evolving opportunities and use the fourth quarter quarterly letter to share our findings with you. We have already begun this discovery process, and immediately find ourselves down the proverbial information rabbit hole regarding trade and the realities of economic decoupling.

As the pandemic-era boom in U.S. imports has cooled off, our purchases from China have come down dramatically. Data from the Department of Commerce shows China accounts for ~14% of U.S. imports, down from a pre-trade war (2018) high of ~22%. This has led some to conclude that trade decoupling is in full swing, and that China is losing its access to the U.S. market. We have begun to learn, via conversations with contacts, the truth is more complex.

The main impact of the trade and technology war and its associated tariffs has not been to cut our dependence on Chinese goods, but to make supply chains more complicated, elongated, and opaque. So, while the share of U.S. imports coming directly from China has declined, one contact who tracks such data says it's not the eight percentage point suggested in the headline number. Much of the measured decline is the result of re-routing shipments through regional "middle-man" countries. In our contacts words, "bilateral trade data is an increasingly poor gauge of US/China interdependence".

Tariffs and trade restrictions work to deter trade by raising the costs involved -- but at the same time those costs create stronger incentives for companies to evade and reduce them. While much of this remains circumstantial, from what we have been advised, the anecdotal evidence strongly supports that Chinese exporters are shipping goods to factories and warehouses in Southeast Asia -- Vietnam, Thailand, Cambodia -- either for direct shipment to the U.S., or for final assembly and small value-add-ons. And it is very likely that China is diverting shipments to the U.S. through other trading partners as well, although at a smaller and less obvious scale.

The real drop in China's share of U.S. imports is therefore probably not to 14% from 21%, but something closer to 20% -- not an insignificant change, but not exactly a world-changing one either. In response to higher barriers to trade, companies have adapted, both through simple tariff evasion and through more complex reworking of supply chains to include third countries. Whether this state of affairs can continue depends on whether the U.S. tries to aggressively crack down on these triangular flows. Beyond those specific examples, trade will continue to flourish, making it harder to discern the true level of U.S.-China interdependence.

Regards,

Adam S. Abelson
Chief Investment Officer
U.S. Large Cap Equity Strategy