Cornhill Management

View from the Dome

Newsletter, September 2019

Japan-South Korea trade war opens old wounds and puts the tech global supply chain at risk

World markets update

Get in touch if you want a meeting

Japan-South Korea trade war opens old wounds and puts the tech global supply chain at risk

While tense relations between Washington and Beijing are getting all the headlines, a separate, but equally acrimonious, trade spat between two of the world's biggest economies has been steadily worsening over the summer and is threatening supplies in one of the global economy's key industries.

Trade relations between Japan and South Korea have deteriorated to their worst level in decades and are already impacting both countries' economies, the global tech industry and a global economy already struggling to deal with the fall-out from the trade war between China and the US.

However, with governments in Tokyo and Seoul hardening their positions and the dispute even spilling out into matters of national security, there seems no end in sight for a conflict which, while unlikely to cause as many global problems as the dispute between the US and China, could have serious ramifications for some of the world's largest companies.

A century-old grudge?

The trade dispute between the two Asian neighbours ostensibly began in July when Japan announced restrictions on the exports of certain chemicals used in the production of semi-conductors – Korea's top export item – and display screens.

Tokyo claimed the move was based on national security concerns amid fears some of the restricted items were finding their way from South Korean companies into North Korea in violation of international sanctions.

South Korea denied the allegations, and when Tokyo earlier this month moved to take South Korea off a 'white list' of countries with fast-track export status, Seoul reacted by taking Japan off its own list of trusted trade partners.

"You have trade disputes that escalate and there's no hand brake anymore, so they roll over into security disputes — and then again, there's no hand brake, so they can continue to percolate and there's no obvious way to end them."

Deborah Elms
Executive Director
Asian Trade Centre

Japan's initial claims of fears over national security as justification for the export curbs have been doubted by many analysts as well as Korean politicians.

They believe, as Korean President Moon Jae-in has said publicly, the move is retaliation for a Korean court ruling last year related to Japan's colonial rule of South Korea from 1910 to 1945.

The Supreme Court's ruling that Japanese companies must compensate victims of forced labour during Japan's rule angered Tokyo which claimed it had already settled the matter in a 1965 treaty between the two countries.

Initial effects

Whatever the exact reasons, the effects of the decisions by both administrations are already being felt in both countries.

The semi-conductor industry is crucial to South Korea's economy: semi-conductor sales accounted for 92% of the country's export growth in 2018, the chip manufacturing sector was responsible for 21% of all exports last year, and Korean companies account for more than 60% of the global supply of components used in memory chips.

Now, though, local companies like Samsung and LG are desperately searching for new non-Japanese suppliers and the potential effects of the Japanese export curbs have worried investors – Samsung shares alone lost almost 6% between the start of July and mid-August.

The South Korean government has already had to pledge USD37bn of help to the key sector to help it become self-sufficient when it comes to crucial components.

Japanese firms have not been immune, though. South Koreans have boycotted some Japanese products, including beers from brewers Kirin, Asahi, Sapporo and Suntory. More than 60% of Japanese brewers' exports went to South Korea in 2018. But according to Korean data, imports of Japanese beer in July were down 45% on the previous month.

Japanese clothing companies have also been hit - fashion giant Fast Retailing's Uniqlo brand, which has nearly 190 outlets in South Korea, claims it has been affected. Meanwhile, sales of Japanese cars in South Korea were down a whopping 32% m-o-m in July.

The tourist industry has also not escaped unscathed. South Koreans accounted for the second largest number of foreign visitors to Japan last year, according to official data from Japan's tourism authorities. But visitor numbers were down 7.6% y-o-y in July and reservations in August and September have tailed off steeply.

The wider economic effects have yet to be seen – the measures on both sides have only just been implemented – but the potential disruption is significant as Japan and South Korea are each other's third-largest trading partners.

However, the Korean central bank has said it is considering more monetary stimulus to deal with the effects of the dispute and at the end of August ratings agency Moody's cut its economic growth forecast for the country to 2.0% - down from 2.1% - because of the trade spat.

Who will end up worse off?

Economists and analysts are divided on what effects the dispute will have on the two economies.

At first glance, it appears that Japan's much larger economy is likely to be less detrimentally affected. It is the third biggest economy in the world, compared to South Korea's economy which, although the fourth largest in Asia, is the 11th largest globally.

In 2018, Japan recorded a USD20bn trade surplus with Korea. Its aggregate investments in Korea were close to USD5bn, as opposed to Korea's roughly USD2bn in Japan. According to research by Bloomberg, South Korea is more reliant on Japan for key manufacturing components than vice-versa with Japan buying mainly raw materials from its neighbour. It buys less than 9% of its semiconductors from South Korea.

Kwon Tae-shin, head of the Korea Economic Research Institute, warned that, South Korea's "overall business ecosystem" could face trouble. He told AFP news agency: "Six out of 10 small and mid-sized firms will not be able to stand the measures for more than six months."

Korean semiconductor industry experts say that local firms have no real alternatives to Japanese suppliers of some of the materials affected by the export curbs.

However, others suggest the Japanese economy, and some of its firms – not just the companies which supply the materials directly subject to the export curbs, may feel some of the effects sooner or later.

In August, Park Jea-gun, president of the Korean Society of Semiconductor and Display Technology, told the Korea JoongAng Daily that if the conflict deepened, South Korea could decide to cut its exports of organic light emitting diode (OLED) screens, hitting Japanese electronics giants such as Sony.

"This will invariably create problems for them in electronics and smartphone production," he said.

There are also some who say the dispute has presented an opportunity.

NH-Amundi Asset Management has launched an equity fund investing in Korean suppliers they think will benefit from Japan's export curbs. The asset management firm, which manages around USD33bn of assets, is betting that local companies will turn to Korean suppliers for key parts and that this will eventually drive up their earnings growth potential.

Indeed, the South Korean firm Soulbrain Co, which is involved in the manufacturing of materials for semi-conductors, saw a more than 50% rise in its stock prices between the beginning of July and mid-August, as markets predicted the firm would get more orders from major local chipmakers like Samsung.

Global impact

While not yet having anywhere near the same global impact as the US-China trade dispute, the conflict between Japan and Korea has the potential to have a significant worldwide effect if left unresolved for much longer with experts warning that the global technology supply chain could come under threat.

Korean semi-conductor manufacturers Samsung Electronics and SK Hynix accounted for more than 60% of the global supply of components for memory chips in 2018, with customers including the likes of Apple and Huawei.

Following the new Japanese restrictions, Korean manufacturers will face issues in getting supplies from Japan, which in turn could mean production cuts or problems with quality as they turn to alternative sources.

With semi-conductors being used in almost all electronic products this could affect major tech and electronics firms making everything from PCs and laptops to TVs and smartphones, pushing up prices for consumers and driving down profits for firms in all parts of the world.

This would also be true in the US and China – the world's two largest economies – which are locked in their own damaging trade war.

No breakthrough in sight

The dispute comes as the global economy continues to slow under the weight of the Sino-US trade war and with many economies already feeling the effects of this, including Japan's and South Korea's, some economists have suggested neither Tokyo nor Seoul will be willing to drag their current spat into a long-term conflict that would do further damage to their economies.

However, there are few signs of this dispute ending anytime soon. In fact, both Tokyo and Seoul appear to be hardening their positions and the dispute has even spilled over into national security with South Korean officials announcing earlier this month they would no longer be sharing intelligence on North Korea's nuclear programme with Japan.

Attempts by third parties, including the US, to mediate have made little impact.

And some trade experts believe the situation could get worse before it gets better.

Speaking to cnbc.com, Deborah Elms, Executive Director at the Asian Trade Centre, said: "You have trade disputes that escalate and there's no hand brake anymore, so they roll over into security disputes — and then again, there's no hand brake, so they can continue to percolate and there's no obvious way to end them."

To find out more about our Cornhill funds or products please speak to your Regional Sales Manager or get in touch with us at ***newsletter@1cornhill.com***

WORLD MARKETS UPDATE

General

Global equity markets had a torrid time in August with trade tensions between the US and China rising alongside fears of a global economic slowdown. The MSCI World Index reflected this losing 2.0%. With sentiment decidedly risk-off amid elevated volatility, it was perhaps unsurprising that emerging market (EM) equities underperformed their developed peers. The MSCI EM index lost 4.8%.

Some of the biggest falls were in markets with close ties to China and likely to be most affected by the fall-out from the trade dispute. Equities in major Asian markets were down – Hong Kong had a very poor time, although this was not entirely because of trade concerns – but worries over the ongoing dispute between Washington and Beijing weighed heavily on sentiment in other regions as well.

However, even those potentially least affected directly by the Sino-US spat were not spared from poor performance. The most spectacular market losses in August came in Argentina where stocks plummeted, shedding a whopping 50%, after the electorate delivered a political shock. The negative returns for stocks in the rest of Latin America could be classed as a stunning outperformance in comparison.

US

S&P 500	-1.6%	Dow Jones	-1.3%
MSCI USA	-1.7%	NASDAQ	-2.5%

US markets fell in August, pushing lower as the trade dispute between Washington and Beijing escalated. President Donald Trump's announcement at the start of the month of plans to impose new tariffs on Chinese goods set the tone for the rest of August and prompted retaliatory measures from China. Fears of an all-out trade war were elevated throughout the period. Energy stocks led the way down as oil prices fell on fears that demand will weaken as the effects of the trade dispute begin to bite. Financial shares were also down.

Meanwhile, economic data suggested the US economy is feeling the effects of the dispute with manufacturing a notable weak spot. GDP grew at a downwardly revised 2.0% in 2Q2019. It is the weakest growth for the US economy since the start of 2017. However, consumer spending grew 4.7% in the same period, topping all forecasts and the biggest gain since 2014. There had been fears that the trade war could eventually push consumers to cut back on spending, although the latest figures indicate otherwise.

Going into the coming month, it is hard to predict what may happen with the trade dispute. The latest is that both sides have agreed to resume face to face talks in October. While that announcement helped markets to an extent, the history of this conflict suggests pinning hopes of any meaningful breakthrough in any single series of meetings is probably unwise. The latest round of tariffs imposed by each country is in effect with the US planning more for October and China ready to respond with others in December.

Europe

MSCI EMU	-1.2%	DAX	-2.0%
FTSE 250	-1.1%	CAC 40	-0.7%

European stocks ended August with a moderate loss. The month had started poorly amid trade tensions, but local markets managed to make up some ground later on as rhetoric out of the White House appeared to soften. The MSCI EMU GR index closed 1.2% lower and many of the major regional bourses ended in negative territory.

Within individual sectors, defensive shares, such as healthcare and consumer staples, saw the best performance, while financials and energy stocks fared worst.

However, August saw rising concerns over the regional economy, and particularly Germany's amid further evidence that Europe's key economy is moving closer to recession. The latest Ifo Institute business climate index reading for the country came in at a seven-year low and fell for the fifth consecutive month. This comes after the German economy contracted 0.1% in 2Q2019 amid declines in investment and construction while the latest manufacturing Purchasing Managers' Index (PMI) reading was well in contraction territory at 43.6. The data fuelled speculation the European Central Bank (ECB) would move as soon as the coming month to try and help the Eurozone economy.

Politics was once again in focus with developments in Italy and Brexit making headlines. In the former, the ruling coalition collapsed, prompting market panic initially before it emerged a new coalition was in the offing. This was seen as better for the market environment. Clarity on the UK's exit from the EU remained elusive, at best, as a no-deal Brexit appeared to become

more and more likely as the month went on sparking fierce debate and the prospect of an election.

Asia

MSCI Asia ex-Japan	-4.4%	Shanghai Composite	-1.6%
MSCI ASEAN	-4.0%	Nikkei 225	-1.2%
		SENSEX	-0.2%

The escalating Sino-US trade war weighed heavily on Asian equities and most of the region's major indices closed lower. The MSCI AC Asia ex Japan GR index was down 4.4% and the MSCI Japan index lost 1.0% in the month.

In Japan, the main local benchmarks registered significant losses with trade concerns blighting sentiment. During the month it was reported that nearly 70% of major Japanese companies view the domestic economy as having levelled off and 10 percent believe it has already started to contract, affected partly by the prolonged US-China trade dispute. Meanwhile, nominal JPY-denominated merchandise exports fell 1.6% y-o-y in July. The contraction was driven by falling exports to China. But data on economic growth provided some cheer, with the economy expanding at a better than expected 1.8% in the second quarter of the year, driven by household consumption and capital expenditure.

In China, the mainland benchmarks ended in negative territory although losses were not overly large with investors having reacted positively to government announcements of various measures to help boost the economy. This comes as economic data continues to underwhelm – the latest readings for industrial output, retail sales and fixed-asset investment have all been disappointing. Meanwhile, the manufacturing Purchasing Managers' Index (PMI) reading published by the National Bureau of Statistics and the China Federation of Logistics and Purchasing dropped to 49.5% in August from July's 49.7%, remaining below the 50.0% threshold that separates contraction from expansion in the manufacturing sector for the fourth month in a row.

There were very heavy falls for equities in Hong Kong – which was the worst performer in the region - with the Hang Seng index giving up more than 7% over the month. This came amid not just trade worries but violent anti-government protests. There are growing concerns the Hong Kong economy could be pushed into recession as the protests affect the city's tourist and retail industries, among others.

In Taiwan, the trade war also weighed on performance with the local market delivering negative returns. In other news, Taiwan's merchandise exports decreased 0.5% in July compared to the same month a year earlier. Export orders fell 4.5% in June, which is slightly better than the 5.8% decrease in May but still suggests that Taiwan's external sector will remain plagued by weak demand in the coming months. The PMI reading for August rose slightly on July, standing at 48.2, but still showing the local manufacturing sector in contraction.

Elsewhere, the South Korean market saw large falls too as trade worries hurt sentiment. However, the concerns were not limited to the US-China spat as Korea's own trade problems with Japan worsened. Seoul and Tokyo have been at loggerheads for months after Japan imposed restrictions on exports to South Korea of materials used in the manufacture of semi-conductors, which are the country's top export items. The Korean central bank's composite consumer sentiment index dropped to 92.5 in August from 95.9 in July, likely due in part to trade tensions with Japan.

India's main equity benchmarks ended August in negative territory as investors fretted over the country's slowing economy. Latest data has confirmed economic growth is slowing - India's GDP growth rate stood at 5% in the last quarter, according to official data, compared to 8% in the same period last year – and during the month the government announced a package of measures to stimulate the economy and cancelled plans for extra taxes on very high earnings. The plans for the higher taxes had spooked markets and foreign investors, who would have been among those most affected by the levy, and as a consequence they have been pulling money out of Indian markets since the tax was announced in the budget in July. The central bank reacted to the weakening economy by cutting its key lending rate by a larger than expected 35 basis points. The move has raised expectations of greater monetary policy support.

As with most emerging markets in the month, equities in the ASEAN region finished lower as investors fretted over what effects the ongoing trade war between Washington and Beijing could have on the region. The MSCI AS ASEAN GR index lost 4.0%. Economic data from around the region presented a mixed picture – Singapore's Purchasing Managers' Index (PMI) reading for August came in at 49.9, up marginally from July's 49.8 reading but still in contraction territory. In Thailand, the central bank cut its policy rate by 25 basis points, from 1.75% to 1.50% as data showed economic growth decelerating. Indonesia's economy expanded 5.0% in the second quarter, down from 5.1% in the first quarter. But Malaysia's economy grew 4.9% in annual terms in the second quarter, up from 4.5% y-o-y in the previous quarter.

Latin America

MSCI Latin America	-8.1%	FBOVESPA	-0.7%
MSCI Brazil	-9.1%	MSCI Mexico	-0.4%
MSCI Argentina	-50.4%		

Equities in Latin America performed very poorly in August with the MSCI Latin America index losing over 8% for the month and all regional markets seeing falls. Argentina saw a spectacular drop – the MSCI Argentina GR index lost more than 50% – as the country was plunged into crisis following the defeat of incumbent President Mauricio Macri in primary elections. The result of the elections, which are designed to whittle down the number of candidates who will take part in full presidential elections due to be held later this year, shocked markets and prompted a massive sell off in local equities and the currency. Populist-opposition candidate Alberto Fernandez is thought likely to repeat his win in the presidential elections. Since the primary, Argentina, whose economy is in recession and is blighted by astronomic inflation, has been forced to run down its foreign reserves in a desperate bid to prop up the flailing currency and the government unilaterally announced a restructuring of USD100bn of debt. Ratings agency S&P briefly cut the country's credit rating to selective default.

With general sentiment on emerging markets (EM) turning sour, other markets in the region struggled. Falls for the Brazilian currency hurt local equities' returns in USD. Problems with the Mercosur trade deal between regional countries and the European Union surfaced as the Brazilian government threatened to pull out of the deal if Argentina's populist opposition presidential candidate comes to power later this year. EU leaders also warned they could back out of the deal over President Jair Bolsonara's failure to deal with raging fires in the Amazon.

However, there were further signs the Brazilian economy is slowly turning the corner as it was reported the unemployment rate fell to 11.8% in the second quarter and the economy grew at 1.0% y-o-y and 0.4% q-o-q over the same period. The latter reading means the economy escapes falling into recession.

Relatively speaking the Mexican market outperformed with the MSCI Mexico index ending with a marginal 0.4% loss for the month. During August the central bank cut rates by 25 basis points to 8.0% and left the door open to further cuts. Investors also welcomed news that President Andres Manuel Lopez Obrador had reached a deal putting an end to a dispute over pipeline contracts. Latest economic growth readings were also positive while industrial production rose 1.1% in June having fallen in May.

Africa

MSCI Africa	-0.1%	FTSE/JSE	-8.4%
MSCI South Africa	-8.9%	NSE	-0.7%
MSCI Kenya	1.3%		

It was a mixed month for major African markets with some seeing surprisingly strong gains and others heavy losses. Egyptian equities were the standout performers. The MSCI Egypt GR index rose just a shade under 10%. Among the developments driving the gains was a larger than expected rate cut from the central bank. It was the first cut since February and came with July inflation readings well below expectations. Analysts have called for further cuts to give a significant boost to investment.

The MSCI Kenya GR index finished in positive territory for the month, although there were some losses registered by the narrower local gauges and some large caps saw notable falls. Foreign investors were net buyers for August, having been net sellers in July.

Nigerian equities finished well down with the MSCI Nigeria GR index losing 4.5%. The local market saw continuous selling pressure over the month and with analysts pointing to a lack of any positive catalysts, September is unlikely to be much better.

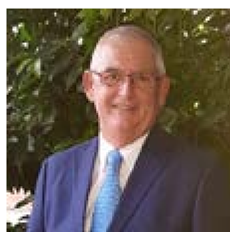
The big loser in the region in August was South Africa which saw currency volatility – the ZAR recorded its worst month since February – and investors fretting about trade, the global and domestic economies. The MSCI South Africa GR index shed just under 9% over the month with financials struggling with a weak local ZAR and banks and industrials also seeing sharp falls. There were some gains though for gold miners amid rising bullion prices as risk-off sentiment pushed global investors to safe haven assets. Overall performance was also helped by gains for ZAR-hedge stocks. Economic worries persisted, but there was some cheer as South Africa managed to avoid a second recession in as many years as data showed the economy expanding at an annualised rate of 3.1% in the second quarter of the year. The beleaguered electricity utility, Eskom, was in the news once again. The company, which supplies 90% of the country's energy, is mired in debt and relies on state bailouts to keep it operational. The government plans to sink more than USD4bn into Eskom over the next two years on top of other multi-billion USD bailouts already planned over the coming three years. At the end of the month the government presented a plan to restructure the company and potentially sell off some of its debts, even as it admitted Eskom may need even more funds by March next year. There are concerns over state finances because of the continued help for the company and that the government could find itself in a debt trap. ■

To find out more please speak to your Regional Sales Manager or get in touch with us at ***newsletter@1cornhill.com***

Cornhill Sales Diary

Welcome to the Cornhill Sales Diary… here we outline the upcoming movements of our Sales team. If you would like to meet with any of them while they are in your region, please drop them a line.

IN ASIA this month…



Karl Flood

Regional Manager Asia

Covering Thailand, Vietnam, Cambodia, Philippines, Laos, Myanmar

karl.flood@1cornhill.com

September

Su	Mo	Tu	We	Th	Fr	Sa
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	1	2	3	4	5

Karl will spend the last two weeks of September travelling through the Philippines and Vietnam

IN ASIA this month...

Richard James
Regional Manager Asia
Covering Malaysia, Indonesia, Japan, Singapore, Hong Kong, China
richard.james@1cornhill.com

September

Su	Mo	Tu	We	Th	Fr	Sa
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	1	2	3	4	5

Hong Kong

Malaysia

Richard is going to be in Hong Kong on 17 and 18 September; rest of the month in Malaysia.

IN CONTINENTAL EUROPE this month...

Colin MacLean
Regional Manager Europe
colin.maclean@1cornhill.com

September

Su	Mo	Tu	We	Th	Fr	Sa
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	1	2	3	4	5

Canceled

Unfortunately, Colin has had to cancel all travel in September until he recovers from a collar bone injury.
All the best Colin – get well soon!

IN THE MEDITERRANEAN this month...

Kenneth Hughes
Director – Global Sales
kenneth.hughes@1cornhill.com

September

Su	Mo	Tu	We	Th	Fr	Sa
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	1	2	3	4	5

Ken will be based in Cyprus for the month of September

IN THE MIDDLE EAST, AFRICA AND ASIA this month...

Simon Smith
Regional Director
Middle East, Africa and India
simon.smith@1cornhill.com

September

Su	Mo	Tu	We	Th	Fr	Sa	
1	2	3	4	5	6	7	India
8	9	10	11	12	13	14	
15	16	17	18	19	20	21	Dubai
22	23	24	25	26	27	28	India
29	30	1	2	3	4	5	

Simon will spend the first half of September in India, the third week in Dubai before popping back to India for the final week of the month.

IN THE MIDDLE EAST, AFRICA AND ASIA this month...

David Oliver

Regional Manager Africa

Covering South Africa, Botswana, Zimbabwe and Mauritius

david.oliver@1cornhill.com

September

Su	Mo	Tu	We	Th	Fr	Sa
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	1	2	3	4	5

holiday!

Mauritius

David will be taking a well-deserved two-week vacation in the middle of September.
On his return he will be in Mauritius for 5 days.