October 29, 2024

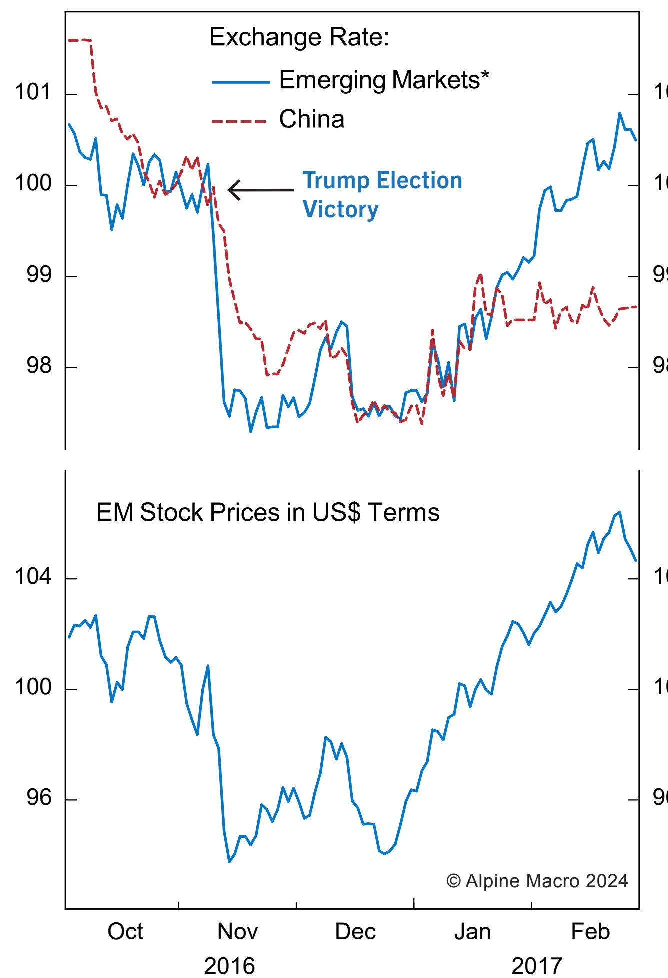
Trump 2.0: EM Lessons From His First Term

In This Report

All eyes will be on the U.S. presidential elections next week. The race remains too tight to call, with slightly higher odds favoring former President Donald Trump.[1] We expect President Trump, once in office, to water down his aggressive tariff threats and likely govern more pragmatically. Nonetheless, it will only be feasible to analyze potential U.S. policies and priorities once we know who wins the election, the makeup of Congress, and key members of the Cabinet.

In the near term, EM assets are bracing for essentially a binary outcome pending the U.S. election, with China as the primary focus. A victory by Vice President Kamala Harris ensures consistency and continuity, while a Trump 2.0 would lead to an abrupt policy shift on many fronts (**Chart 1**). Shorting the Chinese RMB, especially against the Japanese yen, could be a low-risk hedging tool. Meanwhile, the macro backdrop, including Fed policy and the performance of the dollar, also plays an important role in driving EM assets. On this front, today's situation is very different from the end of 2016 when Trump won his first term.

Chart 1 Frist Trump Shock



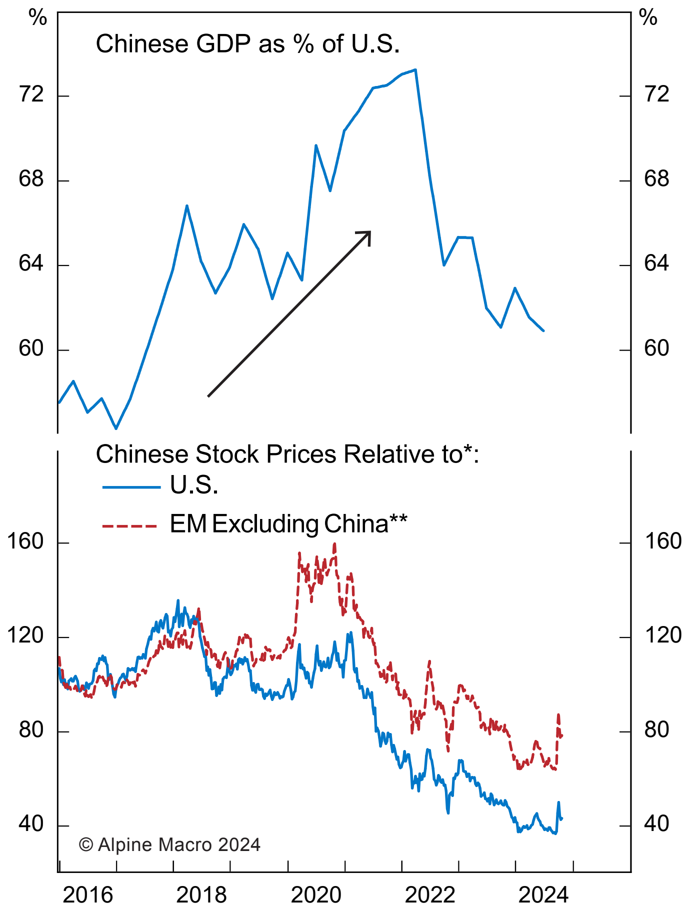
*Calculated as stock prices in US$ terms divided by those in local currency terms
Note: All series are rebased to Nov 6, 2016=100; source: MSCI

How Will Beijing Respond?

The U.S. election could be one reason why Beijing has so far not released concrete numbers for its latest growth push. Officials indicated that the stimulus package requires legislative approval,

1 Alpine Macro *Geopolitical Strategy* "United States: (Still) Trump's Election To Lose" (October 24, 2024).

Chart 2 How Did China Fare During Trump's First Term?

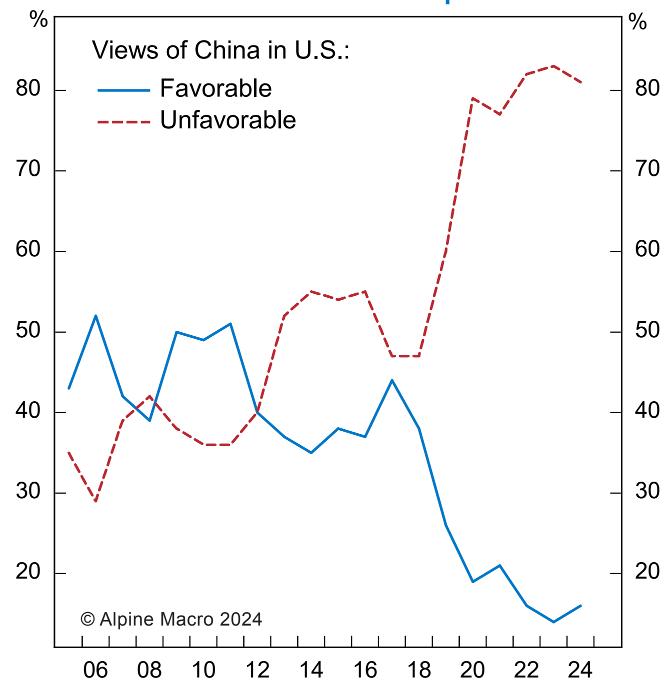


*Series are rebased to Jan 2017=100
**Source: MSCI; Bloomberg Finance L.P.

likely from the Standing Committee of the National People's Congress, which is scheduled to hold its next session from November 4th to 8th. It is worth noting that China's policy U-turn was announced on September 24th, a few days after the first Fed rate cut. Beijing may wait for some clarity on the U.S. election to map out its game plan.

While Beijing may be bracing for a second Trump presidency, in his first term, China's economic growth and stock market performance were fairly robust. Despite Trump's "full court press" tactics on trade and many other issue, China's real GDP growth was far higher than the U.S. level between

Chart 3 Deterioration Of China's Image In America Since Trump's First Term



Note: "Don't know" responses are not shown
Source: Pew Research Center

the beginning of 2017 and the end of 2020. In nominal dollar terms, the size of the Chinese economy was rapidly catching up to the U.S. (**Chart 2**). Meanwhile, Chinese stocks were among the best performers during those four years, largely on par with the U.S. market, and massively outperforming the rest of EM and DM.

Fast forward to today, China is in a far weaker economic and geopolitical position compared to eight years ago.

- Internally, China is struggling with a sharp growth downturn, a housing market meltdown, and intense deflationary pressure.

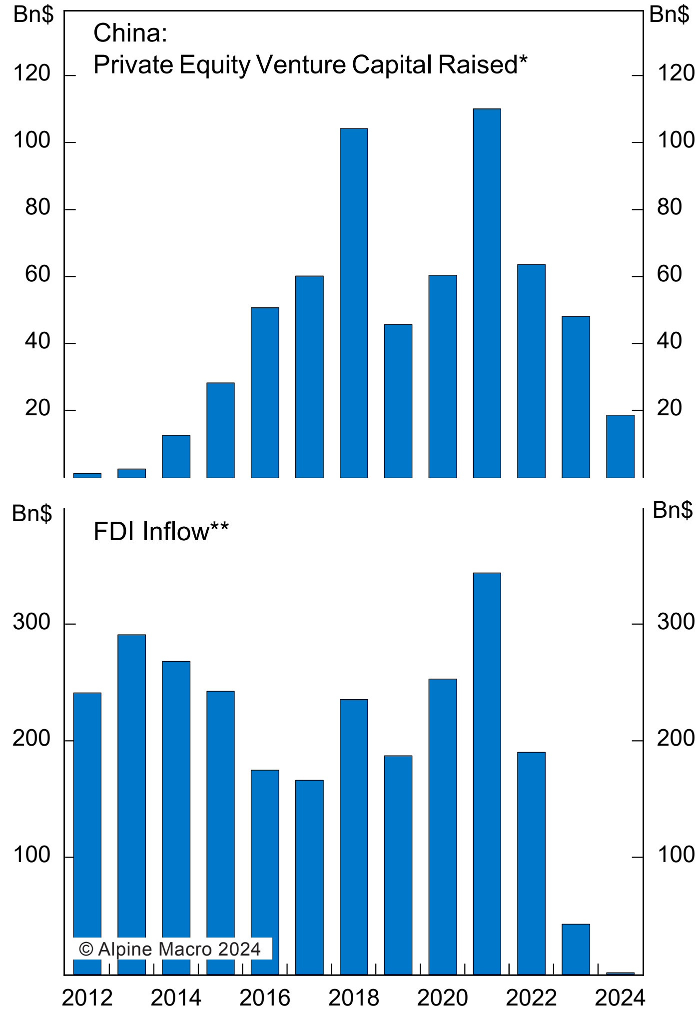
- Globally, China is regarded as the "public enemy number one" by both U.S. political parties and is viewed much more negatively than during Trump's first term (**Chart 3**). Beijing's relationships with many other major economies, especially Europe, have also become very strained due to its stance on the Russia-Ukraine war. Imposing punitive tariffs on Chinese goods, which were very rare and mostly targeted specific products eight years ago, is now much more commonly used by many countries.

To some extent, this may be attributable to Washington's strategy to rally allies and build an effective "anti-China encirclement." However, most of China's current problems are self-inflicted: Cyclically, Beijing had refused to use strong countercyclical measures to support aggregate demand, creating a deflationary downward spiral. Structurally, its many policy flip-flops have severely damaged business confidence and entrepreneurship, leading to a widespread confidence crisis (Chart 4).

It appears Beijing has made a complete policy U-turn on all these fronts since the end of September.[2] Even diplomatically, Beijing has been mending ties with other major countries. China is resuming imports of seafood from Japan, a year after banning them in response to Japan's release of treated radioactive water into the ocean. Last week, China and India began implementing a new border agreement to end the military standoff, the biggest thaw between the two countries since deadly clashes between their armies four years ago. Meanwhile, Beijing has refrained from aggressive tit-for-tat retaliation against the EU's decision to impose tariffs on Chinese EVs and has also been trying to improve relations with the U.K.'s new government.

2 Alpine Macro *EM & China Strategy Special Alert* "China's 'Whatever It Takes' Moment?'" (September 24, 2024).

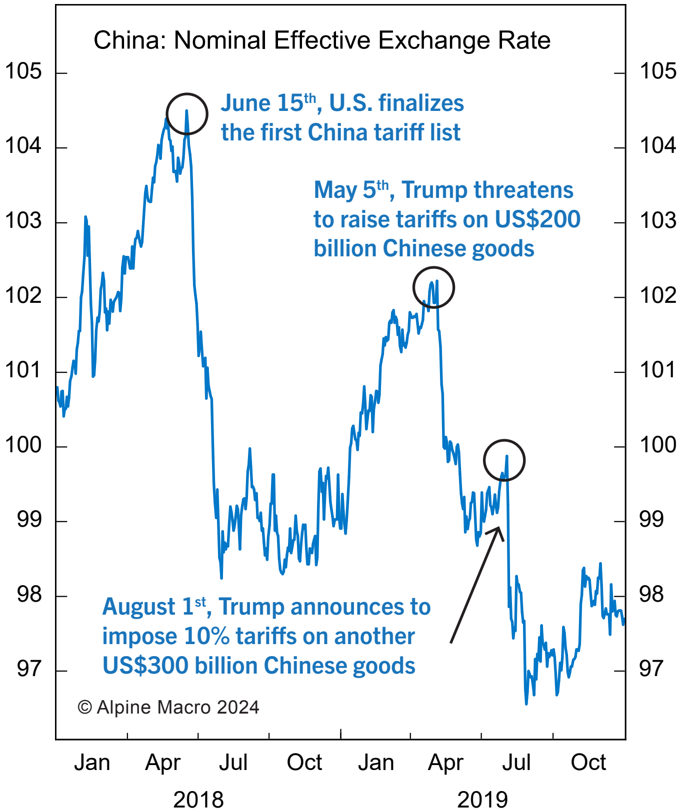
Chart 4 China: Out Of Investors' Favor



*Data for 2024 is as of October; source: Bloomberg Finance L.P.
**Shown as 4-quarter moving sum

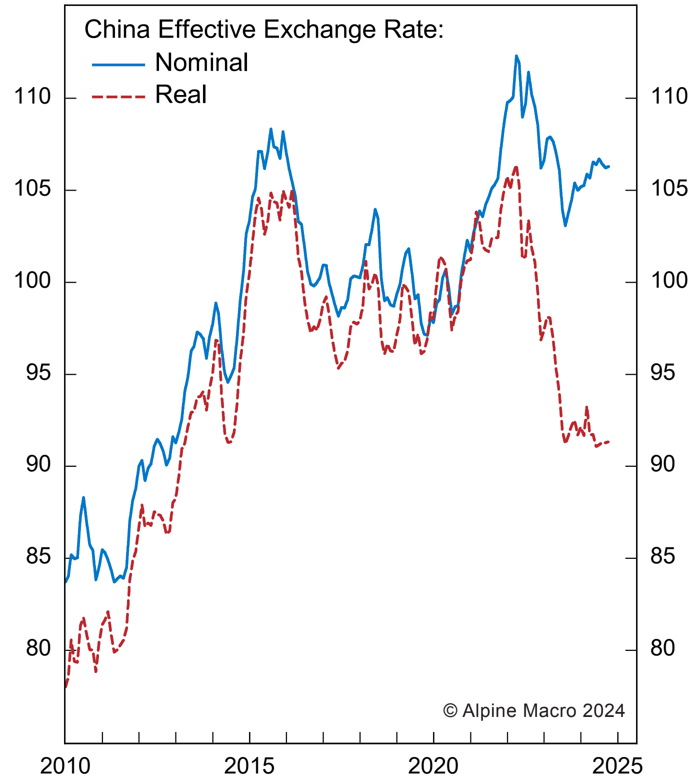
The key takeaway is that for a large economy like China's, domestic policies matter decisively more than global factors. External demand certainly plays a role, but China's business cycle has historically always been driven by domestic policies. In this vein, Beijing's ongoing policy shift is much more important than the U.S. election outcome. The upshot is that the growth downturn and pervasive pessimism have pushed Chinese asset prices and most economic variables to extremely depressed levels, and it may not take much to trigger a sharp

Chart 5 The RMB During "Trade War 1.0"



Source: BIS

Chart 6 The RMB Needs To Cheapen



Source: BIS

improvement.[3] Beyond the near term, it remains to be seen whether Chinese policymakers can regain trust and rebuild credibility among domestic entrepreneurs and international investors.

The Case Against The RMB

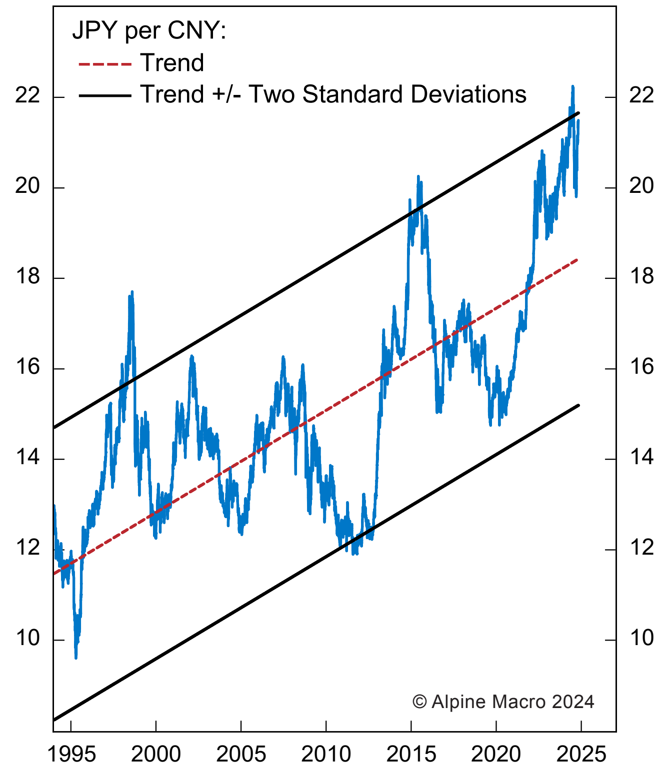
It makes sense to short the Chinese currency, both for fundamental reasons and as a hedge against near-term U.S. election uncertainty. A Trump victory and the threat of imposing 60% tariffs on all Chinese imports could create severe downward pressure on the currency. In Trump's first term, the RMB always depreciated when the U.S. imposed tariffs on Chinese products (**Chart 5**).

3 Alpine Macro *EM & China Strategy* "Will Chinese Reflation Work?" (October 22, 2024).

There is also a fundamental case for the RMB to weaken due to the intense deflationary pressure in the economy. In trade-weighted terms, the RMB is still hovering near record highs – only 5% below its all-time peak, which is clearly unjustified by the poor economic performance. Without nominal depreciation, the downward adjustment of the RMB has primarily occurred through price deflation, a much more painful process (**Chart 6**). In fact, aiming for a weaker RMB should be part of Beijing's reflation drive.

Traders can either short the CNY (CNH) versus the dollar or take out-of-the-money put options on CNY/USD in the coming days to hedge against election uncertainty. Meanwhile, we see attractive

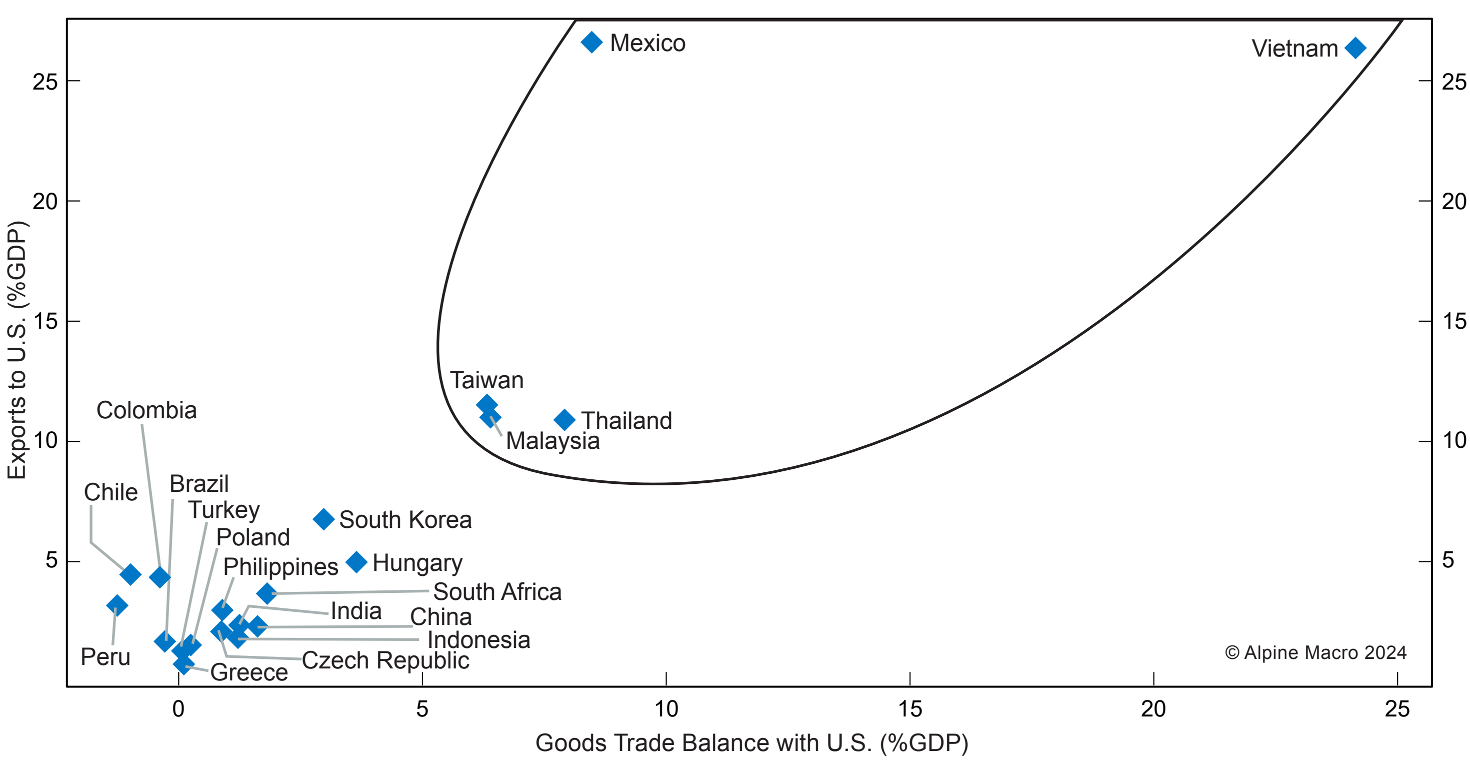
Chart 7 CNY/JPY And The Long-Term Trend



risk-return trade-offs in shorting the CNY versus the Japanese yen. The CNY/JPY cross has been on a long-term uptrend for several decades, with wild oscillations on both sides of a central trendline (Chart 7). Since 2021, the CNY has appreciated by a whopping 50% against the JPY, pushing it from a two-sigma undershoot to a two-sigma overshoot. Historically, such extreme levels often trigger a mean reversion in the other direction. After a brief pullback, the CNY appreciated against the JPY again in the past several weeks, creating an excellent entry point.

Bottom Line: The RMB should weaken in trade-weighted terms. Short CNY (CNH) versus the dollar as a short-term tactical hedge. Short CNY (CNH) versus the JPY as a longer-term strategic position.

Chart 8 Ranking EM Vulnerability To Trump's Potential Trade Policies

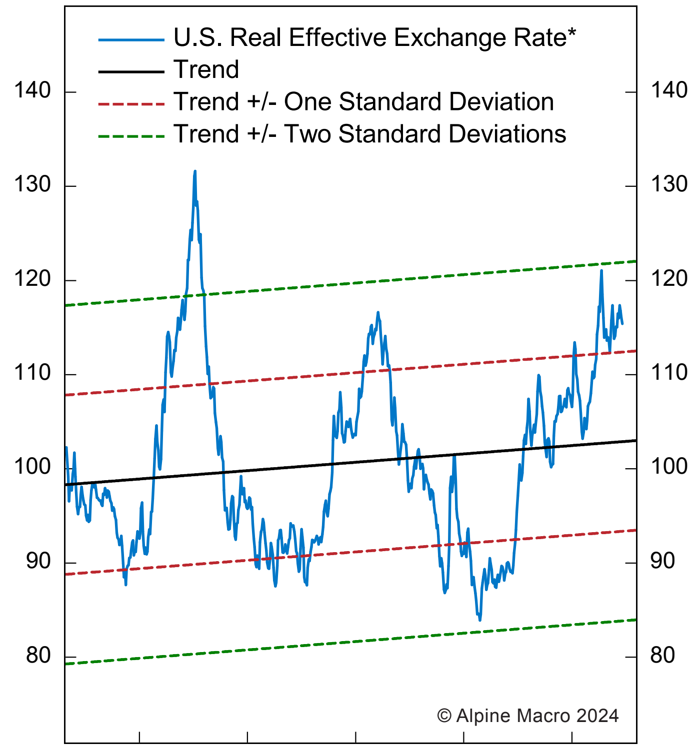


EM Macro Backdrop: Spot The Differences

Many EM countries will also be in the crosshairs of Trump's trade policy if he gets re-elected, as discussed in greater detail in an earlier report.[4] In a nutshell, those most reliant on U.S. sales and holding significant trade surpluses with the U.S. are the most vulnerable to Trump's protectionist policies. By this matrix, Mexico, Vietnam, Taiwan, and Malaysia are most exposed, while Chile, Colombia, Peru, Brazil, and South Africa are the least (**Chart 8**).

In addition, countries with free-trade agreements (FTAs) with the U.S. are also likely to be relatively safe. These include Singapore, South Korea, Chile, Peru, and Colombia. Mexico also has an FTA with the U.S. through the US-Mexico-Canada Agreement (USMCA), but it is unlikely to be immune from possible trade attacks under another Trump term.

Chart 9 **The Dollar Bull Market Is Stretched**



*Source: Federal Reserve

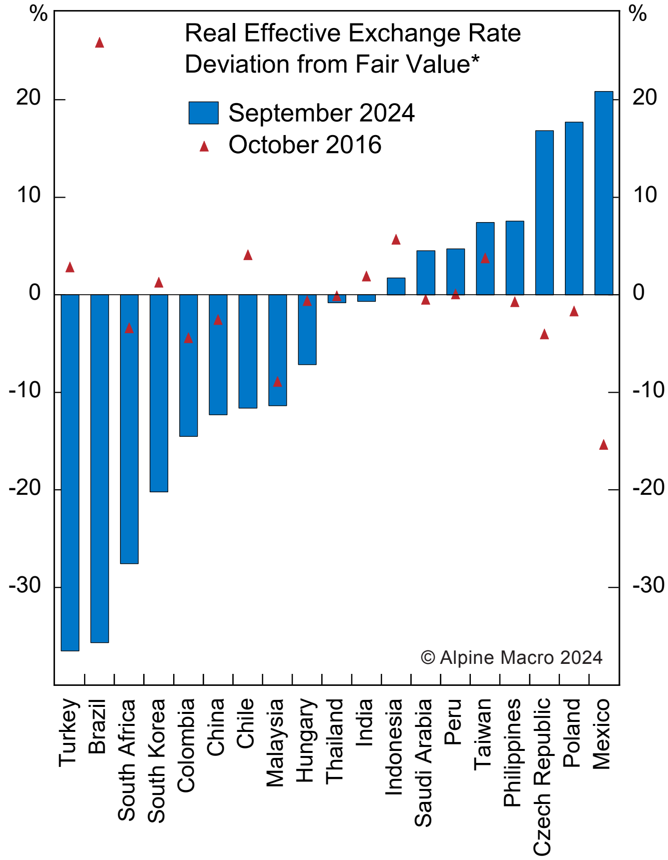
For the broader EM investment strategy, it is premature to adjust beyond any knee-jerk reactions. We will follow up and discuss the impact on EM assets once the U.S. political dust settles in the coming weeks and months. It is also important to keep in mind the big picture of other key macro factors affecting the performance of EM assets. More specifically, there are several important differences compared with the onset of Trump's first term.

The first is the trajectory of the U.S. dollar. At the end of 2016, the dollar was just emerging from an undervalued starting point after a prolonged bear market. But now, the dollar has become overvalued, and the bull trend has become stretched after a decade-long rally (**Chart 9**). The flip side of an expensive dollar is that most EM currencies are undervalued and much cheaper than eight years ago (**Chart 10**).

Second, there is a similar valuation gap for EM stocks. Stocks in most EM countries are trading at lower multiples than not only their DM counterparts but also their levels eight years ago – the only exceptions being India and Taiwan (**Chart 11**). This valuation buffer should offer a bigger safety margin against unexpected risks.

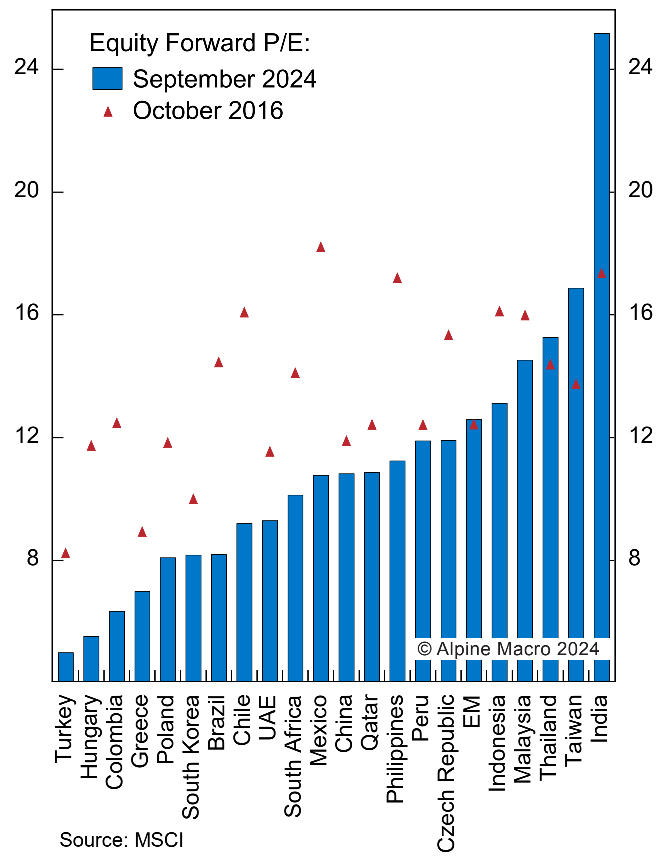
4 Alpine Macro *EM & China Strategy* "Trump 2.0: Impact On China And EM" (July 30, 2024).

Chart 10 EM Currencies Are More Undervalued Than Eight Years Ago...



*Alpine Macro proprietary indicator

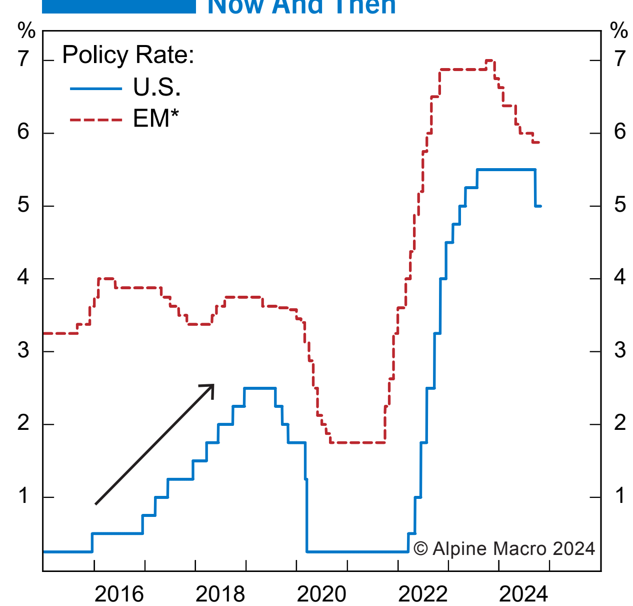
Chart 11 ... So Are EM Equities



Source: MSCI

Finally, another key difference is U.S. monetary policy. At the onset of President Trump's first term, the Fed was just embarking on a tightening cycle, putting upward pressure on both the dollar and interest rates in other EM countries (Chart 12). Currently, the Fed is at the beginning of an easing cycle, which is taking some heat off the dollar and allowing other EM countries to continue easing. Overall, this provides a much more favorable macro backdrop for EM assets.

Chart 12 Fed And EM Monetary Policies: Now And Then



*Median of 18 emerging economies; Alpine Macro proprietary indicator

Bottom Line: EM assets are facing heightened volatility until there is more clarity on the U.S. political landscape. While Trump's trade policies could pose risks, the undervaluation of EM currencies and stocks, along with a more favorable U.S. monetary policy, offer a more supportive macro backdrop for EM assets than eight years ago.

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Chief Emerging Markets & China Strategist

Investment Recommendations

Strategic Positions (6 - 12 months)				
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Long Colombian 10-year Government Bond, Currency Unhedged	11/21/2023		3.3%	Long Colombian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long MSCI Greece Equity Index	11/21/2023		5.0%	Long MSCI Greece Equity Index in US$ terms; stop point at -10%.
Long Indian 10-year Government Bond, Currency Unhedged	06/04/2024		3.5%	Long Indian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long Malaysian Equities, Currency Unhedged	08/20/2024		-0.5%	Long MSCI Malaysia Equity Index in US$ terms; stop point at -10%.
Long ASEAN Equities, Currency Unhedged	09/17/2024		-2.5%	Long MSCI EM ASEAN Index in US$ terms; stop point at -10%.
Long BRL/MXN	09/23/2024		0.0%	Long Brazilian *Real* versus Mexican Peso; stop point at -10%.
Short CNY/JPY	10/29/2024		-	Short Chinese Yuan against Japanese Yen; stop point at -5%.

Tactical Investment Positions (3 - 6 months)				
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Short CZK/HUF	06/05/2023		2.9%	Short Czech Koruna versus Hungarian Forint; rolling stop point at -5%, or -2.1% from current level.
Long MSCI China Equity Index	02/20/2024		28.3%	Long MSCI China Equity Index in US$ terms; rolling stop point at -10%, or -9% from current level.
Short COP/CLP	03/05/2024		9.4%	Short Colombian Peso versus Chilean Peso; rolling stop point at -5%, or -3.5% from current level.
Long CSI 300 Index	02/20/2024*		10.9%	Long China A-shares Index in US$ terms; stop point at -10%. *Trade opened on Feb 20, 2024, closed on Sep 13, 2024 and reopened on Sep 24, 2024.
Short CNY/USD	10/29/2024		-	Short Chinese Yuan against US Dollar; stop point at -5%.

EM Equity Country Allocation				
Strong Overweight	**Overweight**	**Neutral**	**Underweight**	**Strong Underweight**
	Brazil Chile China Colombia Greece South Africa Indonesia Philippines Malaysia Thailand South Korea		India Czech Republic Hungary Mexico Peru Poland Taiwan Turkey	

EM Equity Sector Allocation	
Strong Overweight	**Overweight**
	Materials Health Care Consumer Discretionary Consumer Staples
Neutral	
Energy Communication Services Information Technology Financials	
Strong Underweight	**Underweight**
	Industrials Utilities

EM Local-Currency Government Bond Allocation		
Overweight	**Neutral**	**Underweight**
Indonesia Peru Brazil Colombia Chile India	Poland Hungary South Korea Malaysia Philippines South Africa Mexico	Czech Republic Thailand China Taiwan Turkey

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