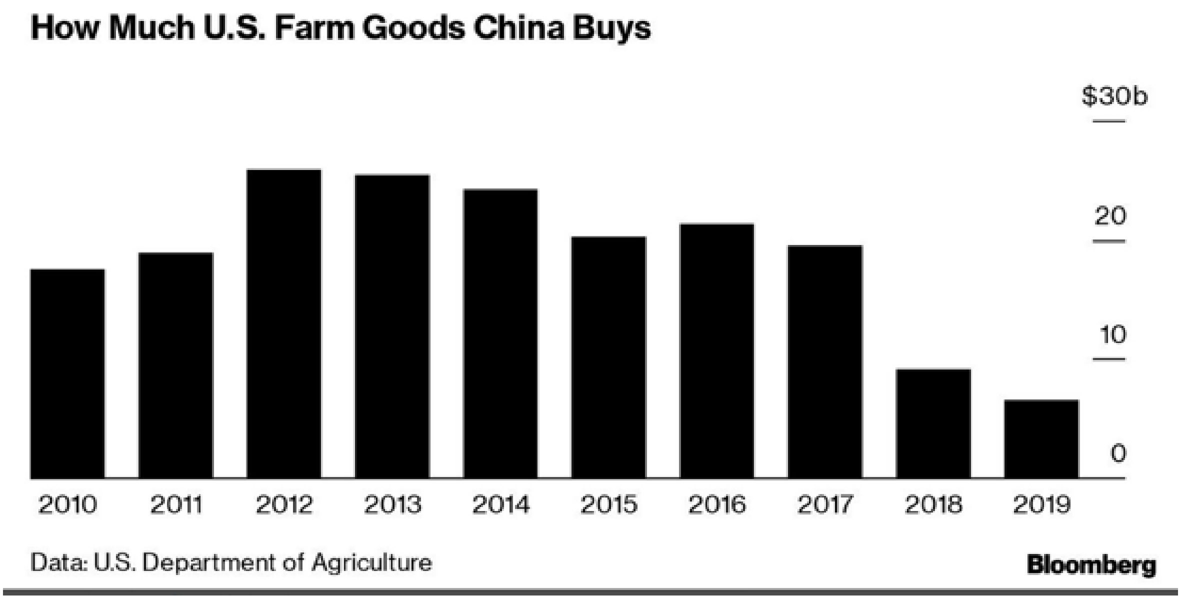
Unlike most trade deals where the terms are readily available, the details of the Phase One trade agreement between China and the U.S. will not be announced nor signed in public. Accordingly, investors are left to cobble together official comments, anonymous statements from officials, and rumors to ascertain how it might affect their portfolios.

Based on official and unofficial sources, existing tariffs will remain in place, new tariff hikes will be delayed, and China will purchase $40-50 billion in agricultural goods annually. At first blush, the ?deal? appears to be a hostage situation- China will buy more goods in exchange for tariff relief.

The chart below, courtesy of Bloomberg, provides reasons for skepticism. The rumored $40-50 billion in goods is nearly double what China purchased from the U.S. in any year of the last decade. It is over four times what they bought in 2018 before the trade war started in earnest.



The commitment is even more questionable when one considers that China recently agreed to purchase agricultural products from Brazil, Argentina, and New Zealand.

The following tweet by Karen Braun, (@kannbwx), a Global Agricultural Columnist for Thomson-Reuters, puts the massive commitment into further context. She claims that the maximum annual totalimport of four key agriculture products, only adds up to $56 billion. As she stresses in the tweet, the figures are based on the maximum amount China bought for each respective good in any one year.

Karen Braun @kannbwx · 13h

And because I am a data freak, I pulled the max values by year and added them together. That yields $56.4 billion.

By commodity:
#Corn $13.7B (2011)
#Soybeans $24.8B (2012)
#Wheat $11.3B (2008)
#Pork $6.65B (2014)

Notice none of them were in the same year.

Either China will buy more agriculture than they need and stockpile a tremendous amount of agriculture, which is possible, or they have agreed to something else that is not being disclosed. That, to us, seems more likely. We have a theory about what might not be disclosed and why it may matter to our investment portfolios.

Donald?s Dollar

Given the agreement as laid out in public, what else can China can offer that would satisfy President Trump? While there are many possibilities, the easiest and most beneficial commitment that China can offer the U.S. is a stronger yuan, and thus, a weaker dollar.

The tweets below highlight Trump?s disdain for the strengthening dollar.

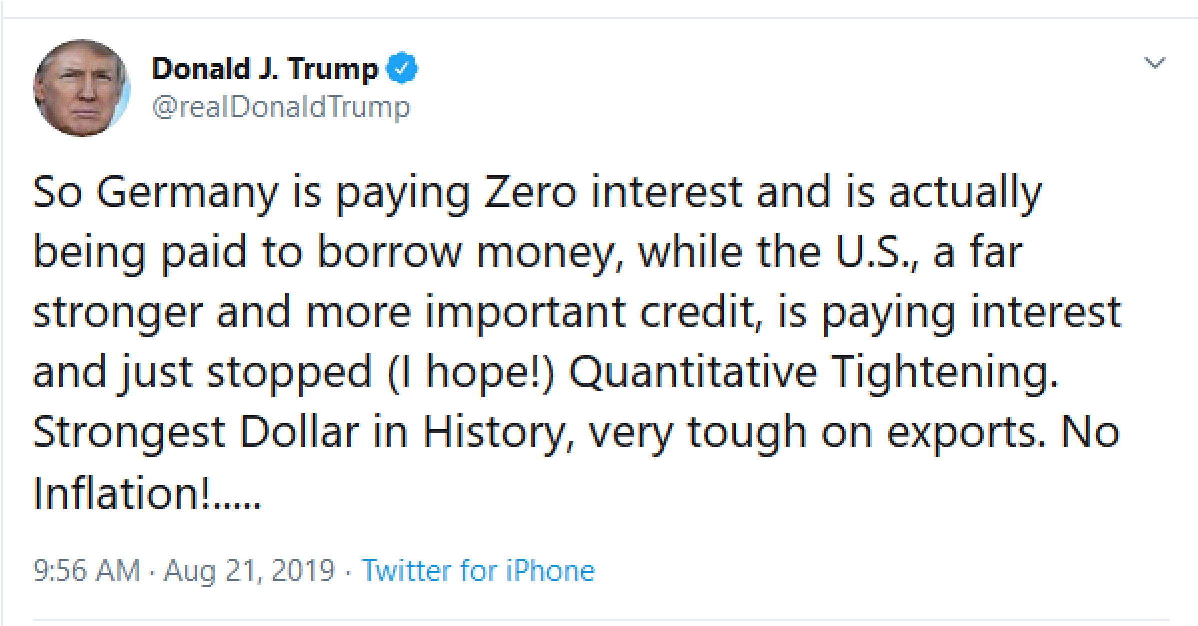
Donald J. Trump @realDonaldTrump · Aug 8, 2019

As your President, one would think that I would be thrilled with our very strong dollar. I am not! The Fed's high interest rate level, in comparison to other countries, is keeping the dollar high, making it more difficult for our great manufacturers like Caterpillar, Boeing,.....

Donald J. Trump
@realDonaldTrump

....John Deere, our car companies, & others, to compete on a level playing field. With substantial Fed Cuts (there is no inflation) and no quantitative tightening, the dollar will make it possible for our companies to win against any competition. We have the greatest companies...

70.9K 9:38 AM - Aug 8, 2019



A weaker dollar would reduce the U.S. trade deficit by making exports cheaper and imports more expensive. If sustained, it could provide an incentive for some companies to move production back to the U.S. This would help fulfill one of Trump?s core promises to voters, especially in ?fly over? states that pushed him over the top in the last election. Further, a weaker dollar is inflationary, which would boost *nominal* GDP and help satisfy the Fed?s craving for more inflation.

From China?s point of view, a weaker dollar/ stronger yuan would hurt their exporting sectors but allow them to buy U.S. goods at lower prices. This is an important consideration based on what we wrote on December 11th, in our RIA Pro daily Commentary:

?In part, due to skyrocketing pork prices, food prices in China have risen 19.1% year over year. In addition to hurting consumers, inflation makes monetary stimulus harder for the Bank of China to administer as it is inflationary. ***From a trade perspective, consumer inflation will likely be one factor that pushes Chinese leaders to come to some sort of Phase One agreement.****?*

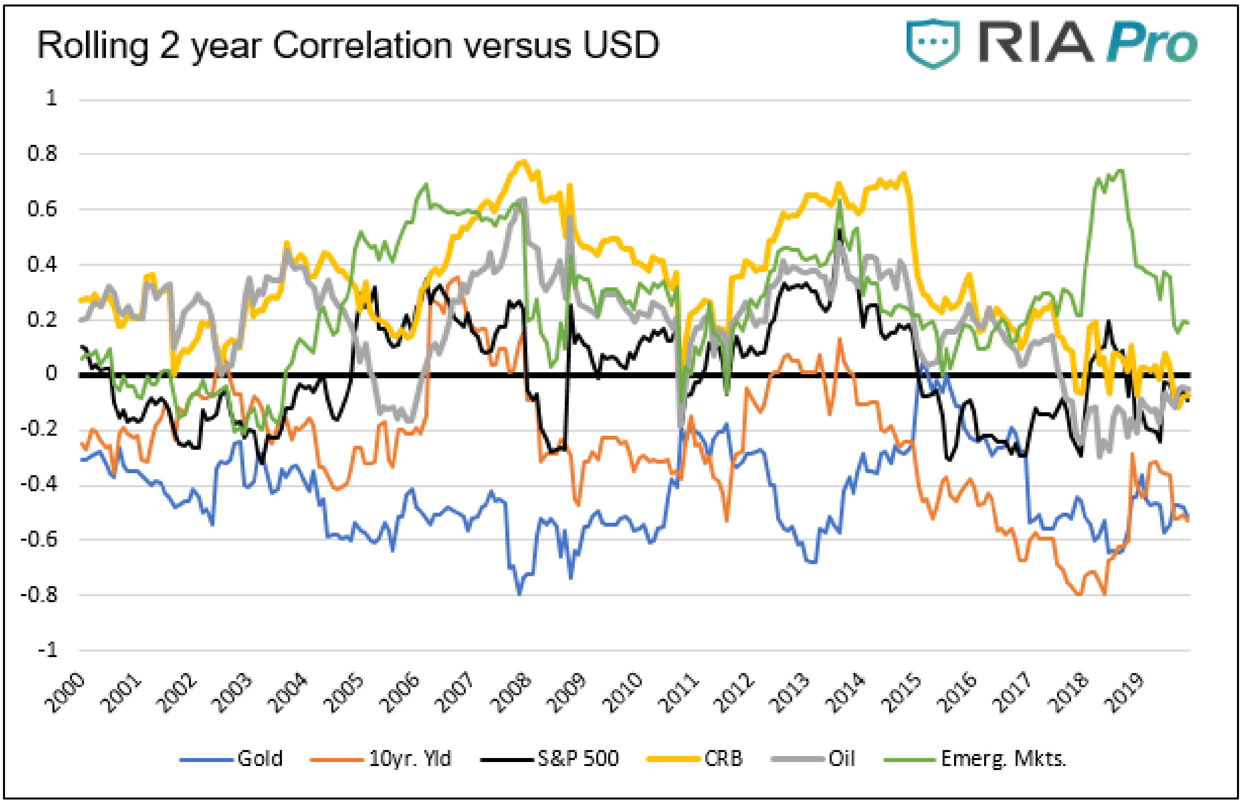
Food inflation is a growing problem for China and its leadership. In part, due to the issues in Hong Kong, Chairman Xi benefits from pleasing his people. While a stronger yuan would result in some lost trade and possibly jobs, the price of the agricultural goods will be lower which benefits the entire population.

A stronger yuan is not ideal for China, but it appears to be a nice tradeoff and something that benefits Trump. This is speculation, but if correct, and recent weakness in the dollar suggests it is, then we must assess how a weaker dollar affects our investment stance.

Investment Implications

The following table shows the recent and longer-term average monthly correlations between the U.S. dollar and various asset classes. Below the table is a graph that shows the history of the two-year running monthly correlations for these asset classes to provide more context.

	Current 2yr Correl. vs. USD	2010-Current Avg Correl. vs. USD
UST 10yr Yld	-0.532	-0.350
S&P 500	-0.092	0.025
Emerg. Mkts	0.192	0.294
Gold	-0.512	-0.383
Crude Oil	-0.048	0.140
CRB Index	-0.075	0.308



Data Courtesy Bloomberg

The takeaway from the data shown above is that gold and ten-year Treasury yields have a consistent negative correlation with the dollar. This means that we would expect higher gold prices and Treasury yields if the dollar weakens. Interestingly, the CRB (broad commodities index) and Emerging Equity Markets have the most positive correlation. Oil and the S&P 500 appear to be neutral.

The S&P 500 is a broad measure, so when looking at particular stocks or sectors, it is important to consider the size of the company(s) and the global or domestic nature of the company(s). For instance, domestic large-cap companies with global sales should benefit most from a weaker dollar, while small-cap domestic companies, reliant on foreign sources to produce their goods, should perform relatively poorly.

Summary

From the onset of negotiations, the China-US trade war has been tough to handicap. China has a lot to lose if they give in to Trump?s demands. Trump has leverage as a tariff war hits China?s economy harder than the U.S. economy. China is fully aware that the U.S. election is only 11 months away, and Trump?s re-election prospects are sensitive to the state of the economy and market sentiment. A trade victory should help Trump at the polls.

Our dollar thesis is speculation, but such an agreement is self-serving for both sides. Keep a close eye on the dollar, especially versus the yuan, as a weaker dollar has implications for all asset classes.