



Three Themes Investors Should Watch in U.S.-China Relations



Competition between these powers creates risk and opportunity.

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Lawmakers on both sides of the aisle increasingly view U.S. economic policy through the lens of strategic competition with China. Continued U.S. hawkishness would have important implications for markets and certain industries.

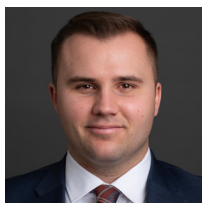
Let's explore three themes we're watching in U.S.-China relations over the near to medium term and what they might mean for investors.

1. The U.S. is focused on national security and gaining an edge in innovation.

This theme arguably runs throughout much of the major trade and economic policies that the U.S. has pursued over the past half-decade.

Recall the Trump administration's efforts limit China-based telecom equipment company Huawei's access to critical components from the U.S. and to encourage allies not to use the firm's products as they built out their 5G wireless networks.

In a more recent example, the U.S. Department of Commerce stipulated that companies receiving subsidies through the CHIPS and Science Act cannot build leading-edge semiconductor manufacturing capacity in China and other "entities of concern."



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This trend is likely to continue. Here's what could be coming down the pike.

The U.S. is considering expanding the list of technologies and Chinese companies covered by export controls. Here, surveillance and biotech could emerge as new areas of emphasis.

The tightening of outbound investment rules also bears watching. Over the medium to long term, this framework could evolve to the point that U.S. companies need to seek government approval before making certain investments in key countries.

This development, were it to happen, would mark a significant shift for U.S. investors in international markets. We will monitor the situation closely.

2. The U.S. may need to go its own way on some foreign policy issues.

The Biden administration has made a point of engaging more closely with

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traditional U.S. allies in pursuing its foreign policy objectives.

Earlier this year, for example, the U.S. reached an agreement whereby Japan and the Netherlands would introduce their own export controls on chipmaking equipment. These restrictions would reinforce the unilateral actions taken by the U.S. to limit China's access to advanced semiconductors and to impede its efforts to develop domestic capabilities in this area.

However, traditional allies may not be aligned with every new U.S. restriction on China. Diverging interests on key issues could lead to further tension with these partners, adding to geopolitical uncertainty.

3. Hawkish U.S. policies toward China may lead to a response.

China's response to recent U.S. export controls has been somewhat limited thus far, especially relative to the tit-for-tat trade tariffs that the two countries instituted while President Trump was in office.

However, at the end of March, China's Office of Cybersecurity Review issued a statement that it would investigate products sold by Micron Technology, a U.S.-based producer of memory chips, because of security concerns.

The details of this review and its outcomes remain to be seen. However, the announcement serves as a reminder that investors should be on the lookout for potential responses to U.S. trade and economic policies.

Key Takeaways for Investors

The gradual decoupling of U.S. and Chinese technology appears likely to continue. Investors should be clear eyed in understanding that a deterioration in relations between the two nations could increase the risk of further sanctions.

Still, these disruptive trends could create risks and opportunities for investors as the U.S. and China seek to shore up strategically important industries.

Companies that provide the software and the highly specialized equipment needed to design and manufacture semiconductors, for example, should benefit from the push to build chipmaking capacity in the U.S. and Europe.

We also see the potential for China to focus on expanding its capacity to produce less-advanced analog semiconductors, which could create the risk of that market segment becoming oversupplied in the medium to long term.

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