The Intersection of Geopolitics and Deglobalization

A fracturing of the global order will create risks and opportunities for investors.

Insight from sub-adviser Wellington Management

Thomas Mucha,
Geopolitical Strategist

As the devastating conflict and humanitarian catastrophe in the Middle East once again underscores, we find ourselves in the most complex, dangerous, and unpredictable geopolitical environment in decades. What do investors need to know while navigating the investment landscape?

These geopolitical challenges are likely to continue throughout 2024 and, indeed, for years to come as the Ukraine/Russia war, US/China great-power tensions, growing climate stresses, and other national-security issues further impact the global investment, policy, and macro backdrops.

Meanwhile, elevated geopolitical risk around the world is also raising new and important questions about the pace and direction of deglobalization.

In my conversations with global policymakers, it's clear these jarring geopolitical events are fracturing the global order and, importantly, strengthening a focus around national security—sometimes at the expense of economic efficiency.

As a result, I expect strategic decoupling (or "de-risking" in the current parlance) to be a key investment theme in 2024, particularly in industries critical to deepening great-power competition between the US and China.

To be sure, this doesn't mean globalization is dead.

But it does mean policymakers in Washington, Beijing, and elsewhere around the world may seek to protect and promote a growing number of strategic sectors central to establishing economic and military power in coming years and decades.

These "dual-use" civilian-military applications include semiconductors, next-generation communications, critical minerals, and a variety of other renewable energy inputs, biotech, space-related technologies, robotics and automation, as well as artificial intelligence and quantum computing, among others.

In the US, the CHIPS and Science Act, which is designed to boost US semiconductor manufacturing, is particularly instructive as are stringent export controls and proposed outbound investment restrictions on advanced semiconductors.

That's because these policy actions can be seen as a potential "blueprint" for how current and future US administrations and the US Congress will address great-power competition across strategic industries—working, wherever possible, with US allies globally to broaden the economic and geopolitical impacts of these measures.

This emerging industrial policy is a long way from the heady days of globalization, when policymakers were keen to take a more hands-off approach and allow markets and companies to more freely allocate capital.

But given the national security imperatives of great-power competition—and the myriad supply-chain disruptions the COVID-19 global pandemic revealed—I believe policymakers around the world will remain committed to reducing dependencies in these critical sectors in 2024 and, indeed, beyond.

Specific Geopolitical Risks to Watch in 2024

Given the focus on national security, I expect the global-policy environment and markets to be impacted by a number of geopolitical risks in 2024, including:

Key Points

- Jarring geopolitical events are fracturing the global order and placing a greater focus on national security.
- Globalization isn't dead but nations may grow and protect civilian-military applications such as semiconductors, AI, and quantum computing.
- Higher macro and market differentiation across the world may benefit actively managed strategies.

- The escalatory potential of the Israel-Gaza conflict, especially the significant energy, inflation, and monetary-policy implications a wider regional war could trigger
- Structural stresses in the US-China relationship, particularly around the outcome of Taiwan's presidential election in January and the US presidential election in November
- The escalatory potential of the Ukraine/Russia war, which shows few signs of ending soon
- The growing national-security challenges of climate change, as this accelerating trend further stresses "hot zone" regions across the equator and the tropics where many of the world's most intractable geopolitical problems currently reside

Other Geopolitical Risks Are Also Easy to Imagine in 2024:

- An increasing probability of global terrorism if the war in the Middle East escalates
- The risk of a major cyber-attack on US critical infrastructure amid new conflicts and rising great-power tensions
- An increasing probability of US domestic political violence in a contested US presidential election
- Rising information warfare and disinformation campaigns such as "deep fake" videos and other AI-enabled technologies taking root

Implications for Investors

Several key investment considerations come to light amid these ongoing shifts in the geopolitical and policy environments.

First, actively managed strategies have the potential to benefit from the higher macro and market differentiation that these disruptive policy developments may produce.

Properly marrying the right "bottom-up" analysis with these top-down geopolitical and policy trends may uncover numerous alpha[1] opportunities—at the regional, country, industry, company, and asset-class levels.

Second, several "great-power competition" investment themes may create additional alpha opportunities in 2024, including traditional defense contractors, defense innovation, climate resilience, and decarbonization.

These investment themes and others may enjoy government spending support for years to come. So, in general, consider whether getting more exposure to relevant thematic approaches should be a bigger part of the investment toolbox as these deepening structural shifts accelerate in 2024.

Finally, supply-chain and other policy disruptions in coming years may contribute to structurally higher inflation over time and lower global growth than we experienced in previous "goldilocks" eras.

Investors should consider how the macro implications of geopolitical risk, policy risk, and accelerating deglobalization could affect their investment strategy.

Talk to your financial professional for help with managing your portfolio in light of geopolitical risks.

[1] Alpha is the measure of the performance of a portfolio after adjusting for risk. Alpha is calculated by comparing the volatility of the portfolio to some benchmark. The alpha is the excess return of the portfolio over the benchmark.