

Geopolitical Risks and Financial Markets

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Purpose and Structure of the Panel

The July Board 2022 offsite includes the panel discussion of Geopolitical risks and Financial Markets. The objective is to enhance our understanding of the nature of geopolitical factors, how these factors influence financial markets, and the implications for long term investors. This panel gives the Board the opportunity to hear and question two experts experienced in analyzing the geopolitical influences on financial markets. To facilitate this discussion, we have identified three broad themes

1. The influence of geopolitical factors on near versus long term market outlooks. What are geopolitical factors? What do they influence? Do they change over time? What are the implications for long term investors?
2. Different perspectives on the current range of opportunities. Differences are created by a number of factors, including regional (e.g. Europe vs North America vs Asia), and market development (e.g. developed versus emerging markets)
3. Every country has its own culture, laws, objectives, governance, regulations, and capital markets. Is it reasonable to expect these countries to evolve to western, developed market standards and purposes? Or will we have to accept differences? What are the implications for ESG based investing?

Like many topics, there is a diversity of opinion regarding the geopolitical influences on world affairs. To further illustrate this diversity, we include the NIC 'Global Trends 2040: A More Contested World' as background reading. We provide this report as background material, separate from though related to the panel discussion. The panel discussion will reflect the views of the panelists. The remainder of this memo summarizes the Global Trends report.

The NIC Global Trends: 2040 Outlook

This report is published by The National Intelligence Council which supports the Director of National Intelligence. Since 1979 ["the NIC has served as a bridge between the intelligence and policy communities, a source of deep substantive expertise on intelligence issues, and a facilitator of Intelligence Community collaboration and outreach"](#). In the words of the authors, the Global Trends 2040 report

is designed to provide an analytic framework for policymakers early in each administration as they craft national security strategy and navigate an uncertain future. The goal is not to offer a specific prediction of the world in 2040; instead, our intent is to help policymakers and citizens see what may lie beyond the horizon and prepare for an array of possible futures.

The report is structured in three parts. The first section describes structural forces – demographics and human development, environment, economics, and technology - likely to influence the future shape of the world:

Demographics and human development. Broadly speaking the global population is aging, while its growth is slowing. These trends will have regional variations, with younger developing countries having higher potential for growth, while more developed economies will age more rapidly and be more challenged to sustain economic growth. These aging populations will create pressure to increase the challenges of sustaining funding for healthcare, education, and other social benefits.

Environment. Climate change will continue to increase risks to people, property, and states, though regional effects will vary creating winners and losers. The result will be increased migration and economic stress, coupled with increased tensions between multiple stakeholders, including states, non-government organizations, and social groups.

Economics. National debt is likely to continue rising, while there is increasing potential for markets to fragment around regional powers and trade groups. Continued technological innovation is likely to continue to disrupt employment, while the continued growth of large global firms, will increase tensions as nations compete to set standards and regulatory environments.

Technology. Technology will continue to create new opportunities while disrupting old. In fact, the pace of this disruption is likely to quicken, and domestic and international tensions will rise. Competition to control this technology will lead to further increasing tensions between states.

In the second section, the dynamics of societies, states, and international systems are discussed, as well as the influence of these forces on emerging dynamics in societies, states and international systems.

Societal. The factor trends mentioned above – disruption arising from technology, slowing of economic opportunity, increased competition for limited resources - will challenge individuals, who are likely to become increasingly pessimistic, and less trustful of the domestic and international institutions. New technologies will enable individuals to align around new forms of organizations, potentially siloed and isolated from existing communities and governments.

State. Governments, and their ability to govern, will be challenged by declining economic growth, the challenges of climate change, aging populations, and a citizenry becoming both more fragmented and empowered. Governments will be faced with a growing gap between what the citizenry expects, and what the government can deliver, further increasing tensions. This tension may lead to a variety of challenges to current forms of government.

International. The growing importance of China as an economic military power increases the likelihood regional blocs will develop, influencing global dynamics. The

competition for resources will increase, forcing states and non-state actors to align with regional blocs, and increasing the risk of conflict while reducing cooperation to address global issues.

In the third section, five plausible scenarios are developed to illustrate the use of the framework and explore the range of future outcomes. The authors summarize their scenarios as follows:

Renaissance of Democracies. Slowing global population growth and a rising median age will help some developing economies, but rapidly aging and contracting populations will weigh on many developed economies. Decades of progress in education, health, and poverty reduction will be difficult to build on or even sustain. Pressure for migration is likely to increase. Many populations are increasingly pessimistic and distrustful as they struggle to deal with disruptive economic, technological, and demographic trends. Newly prominent identities, resurgent established allegiances, and a siloed information environment are exposing fault lines within communities and states, undermining civic nationalism, and increasing volatility. Populations are more informed and have greater ability to express their demands. The world is in the midst of a resurgence of open democracies led by the United States and its allies. Rapid technological advancements fostered by public-private partnerships in the United States and other democratic societies are transforming the global economy, raising incomes, and improving the quality of life for millions around the globe. In contrast, years of increasing societal controls and monitoring in China and Russia have stifled innovation.

A World Adrift. The international system is directionless, chaotic, and volatile as international rules and institutions are largely ignored. OECD countries are plagued by slower economic growth, widening societal divisions, and political paralysis. China is taking advantage of the West's troubles to expand its international influence. Many global challenges are unaddressed.

Competitive Coexistence. The United States and China have prioritized economic growth and restored a robust trading relationship, but this economic interdependence exists alongside competition over political influence, governance models, technological dominance, and strategic advantage. The risk of major war is low, and international cooperation and technological innovation make global problems manageable.

Separate Silos. The world is fragmented into several economic and security blocs of varying size and strength, centered on the United States, China, the EU, Russia, and a few regional powers, and focused on self-sufficiency, resiliency, and defense. Information flows within separate cyber-sovereign enclaves, supply chains are reoriented, and international trade is disrupted. Vulnerable developing countries are caught in the middle.

Tragedy and Mobilization. A global coalition, led by the EU and China working with NGOs and revitalized multilateral institutions, is implementing far-reaching changes

designed to address climate change, resource depletion, and poverty following a global food catastrophe caused by climate events and environmental degradation. Richer countries shift to help poorer ones manage the crisis and then transition to low carbon economies through broad aid programs and transfers of advanced energy technologies

Each scenario provides the foundation for exploring 'what if', and the implications for investors. The 'Separate Silos' scenario, for example, posits a world of regional blocs, decline in trade, reduced innovation, and increased costs. In such a world, investors would expect reduced returns and, through the reduced ability to diversify, increased risks.