GLOBAL
Insight

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Executive summary

Worlds apart

Risks and opportunities as deglobalization looms

With trade relations more fragmented and the potential for a great power rivalry between the U.S. and China, investors need to be ready for a new paradigm.

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For important and required non-U.S. analyst disclosures, see page 6.

All values in U.S. dollars and priced as of market close, May 31, 2023 unless otherwise stated
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EXECUTIVE
Summary

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Worlds apart: Risks and opportunities as deglobalization looms

The world is at an inflection point. After decades of close trade ties and economic progress, globalization is being unwound. With trade relations becoming more fragmented and the potential for a great power rivalry between the U.S. and China, it's paramount to understand the new paradigm.

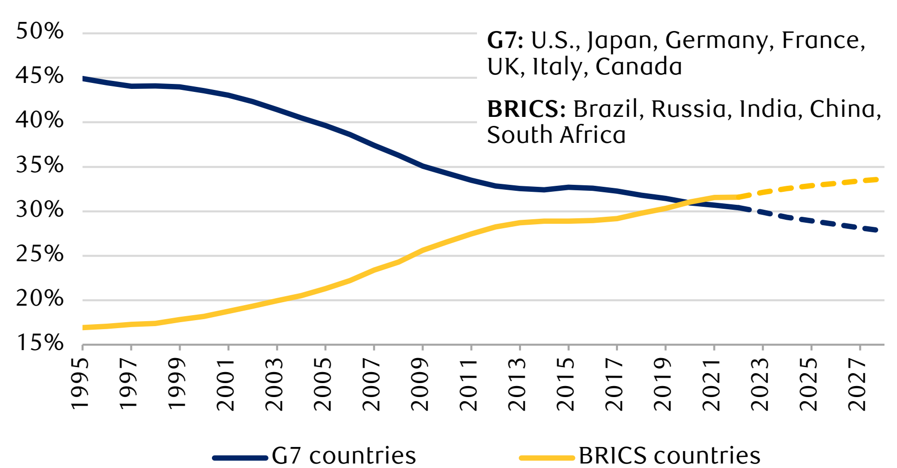
Following is an executive summary of the first article in a series exploring the trend away from globalization and its ramifications for investors, economies, and financial markets.

Geopolitical power struggles shouldn't be underestimated: Globalization boosted economic growth, corporate earnings, and stock prices for decades. But in recent years globalization has stalled out. It seems at risk of breaking down into deglobalization as geopolitical tensions persist.

- The U.S.-China relationship has become mired in mistrust, security concerns, and disputes related to Taiwan.
- Saudi Arabia and other Middle Eastern countries no longer view the U.S. as their principal ally. They have forged close, formal strategic partnerships with China.
- Two entities in which China, Russia, and India play key roles—the BRICS association and the Shanghai Cooperation Organisation (SCO)—are expanding their memberships, and countries within them are deepening their ties. Their economic influence is growing.

BRICS GDP surpassed G7 GDP in 2021, and the trend is expected to continue

Share of global GDP based on purchasing power parity in U.S. dollars*



* Data from 2023 through 2028 are IMF projections.

Source - RBC Wealth Management, IMF database; data as of 5/17/23

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The sticking point for the West: BRICS and the SCO seek to form a “multipolar world” wherein a number of countries would play global leadership roles.

- Many countries within BRICS and the SCO view the U.S.-led Western hegemony as a relic of the past or something that will be soon.
- They have stated the world has moved—or is moving—beyond the post-Cold War era when U.S. leadership reigned supreme, and Washington and its allies set the terms.
- BRICS and SCO countries have a lot of economic, commodity, and rare earth mineral leverage to assert a more collective, multipolar approach.
- But we highly doubt the U.S. and its allies will quietly acquiesce to this framework. No power that has sat in the driver’s seat for over 30 years would willingly relinquish its dominant role.
- Therefore, the geopolitical power struggle will likely persist and intensify.

Why it matters: We think major shifts in relations between great powers change the investment environment.

- The geopolitical power struggle creates risks for economic growth, markets, and sectors—and therefore for portfolios.
- But it should also provide investment opportunities.
- Many countries are attempting to develop technological security, energy security, food security, and health security initiatives—all of which dovetail with national security.
- China has been pursuing this sovereign development strategy for many years with economic planning and significant R&D spending.
- The U.S. and its allies have recently begun to encourage and incentivize onshoring of manufacturing and “friend-shoring” (i.e., developing and strengthening supply chains among allied and like-minded countries).
- These initiatives should benefit a number of industries, including advanced semiconductor technologies, artificial intelligence, cybersecurity, critical minerals and rare earths, energy transition technologies, water resource technologies, select industrial and infrastructure technologies, military and space equipment, biotechnology, and life sciences.

Protectionism appears to be back: There are, however, downsides to the drift away from globalization. We view onshoring and friend-shoring as old-fashioned protectionism with new, more palatable names.

- If protectionism persists over the long term—with more trade barriers, tariffs, and sanctions piling up—we believe the economic drawbacks would eventually come home to roost.
- Many companies could be faced with higher expenses, more friction within supply chains, and more difficulty sourcing select commodities.
- The International Monetary Fund’s chief wrote, “The longer-term cost of trade fragmentation alone could range from 0.2 percent of global output

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in a limited fragmentation scenario to almost seven percent in a severe scenario—roughly equivalent to the combined annual output of Germany and Japan."

- Most sources agree that if technology cooperation between the U.S. and China is cut off to a great extent, there could be more damaging global economic consequences.

The bottom line for investors: We believe these trends argue for rethinking portfolio allocations.

- Sub-asset allocations within equities and fixed income should no longer be viewed through the lens of cooperative globalization.
- Instead, they should be viewed through the lens of trade fragmentation and protectionist risks, and the realignment of relations between nations into formal and informal blocs.
- We think this begs for more active asset management for country, industry, and company investment exposures.
- A number of strategically important industries seem poised to benefit. But if the protectionist trends persist over the long term, global economic growth and equity market gains could be more muted than they were during the globalization heyday.

For in-depth information, please see the full report: *Worlds apart: Risks and opportunities as deglobalization looms*.

Research resources

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