

# INVESTMENTS & WEALTH MONITOR

*A reprinted article from January/February 2023*

## The End of Globalization: Implications for Inflation and Investment

*By Jason De Sena Trennert*



**INVESTMENTS & WEALTH INSTITUTE®**

# The End of Globalization

## IMPLICATIONS FOR INFLATION AND INVESTMENT

By Jason De Sena Trennert

**I**t started to be heard, barely a whisper, in investment committees during the pandemic: “Is China really investable?” Then the voices grew louder, especially as China pursued an increasingly harsh zero-COVID policy—despite the impact on its population and the economy.

Asking such impertinent questions is the role of an investment committee. But it’s also easy to see how a generation of asset allocators and consultants schooled in the Yale model and the efficient frontier might see any suggestion that investors stay closer to home and stick with more transparent and less fee-intensive investments as heresy.

Indeed, for the past three decades it’s been assumed that international trade will break down barriers of culture, faith, and tradition that can stand in the way of the free flow of goods and services. Since the Berlin Wall came down in 1989, the West has sincerely hoped that countries where freedom and individual expression are less valued might become more Western. For a long time, it seemed to work—at least as far as the superficial ubiquity of American pop culture and materialism might suggest. China’s acceptance in the World Trade Organization in 2001 further boosted the concept, bestowing esteem on an international political class and untold riches on global industry. Markets soared and kinetic conflicts among nation states appeared to be a thing of the past.

Globalization also contributed to low and stable prices in goods and services. But there was a growing sense that ever-cheaper consumer goods incurred significant social and economic costs for those least able to realize the benefits. In particular, non-college educated working classes in industrialized economies found it difficult to integrate into the information economy. To the extent that the greatest benefits of globalization accrued to one country—China, a country that fixed its currency, insisted on majority control of joint ventures, and possessed a loose relationship with the concept of intellectual property—the Brexit vote and the election of Donald Trump aren’t so surprising. Populism, whether from the left or the right, appears to be the natural residue of this tainted adoption of free trade.

The pandemic, of course, changed everything, proving again how times of stress often don’t build character but reveal it. Economist Larry Summers has deemed it a “hinge moment” in history. We believe he is right. China has been at the heart of globalization and outsourcing for the past two decades. But the pandemic, it would appear, has irreparably damaged the country’s brand and the ability of developed economies to import disinflation. Few businesspeople or policy-makers are now viewing China as the benign economic partner or source of riches they considered it a mere five years ago.

Until recently there was hope, especially among investors, that China might

return to “normal” both politically and economically after President Xi Jinping consolidated power following the 20th Communist Party Congress in October 2022. But chilling images of former President Hu Jintao being forcibly removed from committee proceedings before key votes were a stark reminder of Mao’s observation that political power grows out of the barrel of a gun. (It should be no surprise that the official voting results showed all proposals passed unanimously with no abstentions.)

Russia’s invasion of Ukraine and its use of its vast oil resources as leverage against the West suggest that dollars and cents alone cannot bridge the gap in values between civilizations. Even the most committed citizen of the world has to be skeptical that the great hopes of globalization can ever be realized. Such doubts would seem to be all the more relevant for investors committed to environmental, social, and governance (ESG) investing. By any objective measure, most investments in emerging markets are not particularly compliant with ESG considerations.

China as well does not seem content exercising control only within its borders. Xi and the Chinese Communist Party have become increasingly aggressive, at least rhetorically, in threatening the independence of Taiwan and restricting freedoms enjoyed by the semi-autonomous regions of Hong Kong, Tibet, and Xinjiang province.

The net result likely will be somewhat slower economic growth over the long term and a period in which Washington and Beijing will compete for economic and geopolitical influence. Harvard government professor Graham Allison (2018) spoke about the inevitable tension between hegemonic powers and those countries wishing to replace them. He wondered aloud whether America and China could escape the Thucydides' Trap, which leads such competitors to war. He explained, "It was the rise of Athens and the fear that this instilled in Sparta that made war inevitable." Allison describes 16 historical instances in which an emerging power threatened to displace a ruling one; 12 of these conflicts ended in war.

In our opinion such a world is likely to change for investors in the following ways:

**Higher inflation and weaker profit margins.** Technological innovations and more open-trading arrangements with less-developed nations have allowed multinational corporations to feast on arbitrating labor costs across borders. This has been especially true for the wages of unionized U.S. workers. Corporate profits as a percentage of gross domestic product (GDP) remain near record levels, but wages as a percentage of corporate GDP remain low. Building more-robust supply chains closer to home that don't rely on countries with interests that don't align with ours may, in the end, be a wonderful development for the United States, its working classes, and its allies—but it won't be cheap.

**Slower economic growth.** For a supply-sider, it is difficult to imagine a world in which slower profit growth is not associated with slower economic growth and productivity. This is especially true in a post quantitative-easing world with significant constraints on public spending. Greater tensions among nations likely will lead to increased trade barriers and the manipulation of currency

values as a method of maintaining or growing market share.

**Greater global defense spending.** The global economy benefited immensely due to the peace dividend that followed the fall of the Berlin Wall in 1989. Almost in a flash, the United States and its NATO allies were able to save billions of dollars in defense spending in the absence of Soviet Bloc threats. In the ensuing years, security threats have emerged from non-state actors. Those threats, too, have proved expensive, especially for the United States. Russia remains a threat to the sovereignty of Eastern European countries, China appears committed to projecting its power far beyond its borders, and the United States no longer will be able to shoulder alone the defense costs associated with a multi-polar world. Some of the world's largest economies—such as Japan and Germany—have started to greatly increase spending on their own national defense.

**Fossil fuels will remain prized and energy stocks likely will continue to outperform.** No one doubts that a world with fewer carbon emissions is a noble goal. Still, with the benefit of hindsight, it might appear that fully adopting environmental policies without having robust energy policies alongside them may have increased global tensions rather than allayed them. Recall how, in 2018, the German delegation to the United Nations laughed when U.S. President Donald Trump questioned the wisdom of Europe being so dependent upon Russian fuel supplies. A blind commitment to sustainability goals without regard for its cost to national economies and their citizens is likely to continue to support the price of oil and natural gas. In a world where above-average equity returns will be difficult to achieve in the absence of multiple expansion, the energy sector is likely to continue to throw off tons of cash to be redistributed to shareholders. This may change, but it seems unlikely without significant changes in political power.

**Greater political volatility in the West.**

Although the global political establishment is fighting tooth and nail to maintain the old-world order, democracies, in the end, must be beholden to their voters. In our opinion, the move toward populism—whether from the right or the left—will be a feature of democracies until citizens are confident that the political classes have citizens' best interests at heart. As British politician Michael Gove put it during the Brexit debate, "I think people in this country have had enough of experts." Old political loyalties will be less important for the average voter who merely seeks competence. Changes in leadership likely will be more common, challenging companies to be nimble in responding to more-frequent changes in fiscal, regulatory, and trade policies. Companies that understand this dynamic and are willing to engage with new political leadership are likely to outperform.

The worldview expressed here may strike many as sad, cynical, dystopian. After all, the movement toward free trade and globalization goes beyond trading relationships with China and Russia. However, like it or not, those relationships with China and Russia lie at the center of the global economy today. A greater sense of the need for realpolitik in international affairs seems inevitable. In the words of Harvard political scientist Samuel Huntington (1997):

*The West won the world not by the superiority of its ideas or values or religion ... but rather by its superiority in applying organized violence. Westerners often forget this fact; non-Westerners never do.*

It seems likely, if not necessary, that countries will be increasingly drawn to policies that recognize the world as it is rather than the way they might want it to be. For investors, this might suggest that renewed focus on the unique and special features of the West—equal justice under the law, private property rights, and

*Continued on page 42 →*

## THE END OF GLOBALIZATION

*Continued from page 6*

a respect for individual liberty—may no longer be secondary considerations for those seeking to make investments outside their home markets. We also might not be so willing to take our own natural resources for granted. Such Victorian notions may be even more important in a period of structurally slower economic growth and higher inflation. ●

*Jason De Sena Trennert is chairman and chief executive officer of Strategas and its related companies. He earned an MBA from The Wharton School of the University of Pennsylvania and a BS in international economics from Georgetown University. Contact him at [jtrennert@strategasrp.com](mailto:jtrennert@strategasrp.com).*

### REFERENCES

Allison, G. 2018. *Destined For War: Can America and China Escape Thucydides's Trap?* Boston/New York: Mariner Books.

Huntington, S. P. 1997. *The Clash of Civilizations and the Remaking of World Order*. New York: Touchstone.

### IMPORTANT DISCLOSURES

Past performance is not indicative of future results. This communication was prepared by Strategas Securities, LLC ("we" or "us") and is intended for institutional investors only. Recipients of this communication may not distribute it to others without our express prior consent. This communication is provided for informational purposes only and is not an offer, recommendation or solicitation to buy or sell any security. This communication does not constitute, nor should it be regarded as, investment research or a research report or securities recommendation and it does not provide information reasonably sufficient upon which to base an investment decision. This is not a complete analysis of every material fact regarding any company, industry or security. Additional analysis would be required to make an investment decision. This communication is not based on the investment objectives, strategies, goals, financial circumstances, needs or risk tolerance of any particular client and is not presented as suitable to any other particular client. The intended recipients of this communication are presumed to be capable of conducting their own analysis, risk evaluation, and decision-making regarding their investments.

For investors subject to MiFID II (European Directive 2014/65/EU and related Delegated Directives): We classify the intended recipients of this communication as "professional clients" or "eligible counterparties" with the meaning of MiFID II and the rules of the UK Financial Conduct Authority. The contents of this report are not provided on an independent basis and are not "investment advice" or "personal recommendations"

within the meaning of MiFID II and the rules of the UK Financial Conduct Authority.

The information in this communication has been obtained from sources we consider to be reliable, but we cannot guarantee its accuracy. The information is current only as of the date of this communication and we do not undertake to update or revise such information following such date. To the extent that any securities or their issuers are included in this communication, we do not undertake to provide any information about such securities or their issuers in the future. We do not follow, cover or provide any fundamental or technical analyses, investment ratings, price targets, financial models or other guidance on any particular securities or companies. Further, to the extent that any securities or their issuers are included in this communication, each person responsible for the content included in this communication certifies that any views expressed with respect to such securities or their issuers accurately reflect his or her personal views about the same and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this communication. This communication is provided on a "where is, as is" basis, and we expressly disclaim any liability for any losses or other consequences of any person's use of or reliance on the information contained in this communication.

Strategas Securities, LLC is affiliated with Robert W. Baird & Co. Incorporated ("Baird"), a broker-dealer and FINRA member firm, although the two firms conduct separate and distinct businesses. A complete listing of all applicable disclosures pertaining to Baird with respect to any individual companies mentioned in this communication can be accessed at <http://www.rwbaird.com/research-insights/research/coverage/third-party-research-disclosures.aspx>. You can also call 1-800-792-2473 or write: Robert W. Baird & Co., PWM Research & Analytics, 777 E. Wisconsin Avenue, Milwaukee, WI 53202.



# INVESTMENTS & WEALTH INSTITUTE®

5619 DTC Parkway, Suite 600  
Greenwood Village, CO 80111  
Phone: +1 303-770-3377  
Fax: +1 303-770-1812  
[www.investmentsandwealth.org](http://www.investmentsandwealth.org)

© 2023 Investments & Wealth Institute®. Reprinted with permission. All rights reserved.

INVESTMENTS & WEALTH INSTITUTE® is a registered mark of Investment Management Consultants Association Inc. doing business as Investments & Wealth Institute. CIMA®, CERTIFIED INVESTMENT MANAGEMENT ANALYST®, CIMC®, CPWA®, CERTIFIED PRIVATE WEALTH ADVISOR®, RMA®, and RETIREMENT MANAGEMENT ADVISOR® are registered certification marks of Investment Management Consultants Association Inc. doing business as Investments & Wealth Institute.