Economic overview

November 2024

How can you protect yourself from political and geopolitical risks?

The results of the US elections on 5 November were a big surprise. Donald Trump and the Republicans achieved a landslide victory, including in the Senate and the House of Representatives. As a result of this red sweep, there are now clear majorities in both the executive and legislative branches. The scenarios imagined during the election campaign can now be reduced to: *"MAGA=MIGA, Make America Great Again is Make Inflation Great Again"*.

Trump is inheriting an economy that remains quite robust. Manufacturing, technology and pharmaceuticals, as well as business and personal services, are still growing. While the situation in the labour market is easing, it is not causing concern, and purchasing power is being maintained thanks to rising wages and lower inflation.

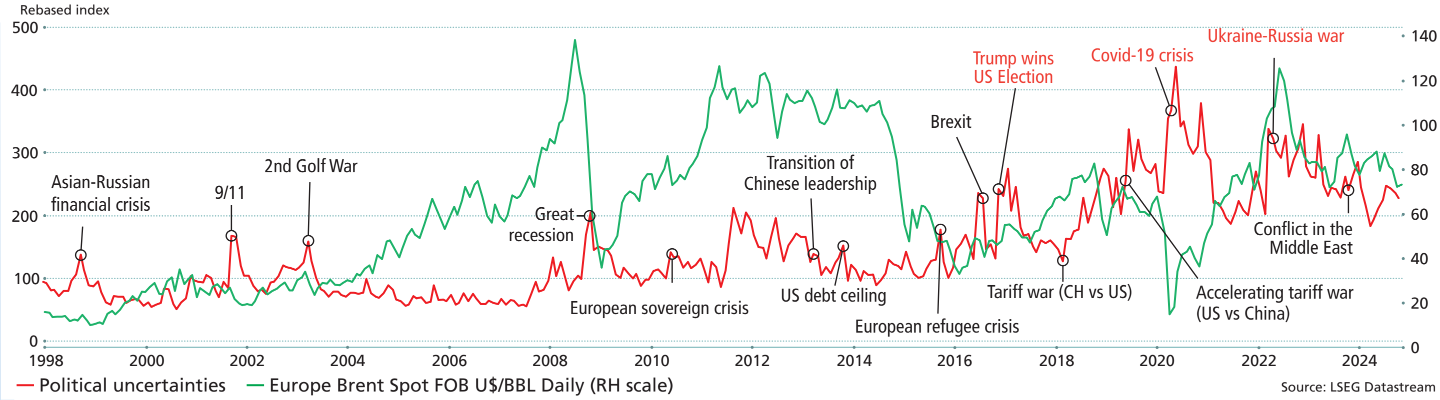
Among the main issues Trump is championing are import tariffs, immigration, lower corporate taxes, and the very likely slashing of the IRA (Inflation Reduction Act), which promotes investment in alternative energies and climate protection. The result is likely to be higher import prices due to a tax of 10% for all regions that do not belong to the free trade area and 60% for most Chinese products. Illegal immigrants, who create new jobs in low-wage sectors, will be deported. The twin deficits (current account and budget deficits) will weaken the dollar, and investment in fossil fuels will again increase. All these factors will combine to drive up costs and prices, leading to a loss of purchasing power for businesses and households alike. If the Fed still wants to achieve its inflation target, it will have to act very carefully because domestic inflation is proving stubborn, especially when it comes to services. Monetary easing could therefore come to an abrupt halt in 2025 with interest rates at around 4%.

The uncertain global political situation is leading to an increasing fragmentation of world trade and reinforcing the existing trend in the international movement of goods towards greater regionalisation of trade and a concentration of production of goods that are transported over long distances, such as laptops, computer monitors, flat screens and mobile phones. We are also seeing a resurgence in trade in raw materials, particularly in iron ore and soya, which are once again dominating international trade. Some regions, such as the United States, are now self-sufficient in energy (which is a clear competitive advantage), or have at least secured their supply. However, dependence on metals needed for structural change, such as copper, nickel, cobalt, lithium, graphite, rare earth elements, etc., continues to increase. These metals are mainly processed in China. In the future, there could be more frequent and serious supply shocks (triggered by geopolitical, climate-related or other factors) for these metals worldwide because of the difficulties in securing raw materials and the concentration of production chains.

Ultimately, the risk of an external shock is concentrated in a few manufacturing sectors and a few companies that have a quasi-monopoly and determine growth (Nvidia, Microsoft, Google and Apple in the US, Roche and Novartis in Switzerland). This is not new, but it has accelerated sharply since the COVID crisis and efforts to protect a few strategic sectors by expanding capacities (especially in the US pharmaceutical and technology industries). The monetary authorities are well aware of this, which is why they need to anchor domestic inflation even closer to the target level to make it as resistant as possible to external shocks. The challenge is to prevent a possible concentrated shock from spreading to the rest of the economy. But what exactly does this "rest" comprise? It comprises business services such as legal advice and personal services such as tourism. Although such services can be traded internationally, they are hardly affected by tariff barriers because they are predominantly provided domestically. Business and household spending on services has been rising steadily since 2023. This also helps explain why economies have proven quite resilient and continue to grow despite the faltering of some sectors. In Western economies, services account for almost 70% of value added. Manufacturing accounts for only 30%. On the stock markets, it looks almost the other way around. The stock exchange is dominated by manufacturing companies (e.g. Microsoft or Pfizer in the US), particularly in the technology and pharmaceutical sectors (together accounting for almost 50% of the market capitalisation of the S&P500, with the pharmaceutical industry accounting for 35% of the SPI).

According to experts, the risk of geopolitical fragmentation is leading to a concentration of international trade and greater sensitivity of some sectors to commodity prices and the US dollar as a reserve currency. To protect against possible shocks, diversification is crucial, both regionally and sectorally and in terms of corporate activities, commodity supply and sources of financing. Economists and central banks recommend this while investors tend to forget it, especially in phases of rising stock markets. Those who bet on these concentrated global markets can achieve a good return but forget that only broad diversification and good selection can protect them from a shock. Managers who rely on active management and good stock selection have been badly shaken in the last two years. 90% of them have achieved lower returns than their respective markets. The next price shock, which, given the current political and geopolitical situation, could occur sooner than it has in the past, could trigger a chain reaction that can only be absorbed by diversification and selectivity.

Geopolitical uncertainties indicator



Source: LSEG Datastream

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