The (re)globalization Megatrend: A new world order

Identifying and capturing the opportunities created in a shifting global picture

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How will a (re)globalized world take shape?

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Anybody who spends any time listening to the financial press, or indeed the wider mainstream media, could be forgiven for thinking that the world's rapid slide into a multi-polar, deglobalized state is all but inevitable.

The factors behind this narrative read as a familiar list at this point: Covid-19 exposing the fragility of global supply chains; increased geopolitical tensions between the West and China; the invasion of Ukraine; and increased worries over climate change.

At first glance, it appears deglobalization is the inevitable reaction to our rapidly changing world. But new research published by New York Life Investments argues that we are in fact more likely to see the re-globalization of the world's economy, albeit in a vastly different form to how we understand globalization today.

To support their argument, New York Life Investment's Multi-Asset Solutions team detail three roadblocks – in energy, technology, and finance supply chains – that will not only serve to deter efforts at deglobalization, but present entirely new investment opportunities in the process.

And in the 'Ask the Experts' interview, we sit down with one of the authors of the piece and an investment expert on this topic to challenge their ideas and explore in greater depth how their insights can be applied to the investment process.

Identifying the investment opportunities created in such a rapidly shifting world will never be an easy task. But careful study of what's really going on underneath the headlines, coupled with the use of a framework that enables investors to more accurately and comprehensively capture these larger trends, offers one a path to success.

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Lauren Goodwin
Director of Portfolio Strategy, New York Life Investments

Lauren is an Economist and Director of Portfolio Strategy at New York Life Investments. Her Multi-Asset Solutions team manages a combined $8.6B in assets (as of 6/30/23).

Prior to joining the firm, Lauren held economist positions at JPMorgan, Wells Fargo, Frontier Strategy Group, and the OECD. She is a CFA Charterholder, graduated summa cum laude from the University of Southern California and holds a master's degree in international economics from Johns Hopkins.

Timothy Humphreys
Head of Global Listed Infrastructure, Ausbil Investment Management Limited

Tim is Head of Global Listed Infrastructure and has over 20 years of financial markets experience working in Sydney and London with companies such as AMP Capital, AMP Capital Brookfield, RARE Infrastructure, Insight Investment and Rothschild Asset Management.

Tim holds a Bachelor of Engineering (Civil and Structural Engineering) from The University of Sheffield (United Kingdom) and studied Engineering Science at Oxford University.

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(re)globalization

Anticipating the future state of global economics and geopolitics requires more than an extrapolation of current trends.

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(re)globalization: Anticipating the future state of global economics and geopolitics requires more than an extrapolation of current trends

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Roadblocks to deglobalization

The story told by much of the policy- and economics-focused world currently is that of a coming deglobalization.

And this talk is seemingly being backed up by action – vast sums of money being spent on reshoring manufacturing, tensions between the U.S. and China ratcheting up, and the cutting of Russia from Western finance – all highlighting how quickly the consensus of just a few years ago has fractured.

However, moves to deglobalize the world economy would require a radical rethink of how three critical supply chains operate – these being technology, energy, and finance.

The report – Megatrends 2023 – argues that technological and political innovation, along with a renegotiation of global relationships, appears to be the inevitable response to problems key global supply chains face. It urges investors to consider how these megatrends will impact the future economic climate, and the investment opportunities within it.

"...moves to deglobalize the world economy would require a radical rethink of how three critical supply chains operate – these being technology, energy, and finance."

Technology

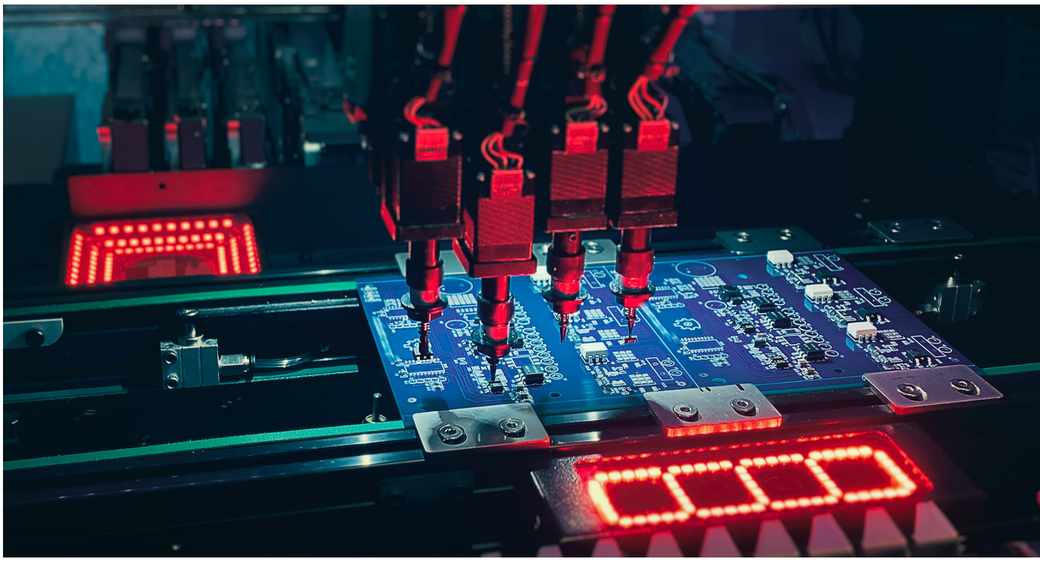
While technology covers a huge array of industries and products, the semiconductor supply chain stands out as among the most critical to protect, and the most in need of innovation. Powering everything from household appliances to artificial intelligence, the world and modern life as we know it is dependent upon these chips. And with 60% of all computer chips being made in Taiwan, the continued functioning of this supply chain in its current state seems especially precarious.

However, the report presents research showing that even though richer countries are spending enormous amounts of money in an effort to become self-sufficient in chip manufacturing – to the tune of US$280bn in the U.S. and US$47bn in Europe – the goal of developing self-sufficient research and production processes looks unfeasible.

This is because the existing supply chains and technical processes that power chip production are controlled by deeply entrenched monopolies, the manufacture of different types of chips is already highly fragmented across different economies, and China is responsible for 70% of global silicon production.

While some parts of the production process will be reshored, to do so completely would be impractical. Instead, the investment

“...the semiconductor supply chain stands out as among the most critical to protect, and the most in need of innovation.”



opportunity lies in the development of new international trade relationships and political ties.

Energy

The global impacts of climate change and the invasion of Ukraine are just two factors driving the global race to secure energy access as well as the transition to green energy.

The quest for energy independence will see countries short on traditional natural resources rely more on renewable sources. And New York Life Investments highlights how, because there likely are not enough available raw materials to transition to green energy at current technology levels, innovation, especially in nuclear energy, will be necessary to achieve this goal.

Currently, China is dominant in supplying and processing raw materials for all types of energy production, and Russia has a monopoly on supplying uranium – a substance so important that commercial supplier Rosatom was exempt from recent U.S. and European sanctions.

“... future supply chains may be just as significantly impacted by a reorganization of geopolitical relationships.”

As well as being driven by technical innovation, future supply chains may be just as significantly impacted by a reorganization of geopolitical relationships. It is here where investment opportunities lie.

Finance

The U.S. cut Russia from the SWIFT payments network following its invasion of Ukraine, highlighting the power of economic sanctions as a policy tool. Now, many countries must weigh the risk that taking actions America disagrees with may result in their removal from the global economy.

This comes on top of Saudi Arabia considering pricing some oil contracts in the Chinese renminbi, helping to foster a narrative that the world is on the verge of moving away from the U.S. dollar and the infrastructure that supports it.

“...whatever system replaces the dollar does not yet exist but may take the form of digital currencies.”

The report concedes that changes in the global reserve currency may occur, and that the dollar is under pressure, but asserts that innovation will act as a catalyst for change in this domain, not geopolitical disagreements. This prediction is in line with historical trends. For example, the dollar replaced the British pound because the development and use of the telegraph and the beginning of the aviation industry allowed America to make trade more efficient.

The authors state that whatever system replaces the dollar does not yet exist but may take the form of digital currencies – be they on a blockchain or otherwise. Investors will need to monitor changes in technology and the impact these have on trading dynamics across the world.

Invest around the opportunity

Predicting how the megatrends presented by New York Life Investments will play out is extremely difficult, but this paper presents a way for investors to approach the subject in a careful and systematic manner.

In considering the infrastructure that will help power these megatrends, investors will be able to take advantage of a long and complicated transition that will foster change on a global scale.

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Ask the Expert Interview with New York Life Investments:

(re)globalization: A world of possibilities

A re-globalization of the world economy rather than the much-touted deglobalization is a megatrend that will necessarily encompass huge innovations in technology and trade policy and a realignment of the existing geopolitical regime. How can investors approach such a vast and complicated picture? We spoke with New York Life Investment's Lauren Goodwin and Ausbil's Tim Humphreys to find out.

Moderator
Gary Adams
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Lauren Goodwin
Director of Portfolio Strategy, New York Life Investments

Timothy Humphreys
Head of Global Listed Infrastructure, Ausbil Investment Management Limited

To what extent, has any deglobalization occurred already?

Lauren: World trade as a percentage of GDP has stabilized at between 25% to 30%. Global value chain trade as a percentage of world trade appears to have peaked at around 52%, coming down just a little bit.

But this trend of deglobalization means something else – a shift from a focus on efficiency and expansion at all costs, to security and access to different supply chains. And that change in mindset may be accompanied by higher costs.

Tim: The impact of the Russian invasion of Ukraine led to natural gas going to Europe from Russia being shut off. Europe has really had to focus on repowering itself. In the short term, this is achieved by importing more liquefied natural gas from places like the U.S., and in the longer term by developing much more renewable energy to replace the gas.

Additionally, the U.S. Inflation Reduction Act has changed the landscape in terms of renewable energy development in the U.S. itself. This has created huge incentives for the building of renewable energy infrastructure in the country. European nations will need to attract capital to build the renewable energy infrastructure they need.

With there not being enough raw materials to implement a full transition to more renewable forms of energy production, how much of a role must oil and gas continue to play in investor portfolios for the next few decades?

Lauren: There's no doubt that oil and gas will continue to play a very important role for the foreseeable future.

It's also increasingly clear that the overleveraging of oil and gas in production is challenging for a global investor, not only from the risks of these energy

sources ultimately being replaced, but through cultural and political risk with respect to their contribution to climate change. This risk will increase.

Tim: It's difficult to see oil disappear completely until new technologies have been developed. But certainly, we think its role will lessen over the coming years. We think natural gas has a much longer role to play.

Natural gas is the only fuel able to back up intermittent renewable energy sources such as wind and solar in a matter of minutes.

There may be new technologies that don't emit carbon dioxide that could be used to replace natural gas, but these are a long way off. Until we start to see these technologies able to scale up in a cost-effective and reliable way, natural gas will have a role to play – especially if carbon capture technology can be developed.

Predicting knowledge creation is difficult. Is there a framework that investors can use to think about capturing opportunities in innovation?

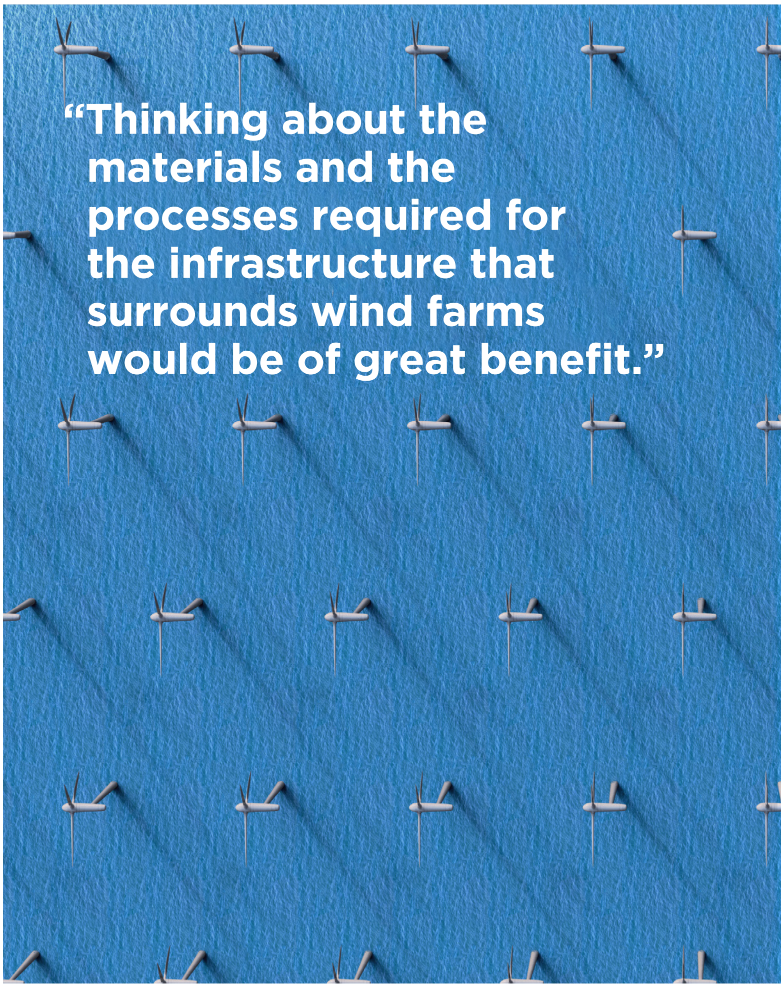
Lauren: There are winners and losers in every megatrend, and early winners might not be the ultimate winners. Investors will benefit from diversification through taking a thematic approach to a trend rather than being too myopic on the change itself.

This is closely tied to the second idea within this concept of diversification, which is to look beyond the obvious beneficiaries. One of the things that we speak about a lot is the infrastructure needed to support changes.

For example, offshore wind farms need very specific types of ships to help build and service them. Thinking about the materials and the processes required for the infrastructure that surrounds wind farms would be of great benefit.

Tim: When the motor car was being developed, you could have bet on Ford. Or you could have bet on toll roads that charge a fixed amount regardless of what make of car uses the road. This is how we think about benefiting from innovation – not betting on the individual technologies themselves, but on those infrastructure companies that will win regardless of which technology wins.

"Wind and solar are the cheapest forms of electricity generation at the moment, but this might change if there is a nuclear renaissance or some other technology to replace them."



The megatrends you talk about might take decades to evolve and they require a lot of money. How can asset allocators stay invested for the long term and avoid short-term thinking?

Lauren: We encourage investors to ask if a trend or event that's happening is investable in any practical way right now. Often, with geopolitical risk, the answer is no. The reason we decided to write about the re-globalization trend is because we think it's highly investible.

This requires investors to be always scoping the landscape, looking far into the horizon, and then pulling things back to how they might impact investments on a three to five-year time horizon.

Tim: The energy transition will take decades to happen and there will be winners and losers along the way. Wind and solar are the cheapest forms of electricity generation at the moment, but this might change if there is a nuclear renaissance or the development of some other technology that replaces them. You can pick the short-term winners such as wind or solar, or you can play it by the assets and companies that will benefit regardless of what technology comes out on top.

How much attention should investors be paying to artificial intelligence (AI)?

Lauren: This is the perfect example of this dynamic of having a long-term vision of the future and ensuring you can tie it to near-term opportunities.

"AI is a hugely exciting area with very wide-ranging implications across a number of different sectors. And again, infrastructure is a key enabler."

Tim: A huge amount of electricity is required to power the processes that train AI. And in an increasingly mobile economy, AI will mean that more data is sent via the mobile phone network, which benefits the mobile phone tower companies.

When we look at transportation, increasingly autonomous vehicles can help traffic move much more smoothly, reducing travel times. They can also reduce emissions because cars aren't stopping and starting all the time. AI is a hugely exciting area with very wide-ranging implications across a number of different sectors. And again, infrastructure is a key enabler.

Your report states that because national self-sufficiency in chip manufacturing is impossible to achieve, the formation of new political and trade relationships is key. How does this translate into investible opportunities?

Lauren: In 2019, when the U.S. cut off sales to Huawei alongside a number of Chinese firms, it essentially exacerbated the fragmentation of an already fragmented technology supply chain. This created tension between the U.S. and China, but it also resulted in different countries and companies having to be careful about how they do business and with whom they pick sides. This created opportunities in European, U.S., and Japanese supply chain participants.

Japan is currently one of the most talked about ideas for the first time in a very long time, in part because of the investments that the Japanese government is promoting in favor of stepping into this technology supply chain. Political or competitive decisions between two countries have wide-ranging ripple effects.

Could you discuss the race to develop and implement central bank digital currencies and how this fits into your thesis concerning the risk of de-dollarization?

Lauren: We can say with conviction that shifts in global currency dominance come not just from ebbs and flows in national power, but also through important innovations that make the financial system more efficient to the degree that it is worth the switching cost.

It's unlikely that an alternative system exists in a form that we know of today, but we can look across the landscape and identify clues from recent developments. Central bank digital currencies are one innovation that has the potential to disrupt money and banking in important and unpredictable ways, perhaps under a system using digital currencies. And maybe there will be no need for a single dominant currency because transactions between countries will be more seamless.

Where I would encourage investors to take the lessons from our conversation so far is that if this is the case, if we do have a new global system dominated by much more transactional central bank digital currencies, ask what other needs might we have? What other regulations or security systems or financial plumbing might we need to support the transition from paper fiat currency to a digital currency world?

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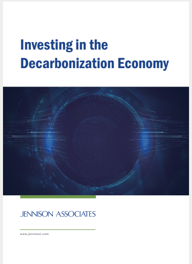

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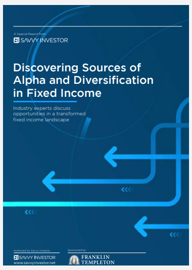

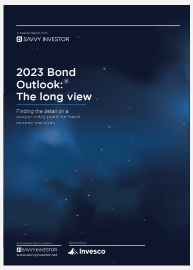

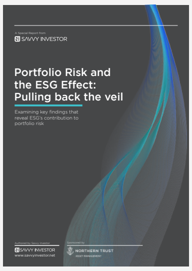

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