
HOW TO THINK GEOPOLITICS IN INVESTMENT

Liqian Ren — Director of Modern Alpha
08/02/2022

The importance of geopolitics in the investing world has become more apparent lately, particularly after Russia's invasion of Ukraine.

There are generally two kinds of geopolitical events that impact equity markets. One does not fundamentally challenge the U.S.-dominated economic system, while the other fuels the potential rise of a [multi-polar](#) world.

Many investment shops attempt to quantify the investment impact of the first kind of geopolitical events. Blackrock studied 68 geopolitical risk events since 1962, such as the Vietnam War, Brexit and September 11. It found the market response to be relatively modest and short-lived. Many other investment managers found similar results. This isn't surprising—many geopolitical events impacted sentiment at the moment and reduced equity returns, but did not fundamentally change the global economic system.

The second kind of geopolitical risk, with the potential to lead to a multi-polar world, may impact the U.S. The premium that comes with the dollar as a reserve currency or [risk premia](#) associated with demand for safe U.S. assets could potentially change.

After the 2016 presidential election, trade wars and sanctions made it clear that the U.S. is going to seriously engage with China on many levels of competition. COVID-19 and the Russian invasion appear to have fundamentally changed the U.S. public's view of China, and solidified a view of China as a major economic competitor to the U.S.

Our podcast guest, Louis-Vincent Gave, founder of investment advisory firm Gavekal, spoke of this big-power geopolitics sentiment before many people realized the changes were coming.

In a book written before the pandemic, *Clash of Empires: Currencies and Power in a Multipolar World*, he laid out the potential rise of China's currency and the Asian monetary zone. In the more recent *Avoiding the Punch: Investing in Uncertain times*, he showed a way to build a portfolio at a time of rising geopolitical strife.

In our conversation, Louis mentioned his believe that developed market bonds are unlikely to enjoy stellar performance in the future. He thinks emerging markets debt, precious metals, energy and consumer staples are substitutes.

He also believes energy will continue as a central element of an economy's growth. Whoever can secure cheap energy, whether China's use of coal or the U.S.'s abundance of shale gas, will likely lead globally. And on this matter, Europe must make a tough choice to reduce [ESG](#) goals and re-start domestic energy production, with coal or nuclear.

Louis also laid out arguments that China's Taiwan risk is contained for now, which I also agree with.

After our podcast was published, China's banking problems made the news as some households threatened to stop paying mortgages. For these time-sensitive topics, I've written tweet threads to help quickly assess the situations, and believe the fear of financial crisis is overblown. I think that understanding China better could help the U.S. compete better.

In my opinion, the current discourse that the U.S. is in decline is simplistic and overly pessimistic. I believe it means the U.S. will face high volatility. The U.S. is more flexible than China in dealing with challenges. The dollar's status as a reserve currency will continue for decades even in a multi-polar world.

But U.S. optimism does mean many Americans need to be willing not to pander to popular sentiment and work toward meeting future challenges. Simple optimism without actions to preserve what's best in the U.S. is not enough.

Yuan stockpiles

Russia has nearly a third of all reserves in China's renminbi.

(identified country holdings of Chinese RMB, billion of U.S. dollars, end-2021)

■ Russia ■ Brazil ■ Switzerland ■ Mexico ■ Israel ■ Chile ■ South Africa



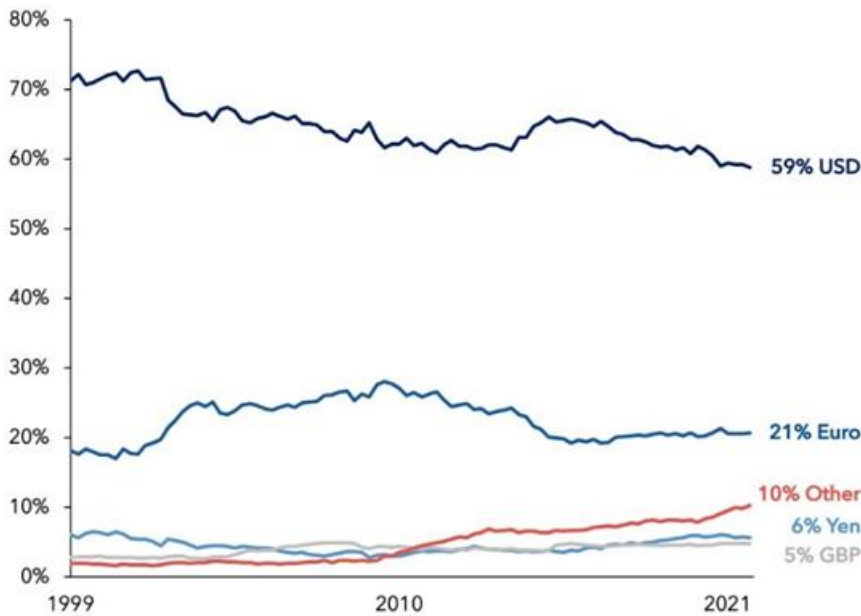
Source: IMF COFER, IMF Reserve Data Template, and central bank annual reports.
 Note: Chart shows countries that have disclosed Chinese RMB holdings of at least US\$3 billion in their reserve assets at end-2021. Data for Israel and South Africa are for Mar 2022 and Mar 2021, respectively.



Currency composition

Nontraditional currencies have played a larger role in global foreign exchange reserves in recent years.

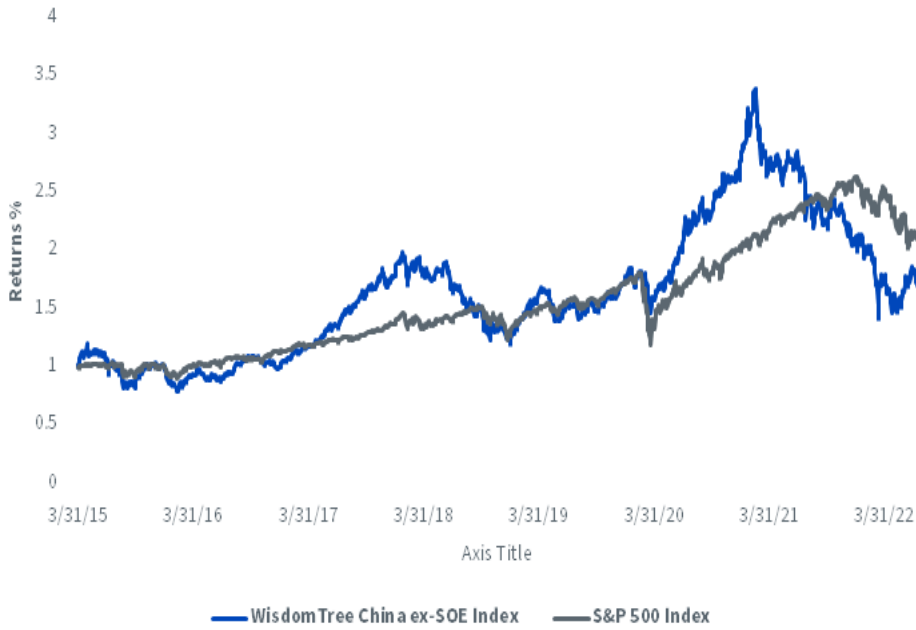
(currency composition of global foreign exchange reserves, percent)



Sources: IMF Currency Composition of Official Foreign Exchange Reserves (COFER).
 Note: The "other" category contains the Australian dollar, the Canadian dollar, the Chinese renminbi, the Swiss franc and other currencies not separately identified in the COFER survey. China became a COFER reporter between 2015 and 2018.



Cumulative Returns U.S. and China March 31, 2015–July 15, 2022



Sources: FactSet, WisdomTree. Past performance is not indicative of future results. You cannot invest directly in an index.

For definitions of indexes in the chart, please visit the [glossary](#).

For more on this topic, please listen to our latest *China of Tomorrow* podcast below.

China of Tomorrow by WisdomTree Asset Management · Interview with Founder and CEO Louis-Vincent Gave, Gavekal

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Kara Marciscano, Jianing Wu, Brian Manby and Scott Welch are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Multipolarity : A distribution of power in which more than two nation-states have nearly equal amounts of power.

Risk premia : Refers to the amount by which the return of a risky asset is expected to outperform the known return on a risk-free asset.

ESG : An acronym for environmental, social and governance, ESG standards quantify the degree to which a company is socially responsible.