TALKING POINT

Geopolitical risks – choosing the right navigator

March 2024

INN8 INVEST

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Key Points:

- Geopolitical divides could create a more 'fragile' global economy.
- We use as many levers as possible to optimally diversify your portfolio.
- A reputable DFM, with a proven record in managing risk can guide investors through the ongoing geopolitical challenges.

> "The growth of nationalism, protectionism and populist movements in recent years has created an environment of increasing uncertainty and could potentially lead to deglobalisation".
> – S&P Global

A world that has been ordered by globalisation and geoeconomics for decades, has quickly become a world stranded in geopolitical risk. Persistent regional conflicts, trade wars, more frequent cyber-attacks and rising nationalism has ripple effects globally, with vast commercial impact on industry stability and business operations. Prices fluctuations, supply chains and investment flows pose major challenges for investors.

Regardless of what your thoughts or views are of the current geopolitical climate, the world is filled with noise and emotion – at levels many of us have never experienced in our lifetimes. In this article, we set out some of the likeliest and most impactful geopolitical risks of 2024 and the important role DFMs and financial advisers must fulfill to help clients to navigate the uncertainty and associated investment risks.

Geopolitical minefields

Geopolitical risk can be categorised into several interconnected and often overlapping types.

Regional conflicts

The conflict in Gaza, the Red Sea shipping battles; and the ongoing war between Russia and Ukraine are all contributing to massive global uncertainty, triggering energy price fluctuations, global supply constraints, refugee crises, and broader market volatility. Understanding the potential impact of these conflicts on specific regions and asset classes is crucial for informed investment decisions.

Trade wars

The two largest economies in the world have been locked in a bitter trade battle. It started in 2018 when the US began setting tariffs and other trade barriers on China with the goal of forcing it to make changes to what the US says are longstanding unfair trade practices and intellectual property theft.

In China, there is a perception that America is trying to curb its rise as a global economic power. The ongoing dispute has seen the US and China impose tariffs on hundreds of billions of dollars' worth of one another's goods. Investors face exposure to these disruptions through various sectors, demanding careful consideration and potential adjustments.

This article first appeared in Q1 2024 edition of Liberty DFM Future Focus, published in April 2024

Cybersecurity

The data breach at Yahoo is one of the worst and most infamous cases of a known cyberattack and currently holds the record for the most people affected. A team of Russian hackers targeted Yahoo's database using backdoors, stolen backups, and access cookies to steal records from all user accounts. Initially, Yahoo reported stolen data from about 1 billion accounts, however, after Verizon bought out Yahoo in 2017, they reported that the final number of records affected totalled about 3 billion accounts.

The risk rating of major cyber-attack(s) is at a high level and the ongoing attacks highlight the vulnerability of critical infrastructure. Sophisticated cyber-attacks targeting businesses and governments, can lead to devastating data breaches, financial losses, and reputational damage. Companies across industries are vulnerable and need to assess their exposure and mitigation strategies.

> Cybercrime projected to hit $10 trillion annually by 2025
> - University of San Diego

Nationalism and populism

Anti-globalisation sentiment and inward-looking policies championed by some governments can hamper international cooperation and trade. This impacts global economic growth and has the potential to lead to market isolation for specific sectors. Many investors are bracing for the return of Donald Trump – a Trump presidency could bring sharp policy reversals in 2025 and include steep import tariffs and a potential exit from NATO. The consequences of these potential policy changes should be on the radar screens of investors.

Diversification...a powerful tool

With the right strategy, diversification can be a powerful tool for building a resilient and successful investment portfolio, even in a world filled with geopolitical uncertainties.

It is the diversification across asset managers – investment philosophies and styles – asset classes, sectors, geographies that helps to mitigate the impact of any single geopolitical event and smooth out portfolio volatility.

> "Diversification is the process of allocating capital in a way that reduces the exposure to any one particular asset or risk by investing in a variety of assets or across many risk factors."
> - Joao Frasco, Liberty DFM: CIO

Examples include:

Spreading the impact
A single event might cripple a specific region or industry, but it is unlikely to affect everything simultaneously. By diversifying across different geographic regions, asset classes, and sectors, you can ensure that the negative impact of any event is spread thin, minimising the overall effect on your portfolio.

Reducing dependence
Over-reliance on any single country or region leaves you vulnerable to its political whims. Diversification breaks that dependence, offering exposure to economies with different political systems and risk profiles. This reduces the sensitivity of your portfolio to events in any specific location, making it less susceptible to sudden shifts in policy or leadership.

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Capturing global growth

The world is a vast and diverse marketplace and by limiting yourself to one region, you could miss out on exciting opportunities elsewhere. Diversification opens doors to the growth potential of different economies, allowing you to benefit from advancements and innovations happening around the globe, regardless of local political landscapes.

Long-term perspective

Geopolitical events often create short-term disruptions, but their long-term impact is usually less severe. Diversification encourages a long-term view, allowing you to ride out these temporary waves of volatility and focus on the underlying fundamentals of different economies and assets.

Choosing the right navigator

Partnering with a reputable DFM with a proven track record is certainly a good start to protecting your advice practice and more importantly, your clients during geopolitical uncertainty. DFMs conduct thorough risk assessments, stay informed about geopolitical trends and adapt investment strategies accordingly. Hence, partnering with a DFM can help clients navigate these uncertain times with greater confidence and potentially achieve their long-term financial goals. BUT selecting the right DFM requires careful consideration. Key aspects to bear in mind include:

- **Experience in managing geopolitical risks:** look for a DFM with a proven track record of navigating past geopolitical challenges and demonstrably adapting their strategies accordingly.
- **Investment philosophy and approach:** ensure the DFM's philosophy aligns with your clients' risk tolerance and investment objectives.
- **Track record and performance:** evaluate the DFM's historical performance against relevant benchmarks.
- **Research capabilities and resources:** ascertain the depth and quality of the DFM's research team and their access to global intelligence sources.
- **Transparency and communication:** choose a DFM that prioritises clear communication, keeping both advisers and clients informed about relevant developments and portfolio adjustments.

In conclusion, the current geopolitical landscape demands a proactive approach to risk management. By leveraging the expertise and resources of an experienced DFM, advisors can empower their clients to navigate uncertain waters with greater confidence and achieve their long-term financial aspirations.

Remember, in a sea of uncertainty, choosing the right navigator can make all the difference.

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