Political Risk and the Global Markets: Key Risks and Opportunities in 2019 and Beyond

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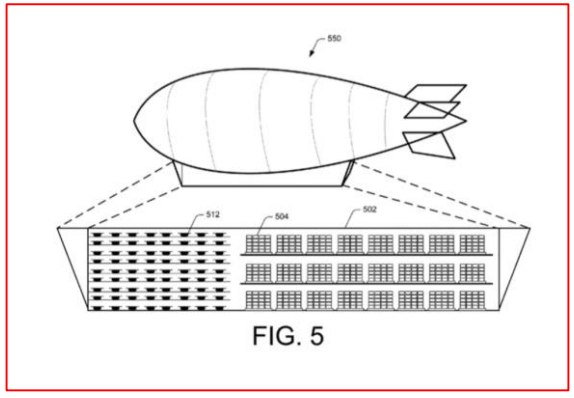
Geopolitics are increasingly impacting our daily lives as well as the global markets.

Here are the leading issues and trends that are likely to impact us in 2019 and beyond.

The growth of populism globally: How does it end? Is this the result of technology and demographics?

- One of the more perplexing questions of the decade: How far will populism go? When will it end?
- The answers may lie in demographics and technology – both of which are increasingly seen as a threat to the average worker. Demographic downturns in Europe, the United States, China, Russia, etc. have clearly led to heightened demographic shifts – and social insecurity.
- The rise of the driverless cars and truck, the use of drones for commercial use, robotics and artificial intelligence
- The potential risks are enormous and until leaders begin to talk about these huge societal and cultural shifts in a constructive manner, most social scientists believe the populist movements will continue to grow and gain momentum.



The New China: Rise of a global political and military super-power

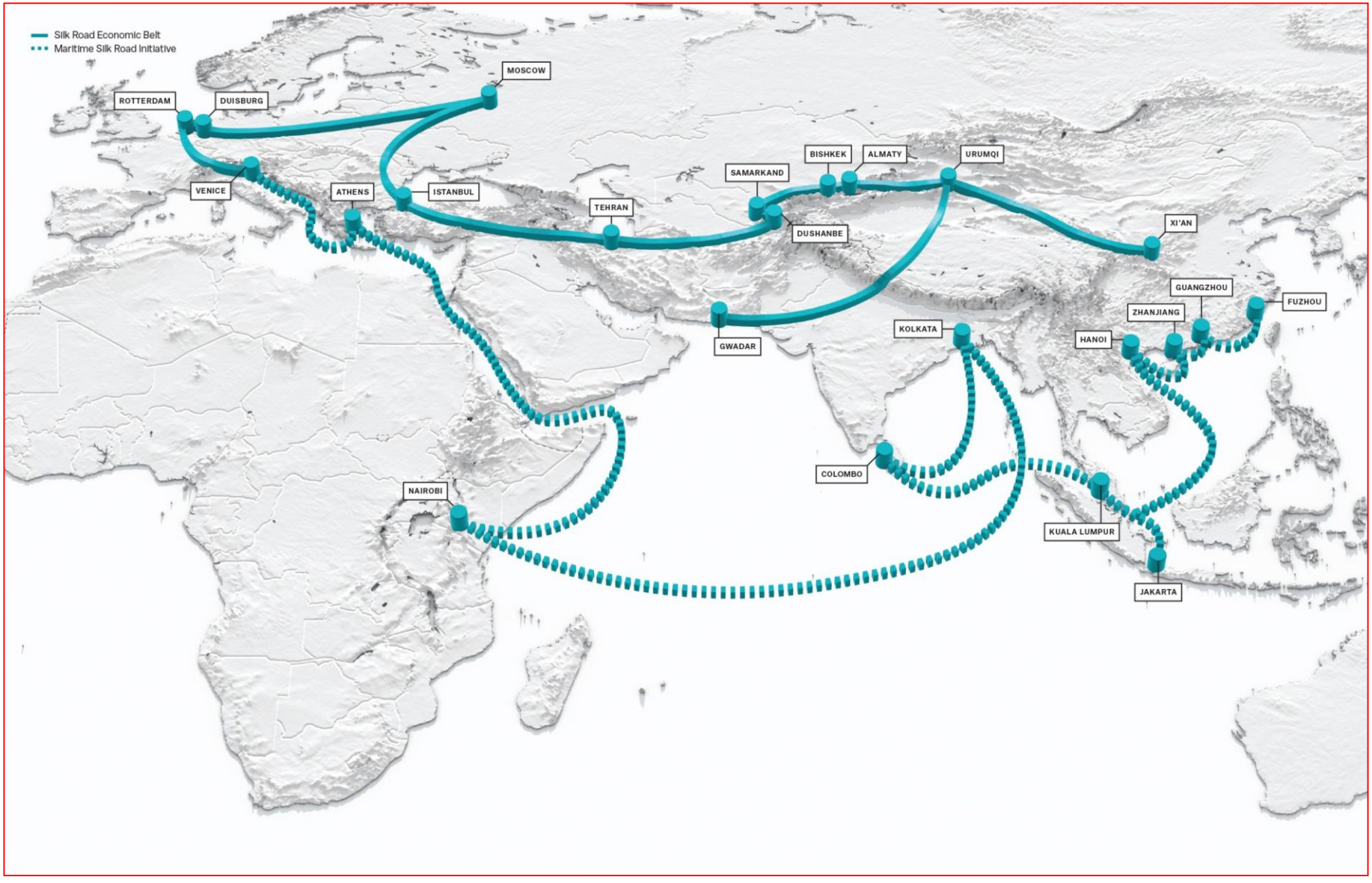
- The last Chinese Communist Party Congress altered the essential vision and strategy of China. In essence, China will now more holistically engage around the world beyond trade.
- In other words, expanded political and military engagement globally. A true superpower has emerged.

Chinese military base, Djibouti

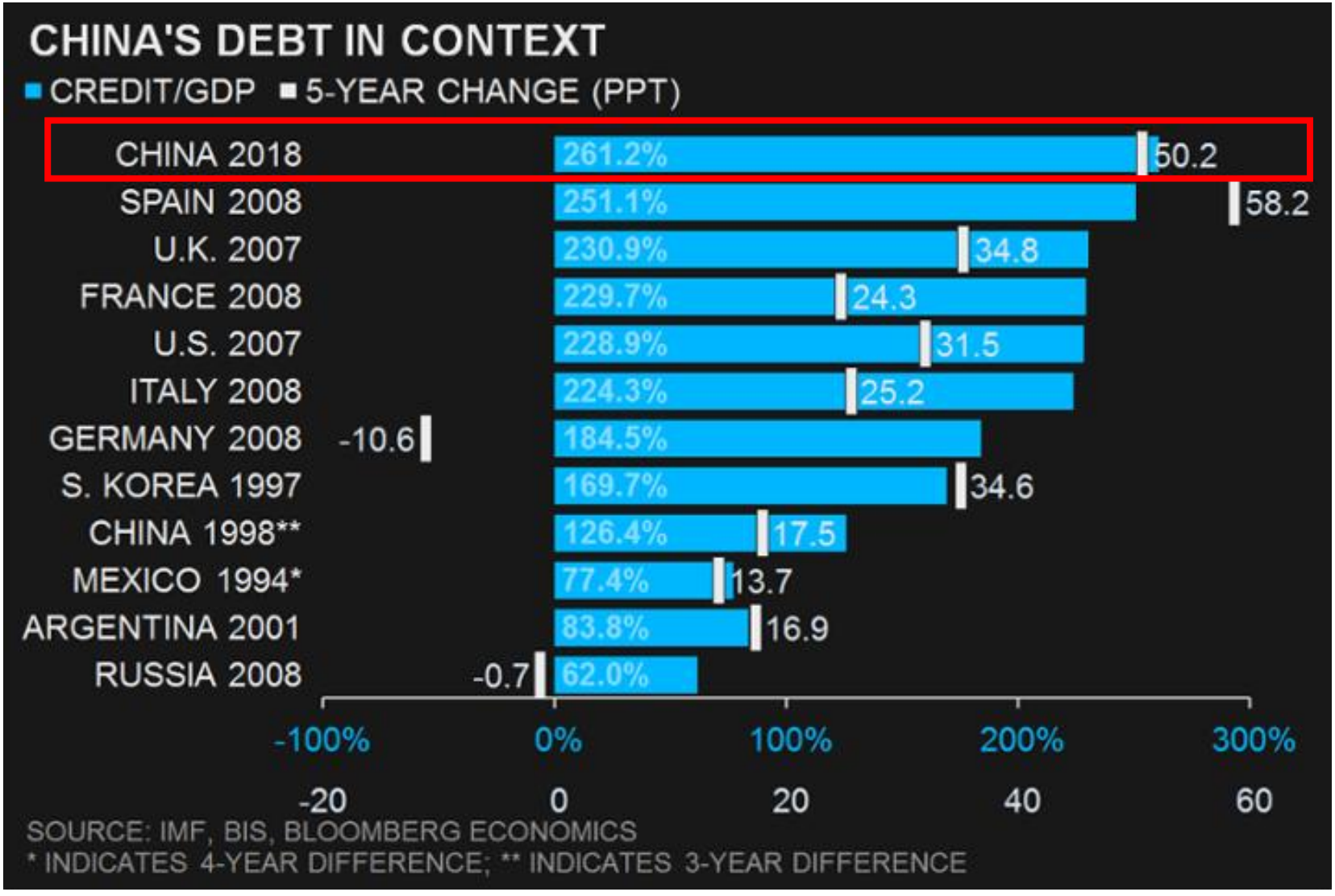
"String of Pearls":

Locations where China either has or is currently negotiating to establish military bases.

All to support China's extraordinary global economic plan, the Belt and Road Initiative

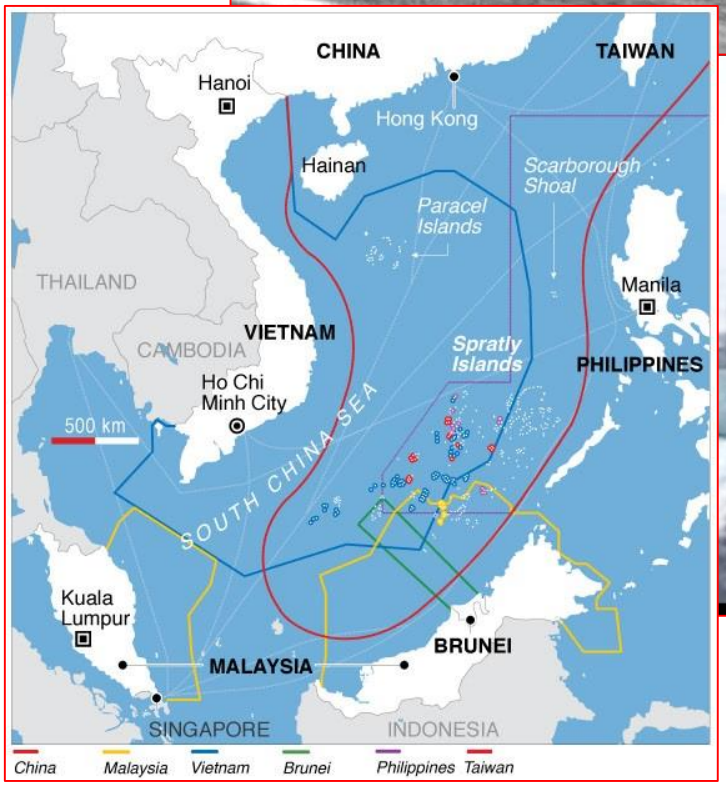


But with all this comes substantial debt…



Source: Bloomberg

But with all of this comes rising political and military tensions: Watch the South China Sea



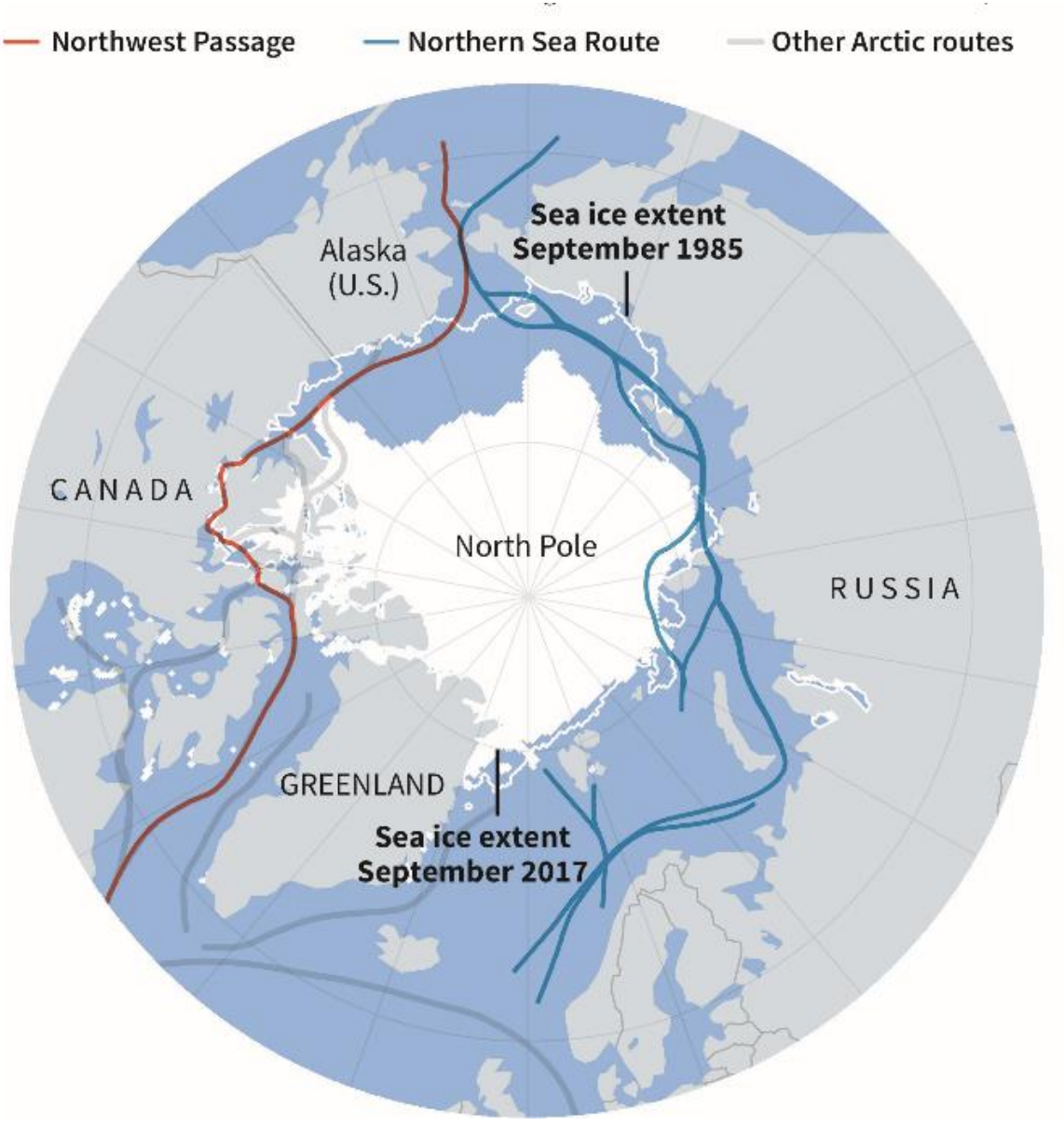
Sources: Stratfor, Reuters

Global trade tensions: What to watch and how do they end?

Trying to keep up trade policy decisions globally has many market participants confused. Here is a quick break-down:

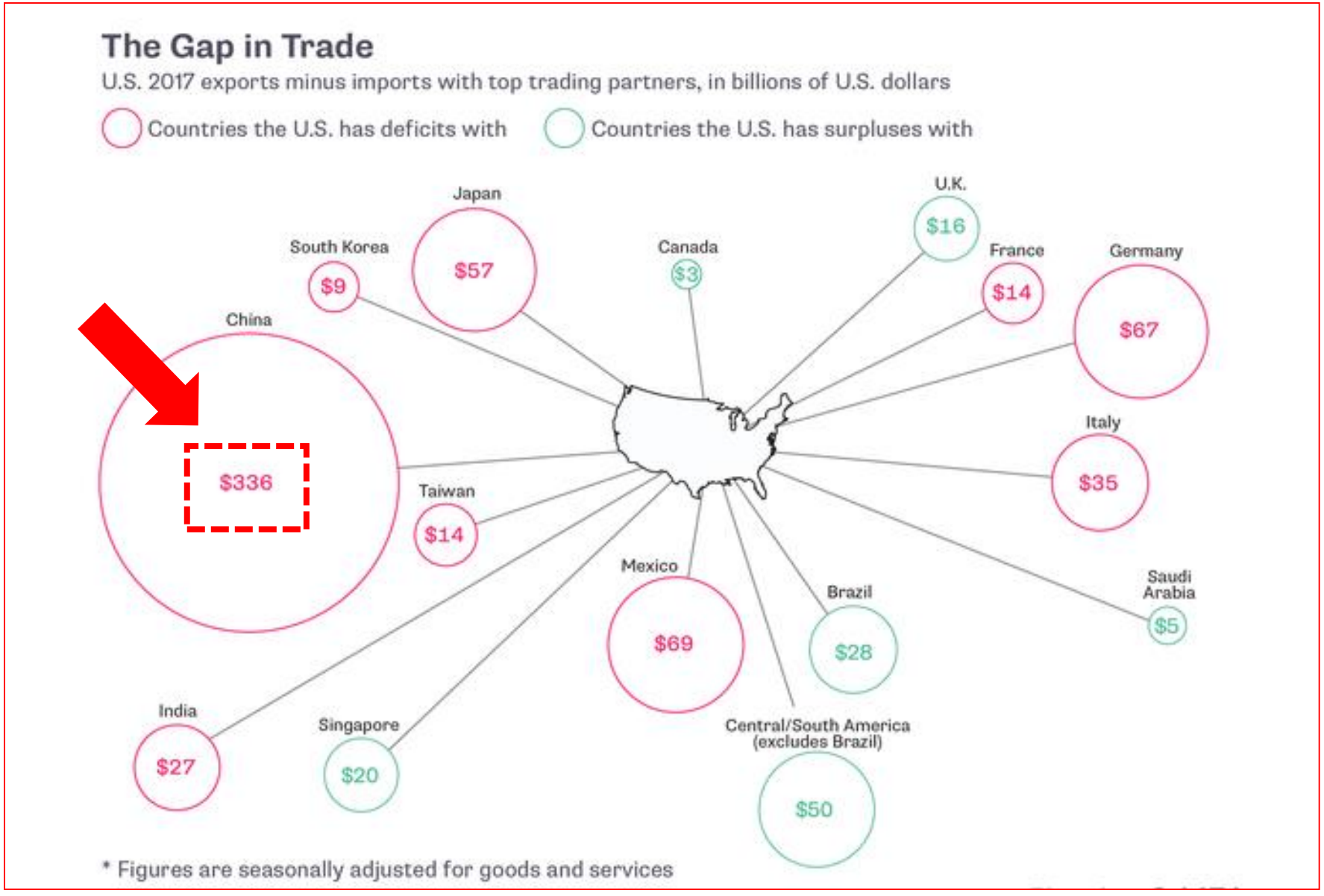
- **USMCA (NAFTA 2.0):** It's done and will likely be by Congress in Q2 2019. Net positive for all three countries (Canada, Mexico, US)
- **Japan:** President Trump is pursuing a bilateral free trade agreement.
- **UK:** President Trump wants a bilateral once Brexit is done; UK will pursue a deal with Japan and others.
- **EU:** There was apparently a truce and agreement to start talks with EU President Juncker. Quiet talks have just started.
- **China:** Do not expect this to be settled in 2018. Now moving from tariffs to sanctions (i.e. People's Liberation Army, Chinese banks, senior government officials, etc.)

And thanks to climate change, trade has new ways to reach around the world – is that a good thing?



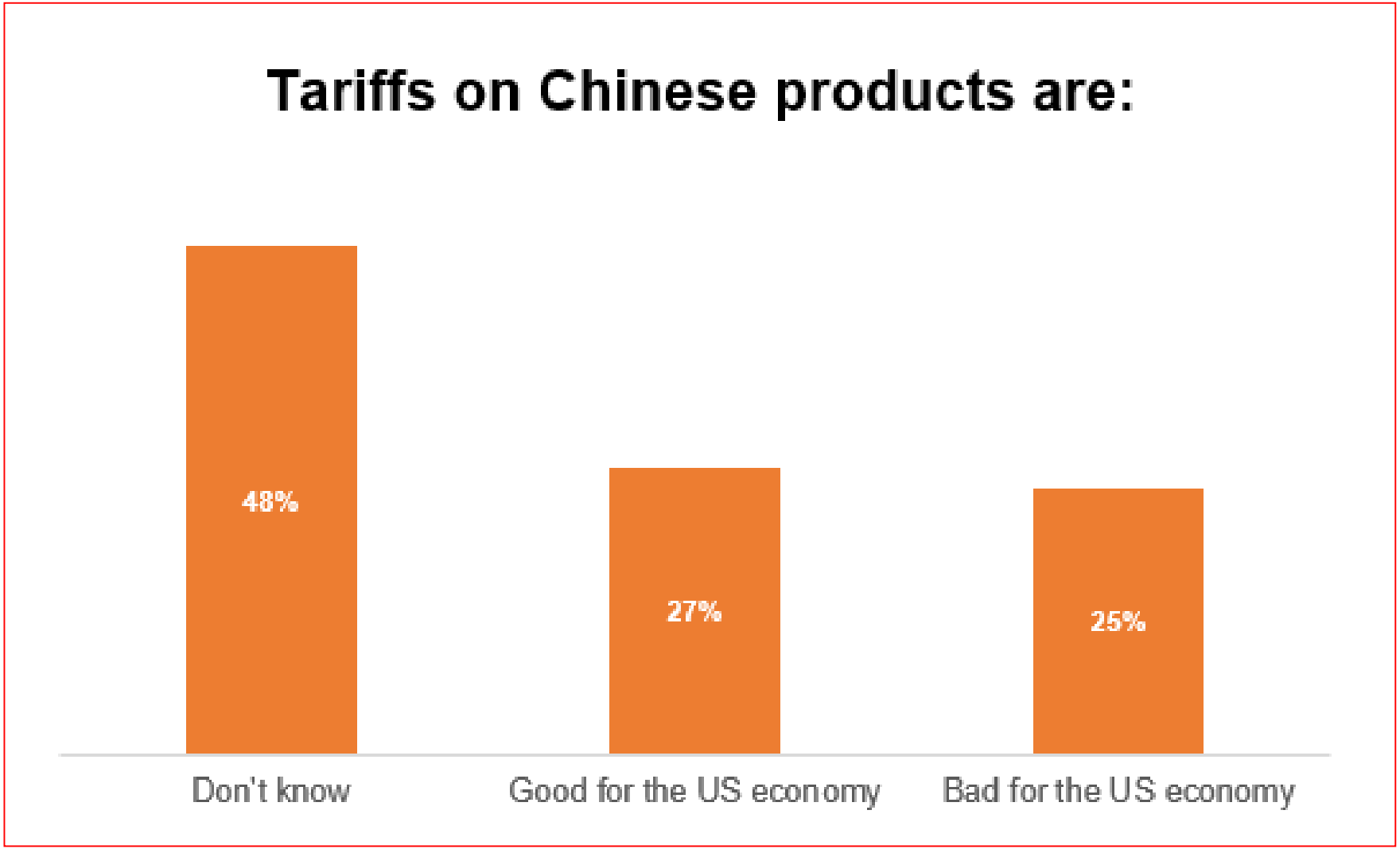
Source: Reuters

How does China match up with other countries in terms of the trade gap with the US?



Source: BloombergQuickTake

What does the average American know about tariffs placed on China?

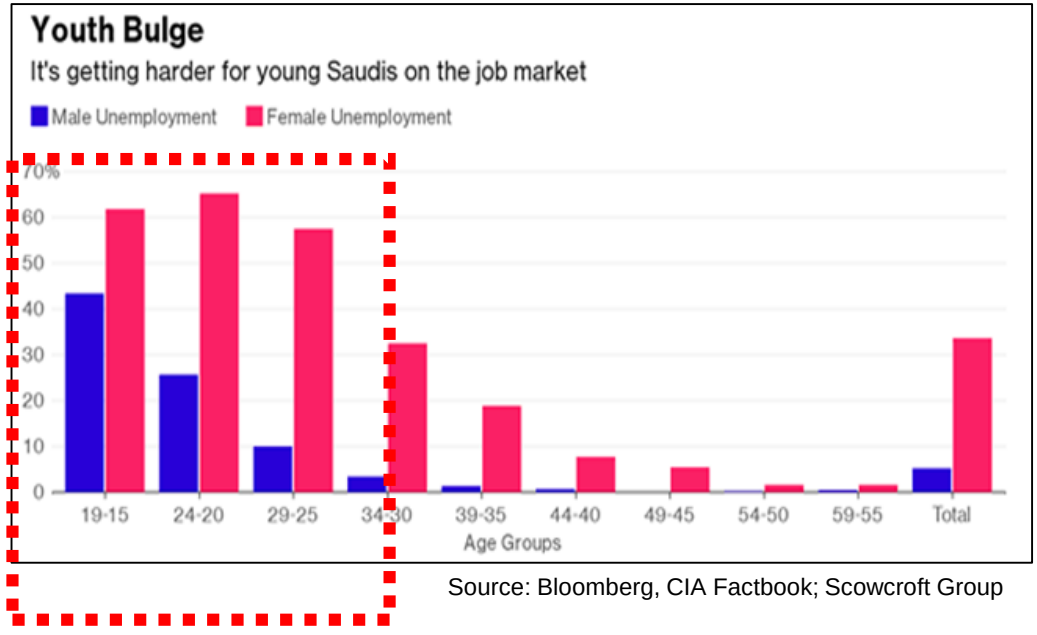


Source: RIWI

The Future of the Middle East: What next?

- **Saudi Arabia** is well into the Vision 2030: an ambitious plan to transform the country from the world's greatest petroleum state into the world's leading tech and investment state. However, MBS's controversial leadership now threatens to undermine international investment.
- Before the Khashoggi murder, the biggest challenge was internal demographics and workforce transition (70 percent of population is under the age of 30) and ongoing competition in global oil market.
- How long before there is a backlash to the significant internal political, economic and social changes he has allowed?

Deputy Crown Prince Mohammed bin Salman



Source: Bloomberg, CIA Factbook; Scowcroft Group

What next for the Middle East? (cont.)

- In **Iran,** the Rial has plummeted to new lows, losing approximately 70 percent of its value this year alone.
- Street protests are increasing across the country in defiance of the religious and military leadership. Complaints range from the price of eggs to corruption of building inspectors which has led to building collapses.
- But sanction pressure may actually bolster support for hardliners rather than undermine it.
- The Revolutionary Guard has ramped up the political pressure against President Rhouhani; more than 300 functionaries were recently arrested and tried – in one day – with sentences ranging from death to 20 years in prison.
- Iran increasingly is looking to China for assistance. China is Iran's #1 trading partner and buyer of Iranian oil.
- US waivers may not last that long. What exactly can Tehran do to escape the pressure?

Source: The Economist

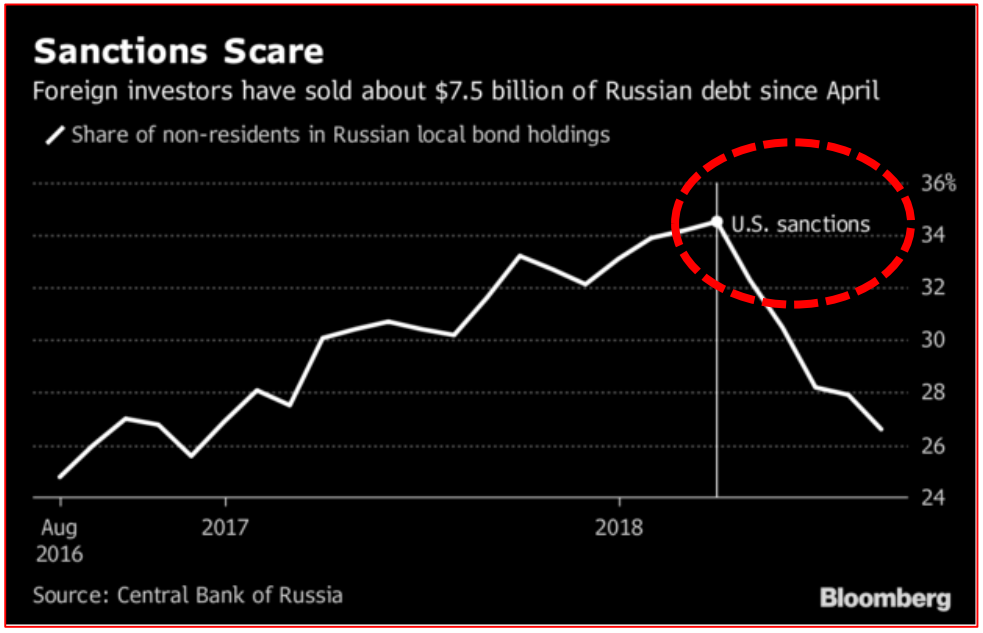
What next for the Middle East? (Cont.)

- In **Turkey**, the Lira has plunged as much as 40 percent this year; inflation is at 20 percent and growing.
- Turkey cannot afford to leave NATO yet Erdogen seems to want to test the relationship.
- However, Erdogan has used Brunson and Khashoggi to de-escalate tensions with the US, and his role in Syria gives him a trump card with EU.
- Turkish finances will be critical thing to watch, particularly the possibility of Halkbank fines and any sign of a bailout from Qatar or even Saudi in exchange for Khashoggi pressure reduction
- And how hard will President Erdogen push for supremacy of the natural gas fields off Cyprus? Will Turkey become a regional energy power?

Source: Stratfor, AP

Russia: What real threat does Putin actually pose? Enough for new, crushing sanctions from US?

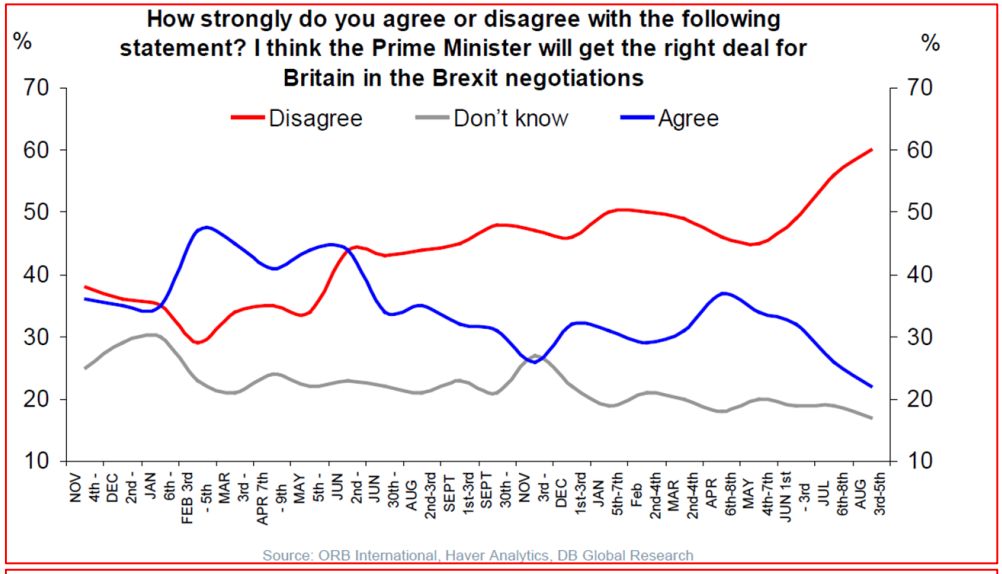
- Western sanctions are taking a sizeable and painful bite out of **Russia**'s economy.
- Russia shrinks by 700 people per day. Demographers believe by 2050 the overall population could shrink from 149 million to 115 million.
- And more sanctions are potentially on the way among them bans on Russian Sovereign Debt.
- Watch for the growing stand-off in the Sea of Azov. 25 percent of Ukrainian GDP comes from steel exported from here through the Black Sea to the rest of the world. Russia is beginning to choke off the route.

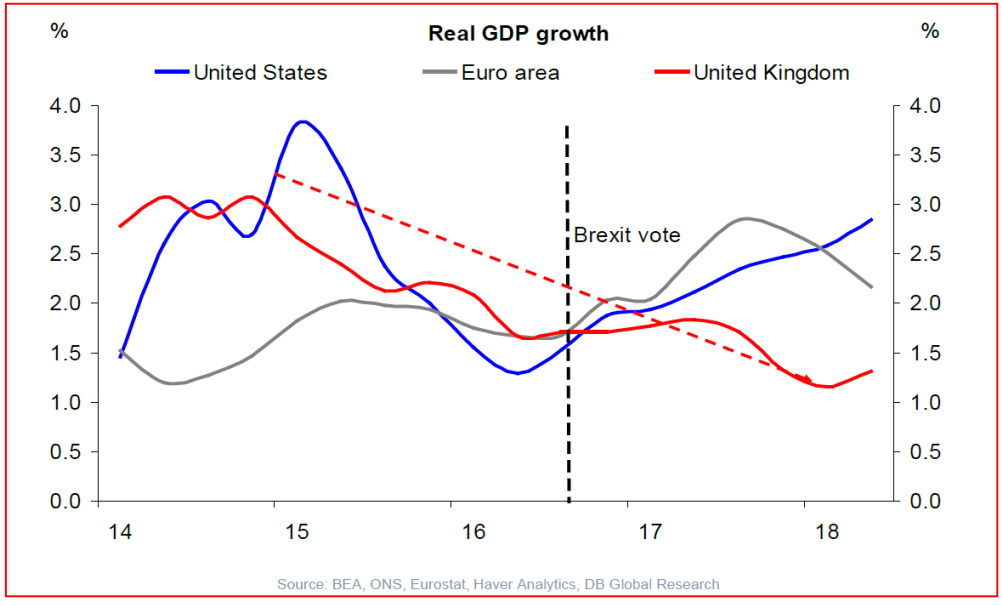


Sources: Bloomberg; World Bank: Washington Post; IISS

The Future of the EU: Brexit, Changes in Germany, Impact of Italy all point to new dynamics for Europe

- The big question at this point in time is how is this going to end? Here are several scenarios:
  - **Hard Brexit** – probability quoted at "60-40" by Trade Secretary Liam Fox (August). Anticipated 4% GDP loss in the UK (over 5 years) versus no Brexit.
  - **Soft Brexit** – along the lines of Prime Minister May's Chequers White Paper.
  - **Deadlock and Extension** – according to EU, this is only possible if there is a significant shift in the UK's negotiating position or May's government is replaced by new leadership.
  - **Second Referendum or Elections** – If necessary Parliamentary approval for any deal cannot be won, pressure will rise to push the Brexit question back to the people.



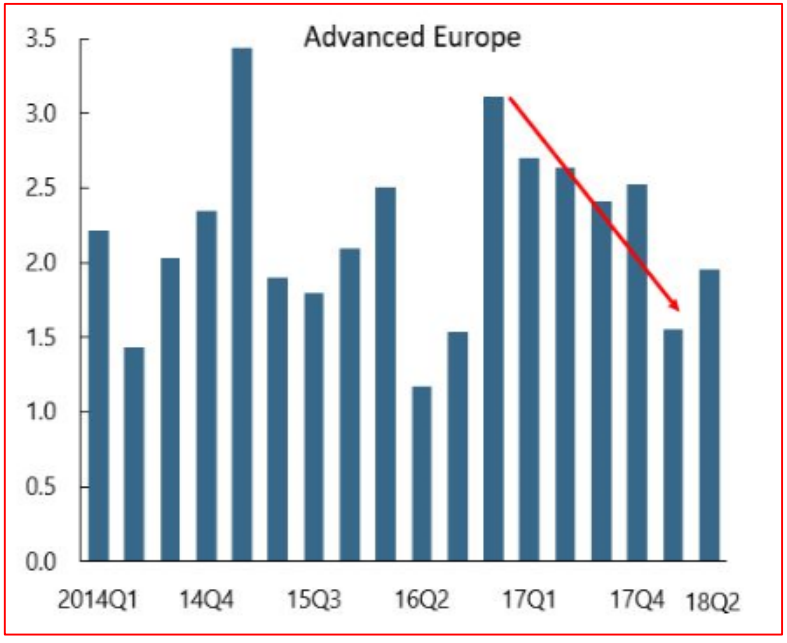


Source: Deutsche Bank Research

The Future of the EU (Cont.)

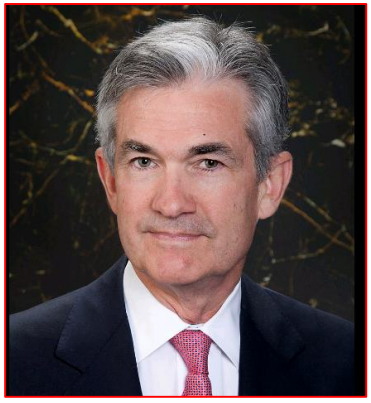
- 2019 brings so many questions about the future of the European Union, including:
  - **The End of the Merkel Era** – Who replaces her in Germany as well as in the broader EU as a leader? Is there actually one person or are the new emerging political parties forcing strange new, coalitions to exist?
  - And with this, is there a risk of German Economic Slowdown? And what will be the impact on the rest of the EU?
  - **And what about Italy?** Will the European Commission ramp up their opposition to Rome's plans?
  - Back to the Belt & Road for a moment - what will Moscow do – if anything – to try to counter China's growing influence in Europe?

EU grows at respectable rate but has slowed



Source: Bloomberg, IMF

A strong US Federal Reserve Chair and Vice Chairs work well with other central bankers for careful coordination



Chairman Jay Powell

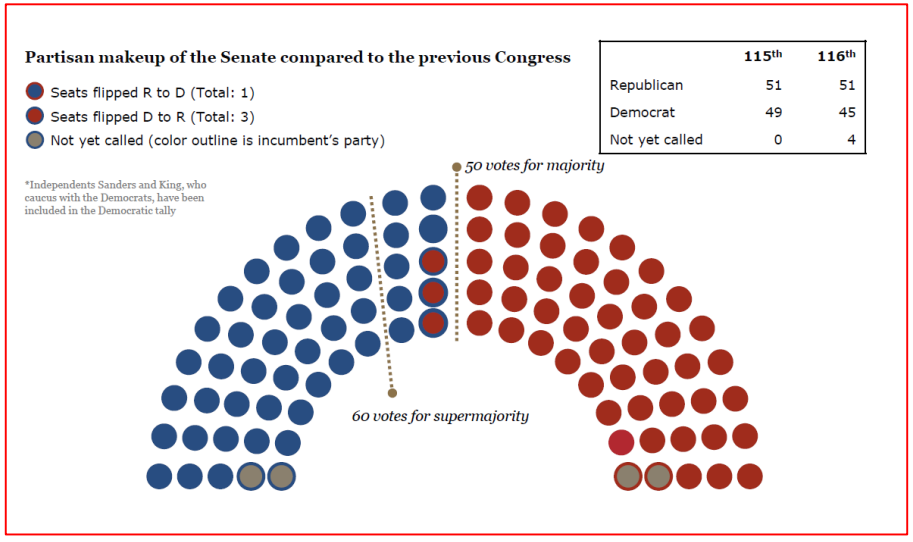
Vice Chair Quarles

Vice Chair Clarida

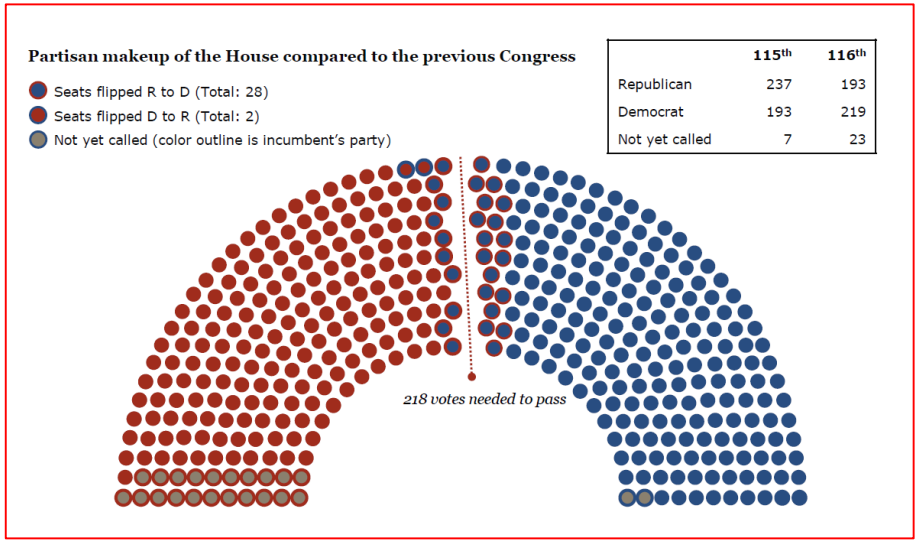
- Federal Reserve Chair Jerome (Jay) Powell is a strong, deliberative and independent leader – will not bend to political pressure.
- Powell is a highly experienced Washington insider (born and raised) with excellent political instincts to go with superb market and monetary experience.
- Teaming up with him is Randall (Randy) Quarles, Vice Chair for Supervision and Regulation. Quarles strengths are deep in both regulation and monetary policy – an understand the intersection of both.
- Both have substantial and lengthy international central banking experience and relationships.
- And now Richard Clarida is on board as the new Vice Chair for Monetary Policy.
- Marvin Goodfriend and Michelle Bowman are close to being confirmed.

US mid-term elections: Everyone won a little something. Will we all win with infrastructure spending?

- The mid-term elections have led to a split Congress: A Republican Senate and a Democratic House.
- While the markets expect “gridlock” there is hope the two parties can come together to move on a large infrastructure plan.
- Why should global markets care?
- It will be highly stimulative to the US economy and by extension the global economy.
- There is substantial discussions about using direct foreign investment to help fund it (i.e. Japan, China, etc.).
- But no matter what, life has just become much more hard for President Trump – expect intense investigations of his business activities and policies his Administration has taken.



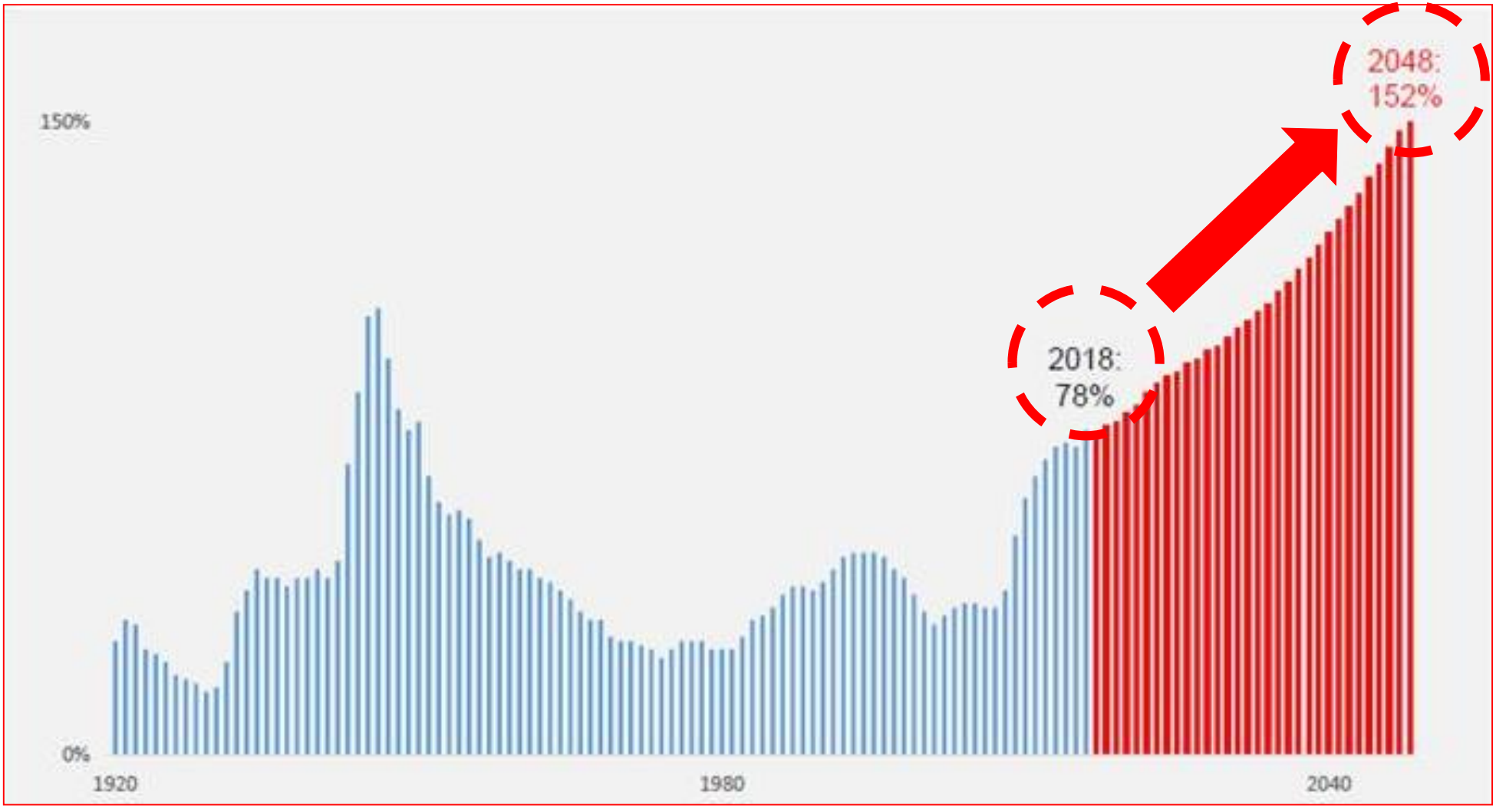
	115th	116th
Republican	51	51
Democrat	49	45
Not yet called	0	4



	115th	116th
Republican	237	193
Democrat	193	219
Not yet called	7	23

Source: National Journal

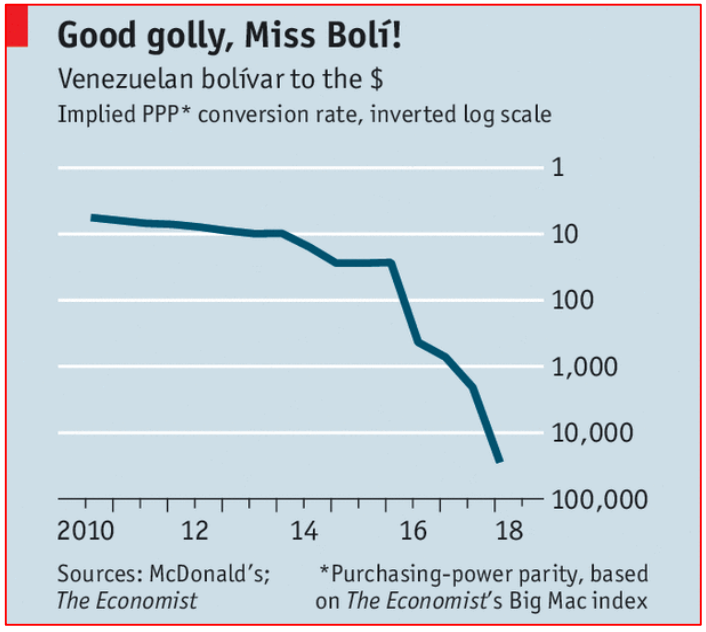
The growing threat: US Government Debt to GDP
Projected to double over next 30 years



Source: Congressional Budget Office

Latin America: The impact of the new Brazil and the sinking Venezuela on the Southern Hemisphere

- The average **Venezuelan** has lost approximately 30 pounds/13 kilos in the last year.
- More than 2.3 million Venezuelans have fled the country (total population is 32 million).
- **Colombia, Brazil, Mexico, Chile** are becoming overrun with refugees who have little or no chance to settle.
- With inflation now plus 1 million percent and President Maduro's recent currency devaluation, how much longer can the country continue at this rate?
- Questions are also growing as to overall economic and political impact on the region. Case in point: will the refugee crisis create a new political crisis in Colombia? Did this help lead to the recent populist election in Brazil?



Source: The Economist; Atlantic Monthly

Who…what… when…how…

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