

Looking Forward: Now Seating, Party of Three

By Arthur Heinmaa, CFA, Chief Investment Officer

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Frames are not just for hanging pictures. Framing also refers to how you set up the basic outline of a problem or situation. For instance, you can think about an investment in terms of losses, by focusing on the bad outcomes, or in terms of gains, by focusing on the good outcomes. Interestingly, your decisions can be significantly influenced by how you frame the problem so it is important to examine any problem from many different angles. With the invasion of Ukraine by Russia, we thought it would be useful to develop a larger frame within which to examine different investment opportunities. By solely focusing on historic data, whether it be company specific or macroeconomic indicators, you are tacitly assuming that all of the international relationships and motivations will remain roughly the same in the future as they have in the past. We argue that this war will have longer term implications for investment returns and will impact where to look for opportunities.

We believe that the world will split into three different geopolitical zones. Increasingly, trade and economic activity within the regions will come to define economic growth and prosperity, with much less emphasis on a view that economic prosperity will be a broader global pursuit. For years, the expectation was that by fostering closer economic ties between nations the incentive for conflict would be significantly reduced. If you are making money, why pursue a military strategy beyond your borders? The pandemic laid bare the fragility or folly of having a single source of supply for key inputs. The Russian invasion of Ukraine inextricably linked the issue of supply chains with national security. The discussion now does not look to the cheapest source of supply, but rather how we can attain confidence in security of supply from countries seen as allies. A Chinese annexation of Taiwan, once only an afterthought, is now seen as a possibility and one that has forced companies to come up with contingency plans if that should ever occur. Simply stated, business strategy will change from just in time to just in case.

How societies experience day to day life will also change. In Europe and North America, the free flow of ideas and information will be in stark contrast to how an average Chinese or Russian citizen experiences the internet. Heavy censorship and detailed monitoring will allow both the Russian and Chinese to influence how their populations

interact with the rest of the world. This is not only restricted to information available but also how their populations will be influenced. The combination of hard restrictions & tariffs will increasingly turn e-commerce inward and serve to reinforce the fracturing of the global economy. Moreover, the freezing of Russian central bank assets increases the urgency for China and Russia to develop payment mechanisms that are not reliant on Western systems for settlement. For quickly growing companies, their growth prospects outside of their region will likely be more limited. One can't simply assume that profitable Chinese expansion is their future. It is too soon to tell how much growth might be curtailed, but increasing tariffs and buy domestic policies will feature prominently in the future. This will result in shifting the focus of business towards ensuring government support to expanding into foreign markets.

The tragedy of this outcome will likely be felt most strongly in dealing with climate change and perhaps in other matters that require global co-operation. At the very moment where the world needs more co-operation to tackle a global problem like climate change, it is fracturing into different zones that may follow their own self interests. Unfortunately, the cost, both in human and financial terms, is likely to fall hardest on the poorest and most vulnerable nations. The recent Intergovernmental Panel on Climate Change (IPCC) report estimates that in the next decade alone, climate change will drive 32-132 million more people into extreme poverty. The challenge of climate change becomes even greater if there is less cooperation on solutions.

So where does that leave the investor? First, the changing economic landscape needs to be incorporated into valuations. This means a critical reappraisal of the likely growth prospects of a business by looking at factors such as the jurisdictions they can operate in or expand to. Second, it is important to have a strong understanding of a company's key supply chains and what types of political and geographic vulnerabilities may exist. Third, it is prudent to prioritize investments in markets that have a strong backing of regulation and law. One thing that recent events have taught us is that if there is a problem, the last person that any foreign country will care about is the Western shareholder.