

MARKET SIGHT LINES



Geopolitical Risk as a New Normal: Investing in a More Fragmented World

By **Michael O'Keeffe, CFA**
Stifel's Chief Investment Officer



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For decades, many investors often treated geopolitical events as temporary shocks. A crisis would emerge, markets would react, and they would then look for signs that the event was contained. But as we discuss in our **Geopolitical Risk Dashboard**, the world has been shifting from an era of globalization to one marked by increased localization, protectionism, and strategic competition. Recent events — including Brexit, the pandemic, Russia's invasion of Ukraine, the war in the Middle East, and U.S.-China competition — all point to a more fragmented world. While investors cannot predict every geopolitical event, geopolitical risk is becoming increasingly relevant in the investment environment. Companies are rethinking supply chains, governments are prioritizing security and domestic capacity, and investors must consider how these forces affect inflation, growth, margins, capital spending, and market leadership. In this Sight|Lines, we discuss why geopolitical risk is a new normal, and what that means for investors.

THE TAKEAWAY: GEOPOLITICAL RISK IS A NEW NORMAL

Geopolitical events remain hard to predict, but the forces driving them are increasingly structural. In summary:

- The world is moving from globalization toward localization and protectionism.
- Investors can benefit from broadening focus from predicting events to identifying risk channels.
- U.S.-China competition remains one of the clearest examples of a structural geopolitical risk.
- Military conflict and key trade chokepoints can quickly affect energy, trade, and markets.
- Cybersecurity and space are becoming part of geopolitical competition.
- Companies are responding by investing in resilience, domestic capacity, and nearshoring.
- As highlighted in our **long-term investment themes**, securing strategic resources is becoming a higher priority for companies and governments.
- We guide investors to focus on quality, diversification, pricing power, and resilience.

IN-DEPTH: A MORE FRAGMENTED WORLD CREATES RISKS AND OPPORTUNITIES

Specific geopolitical events are difficult to forecast, but investors can monitor how geopolitical risk moves through the economy and markets. Going deeper:

- The world is shifting away from globalization and toward localization and protectionism:
 - Globalization lowered costs and expanded supply chains.
 - Fragmentation increases the value of security, redundancy, and control.
- We believe investors should focus less on predicting events and more on identifying risk channels:
 - An example: 90% of advanced semiconductors are produced in Taiwan, a geopolitical hotspot.
- U.S.-China competition remains one of the clearest examples of clear, structural geopolitical risk:
 - Strategic competition spans technology, trade, supply chains, economic influence, and national security.
 - Tariffs, trade restrictions, and protectionist policies challenge companies reliant on China.
- Military conflict can create key trade chokepoints, quickly affecting energy, trade, and markets:
 - More than \$3 trillion of global trade passes through the South China Sea annually.
 - A broader or sustained Middle East conflict could further disrupt energy markets and increase demand for defense.
- Cybersecurity and space are other important examples of geopolitical considerations:
 - A major cyberattack on companies, government agencies, or infrastructure could paralyze an industry or sector.
 - Space is more contested, with satellites increasingly important for communications, defense, and commerce.
- Companies are responding by investing in resilience, domestic capacity, and nearshoring:
 - There have been more than \$1.5 trillion in announced U.S. manufacturing investments since 2021.
 - 96% of CEOs are evaluating or implementing reshoring initiatives, while 35% of firms are shifting away from China.
- Securing strategic resources is becoming a higher priority for companies and governments:
 - The U.S. Geological Survey has identified 50 mineral commodities critical to the economy and national security.
 - The U.S. relies solely on imports for 12 of those minerals and is more than 50% reliant on imports for most others.
- We believe investors should focus on quality, diversification, pricing power, and resilience:
 - Deglobalization, supply chain reconfiguration, and labor shortages may keep inflation structurally higher.
 - Companies with pricing power, strong balance sheets, secure inputs, and exposure to defense, cybersecurity, energy, and infrastructure may be better positioned.

WHAT WE THINK

Geopolitical risk does not automatically derail the economy or weaken equity markets. Markets have proven resilient, absorbing the impact of wars, oil shocks, recessions, financial crises, pandemics, and political disruptions over time. That said, geopolitical risk is not temporary nor irrelevant. We're in a more fragmented world, where governments are prioritizing security, companies are rethinking supply chains and business models, and capital is being redirected toward domestic capacity, energy security, defense, cybersecurity, and critical inputs. These shifts create opportunities but also risks. Investors cannot predict every event, so a focus on risk is important. To do so, an investment process can emphasize quality, maintain diversification, look for companies with pricing power and resilient supply chains, and recognize that some industries may benefit from a world more focused on security and strategic independence. In a more fragmented world, geopolitical risk is not just a headline; it is a persistent force shaping the investment landscape.

Michael P. O'Keeffe, CFA 

Chief Investment Officer

michael.okeeffe@stifel.com

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