Key Questions

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Is the US Immune From Geopolitical Events?

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Not entirely, but the US enjoys several distinct advantages that leads us to recommend a slight home-country bias toward investing.

Not Like Other Countries

The US is similar to other developed countries in many ways, but profound differences exist, too. Like the United Kingdom, the US shares a distinct geographic advantage of being somewhat detached from other countries. Although in the case of the US, this advantage is far greater with two oceans largely separating the US from other "flashpoints" elsewhere in the world.

Like our neighbor to the north, Canada, the US is rich in natural resources ripe for refinement, production and consumption. But unlike Canada, the US economy is far more diverse. It is also several times larger.

The US was founded and built by people seeking a better life made from hard work and an enterprising spirit. This has consequently shaped the American culture, affected the ways our laws were written and even influenced the way we dress. The demographics of the US has created a low-context culture that eases communication between many different cultural backgrounds and languages via direct and simplified interactions.

Given these characteristics, the US has built itself into the world's largest economy and wields considerable influence. The country's relationships with the world are not one-way streets, however, and it is worth considering how untouchable, or not, the US is to geopolitical events.

Consumer Economy

At roughly $23 trillion, the US economy is over 35% larger than its second largest competitor (China: $16.8 trillion) and is more than four times larger than the third largest economy (Japan: $5.1 trillion). Combined, the European Union is a significant economy, at approximately $15 trillion. The US is still noticeably larger.

Many economists would agree that the US is a consumer economy, meaning the primary driver of its gross domestic product is consumer spending, instead of business or government spending. Consumer expenditures account for roughly 70% of the US GDP. Moreover, since 2001, the US has become a more services-driven economy versus goods-based, with roughly 60% of US output driven by services activities and 30% from goods-related activities. This has generally made the US economy less capital intensive and less cyclical.

The US economy has also become a larger producer of energy. In 1980, for example, the US was the third largest producer of oil, responsible for slightly less than 20% of the world's daily output of oil. Forty-two years later, the US is now the largest producer of oil, providing nearly one-third of the global daily output of oil.

Thus, the US economy is less cyclical and less dependent on foreign energy, two of several distinct advantages. Looking ahead, however, many US consumers are watching their wallets closely.

That's indicated by a downward trend in future spending intentions and an upward trend in concerns over savings and credit-card debt in surveys that attempt to measure consumers' attitudes. Both factors correspond with worries over inflation and geopolitical events. And given how much these two factors go hand in hand, it is evident that the US is not entirely immune from geopolitical forces.

A Lesson From the Past

The Asian financial crisis is worth discussing as it began far away in Thailand and eventually rocked the US stock market despite solid GDP growth. In July 1997, the Thai government devalued its currency relative to the US dollar, causing a capital flight and triggering an international chain reaction. Thailand's stockpile of foreign debt became a domestic burden and threatened the currencies of nearby countries, including Indonesia, South Korea and Malaysia. The pressure spread further as capital slowed or reversed course and growth halted.

The result was contagion as foreign investors shunned other Asian economies. In the US, stock prices fell 12% despite posting robust GDP growth of 4.5% that year.

Eventually, the Federal Reserve organized a bailout for South Korean banks by encouraging US banks with significant exposures to South Korea to restructure or roll over loans. A bridge loan from the US Treasury was also arranged for Thailand.

The negative direct trade impact of the crisis was challenging but manageable for the US, which was able to partially offset cheaper Asian imports and weakened global commodity prices. By 1999, Asia began to recover from the crisis and worked toward financial stability.

This crisis is an example of how events that seem far away may still affect us but can be managed through diligence and proper intervention. Although such events are unlikely to repeat the same way under the same conditions, they may help show the degree the US could be affected in future geopolitical crises.

Conclusion

Examining a past crisis as an example and given the strong interconnectedness of the global economy, it could be challenging to say the US would completely dodge:

- An implosion of the Russian economy.
- Persistent supply chain challenges in Asia resulting from an extended COVID outbreak.
- A recession in Europe, which seems increasingly likely.

That said, while the US may not be entirely immune from geopolitical events, the US economy enjoys several distinct advantages. For these reasons, among others, we have intentionally maintained a modest home-country bias within our clients' portfolios. We have chosen to allocate between 65% and 70% of our equity portfolios to US markets and between 30% and 35% to non-US markets, versus common benchmarks, which are roughly split 50/50.

For more information, please contact your advisor.

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