Geopolitical tensions – the risks for investors

An apparent Chinese spy balloon shot down on American soil, followed by further unidentified flying objects in the days that followed, have seen US-China relations plumb new depths in recent weeks. This activity has been followed by news of a high-level Pentagon official's visit to Taiwan – the first since 2019. But what does this mean for investors looking to China and Asian markets more generally? Is there trouble ahead?

Although the timing of the Taiwan trip looks likely to ratchet up tensions between the US and China, the temptation is to set aside the prospect of any significant further escalation as extremely unlikely.

However, it's a brave person who discounts any possibilities in geopolitics. As we approach the anniversary of Russia's invasion of Ukraine, the conflict is once again on the front pages after President Biden's secret visit to Ukraine and Putin's subsequent anti-West outburst and withdrawal from the New Start nuclear arms treaty.

At the start of 2022, the prospect of a war on the fringes of Europe seemed close to unthinkable. It is probably now best characterised as a 'black swan' event of the type that few would have predicted – think the Covid-19 outbreak or Global Financial Crisis.

As John Husselbee – Head of the Liontrust Multi-Asset team – notes, it is very difficult to predict how potentially volatile situations may pan out, even once events are in train, as they are in Ukraine.

He adds: "Our approach has always been to mitigate the impact of geopolitical risks by targeting sufficient diversification across our funds and portfolios.

"For this reason, we have not made any changes in our asset allocation based on the likelihood of a conflict between China and Taiwan."

While it is a thankless task to try to build a portfolio that is immune from macroeconomic instability, a framework of diversification should give investors confidence that they can target the most attractive investment opportunities globally, knowing that low or negative asset class correlation can mitigate the impact of big shocks.

Husselbee continues: "We continue to look closely at China from an economic perspective, given that it is such an important driver of growth. If China can successfully keep its economy open without having negative impacts on the health of the population, then this will be a positive for the rest of Asia and the world in general.

"While we are seeing increasing moves towards contracting globalisation, Asia is becoming wealthier and, therefore, is less dependent on the rest of the world for its economic development. Asia will also benefit from a weakening US dollar and a further positive for investors comes from relative attractive stock market valuations across the region. I'd also argue that Asia and central banks in emerging markets have taken more of a traditional approach to monetary policy than the West, and, as such, are arguably in better shape. This is particularly true of the more commodity-rich countries and regions."

The Liontrust Global Fundamental team agrees that the prospects for Asia look bright, although fund manager Ewan Thompson highlights India as his pick in the region:

"Set to shortly overtake China as the world's most populous country, India enjoys a hugely more attractive demographic profile than its key Asian economic rival. Indeed, China has recently seen its population decline for the first time since 1961. China's rapidly ageing population and worsening dependency ratio is in stark contrast to India where 25% of the population are under the age of 14 and more than two-thirds of Indians are of working age."

He adds: “Meanwhile only about 7% of the population is above the age of 64 against China’s 12.4%. With continued political stability and a multi-year investment cycle picking up, we believe that the next decade in emerging markets firmly belongs to India.”

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Key Risks

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.