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In the 1975 political thriller film “Three Days of the Condor,” Robert Redford plays a CIA analyst working in a clandestine office where they endlessly read disparate books, newspapers, and magazines from around the world to discern trends, hidden meanings, and other useful information that might be buried in the noise. This paper is similarly an attempt to link a myriad of mega-trends and world events into a tapestry of potential outcomes, and the policies required to get there. Specifically, why did Populist movements in France, Italy, England, and the U.S. make such dramatic strides in upsetting the global order? Why did Russia annex Crimea, and why are they actively engaged in creating a civil war in Ukraine? Why has China created the Asian Infrastructure Investment Bank? Why did the U.S. remove its aircraft carrier group from the Persian Gulf for the first time in decades? These questions are strongly interrelated, and they have a direct impact on global economics and market direction. While there is no way to state unequivocally which way the future will trend, exploring possible outcomes can serve as a directional checklist as the future unfolds, and thus merits conversation.

The key trends today include the growth of globalization, aging demographics (See

Implications of an Aging Society, the acceleration and adoption of technological change, and the effect of these factors on the world populace. Nobel Prize Winner Joseph Stiglitz wrote, “The disparity between what was promised from globalization and what was delivered has angered many and led to a growing distrust of the elites – in politics, media, and academia.”¹ In his book, *The Only Game In Town*, Mohamed El-Erian states that “Fueled by an unusual combination of cyclical, secular, and structural factors, the worsening of income and wealth inequality has been so pronounced within countries that it now also undermines opportunities. This brings us naturally to the third issue. Or the extent to which individual countries have experienced a rise in what I call the inequality trifecta – inequality of income, wealth, and opportunity.”² Both authors go on to say that while globalization over the past 70 years has increased living standards generally, the results have been by no means uniform. The rich have gotten richer, the poor relative to the rich have gotten poorer, and the middle class has been hollowed out. Liz Alderman, writing

¹ Globalization and Its Discontents Revisited, Anti-Globalization in the Era of Trump, by Joseph Stiglitz, page 51, 2018

² The Only Game In Town, Central Banks, Instability, and Avoiding the Next Collapse, by Mohammed El-Erian, page 84, 2016

for the *New York Times* about Europe's shrinking middle class said, "Since the recession of the late 2000s, the middle class has shrunk in over two-thirds in the European Union, echoing a similar decline in the United States and reversing two decades of expansion."³ This inequality is what leads to discontent and politics of anger and populism worldwide. It seems a straightforward assertion that if large segments of the population are worse off they will vote with their wallets and elect those who claim to have a better way forward. Thus, we arrive at today's world of Populist politics, a world in which the U.S. incites trade wars, becomes more confrontational and protectionist, and is less supportive of allies around the world.

In a world with a weakened global order, other nations will step up and challenge the existing structure. Russia's policy agenda is to weaken the West and increase its own sphere of influence. Likely Russian meddling in U.S. elections has weakened trust in our democratic institutions. They may similarly have played a role in shifting England at the margin to move towards cessation from the EU (Brexit). Both outcomes weaken the cohesion of Russia's adversaries, specifically, Western

Europe and the U.S. (NATO). Both were accomplished without bloodshed and without major repercussions, economic sanctions notwithstanding. In a world where "fake news" runs rampant, we can expect destabilizing cyber propaganda to be an ongoing weapon of choice. The 1938 panic caused by the radio broadcast of "The War of The Worlds" by Orson Wells was an early insight into the power of media. Additionally, Russia annexed Crimea in 2014 and has been encroaching on Ukrainian sovereignty with little to no international reprisal. Here, Russia's intent is twofold. Crimea houses Russia's Black Sea Fleet at the port of Sevastopol. Stealing it back from Ukraine represents a huge tactical advantage in controlling access to the Northern half of the Black Sea, serving as both a defensive and offensive bulkhead. Additionally, Eastern Ukraine and Crimea are largely populated by ethnic Russians and Russia has a demographic time bomb ticking - by 2050, ethnic Russians will become a minority in their own country. Muslims will be the majority. At current rates of overall decline, Russia's total population is expected to plummet 31% by 2050, from 144 to 99 million. A proud superpower such as Russia can expand its sphere of influence, defend its extensive and wide-open borders, even with a shrinking and aging population, by absorbing existing pockets of ethnic Russians and extending

³ The New York Times, "Europe's Middle Class is Shrinking" by Liz Alderman, Feb. 14, 2019

its borders to more defensible positions. If the pace of globalization unwinds, we can expect more aggressive moves by Russia in the Ukraine and then possibly north and east from Ukraine up to Estonia.

China too has global ambitions. Importantly, they have a political system and cultural long-term vision that may allow them to make strategic investments that outflank the shorter-term views of Western democracies and challenge the hegemony of the United States. Eurasia represents two-thirds of the world population, economy, and trade, and China wants to dominate this region. Their grand strategy is to be the number one economy in the world. Given their track record of growth and achievement so far, they are doing something right. They are competing against us in part by forced technology transfer, outright Intellectual Property theft, corporate espionage, currency control, and most importantly trade and infrastructure investment. Parag Khanna highlights this when he wrote “Western scholars wasted over a decade pretending that Chinese participation in the World Bank, IMF, WTO and other institutions signaled its desire to play along with a Western-centric order rather than noticing how China joined these institutions mostly to water them down while at the same time creating separate frameworks such as the Asian

Infrastructure Investment Bank (AIIB) to advance its own agenda. The AIIB is budgeted to spend about ten times as much in Asia as the Marshall Plan did in Europe, mostly to finance roads, railways, pipelines, electricity transmission, and other connectivity across Eurasia to smooth its own westward expansion.”⁴ The One Belt One Road initiative is a development strategy adopted by the Chinese government involving infrastructure development and investment in Europe, Asia, and Africa. These projects are ongoing in dozens of countries around the world. They include building overland routes for road and rail transportation, creating and securing sea routes by building ports and canals, pipelines to transmit energy, electrical infrastructure, mine development and much more. The Chinese government views the initiative as a way to enhance regional connectivity and embrace a brighter future. The U.S. views this as a way for China to exert influence in global affairs with a Chinese-centric trading network. It is a direct challenge to the western-supported institutions of the IMF and the World Bank. In colonial history, western nations colonized and suppressed countries to gain access to materials and

⁴ Connectography, Mapping the Future of Global Civilization, by Parag Khanna, page 200, 2016

trade goods. The Chinese are simply buying their way in as an attempt to remap the western-centric global trade order. Here too, demographics are influencing the strategic calculus. China's disastrous One Child policy has created a large elderly population without a younger base to support it. Additionally, they understand that by 2050 Africa will represent 26% of the world population, versus 17% today. China is inserting itself and nurturing this region now to make sure that as Africa grows, they will pivot towards China. If western hegemony was built upon a colonial base, China is building its power via an industrial mercantilist approach, increasing global connectivity back to China and gaining access to resources worldwide.

The answer is shale. The question is - what is allowing the U.S. to retreat from their decades long policy of global intervention and take on a more isolationist approach? Why is that relevant? More broadly, how does energy strategy impact the outlook for trade and globalization? Shale is a rock formation that contains oil. With new technologies like horizontal drilling combined with high power hydraulics referred to as fracking, the energy industry is now able to harness these massive deposits profitably below \$50/barrel. Globally, known shale deposits represent more oil than Saudi Arabia and Russia

have combined. Much of that resides in the United States which is why we are no longer dependent upon international oil imports. According to Peter Zeihan in the *Absent Superpower*, "The end of American dependence upon extra-continental energy sources does more than sever the largest of the remaining ties that bind America's fate to the wider world, it sets into motion a veritable cavalcade of trends: the re-industrialization of the United States, the accelerated breakdown of the global order, and a series of wide-ranging military conflicts that will shape the next two decades."⁵ He presents a cogent but dark outlook for world economies. Extrapolating on current trends such as the rise of Populist politics, trade wars and isolationist tendencies, he looks at the world through a prism in which "The Americans who had created, nurtured, enabled, maintained and protected the post WWII global order were losing interest."⁶ Energy independence is what allows the U.S. to remove our carrier group from the Persian Gulf. This alone fundamentally alters the geopolitical landscape. The Persian Gulf and its surrounding states represent in excess of 30% of world oil production. Therefore, it

⁵ The Absent Superpower by Peter Zeihan, page x, 2016

⁶ The Absent Superpower by Peter Zeihan, page viii, 2016

has been critical for the U.S. to maintain open trade routes for the oil to flow. The U.S. alliance with Saudi Arabia is largely based upon energy access. Obviously, there are additional reasons such as utilizing Saudi Arabia as a military counterpoint to the ambitions of Iran. The Sunni – Shia conflict, which has been raging for centuries, is easily seen in the dynamics of the relationship between these two regional powers. When the U.S. withdraws from the oil security role in the area, this region will be left to sort out their own geopolitics which is likely to become quite volatile as the two powers and their proxies go head to head to exert regional dominance. This has major implications for energy pricing and stability worldwide. Maintaining access to energy sources will likely drive the geopolitical positioning of nations in a more volatile world. The U.S. has actually been slowly extricating itself from the region for over a decade. Since 2007, the number of U.S. military personnel in the area has dropped from 250,000 troops to under 15,000 today. President Trump recently signaled the continuation of this trend by announcing further reductions in the Syrian conflict. After several wars and a near financial collapse, U.S. politics have turned inward (witness the rallying cry of “America First”). As a net exporter of oil, LNG (liquid natural gas), and energy technology, high energy prices and volatile

supply chains will work in favor of the U.S. energy industry.

By now it should be evident that in a world increasingly becoming smaller due to technological innovation, all of these issues are directly related. Changing the nature of the geopolitical order implies potentially major change to how business is done. Whether the change is being driven by competing governments, economic systems, public policy, ideology, technological change, demographics, or even religion, it helps direct policies that create better outcomes. Understanding the root causes of the movement towards change better informs the responses as to what is likely or feasible. The intersection of these interrelated issues is where we need to focus our leadership, our resources, and our energies in order to ensure that the real world ends up with more positive outcomes in the wide range of the possible.

Throughout my own extensive reading there is near uniform agreement among academics, think tanks, and economists that the driving force behind political change has been the growth of inequality. As El-Erian pointed out, the trifecta of inequality worldwide is a major factor that undermines social integrity and societal well-being. Economic malaise, financial instability, structural rigidity in financial

institutions, accelerated technological change, heightened youth unemployment attributed to demographic shifts, regulatory failure, policy missteps, and lack of leadership round out the causes for discontent with the existing wave of globalization. In response, we've seen everything from political extremism to direct confrontation by national actors to challenge the status quo.

Unlike the agreement on what the root causes of discontent are, there is little agreement as to what the likely future looks like. Khanna's view is largely that globalization is an almost immutable force. He views the world through the lens of a globally-connected supply chain. He predicts that technological change and industrial integration will supersede national boundaries and will instead put the focus firmly on access to resources, which will ultimately enhance trade and by default, world security. In his words, "Thanks to global transportation, communications, and energy infrastructures – highways, railways, airports, pipelines, electricity grids, Internet cables, and more – the future has a new maxim:

"Connectivity is destiny. Seeing the world through the lens of connectivity generates new visions of how we organize ourselves as a species. Global infrastructures are

morphing our world system from divisions to connections and from nations to nodes. Infrastructure is like a nervous system connecting all parts of the planetary body; capital and code are the blood cells flowing through it. More connectivity theoretically creates a world beyond states, a global society greater than the sum of its parts. Much as the world evolved from vertically integrated empires to horizontally independent states, now it is graduating toward a global network civilization whose map of connective corridors will supersede traditional maps and national borders."⁷ While this seems like an almost utopian vision of the future, given global trends, some insightful leadership, and a supportive world policy regime, it is not impossible that his vision could be right over the long term. Let's call this the positive New Renaissance outcome. While feasible, it seems unlikely that nations and the global power structure will easily allow such radical change. At least, not without a significant crisis that forces change upon them.

On the other end of the spectrum, Zeihan sees the world at war. Lacking a superpower to maintain the peace, regional conflicts across the world will

⁷ Connectography, Mapping the Future of Global Civilization, by Parag Khanna, pages 5-6, 2016

cause mass upheaval. He writes, “The world has had seven decades to become inured to a world in which the Americans do the heavy lifting to maintain a system that economically benefits all. The world has had three decades to become inured to a world in which the Americans do not expect anything of substance in return. As the Americans back away, very few players have any inkling of how to operate in a world where markets are not open, transport is not safe, and energy cannot be secured easily.

The stage is set for a global tailspin of epic proportions. Just as the global economy tips into deflation, just as global energy becomes dangerous, just as global demographics catastrophically reduce global consumption, just as the world really needs the Americans to be engaged, the United States will be... absent. We stand on the very edge of the Disorder.

The Disorder’s defining characteristic is, well, its lack of order. Remove the comfortable, smothering American presence in the world and the rest of humanity has to look out for its own interests. As many of those interests clash, expect devolutions that are deeply-felt and disastrous in equal measure.”⁸

⁸ The Absent Superpower by Peter Zeihan, page xi, 2016

Let’s call this the marginalized negative world outcome. Zeihan’s writing is both terrifying and yet sadly compelling. He lays out where, why, and how the world can devolve in this manner. Given power politics and base human nature it is not an impossible scenario, albeit dire. The upside is that from a U.S. view, his analysis suggests that the U.S. should largely thrive in this environment. His case speaks to energy and resource independence, geographical distance and defense from the hostilities, military might, technological prowess, the ability to redirect supply chains and re-industrialize the country, strong currency and financial institutions, and yes, even strong demographics. In his future, the U.S. is uniquely positioned to capitalize on global devolution.

Someplace in the middle of the two extremes are the futures presented by Stiglitz and El-Arian. Stiglitz believes that by changing the structure of the global institutions to become more inclusive, that is, accepting a multipolar world of trade and leadership, that will help create a better managed and sustainable globalization trend. He writes, “There is the possibility that twenty-first century multipolar globalization will create a more competitive global landscape, circumscribing the market power, for

instance, of the multinational corporations of the advanced countries. There is the remote possibility that domestic political forces in the United States and Europe circumscribe market power. There is the possibility too that with a better managed globalization there will not be extended periods of deficiencies in aggregate demand.”⁹ His policy prescription is to have globalization with compensation defined as creating social safety nets for the vulnerable such that everyone is a winner from globalization. This hints at a more socialist economy in which we grow entitlements, redistribute wealth, and establish policies to protect against declining standards of living. The rise of Bernie Sanders in U.S. politics, and others in France, Italy and elsewhere, speaks to this possible orientation. While Stiglitz didn’t explicitly state it, one can assume that he would support some form of Universal Basic Income Credit and certainly have a focus on retooling our education system for the purposes of retraining the workforce for the needs of the 21st century. We can extrapolate on possible policy prescriptions when he writes, “Hence, anyone serious about advancing globalization – and the benefits which it might bring, if well managed, –

must see globalization policy within a broader economic framework. What is needed is stronger government actions: macroeconomic policies that push the economy toward full employment; adjustment policies to help worker, firms, and communities adapt to the new circumstances; social protection policies to protect them against losses to the standards of living that they may face in the process of adjustment; and policies that reduce inequalities in market incomes and incomes after tax and transfer.”¹⁰ Let’s call this the socially idealized positive world outcome. While he paints an idyllic picture, let’s remember that it has been tried before in numerous countries over history and largely has not worked.

Lastly, we have the view from El-Erian. As one of the first to recognize that the post 2008 economy would be significantly different than prior economic recoveries, his coining of the term “the new normal” has been essentially correct over the past decade and is now widely accepted by market participants, economists, policy wonks and politicians. Simplistically, his outlook was that we would have slower economic growth, lower interest rates for longer as Central Banks tried to repair the

⁹ Globalization and Its Discontents Revisited, Anti-Globalization in the Era of Trump, by Joseph Stiglitz, page 389, 2018

¹⁰ Globalization and Its Discontents Revisited, Anti-Globalization in the Era of Trump, by Joseph Stiglitz, page 84, 2018

damage of the 2008 financial collapse, rising inequality, and political dysfunction. Today, he is calling for an end to that environment as we approach a critical time for the world economy, one in which we will pivot positively or negatively out of what he coins the “T Junction” in reference to the British road system. He states, “This is to say, the current road we are on, one engineered and maintained by hyperactive central banks, will likely end within the next two to three years, if not earlier, to be replaced by one of two roads that fundamentally contrast in their implications and destinations. One road out of the T Junction ahead involves a restoration of high-inclusive growth that creates jobs, reduces risk of financial instability, and counters excessive inequality. It is a path that also lowers political tensions, eases governance dysfunction, and holds the hope of defusing some of the world’s geopolitical threats.

The other road is the one of even lower growth, persistently high unemployment, and still-worsening inequality. It is a road that involves renewed global financial instability, fuels political extremism, and erodes social cohesion as well as

integrity.”¹¹ The policy prescriptions required to achieve the more positive outcome entail “...invigorating structural reforms, rebalancing aggregate demand, lifting crippling debt overhangs, and modernizing regional and global architectures and policy coordination.”¹² He doesn’t believe that a muddling through scenario is likely and suggests that the odds are 50/50 for either directional outcome. His policy direction is not all that dissimilar from Stiglitz, but he lacks the socialist bent.

In researching this paper, a wide range of views and opinions were deliberately examined to inform, challenge and contrast to my own. All the authors have extraordinary insights, academic pedigree, and senior global policy experience. Only Khanna seems overtly optimistic that the current state of world globalization will not only deliver a better standard of living to the world populace but accelerate towards what could be the next Renaissance. As technological change enhances our abilities to become more productive, as renewable energy technology improves and replaces oil, as

¹¹ The Only Game In Town, Central Banks, Instability, and Avoiding the Next Collapse, by Mohammed El-Erian, page 9, 2016

¹² The Only Game In Town, Central Banks, Instability, and Avoiding the Next Collapse, by Mohammed El-Erian, page 259, 2016

interdependence on resources and communication increase exponentially, the world becomes a much better and safer place. I would position Stiglitz and El-Erian as hopeful that globalization can be saved. The caveat is these outcomes are dependent upon leadership, vision, and policy that get implemented in a timely manner. In my opinion, it is hard to say with any intellectual honesty that we can expect that to be the most likely case. If Zeihan is right, as the world devolves, at least the U.S. will be a good place to live and invest. That's not to say that our financial markets and economies would be in for smooth sailing. I'd expect just the opposite with high volatility creating long-term opportunities.

To me, a more likely scenario involves a gradual devolution of today's global order. None of these trends will play out overnight. They will take years, if not decades. The rise of China, under Xi Jinping, as a significant world player will continue. They might even agree to some de minimis trade agreement that effectively kicks the can down the road as they wait out the Trump presidency. Fundamentally, they may alter their tactics but not their goals. Russia, under Putin, will continue to seek influence in the world and push boundaries wherever possible. Betting on the successful growth and continued integration of the EU as a

political experiment seems hazardous. With England potentially leaving, Italy at the edge of threatening to do so, Greece and Spain continuing to have significant economic and political issues, it seems unlikely that the EU will be able to pivot towards some of the needed policies in the near term. Simply stated, leadership matters, and in the United States we have a dysfunctional government with neither Congress nor the Executive Branch able to get much done much for the good of the country and the welfare of its people. I expect that over time, the global order will devolve into significant regional trading blocs. They are not all that different from today's global economy, but with greater economic integration within each bloc. I could see a North/South American trade zone that runs from Canada to southern Argentina. Strong regional compacts including China, Russia, India, Japan, and South Korea could dominate Asia. The Middle East could trend in any of several directions including Iran, Turkey, Israel, or Saudi Arabia as the regional powerhouse. Given the One Belt initiative of China and a possible U.S. pivot aligning with the former Obama administration, Africa could affiliate with either regional trading bloc as well. Europe and the Scandinavian countries would likely create their own treaties. International trade would become a bit more bifurcated by region as a product of regionally focused re-

industrialization enabled by new technologies such as 3D printing. Issues of cyber security and national security of productive capability will help push in this direction. The current international debate over access to Huawei (Chinese) next generation telecom equipment in the 5G network buildout lends credence to these possible outcomes. As for policy enlightenment and the potential for visionary leadership to arise, I still have some hope. Even with government by crisis only, politicians and policy makers are forced to make required change when a crisis occurs. I am reminded of a quote by Thomas Edison: "Discontent is the first necessity of progress."

However economic events progress from here, the team at Allegiant will help guide you and your portfolio through any challenges that may come our way.

Please feel free to contact me directly at paul@allegiantpa.com if you would like to discuss these concepts, or have any questions or concerns.

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