Opinion **Globalisation**

Investing in the age of deglobalisation

The wisdom of relying on the equity of US multinationals is now suspect

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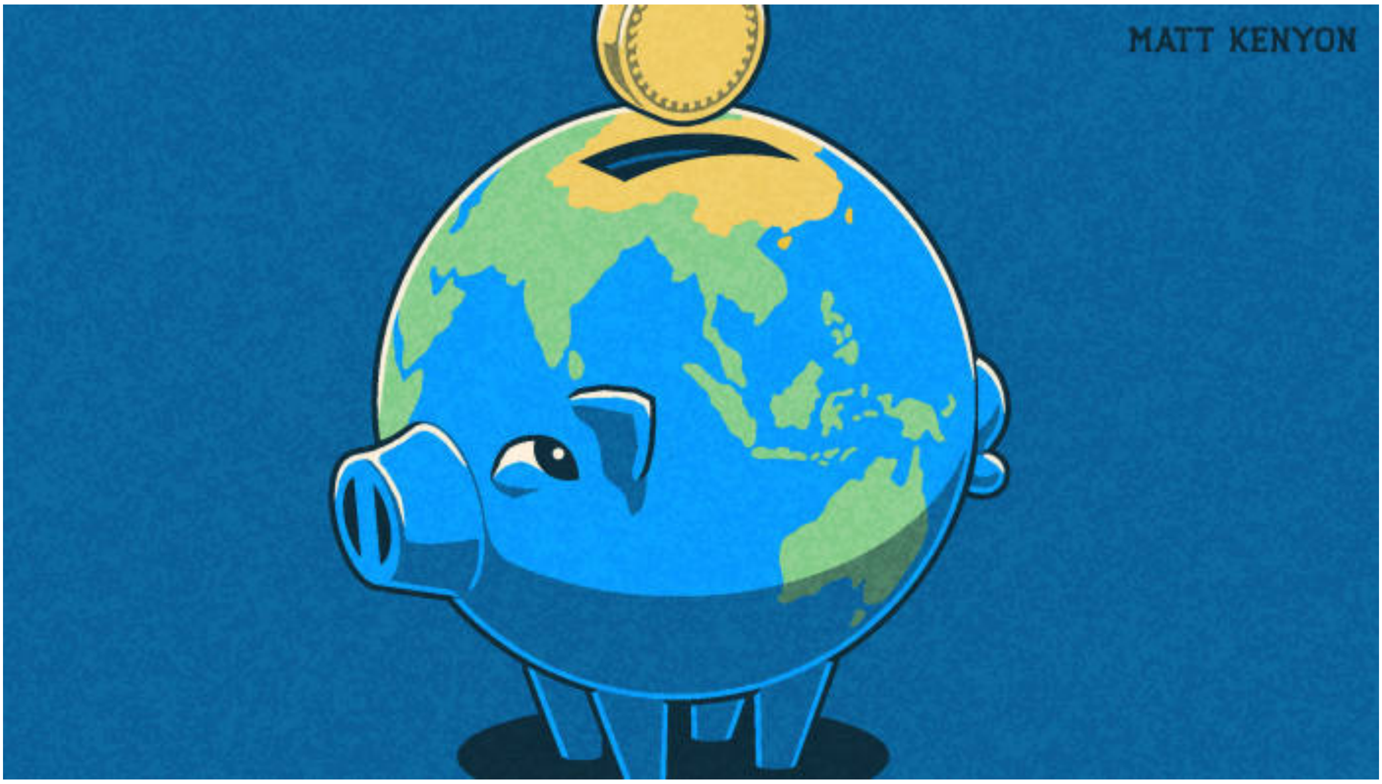

Rana Foroohar YESTERDAY

Warren Buffett once told me that his favourite investments were not so much bets on the US as bets on the ability of American companies to continue exporting capitalism around the world.

Berkshire Hathaway holdings such as American Express, Coca-Cola, Kraft-Heinz and Procter & Gamble were huge global franchises. An increasing amount of their growth came from emerging markets, while they still paid out a reliable dividend. They were, he said in 2012, safer even than US Treasury bills.

What a difference in perspective a few years can bring. Put aside the recent challenges faced by individual companies including Kraft-Heinz. These days, the entire wisdom of hedging via the equity of US multinationals is suspect. It is now quite unclear how — or, in some sectors, if at all — cross-border business will be conducted in the years ahead.

We all know that globalisation is under threat. Figures compiled by the Swiss Economic Institute show that globalisation peaked and began plateauing several years before the current trade wars began. The current headwinds to it — from lower cross-border capital spending to the localisation of supply chains due to populism, tariffs and the push for national champions — are not going away anytime soon.

So the smartest capitalists have begun to rethink their fundamental theories of investing for a new age: the age of deglobalisation. Some of the new rules are obvious — bigger may not be better. A recent JPMorgan report on deglobalisation shows that there has been a very tight correlation between cross-border trade intensity and US corporate profit margins over the past 20 years. Large-cap companies in particular “have greatly benefited from locating labour, factories and resources in countries with the most beneficial wage costs, taxation, regulations and infrastructure”.

That correlation is now breaking down as trade becomes increasingly fractious. Technology will be the chief battlefield on which the trade wars and political conflicts of the future will play out. Consider the recent headlines on that score, including more US-China squabbles over the Chinese tech group Huawei; the EU’s opening of an antitrust case against Amazon and possible fines for Qualcomm; and G7 struggles to agree on a system of digital taxation.

The most globalised tech stocks, which dragged the market up in recent years, will also lead it down. The recent setbacks for the Faangs (Facebook, Amazon, Apple, Netflix and Google’s parent Alphabet) is one sign, but there are many subtler and more telling examples of what is to come. Arrow Electronics, which distributes the components and semiconductors that go into cars, dishwashers, computers and phones all over the world, just gave a profit warning, citing “deteriorating demand conditions”.

This does not mean technology will no longer drive growth — it’s just that the best investment opportunities may be in China and emerging markets. Beijing has made clear that its Belt and Road Initiative will be not just about building infrastructure, but creating an entire high-tech ecosystem based around Chinese digital standards and Chinese companies. China has become the global Petri dish for mobile payments, artificial intelligence applications and cutting-edge biotechnology.

I think of China as being very much like the US in the post-second world war period — a huge, single-language market with rising consumer demand. It will pull the rest of Asia and many emerging markets into its growth orbit.

Witness the recent decision of the Philippines, a traditional US ally, to use Chinese telecoms companies to roll out its 5G network. I cannot imagine investors won’t do better in Asia than in either the US or Europe in coming years.

That may be true not only in equities but in bonds, too. Just as investors looking for yield in a lowrate world rushed into seemingly high-growth areas such as tech stocks in the past decade, so they have tried to hedge a growth shock by piling into debt markets, which are now in a bubble of epic proportions.

It is common to argue that if the US and the world at large head into a recession, people will pile further into US Treasuries as a safe haven. But since the People's Bank of China announced back in 2013 that it was no longer in China's interests to boost foreign exchange reserves, one measure of demand — the "bid-to-cover" ratio for US Treasury bills — has been falling.

Meanwhile, the spread between US 10-year government bonds and their Chinese counterparts is rising. Beijing has made it clear it will use infrastructure-related stimulus to bolster a slowing economy. It is also looking to do more trade in renminbi, and lifting foreign ownership caps on financial companies earlier than expected. All this is to reduce dependency on the dollar, and create a China-centric financial ecosystem.

China's gravitational pull will also bolster commodities markets. The Chinese need oil — hence Beijing's increasing involvement in the Middle East, and cozy relations with Russia, where both bonds and equities are outperforming. Commodities will be one of the few markets insulated from deglobalisation, as they will be driven primarily by the growth of the emerging market middle class. The new era belongs to this demographic, not to US multinationals.

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