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A geopolitical guide to understanding today's global trade and investment landscape

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In the immediate aftermath of President Trump's "Liberation Day" announcement, we can categorize U.S. tariffs into three distinct groups.

1. The upcoming renegotiation of the USMCA, which should begin after the Canadian election. We expect Canada to retain substantial, albeit somewhat reduced, access to the U.S. market after making concessions in various sectors, including lumber, agriculture and defence (i.e., increased spending). Greater restrictions on imports from China will also be part of the new deal. Given the circumstances, a positive outcome could include the imposition of export limits on autos, steel, and aluminum instead of the current tariffs, as the United States attempts to reindustrialize.
2. Reciprocal tariffs targeting most countries. Sufficient progress in talks with key countries could see these tariffs lowered significantly. However, as with the USMCA negotiations, it is unlikely that rates will revert to previous levels.
3. Trade tensions with China are unlikely to see much progress anytime soon. While many U.S. lawmakers criticize tariffs on Canada and other countries, there is broad bipartisan support for a tougher stance against China. However, recent trade tensions with many other countries will make it much more difficult to form a united trade front against China. Finally, companies that were pressured to move production out of China to avoid tariffs are now frustrated by being hit with tariffs in their new locations.

Geopolitical factors for investors to consider

It is important to note that regardless of the outcome of the various negotiations discussed above, the world is likely to continue moving toward a more protectionist environment. The next section outlines key long-term factors that investors should consider as they navigate the evolving trade landscape.

- In addition to analyzing its balance sheet, investors must consider a company's country of origin and any current or potential tensions the country might have with its trading partners. Such conflicts can impede access to key markets. Investors must also assess whether the company's supply chains, and business models are aligned with the geopolitical objectives of the countries where it exports.
- Companies are increasingly locating production closer to points of consumption. For example, many foreign companies in China are shifting from producing goods primarily for export to producing for domestic and neighbouring regional markets. This trend disadvantages smaller countries that lack a large domestic market to attract production in exchange for market access. This is why whether a small country has trade access to a large country nearby is so important.
- Growing protectionism will be particularly challenging for smaller companies. Many do not have the financial resources that large corporations have to overcome protectionist measures by setting up operations in the world's largest markets. Smaller companies also have fewer resources to hire expensive lobbyists to champion their interests in various capitals.
- Increasing levels of efficiency have been achieved over the years by concentrating production of key components among an ever-smaller group of top suppliers in specific regions. For example, the number of companies capable of manufacturing leading-edge semiconductors has plunged from over 25 in 2000 to only three today.[1] Today's increased focus on security is pushing companies to reshore supply chains and manufacturing components in multiple locations. While this boosts national security, it reduces economies of scale and efficiency.
- Companies will increasingly need to undertake the costly process of fully mapping their supply chains to ensure resilience, high levels of security, sanctions compliance, and avoidance of human rights abuses. For many global companies with extensive supply networks, this is easier said than done. Boeing and Airbus, for example, have 20,000 and 18,000 suppliers, respectively. This does not include the suppliers of these suppliers.
- Investors should be cautious if a company is investing in regions influenced by major powers not allied with its home country. This factor likely explains at least in part the recent challenges faced by some Canadian mining companies in Africa. Another example is the tug-of-war between China and the United States over whether American or Chinese companies should operate parts of the Panama Canal.

[1] "Chipmaking is being redesigned. Effects will be far-reaching," The Economist, January 23, 2021

China-U.S. trade tensions

Long before the recent trade tensions between the United States and the West, China-U.S. relations have been a major driver of protectionism.

- Growing tensions between the two countries is driven by a great power rivalry, radically different economic and governance models, increasingly separate communications and Internet systems, conflicting financial regulations, fraying supply chains and, above all, a lack of mutual trust. In this landscape, Chinese and American companies in strategic sectors are seeing access to the other country's market gradually restricted.
- China and the United States are also competing to impose their own industrial standards on the rest of the world. Historically, these standards tended to be set by the United States and other Western countries. Once a global standard is adopted, other countries and companies must rely on the standard setter not only for updates and spare parts, but also for consulting, intellectual property and data management services—all highly lucrative sources of revenue.
- Many existing supply chains in countries like China took decades to perfect. Moving these operations to new regions is likely to entail higher costs on account of stricter regulations, higher wages, worker retraining, and often the need to build ecosystems from scratch. Consequently, instead of maintaining a global supply chain where countries focus on their competitive advantages, many major nations are now restructuring supply chains in key sectors for national security reasons, even if they lack expertise in these sectors.

Bottom line: Investors must increasingly consider geopolitical fault lines, government priorities, and protectionist policies when making investment decisions, as these factors can impede market access or lead to higher operating costs. This is why assessing the willingness of governments to support key sectors has become a critical part of investment analysis in today's global landscape.

It is crucial to also emphasize that in a world where major countries and regions such as the United States, the EU, China and India are seeking to repatriate production, smaller countries must strive to maintain the best possible access to the larger nations most vital to their economic future.

Finally, while recent trade tensions have made it more difficult for traditional allies such as the EU to cooperate with the United States against China, this does not necessarily mean that cooperation between China and the EU will increase. China's reduced access to American consumers could encourage its companies to export more products to the EU, exacerbating trade tensions between the powers. "We will also be watching closely what indirect effects these tariffs could have, because we cannot absorb global overcapacity, nor will we accept dumping on our market," warned the European Commission president.

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