



Research

Institutional Insights

Deciphering strategic investment opportunities in a complex new world order

On a multipolar and volatile global stage, how some nations align with others—and some don't—could play a role in strategic investment decision-making





Irina Tytell, PhD

Head of Secular Research
Asset Allocation Research



Dirk Hofschire, CFA

Managing Director of Research
Asset Allocation Research

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KEY OPPORTUNITIES IDENTIFIED

We have transitioned to a more volatile, inflationary world that will require nimbler investment strategies and more nuanced diversification that is less reliant on the extrapolation of past trends.

In this new world, better analysis and understanding of the underpinnings of productivity gains—and their links to profits and asset-class returns—could hold the key to successful strategic asset allocation in an evolving landscape that is likely unfamiliar to many investors.

Some of the opportunities in the new regime are likely to be driven by the effects of deglobalization and the actions of governments in response to shifting geopolitics. Some of the knock-on investment implications of these X factors may be related to increased reshoring and friend-shoring of manufacturing, and technological innovation related to the energy transition.

- **A boost to investment spending in many developed and some emerging markets:** Historically depressed rates of capital expenditures, public investment, and productivity may receive a lift from shifting structural trends, such as reshoring, rising cost of capital, and clean energy. The countries, industries, and companies that are at the center of these rising investment trends may provide the best asset-market opportunities.
- **Historically high global equity correlations giving way to lower correlations, creating greater opportunities to diversify portfolios according to geography:** Geopolitics and climate risks (climate-related technological transformation) could contribute to even more differentiation across the outlooks for productivity and profits around the world.
- **Many emerging and frontier markets are located far from the systemic geopolitical fault lines and are endowed with key resources.** Countries that can create a favorable environment for domestic and foreign investments may provide an attractive backdrop for investing opportunities.
- **Despite the end of its unipolar global dominance, the United States is well positioned.** It possesses a rich base of financial, corporate, institutional, and natural resources to adapt to shifting secular trends.
- **Europe's economic position may be improving.** Overall, the bloc seems to be headed toward greater economic, fiscal, and political cohesion, and it is increasingly prioritizing new investments in climate and energy security.
- **Thematic portfolios.** Regime shifts in inflation, interest rates, globalization, and climate may increasingly be areas to exploit, based on their ties (or lack thereof) to increased productivity.

How X-factor motives may impact productivity and profits

We believe the broad secular shifts in interest rates, inflation, and globalization are already on their way to changing the incentive structure facing corporations in a way that is likely to alter their behavior away from the low-capex mentality of the past decade.

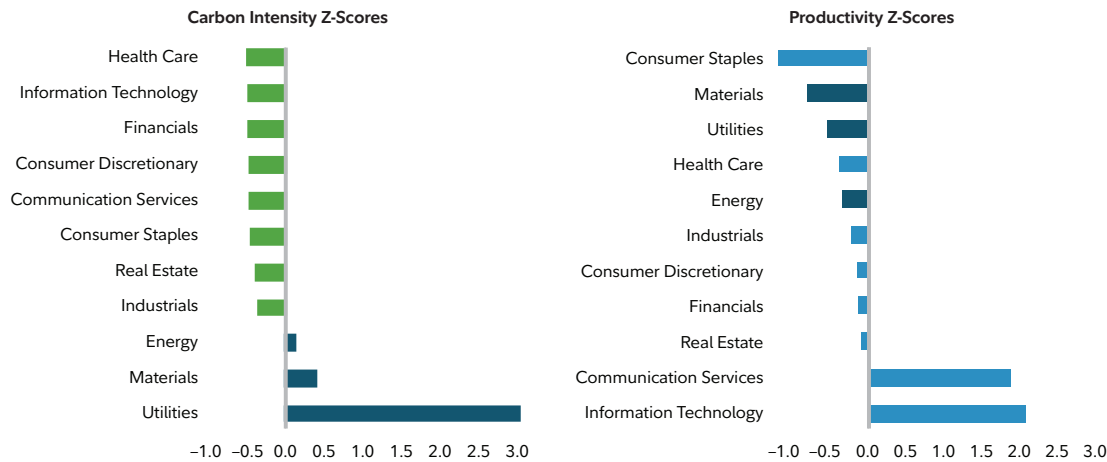
Deglobalization and geopolitics are among the X factors that could affect the behavior and choices of corporations and policymakers in the new regime and are the focus of this excerpt from [“A Strategic Allocator’s Guide to Productivity and Profits.”](#)

The sectors at the bottom of Exhibit 1—energy, utilities, and materials—will likely be at the heart of the technological transformation associated with the energy transition. These three sectors have the highest starting carbon intensity, and they generally have lower historical rates of productivity. The combination of market and policy demands will likely see higher capex in transition associated areas, such as high productivity renewable technologies. Some of this capex may be associated with other sectors, such as technology and industrials, which can both compete with incumbent producers and supply the next-generation, market-share winners.

In any case, we believe the longer-term impact on productivity and profitability has positive potential, even though identifying the winners and losers across industries, companies, and geographies will require strong active management and a keen awareness of shifting conditions over time.

Exhibit 1: Most carbon-intensive sectors exhibit relatively low productivity rates.

Sector Productivity vs. Carbon Intensity, Averages over Last Decade



Sector productivity defined as output per hour and matched to the Global Industry Classification Standard. Carbon intensity defined as Scope 1 + Scope 2 greenhouse gas emissions normalized by sales and weighted by market capitalizations. Averages over the last decade. Source: Bureau of Labor Statistics, Haver Analytics, MSCI, FactSet, Fidelity Investments (AART), as 12/31/21.

Geopolitical risk and deglobalization pressures

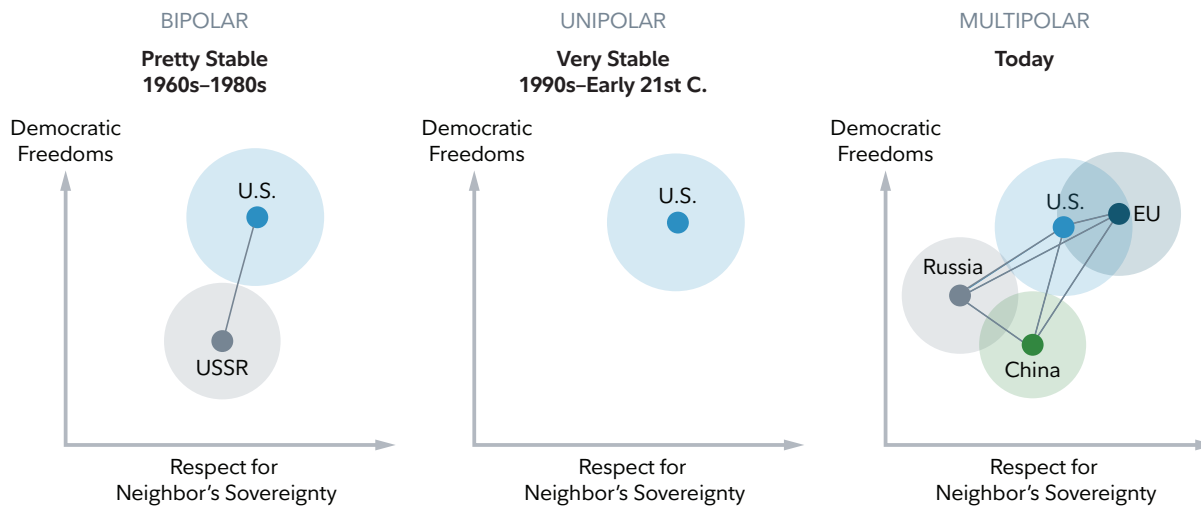
Peak globalization

As we highlighted in prior work over the past several years, the world reached an era of “peak globalization,” where global integration remains at a high level, but stops advancing. (See our 2019 paper [Rising Policy and Political Risk: Implications for Asset Allocation](#).) Globalization stalled for many reasons. In many advanced economies, peak globalization became associated with stagnating household incomes and shrinking manufacturing sectors. The political winds switched from viewing unfettered trade as an opportunity for businesses and consumers toward a threat to workers and domestic production. The pandemic highlighted the fragile nature of extended global supply chains. Policy momentum has switched away from facilitating cross-border efficiencies and toward prioritizing onshoring, reshoring, near-shoring, friend-shoring, and greater self-sufficiency.

Multipolar geopolitics

At the heart of peak globalization, however, has always been the underlying transition in the geopolitical order (Exhibit 2). The stability of the global regime is determined foremost by the distribution of power among the world’s great powers, with fewer powers representing higher stability. Starting with the end of the Cold War, we were fortunate to enjoy nearly three decades of benign, unipolar stability under U.S. hegemony. Before that, a relatively balanced bipolar era kept the Cold War from ever becoming hot. In recent years, however, the relative decline and ambition of U.S. power, along with the ascendance of China’s capabilities and aspirations, created a transitional phase to a more multipolar dynamic. Historically, multipolar regimes have tended to be the most unstable backdrops, contributing to a less-balanced security equilibrium among a larger number of powers. These regimes do not always gravitate toward outright great power wars, but the Russian invasion of Ukraine is a clear manifestation that the new multipolar era has begun.

Exhibit 2: The geopolitical backdrop has shifted to a less stable, multipolar world order.



Source: Fidelity Investments (AART), as of 12/31/22.

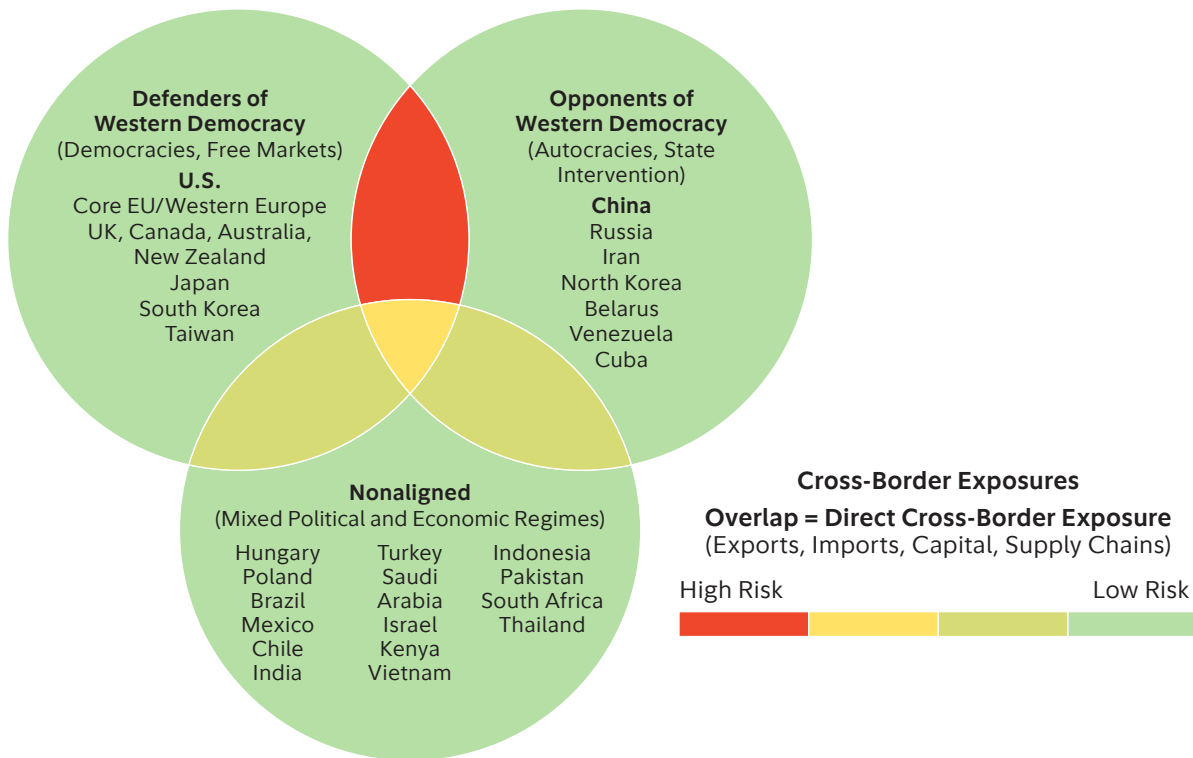
The original architecture of modern globalization has its origins in collective action by like-minded democracies at the end of World War II. The widening of geopolitical fault lines during the 21st century—as well as China’s emergence as the world’s largest trader at the center of the global system—raises unprecedented political and economic challenges to the postwar global system.

What will the new world order look like?

Going forward, we don’t believe rapid deglobalization is the most likely scenario, nor autarky the goal of the world’s most important economies. The broad contour of the evolving global system will likely be defined by the division between those countries seeking to defend and renew the essence of the postwar global architecture and those that seek to fundamentally alter it (Exhibit 3).

The defenders of the Western world view are democracies with relatively developed market-oriented economies, with the United States as the largest economy and most powerful member. The opponents of Western democracy are generally autocracies with economies that tend to be more state directed, with China as the largest economy and most powerful member. A large third group of “nonaligned” nations, made up mostly of developing economies such as India, will deliberately attempt to steer clear of the defender-opponent divisions and follow their own political and economic interests.

Exhibit 3: Loosely defined geopolitical blocs may define the new era.



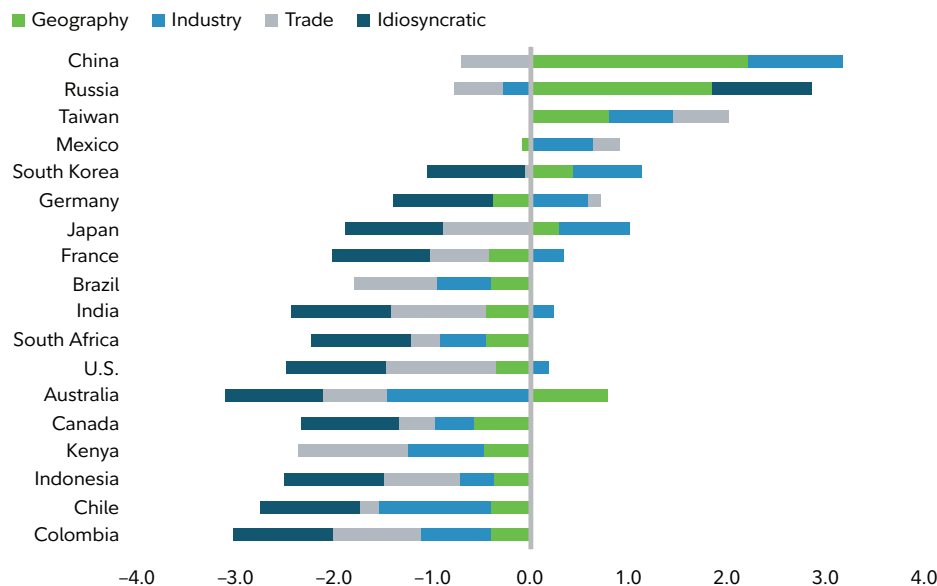
Source: Fidelity Investments (AART), as of 2/28/23.

These three geopolitical blocs conjure an obvious resemblance to the Cold War landscape, and the analogy is reasonable at a high level. However, there are several important differences, including:

- **Bloc relationships are less rigid:** These blocs represent looser affiliations and less cohesive groups than the “democracy vs. communism” divisions of the Cold War. This implies potentially more fluidity and less formality of alliance within the blocs.
- **Bloc leadership is less pronounced:** The United States and China have less influence over their respective blocs than the United States and Soviet Union did during the height of the Cold War. This implies that multipolarity, in contrast to Cold War bipolarity, will increase the range of potential outcomes.
- **The system’s starting point is more globally integrated:** The Cold War emerged from the devastating deglobalization of WWII, but we begin this new era at a historically high level of globalization. This implies the economic (and investment) consequences of geopolitical shifts are likely to be much higher.
- **Today’s nonaligned group is more economically consequential:** Much of the world’s population lives in countries—including 6 out of the world’s largest 20 economies—that are nonaligned, much less socialist, and more integrated with the global economy.

Exhibit 4: Geopolitical and deglobalization pressures would have varying impacts across different countries.

Country Z-Scores Measuring Exposure to Geopolitical and Deglobalization Pressures



Z-scores are standardized scores indicating how much a value differs from the standard deviation of the sample. These calculations are based on our proprietary methodology, incorporating a variety of different metrics. Positive Z-scores represent greater exposure to geopolitical strife or deglobalization pressures, while negative Z-scores represent relative opportunities. Source: World Bank, IMF, Heritage Foundation, Freedom House, Fidelity Investments (AART), as of 12/31/22.

An analysis framework by country and industry

The economic and investment implications of higher geopolitical and deglobalization risks will vary significantly by region, country, industry, and company. The outcomes will depend on how much exposure these entities have to these trends, and what their response will be to changing dynamics.

As a road map for these shifts, we can evaluate the risks and opportunities across the world by investigating a handful of key perspectives.

First, what are the geographic implications of these shifts?

Each country's economic exposure to systemic geopolitical risk is heavily influenced by its bloc membership and the bloc membership of its commercial partners. For example:

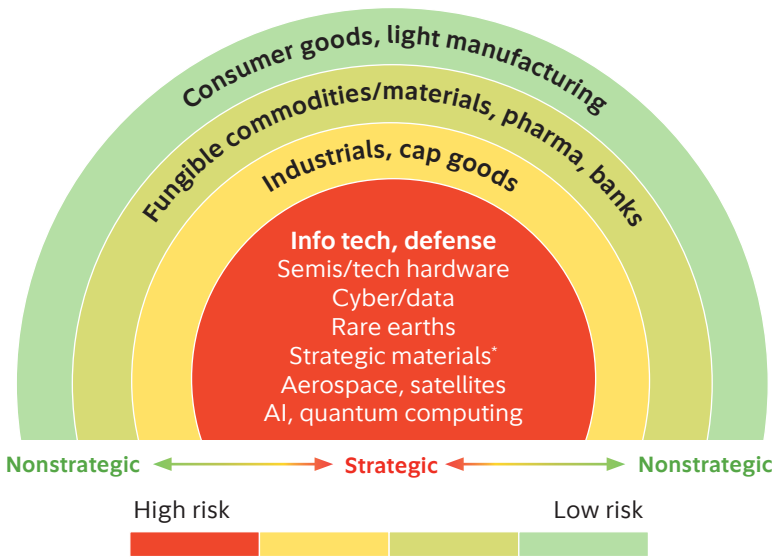
- **Opponents** generally have the **highest economic exposure to geographic geopolitical risk**. Their autocratic political systems are most likely to inject nationalistic and geopolitical influences into their economic policies, and they are most likely to be targets of sanctions or other negative economic actions by defenders.
- **Defenders** generally have the **second-highest** economic exposure to geographic geopolitical risk. As democracies, they are most likely to economically discriminate against other countries based on perceived violations of human rights or international law.
- **Nonaligned** countries have the **lowest** economic exposure to geographic political risk. Their domestic political and economic systems are generally viewed as less objectionable and less likely to be sanctioned than opponents, and their allegiance is coveted by both the other groups in a manner that potentially generates more favorable economic treatment.

Economic exposure to geopolitical risk also depends on the bloc memberships of a country’s key commercial relationships. In general, the more a country trades and interacts within its own bloc, the less exposure it has to geographic geopolitical risk. The area of greatest risk lies at the nexus of defender and opponent interaction. For instance, the U.S.–China relationship is fraught with peril, as both sides look to reduce their dependencies on their key geopolitical rival. Nonaligned countries tend to have the least exposure to geopolitical risk, and they have the highest opportunity of take advantage of their flexible position within the global order.

Second, what are the industry implications of shifting geopolitical and globalization trends?

When national security becomes a predominant consideration, how much economic exposure a country has in the form of “strategic” industries becomes a critical consideration. We believe industries can be ranked according to their strategic significance. On one end of the spectrum, industries with critical military applications are highly strategic. In the 21st century, this includes advanced technologies and critical materials, including aerospace, semiconductors, and rare earths. On the other end of the spectrum, nonstrategic industries such as consumer goods and luxury items are less likely to be targets of government intervention.

Exhibit 5: Strategic industries will likely be more influenced by geopolitical considerations than less strategic ones.



Source: Fidelity Investments (AART), as of 2/28/2023.

* Strategic materials refers to resources that could cause manufacturing disruptions in the event of supply shortages.

Strategic industries will naturally experience higher levels of X-factor decision-making. This implies these industries are more likely to be in the crosshairs of geopolitical friction (Exhibit 5). Such industries face a higher risk of restrictions or sanctions from other countries, such as U.S. export restrictions on semiconductor and technology hardware to China. On the other hand, strategic industries are also likely to benefit the most from favorable domestic policies, such as subsidies. Excessive government intervention may be a negative for efficiency, but policy support may offer favorable opportunities in an environment where market forces remain significant. Our assessment of a country's geopolitical industry risk includes its overall exposure to strategic industries and how well its economic system may be able to take advantage of government support.

Summary of broad geopolitical conclusions

It remains to be seen how acute the systemic geopolitical and deglobalization pressures become in the years ahead. The world may continue to operate at a relatively high level of integration relative to long-term history, but the marginal shift in directional trends from the prior three decades is likely to spur several broad implications.

A multipolar world order is an inherently less stable backdrop for the globalized integration achieved in recent decades. This implies:

- Downward pressure on profit margins, as cost reductions become harder to achieve.
- Upward pressure on inflation, as goods disinflation becomes less pronounced. Higher geopolitical tensions also tend to increase military spending and strategic competition for resources, which typically supports commodity prices and inflationary trends.
- Lower correlations among global assets, as regionalization and bifurcation of key industries such as technology hardware gain prominence.

Reshoring, onshoring, and near-shoring (regionalization) efforts have the potential to catalyze greater investments, particularly among developed economies. Over time, higher investment levels may spur greater productivity gains for some regions and countries.

- For example, in the United States, there is incipient evidence of a revival in onshoring U.S. manufacturing jobs and attracting foreign direct investment (FDI) in industrial sectors. According to the Reshoring Initiative, 364,000 new jobs were announced in 2022 due to companies' reshoring or attracting FDI, up from only a few thousand in 2010. Meanwhile, federal legislation approved in 2021–2022 mandates multiyear increases of several hundred billion dollars in public investments in areas such as infrastructure, semiconductor manufacturing, and climate initiatives. Similarly, Europe's multiyear fiscal commitment to foster a clean-energy transition is likely to gain further momentum amid the energy-security challenges posed by the war in Ukraine.

There are likely to be relative winners and losers from shifting global conditions across multiple dimensions, implying there may be greater global active management opportunities across regions, countries, industries, and companies.

- Developing economies face a varied outlook, but as suggested by our country scores, many are not at the center of systemic geopolitical risks and may benefit from their nonaligned positions. In a world where cheaper labor is a less important component of global competition, successful emerging markets will use this dynamic as motivation to shore up their domestic institutions and capabilities and solidify their place within more regionally focused partnerships.

Strategic investment conclusions

No matter how the aggregate impact of these many crosscurrents ultimately plays out, we believe the backdrop for strategic asset allocation will be very different in the coming years compared with recent decades. The keys to success in this changing environment will be managing a shifting array of risks and identifying profitable opportunities among regions, countries, sectors, and companies.

Not all changes will be positive. Challenges and considerations in the coming years likely will include risks to specific industry groups and corporations tied to extrinsic **X-factor objectives**. If noneconomic motivations manifest as overly intrusive and significantly impair market-oriented mechanisms, expectations for profit growth and return-on-equity may suffer.

Also, greater political risks may present analytical challenges for investment professionals. Both geopolitical and domestic political risks are generally higher for many countries than during recent decades, implying a clear political framework is a necessity for asset allocators.

Other possible risks include:

- **Rising temperatures could continue to cause disruptions:** Damage from more extreme weather patterns is likely to be a regular feature of the economic backdrop for many countries and regions.
- **Inflation may be higher and more volatile:** Shifts in the supply side of the global economy may make it difficult for central banks to restore an era of low, stable inflation rates. These factors include resource-intensive climate transition and geopolitical competition, tighter labor markets due to aging populations, and the move to reconfigure supply chains according to national security and other non-efficiency-related concerns.
- **Real rates may be higher:** A return to ultra-easy monetary policy may be difficult, implying the upside for asset valuations may be lower compared with the prior decade's near-record highs.
- **Asset price volatility will likely be higher:** The many potential shifts listed above imply that uncertainty about many key trends will remain high and shifting investor expectations may generate more sustained asset-price fluctuations relative to the lower volatility average of the past decade.

That said, there will likely be many opportunities tied to lower global correlations. If peak globalization implies some bifurcation (between Western- and China-centered technology ecosystems) and more regionalization (near-shoring and friend-shoring of manufacturing supply chains), then a dominant global cycle or trend may hold less sway. The high global equity correlations of the past decade may give way to lower correlations and greater opportunities to diversify portfolios according to geography. The United States may be in a position of strength. Despite the end of its unipolar global dominance, the United States possesses a rich base of financial, corporate, institutional, and natural resources to adapt to shifting secular trends.

As for Europe, it may be on a more cohesive trajectory. Several of the major secular challenges confronting the European Union—including the geopolitical and energy security risks exposed by Russia's invasion of Ukraine—are pushing the bloc toward greater economic, fiscal, and political cohesion. For example, fiscal and regulatory support for a transition to a cleaner and more reliable energy system may provide investment opportunities across multiple industries.

The “nonaligned” countries may be in a geopolitical sweet spot. Many emerging and frontier markets are located far from the systemic geopolitical fault lines, and they may benefit from favorable treatment. Countries that can create a favorable environment for domestic and foreign investments, including those that are endowed with key resources, may provide an attractive backdrop for investing opportunities. In these locations, an upturn in public and private capital expenditures could potentially boost productivity and create an environment for winning companies to generate sustained profit growth.

And, in general, there may be more active opportunities in the coming years. After a long period of dominance by large multinational corporations, a different backdrop for inflation, geopolitics, and monetary policy implies a broader range of winners and losers across multiple asset categories.

Other possible opportunities include:

- Thematic portfolios: Allocations could be tilted toward or away from exposures to big themes, such as climate or globalization. We suspect identifying industries and companies that may benefit from an uptick in capex would be a good place to start.
- Higher investment spending in many developed and some emerging markets: Historically, depressed rates of capex, public investment, and productivity may receive a boost from shifting structural trends, such as reshoring, rising cost of capital, and clean energy.

Authors

Irina Tytell, PhD

Irina is head of secular research of the Asset Allocation Research team at Fidelity Investments. She generates insights on macroeconomic and financial-market trends and their implications for strategic and active asset allocation.

Dirk Hofschire, CFA

Dirk is managing director of research and leads the Asset Allocation Research team at Fidelity Investments. In this role, he guides the research efforts used to develop asset-allocation recommendations for Fidelity's portfolio managers and investment teams.

Fidelity Thought Leadership Vice President Mike Tarsala provided editorial direction for this report.

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