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# MARKET INSIGHTS

Dr. James Thorne, *Chief Market Strategist*



WELLINGTON-ALTUS



## THE GRAND CHESSBOARD:

# Navigating Geopolitical Investments

In the complex arena of global finance, as in geopolitics, strategic positioning can be just as crucial as raw power. This insight comes from Polish-American diplomat and political scientist Zbigniew Brzezinski in his book *The Grand Chessboard*, which offers a compelling parallel to the world of investing. Brzezinski's analogy paints a vivid picture where nations are likened to chess pieces, with their geographic locations and potential weaknesses playing a pivotal role in the grand strategy of international relations.

Understanding this concept is vital for investors who seek to navigate the markets with foresight and acumen. Like master chess players, successful investors must be able to identify these "geopolitical pivots" and predict how shifts in their stability can ripple through the global economy.

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“ In the grand geopolitical game, it's not always the most powerful states that hold sway, but often those positioned in critical locations. Their vulnerability can significantly impact the strategies of the world's power players. ”

- Zbigniew Brzezinski

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## The Global Economic Chess Match

In the ever-shifting tapestry of global economics and geopolitics, a multi-faceted chess match is unfolding, with economic giants like the U.S. and China making calculated moves as they vie for supremacy. Japan, with its own set of strategies and enigmatic stance, adds another layer of complexity to the game. This dynamic interplay, where every action can lead to a series of reactions, is reminiscent of the delicate dance found in the opening moves of a chess game, where each player seeks to outmaneuver and outthink their opponent.

Investors, akin to chess grandmasters, must anticipate these movements and strategies, understanding that the global market is an extension of the geopolitical chessboard. By doing so, they can position themselves to capitalize on the opportunities that arise from the intricate interplay of global powers.

Currently dominating the chessboard is the upcoming U.S. presidential election, and with it a trend towards a unified industrial strategy to counter economic rivals, reflecting public dissatisfaction with living standards. The sustainability of China's growth, international agreements, and the strategic focus on technology sectors are crucial considerations as each player positions their pawns and knights across the board.

Fiscal pressures and rate hikes evoke struggles for power, with [historical examples of empires collapsing under fiscal mismanagement](#) serving as cautionary tales, not unlike overextended chess players falling victim to their own hubris. Discussions about gold, reevaluating the dollar, and skepticism towards Modern Monetary Theory<sup>1</sup> echo the advice of sage counsellors.

The *100-Year Marathon* by Michael Pillsbury and Graham T. Allison's ominous *Thucydides Trap* prophecy cast shadows over the future of international relations—a threatening fork or pin in a chess game. China's grip on the global manufacturing domain tightens, while the U.S. must confront the realities of a world in flux, with

the looming spectre of deflation and financial instability turning them into a player forced to defend against a relentless attack.

## Crypto's Volatile Realm

Amidst the global economic turmoil, the realm of cryptocurrencies presents its own unique challenges and opportunities in a game where the rules are constantly evolving. Bitcoin, the digital asset that sparked the crypto revolution, has experienced bull cycles as erratic as the shifting fortunes of a hard-fought chess match.

With extreme levels of debt driven by the Modern Monetary Theory view that deficits don't matter, and a need to refinance global debt at lower rates, a refinancing cycle is upon us. Bitcoin emerges as an alternative store of wealth and a form of digital gold offering players refuge from a well-timed castle maneuver.

The first bitcoin bull cycle started in early 2015 when the cryptocurrency's price was \$200, then peaked at nearly \$20,000 by the end of 2018, yielding almost a 99 x return. The second bull cycle began in early 2019 with a price of around \$4,000 and reached its peak at \$70,000 in late November 2021, resulting in a 16.5 x increase. However, the current cycle, now one and a half years in, has seen a more modest 4 x price increase. Investors in this volatile realm must brace themselves for significant drawdowns, ranging from five per cent to a staggering 70 per cent.

Despite the inherent risks, the crypto market continues to grow, with roughly \$12 billion in exchange-traded fund (ETF) inflows and approximately \$60 billion held in bitcoin ETFs, resulting in the fastest launches in ETF history. Small crypto allocations have boosted the returns of traditional 60/40 portfolios, ranging from 33.3 per cent to an impressive range of 53-67 per cent between April 2019 and March 2024<sup>2</sup>, mirroring the strategic deployment of unconventional moves that can turn the tide of a chess game. As with commodities decades ago, it will take time for institutional investors to embrace this new asset class.

<sup>1</sup> Macroeconomic theory that countries which spend, borrow and tax in a currency they fully control (such as the U.S., the U.K., Canada and Japan) are not constrained by federal government spending as they can simply print more money.

<sup>2</sup> <https://insights.glassnode.com/coinbase-x-glassnode-intro-article-q2/>

## The Race for Innovation

Innovation is critical in shaping economic growth and development, while also disrupting established norms. The intense competition between China and the U.S. in artificial intelligence (AI), particularly in semiconductors, is a testament to the strategic importance of staying ahead in technological capabilities, much like the constant pursuit of new chess engines and computational power to gain an edge over human opponents.

According to the Gartner 2023 Hype Cycle™ for Artificial Intelligence<sup>3</sup>, generative AI has reached the "Peak of Inflated Expectations" phase, characterized by significant hype and often unrealistic expectations about its potential. However, the Economic Theory of Blind Betting<sup>4</sup> suggests that when new industries and technologies are born, the total addressable market is not known, and the impact can be vastly underestimated. As AI is poised to affect every aspect of society, from health care to transportation, education to entertainment, the Hype Cycle may be incorrect in its assessment of generative AI's trajectory. The chess match between nations for AI supremacy could have far-reaching consequences that defy traditional forecasting models—a game-changing move that could rewrite the rules of engagement.

The evolution from traditional Central Processing Units (CPUs) to more powerful Graphics Processing Units (GPUs), optimized for AI tasks, marks a significant shift in computing power. The U.S. government's investment in semiconductor manufacturing through the US\$39 billion *CHIPS and Science Act* is a strategic initiative to bolster domestic capabilities in this vital industry.

The future of AI leadership is set to define the next phase of global technological and economic order, with the leading AI innovator likely dictating the direction of the forthcoming technological age, influencing geopolitical alliances and the overall international power structure, much like the emergence of a new chess engine that redefines the boundaries of the game.

## The Federal Reserve's Balancing Act

Central banks, particularly the U.S. Federal Reserve and Bank of Canada, are carefully deliberating interest rate policies in light of China's capacity to influence global price levels. Trade dynamics continue to evolve, and advancements in AI and digital currencies are poised to reshape the economic landscape, akin to the introduction of new chess variants and rule modifications that require players to adapt their strategies.

Confronting a considerable debt load and the limitations of Modern Monetary Theory, the U.S. is prompted to rethink its fiscal approach. Just as a chess player may learn from past blunders, central banks must support growth while ensuring stability, drawing lessons from historical policy missteps.

In an era characterized by fiscal dominance, the only viable path forward involves growing beyond the constraints of debt, necessitating negative real interest rates and a global willingness to invest in U.S. Treasury securities. The looming threat of an Asian currency crisis, with Japan at the forefront, and its potential unintended consequences should not be underestimated as one might an innocuous pawn.

The yen carry trades<sup>5</sup> impact on global liquidity and the consequences of yen devaluation present intricate challenges. As the yen depreciates, intervention becomes lucrative, but the Bank of Japan must navigate a perilous chessboard in an era dominated by fiscal policies.

## Adapting Your Strategy

As the curtains draw to a close on this chapter of global economic theatre, the U.S. and China emerge as the principal players in an intense chess match, vying for strategic advantage and control of the board. Japan's role, though less pronounced, adds an enigmatic layer to the narrative, a hidden player that could potentially swing the game in either direction.

<sup>3</sup> <https://www.gartner.com/en/articles/what-s-new-in-artificial-intelligence-from-the-2023-gartner-hype-cycle>

<sup>4</sup> Concept rooted in the "market for lemons" theory by George Akerlof, which posits that a market in which the quality of goods is uncertain to buyers can lead to adverse selection and a decline in the overall quality of traded goods.

<sup>5</sup> Strategy where an investor borrows money in a currency with low interest rates, then uses the proceeds to purchase a higher-yielding currency.

In this complex world of economic and political maneuvering, various theories and strategies compete for pre-eminence, echoing the intricate calculations and positional battles that characterize a high-level chess game. The economic landscape is riddled with mercantilist maneuvers, deflationary undercurrents, and a fierce contest of innovation between these global titans.

Investors find themselves in a scenario where the risks and opportunities at hand are as pivotal as the decisions made in a high-stakes chess match. The confluence of technological breakthroughs, swelling debt, unseen economic bubbles, financing challenges, and the ramifications of heightened interest rates all highlight the critical nature of strategic planning in investment endeavors.

Both China and the west, especially the U.S., are at a fiscal crossroads, with skyrocketing sovereign debt levels posing a grave threat to the economic equilibrium, much like a player facing the potential of being mated or stalemated due to a lack of resources or strategic oversight.

As this intricate economic saga unfolds, the actions and strategies adopted by nations today will indelibly shape the future. The narrative may lack the physical pieces and board of a chess match, but the stakes are no less real, and the outcomes will determine the course of economic stability and prosperity for generations to come, echoing the enduring legacy of the greatest chess players and their immortal games.

## **What Should Investors Do?**

The parallels between chess and investing offer valuable insights for navigating the current economic landscape. Just as a skilled chess player must employ strategy, anticipate moves, and adapt to changing circumstances, investors must adopt a similar mindset to position themselves for success. Here are some key recommendations:

### **1. Understand the Game**

Before making any moves, investors must thoroughly understand the "game" they are playing. This involves researching companies, industries,

economic trends, and potential risks and rewards. Where a chess player studies the board and piece movements, investors should gain a comprehensive understanding of market dynamics.

### **2. Develop a Strategic Approach**

Successful investing, like chess, requires a well-defined strategy. Investors should establish a clear investment philosophy, risk tolerance, and long-term goals. This strategic approach should guide decision-making and help investors avoid impulsive or emotional moves.

### **3. Anticipate and Prepare**

Both chess and investing demand the ability to anticipate potential challenges and prepare accordingly. Investors should construct diversified portfolios that can withstand economic downturns, industry disruptions, and market fluctuations. Scenario planning and risk management are crucial for mitigating potential threats.

### **4. Adapt to Changing Circumstances**

Just as chess games progress with each move, the economic landscape is constantly evolving. Investors must remain flexible and willing to adjust their strategies based on changing market conditions, new information, or shifts in personal circumstances. Rigidity can lead to missed opportunities or unnecessary losses.

### **5. Seek Guidance from Professionals**

Chess players often seek coaching from grandmasters. Investors too can benefit from the expertise of financial professionals. A trusted advisor can provide valuable insights, help navigate complex market conditions, and ensure that investment decisions align with long-term goals.

### **6. Cultivate Patience and Discipline**

Investors should avoid impulsive decisions driven by fear or greed, and instead maintain a long-term perspective. Staying the course and adhering to a well-defined plan is imperative. Success in both chess and investing requires patience and discipline.

## The Pieces at Play

Interest rates need to be normalized. A 25-basis-point cut is not going to be enough. An inverted yield curve is often regarded by economists as a predictor of an impending recession.

When short-term interest rates exceed long-term rates, it suggests that investors are wary of the near-term economic outlook and demand higher yields for short-term investments. Historically, during times of economic uncertainty, secular growth stocks—those in industries expected to grow consistently over the long term—tend to outperform.

However, the economic growth observed in recent years has been questioned by some who argue it is a mirage, artificially sustained by unprecedented levels of fiscal spending inspired by Modern Monetary Theory, a level of government expenditure not seen since the Second World War. History shows a tendency towards periods of slowing growth and deflation followed by reflation cycles. To be clear, a recession and deflation as experienced in the late 1940s and early 1920s cannot be ruled out. Leadership changes in the market typically happen after a recession.

Since 2009, central banks have engaged in aggressive monetary policies such as lowering interest rates to stimulate economic growth, in what appears to be a four-year cycle. Unique to this cycle is that we've entered an era of fiscal dominance, which is typically good for risk assets. Investors need to recognize, as chess grandmasters do, that optimal strategies continually evolve.

Concurrently, bitcoin has seen a meteoric rise. From its inception in 2009, the remarkable growth trajectory has been propelled by increased adoption, technological advancements, and its burgeoning reputation as a store of value, often referred to as "digital gold."

Secular growth stocks, especially in the technology sector, have also experienced significant advances. Giants such as Apple, Microsoft, Amazon, Google, and Netflix have expanded immensely over the past decade. Yet, bitcoin's performance has eclipsed these stalwarts; it has delivered an astounding 124 per cent annualized return over the last decade, outshining both the S&P 500 and gold, and earning the title of the decade's top asset as of 2024.

As the yield curve un-inverts—a phenomenon we expect to witness in 2025-2026—and the era of fiscal dominance takes hold, investors often seek refuge in safe-haven assets. Will the same hold true today? Central bankers are typically late, as such monetary policy works with a lag. Today is no different, that much is true. As for the evolution of the global chess match, investors are best to keep an open mind.

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