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MARKET INSIGHTS

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FROM TRUMP'S DEMANDS TO CANADA'S DESTINY:

Charting a new course in a shifting world order

Bismarck's 19th-century declaration about the changing realities of geopolitics resonates today as the global economic order undergoes seismic shifts. For decades, Canada and the U.S. have shared a mutually beneficial trade relationship, underpinned by the post-Second World War framework of free trade agreements and multilateral cooperation.

However, Donald Trump's presidency revealed cracks in this foundation. His aggressive demands on Canada—spanning energy, agricultural reforms, and trade concessions—were not merely a reflection of his leadership style. They highlighted a deeper truth: that the modern global trade system is not only in decline, it's broken.

Investors must recognize that the cornerstone to Trump's success lies in achieving world peace; a peace dividend is essential for him to fulfill his agenda. Solutions to conflicts in Ukraine and Gaza, along with a "Grand Bargain" with President Xi of China, are far more crucial than engaging in a trade war. Investors need to separate the signal from the noise.

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> "A statesman … must wait and listen until he hears the steps of God sounding through events; then leap up and grasp the hem of his garment."
>
> - Otto von Bismarck

As we confront this reality, it becomes clear that Trump was not the cause of these changes, but rather a forcing function. The global order established at Bretton Woods in 1944 is broken, and significant adjustments are needed—something that has been necessary for some time now. The framework built on British economist David Ricardo's theory of comparative advantage is faltering under the weight of mercantilist policies, rising debt, unfunded liabilities, aging populations and shifting geopolitical priorities. For Canada, this moment presents both a challenge and an opportunity. By understanding the global context and embracing structural reforms, Canada can position itself for renewed prosperity in an evolving world. The critical question is not just what Trump wants from Canada, but what Canada envisions for itself in this new era.

Navigating uncertainty: Embracing opportunities amidst tariff tensions

In light of the current and ever evolving tensions surrounding Trump's proposed tariffs on Canada, it is essential to remain calm and recognize that a solution is on the horizon. The Canadian government is in transition as the Liberal Party selects a new leader, with a federal election likely to follow. If an early election is called, serious negotiations could begin in early May. Until the political landscape in Canada is redefined, we will remain in a state of flux.

Viewing this situation through the lens of the prisoner's dilemma, both the U.S. and Canada face a choice between cooperation—maintaining free trade—and defection—imposing tariffs, which ultimately leads to mutual harm. While the imposition of tariffs creates immediate chaos, it is crucial to understand that mutual cooperation would yield significantly better economic outcomes.

The final step will likely involve a full renegotiation of the U.S.-Canada Free Trade Agreement, with all carve-outs on the table. It would not be surprising if the outcome includes granting U.S. banks and insurance companies full access to the Canadian market, diverging from current consensus discussions. The U.S. requires Canadian natural resources, as evidenced by the 2020 Canada-U.S. Joint Action Plan on Critical Minerals. A deal will be reached, and with patience and diplomatic efforts, both countries can navigate this challenge to arrive at a mutually beneficial agreement.

Investors should anticipate a slowdown in economic growth, with potential interest rate cuts from central banks. Trump has accelerated the pace at which economies are transitioning during this period. It is important to note that tariffs are a one-time shock to relative prices and do not cause sustainable inflation. While global growth will slow and liquidity will be injected into the global economy, the key question is how this will affect investor psychology. After a brief period of volatility, I expect the market to refocus on the opportunities ahead, particularly for those who can quell their emotions and check their biases at the door.

The end of comparative advantage

Ricardo's theory has long been the cornerstone of global trade. The idea that nations should specialize in producing goods where they have a relative efficiency advantage created an interconnected world where trade flourished. After the Second World War, this principle was institutionalized through agreements like the General Agreement on Tariffs and Trade (GATT), which aimed to reduce trade barriers and promote economic interdependence.

However, this system is unravelling. Major players like China have embraced mercantilist practices—prioritizing exports while protecting domestic markets through subsidies and tariffs. The U.S., once the champion of free trade, has increasingly turned inward, focusing on reshoring industries and imposing tariffs to protect its economy. In this environment, Ricardo's vision no longer holds sway. Instead of mutual benefit through specialization, nations are now locked in zero-sum competition.

For Canada, this shift is particularly significant. As a mid-sized economy heavily reliant on exports to the U.S., it must navigate a world where traditional trade rules no longer apply. This will require a transition to self-sufficiency and diversification of its clients, while recognizing the advantages of integrating further into the U.S. economy.

The U.S. debt crisis: A catalyst for change

One of the most pressing factors reshaping global trade is the U.S.'s fiscal situation. In 2024, U.S. interest payments on national debt surpassed military spending for the first time—US$950 billion compared to US$826 billion. This milestone highlights a troubling reality: America's fiscal trajectory is unsustainable. Historians often view such moments as signs of imperial decline; when interest payments exceed national defence spending, economic power begins to wane.

The implications for Canada are significant. As the U.S. grapples with its debt crisis, it will likely prioritize domestic stability over international commitments. This could lead to reduced military spending, less investment in global institutions, and increased pressure on allies like Canada to take on more responsibility, both economically and geopolitically.

Canada must recognize that there is no more "kicking the can down the road." The post-Second World War system, which John Maynard Keynes warned about at Bretton Woods—a system reliant on American financial dominance—is no longer sustainable. Structural change is inevitable. Investors should take note that both Trump and U.S. Secretary of State Marco Rubio have explicitly stated that the Canadian banking industry is not a level playing field. As we enter a new era, regulated industries will be scrutinized.

This is not business as usual, and investors should view the current environment through a geo-strategic lens, recognizing that opportunities for deals are emerging. Fears of a trade war may be misplaced and often serve as negotiation tactics. With only 14 per cent of goods and services in the U.S. imported, tariffs are not inherently inflationary. While they may change relative prices, basic economic theory does not support the inflation claims made by the U.S. Federal Reserve. The real question is why the Federal Reserve is ignoring these principles. As I've noted before, the central bank may represent the last bastion of progressive left economic thought. Yet, the Overton window is shifting back toward the centre—evidenced by even Mr. Xi embracing the private sector.

The global context: A redefinition of trade

The changes facing Canada cannot be understood in isolation—they are part of a broader redefinition of global trade. After the Second World War, international commerce was driven by technological advances that reduced transaction costs. This led to unprecedented growth in intra-industry trade (e.g., exchanging auto parts between countries) rather than inter-industry trade (e.g., machines for wool).

Today, however, globalization is fragmenting as nations prioritize self-sufficiency over interdependence. Supply chain disruptions during COVID-19 exposed vulnerabilities in relying too heavily on foreign suppliers. As a result, countries are reshoring industries deemed critical to national security—from semiconductors to pharmaceuticals.

For Canada, this trend underscores the importance of self-reliance. By investing in domestic industries—particularly those tied to critical resources like rare earth minerals—it can reduce dependence on volatile global markets while positioning itself as a key player in emerging sectors. The Canadian government has proposed legislative amendments to the *Export and Import Permits Act* to provide authority to restrict the import/export of items in response to acts of foreign states that could "harm Canada" or to create secure and reliable supply chains.

Currency wars between China and the U.S.

The current economic landscape is dominated by currency wars rather than traditional trade disputes. Hedge funds, which are now the main buyers of U.S. Treasuries (UST), are driving short-term volatility, making the Merrill Lynch Option Volatility Estimate (MOVE) index the key measure of market fear. This surpasses even the Chicago Board Options Exchange's Volatility (VIX) index.

As U.S. Treasury Secretary Scott Bessent faces the need to refinance approximately 30 per cent of the U.S.'s debt over the next 12-18 months, the focus shifts to

sustaining debt rather than eliminating it. Investors should expect to see innovative ideas floated to try to deal with the upcoming refinancing wall. With China's economy struggling in a debt-deflation cycle, a weaker U.S. dollar and lower interest rates are essential for reflation. The impending Bank of Canada's quantitative easing, though not labelled as such, signals a broader trend of expanding balance sheets globally.

China's economic stability is contingent on a Plaza Accord-like deal with the U.S., which would enable it to purchase more UST. As the dollar weakens, global liquidity increases, fostering a more harmonious recovery. The interplay between U.S. and Chinese policies is crucial, as both nations need to navigate this liquidity cycle effectively. With Japan's yen also under pressure, the focus on currency valuation intensifies. Ultimately, debt sustainability and global currency dynamics will dictate future market behaviour.

As is often the case, the underlying plot is much different than many suggest, revealing complexities that challenge conventional perspectives on global economic relations. Some have conjectured that a possible solution would be the revaluation of gold to market valuation in order to buy China and the U.S. time, underscoring the logic of establishing a bitcoin strategic reserve. Global liquidity is desperately needed, and Bessent has indicated that leveraging the U.S. balance sheet and revaluing gold offers a viable solution in this context.

President Xi returns to his princeling roots

In macro investing, it's crucial to set aside biases and adapt to significant policy shifts, such as Xi Jinping's recent embrace of the private sector, specifically artificial intelligence (AI). As a Princeling, Xi's support for private businesses and declining yields in China suggest a higher likelihood of a deal with Trump than the consensus anticipates. His call for private enterprises to "get rich first and then promote common prosperity" reflects a wealth redistribution strategy rooted in the 1970s economic reforms.

Given the changing environment, if investors consider allocating capital to China, they must weigh the risk of the Chinese Communist Party seeking control over artificial general intelligence (AGI) and question how long Xi will support the private sector. While tactical trades in Alibaba (BABA) and QWEB may offer short-term opportunities, they should be viewed as rentals rather than long-term investments. With expectations of significant stimulus and a potential Xi-Trump deal, it's important to recognize that the cornerstone of Trump's second term is peace, and his desire to cut deals suggests fears of a trade war may be overstated—Canada must take notice. In this charged political environment, investors should take Trump seriously, not literally, and quell their emotions by tuning out the noise to calmly evaluate the facts. There are deals to be had.

Energy: The key to AI supremacy

As the world hurtles into an era defined by AI, energy has become a critical asset. Training AI models and powering data centres require vast amounts of electricity, making cheap and reliable energy a strategic asset. Much of this energy comes from fossil fuels, natural gas and hydroelectric power—all of which are abundant in Canada.

One of Trump's most underappreciated motives may be securing access to Canada's cheap energy resources, part of his broader strategy to maintain America's technological edge over rivals like China, whose rapid advancements in AI pose a direct challenge to America's technological supremacy. By pressuring Canada on trade and energy policies, Trump could ensure a steady flow of resources while reducing costs for U.S.-based tech giants.

For Canada, this presents both an opportunity and a challenge. On one hand, its abundant oil sands, natural gas and hydroelectric capacity make it an indispensable partner in North America's energy landscape, offering some bargaining power in trade negotiations—a reality Trump likely seeks to neutralize through tariffs and tough rhetoric. On the other hand, reliance on exporting raw resources leaves Canada vulnerable to external pressures.

To thrive in this new era, Canada must rethink its approach to energy policy. Instead of merely exporting resources, it should focus on building domestic industries that capitalize on cheap energy—such as AI research hubs or advanced manufacturing facilities. By doing so, Canada can move up the value chain and secure a stronger position in global markets.

Agriculture: Breaking free from protectionism

Another area ripe for reform is agriculture—specifically Canada's supply management system for dairy, poultry, and eggs. This system imposes strict quotas on domestic production while slapping tariffs as high as 300 per cent on imports. While it protects farmers from foreign competition, it also inflates prices for consumers and stifles innovation.

Trump targeted supply management during the *United States-Mexico-Canada Agreement* (USMCA) negotiations because it represented an outdated protectionist policy incompatible with modern trade dynamics. But dismantling this system isn't just about appeasing American demands—it's about unlocking Canada's economic potential.

By embracing agricultural reform and opening markets to competition, Canada can lower costs for consumers while creating opportunities for farmers to compete globally. This would also strengthen Canada's negotiating position in future trade agreements by demonstrating a commitment to free-market principles.

A vision for Canada's future and geo-strategic edge

Amid current challenges, Canada has a unique opportunity to redefine its role in the global economy through structural reforms focused on deregulation and private-sector growth. By streamlining excessive red tape, particularly in key sectors like energy and manufacturing, Canada can attract global capital and unleash its economic potential. Leveraging its vast natural resources, including oil sands and hydroelectric power, Canada can achieve energy independence while meeting the demand for clean technologies. Moreover, investing in critical minerals will make Canada a key supplier for green technologies, such as electric vehicles. Establishing innovation hubs powered by affordable energy will position Canada as a leader in AI, while modernizing agricultural supply management can lower costs for consumers and open new markets for farmers.

The concept of "Fortress North America," championed by Alberta Premier Danielle Smith, aims to enhance trade, bolster energy security, and improve collaboration on defence and technology among Canada, the U.S., and Mexico. While Trump's provocative remarks about using "economic force" to acquire Canada highlight the potential for deeper economic ties, they also underscore the broader trend toward regionalization in global trade.

To capitalize on its geo-strategic advantages, Canada must elevate commodities and their end products in trade negotiations. This focus can drive a renaissance in manufacturing and ancillary services and advance sustainability policies like methane capture. Geographic diversification is essential for derisking large-scale commodity projects and boosting exports to Asia and Europe. By strategically owning parts of the value chain, Canada can enhance its global profile, strengthen its leverage in trade negotiations, and build resilience against evolving global economic dynamics.

What does this mean for investors?

As market dynamics shift, declining capacity utilization and reduced work hours in the U.S. signal a weakening private sector, raising concerns about future economic growth. These indicators often precede rising unemployment, suggesting that businesses may be scaling back operations in anticipation of lower demand. Compounding this issue are record cuts in government spending implemented by the Department of Government Efficiency (DOGE), which could create a growth scare in 2026 reminiscent of the post-Second World War era. Scott Bessent, and current and former governors of the Bank of Canada Tiff Macklem and Mark Carney have recently suggested that the economic growth we experienced the past few years is a mirage driven by excessive government spending, a view that we have held for many years. Notice currency and credit markets are already reacting with declining interest rates and a weakening U.S. Dollar index (DXY). A global wall of debt needs to be refinanced—the four-year credit cycle should not be ignored. This environment necessitates a global investment perspective, particularly for Canadian investors who often exhibit home bias.

As global allocators of capital, we are closely watching which direction Canada will take in the coming year. We advocate for a diversified portfolio focused on secular growth sectors, including pipelines, utilities, banks, and AI-driven industries. Gold and bitcoin are also compelling assets; especially as sovereign wealth funds begin accumulating them. China needs to reflate, a bazooka-sized stimulus would not surprise—exposure to Chinese equity markets should be considered. Our thesis suggests a return to classical economic principles, favouring reduced regulation and market-driven growth. By aligning with these trends, investors can capitalize on emerging opportunities.

The end of the post-Second World War order requires a strategic shift. Canada's traditional industries are ripe for innovation, particularly in clean energy technologies and AI-driven resource management. Investors should align their portfolios with Canada's priorities: deregulation, resource development, and technological innovation in areas like renewable energy and sustainable agriculture.

As we move through 2025, the potential policies of a second Trump administration recognize a shift from Keynes to Milton Friedman, easing concerns about deficits and inflation. This transition will enable the U.S. Federal Reserve to cut rates more aggressively, positively impacting risk assets. However, significant unknowns remain, particularly regarding market responses to reduced government spending, which may initially create growth fears.

A pro-growth, deregulatory policy environment, paired with tax cuts, should support expectations for non-inflationary economic growth. Expect the U.S. dollar to gradually decline as these moderate policies take shape, with secular growth stocks likely outperforming until substantial evidence of change emerges.

As the federal funds rate normalizes toward around 2.75 per cent, keep an eye on Trump's potential embrace of bitcoin, which could encourage its adoption as a reserve asset. In the commodities market, anticipate oil prices falling to around US$50 per barrel, contributing to disinflation. Given these dynamics, we target the S&P 500 at 7,000 in 2025.

Conclusion: A new era for Canada

The post-Second World War global order is collapsing under the weight of debt crises, protectionism, and shifting priorities. For Canada, clinging to outdated systems will only lead to stagnation. Instead, it must embrace bold reforms that align with the realities of today's world.

By focusing on deregulation, energy independence, AI leadership, and resource development, Canada can transform itself into one of the wealthiest nations once again—a beacon of innovation and resilience in an uncertain era.

This moment demands vision and courage from Canadian leaders—not just incremental change but transformative action that positions the country as a global powerhouse. In doing so, Canada can not only weather the storm but emerge stronger than ever before—a testament to what is possible when old ways are abandoned in favour of bold new paths.

For Canadians willing to embrace change, the future is bright—and boundless. As Bismarck might say today: The great questions of our time will not be solved by clinging to past systems but by adapting boldly to new realities.

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