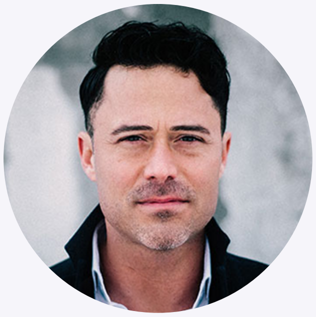
Ask Forstrong

US Elections and the Dollar: Burdened By What Has Been



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Key Takeaways

- Despite substantial differences in policy platforms between US Democrats and Republicans, both parties are aligned on one key issue: aggressively pursuing protectionism.
- Elsewhere, many developing nations are moving in the opposite direction, actively engaging in regional alliances and trade partnerships, signaling a broader shift towards more interconnectedness.
- After a decade of strength, the US dollar is set to be structurally weak in the period ahead.

Ask Forstrong:
With over 100 national elections taking place around the world this year, what impact could these political shifts have on global markets?

That's a wrap on summer, folks. Beaches have emptied, commutes have lengthened, and calendars are filling up. Across the globe, you can hear the collective sigh of relief from parents with young kids as they settle back into the rhythm of daily routines. All the usual September stuff is unfolding as it should. But in 2024, the political calendar has been anything but routine. Countries with more than half the world's population — over four billion people — will send, or have already sent, their citizens to the polls. The congested electoral calendar includes the most divided (America), most disgruntled (Britain), most populous (India), not to mention those front lines of the free world (Taiwan and conceivably even Ukraine). No wonder investors are skittish — the potential for major policy changes is enormous.

Of course, America remains uncontested in holding the world's rapt attention. And why shouldn't it? Forget the overdue and sensible retirement of Joe Biden or this week's unhinged presidential debate. The US has long been the architect of the post-war global order, shaping the institutions that define it. Now, for a second time, Trump threatens to take an even more destructive wrecking ball to these long-standing alliances. He also tells us that as President he will have direct say on when and how the Federal

Reserve sets interest rates, claiming that — you guessed it — his own instincts are better than the people who work at the Fed (note to Trump: Nixon already tried this in 1972 and the results were less than encouraging). While America's reputation may be in decline, its captivating hold on the rest of humanity is clearly not.

Protectionism On The Rise

Yet while November's US election remains pivotal, the multitude of elections worldwide presents an even broader canvas of change. As countries vote in new leaders, their relations with America are central to election discussions. In today's multi-polar world, many nations are re-evaluating their approach to trade, diplomacy, and security with the US, recognizing the need to engage more broadly with other global players and diversify their partnerships.

Big government has also made a comeback across the Western world. The language of subsidies, protectionism and state-led industrial strategy are once again at the forefront of political discourse. Trade is fragmenting along geopolitical lines and fresh cracks are appearing in the plumbing that underpins strategically important sectors — whether in 5G networks, electric vehicles or critical materials essential to the green transition.

In America, despite substantial differences in policy platforms between Democrats and Republicans, there's one major point of convergence: both parties are aggressively pursuing protectionism, particularly through the use of tariffs. This trend isn't isolated to the US either — other developed nations, including Canada and within the EU, are following suit. Notably, Canada recently announced it would match the US's 100% tariffs on Chinese electric vehicles.

The rest of the world is watching this protectionism closely. For example, during Mexico's election in June (where we visited and published a report on our findings), local investors acknowledged that the US results in November could hold more significance for Mexico than its own. While Mexico has been a near-shoring favourite in recent years, Washington now accuses them of serving as a backdoor for Chinese exports and circumventing US import tariffs (it is difficult to refute this: Mexico's imports from China are nearly 50% higher than pre-pandemic levels). America could easily turn on Mexico, especially with the United States-Mexico-Canada Agreement up for review in 2026.

EM Opening Up

Elsewhere in the world, protectionism is not on the rise. In fact, many emerging market nations are actively engaging in regional alliances and trade partnerships, signaling a shift towards more, not less, interconnection. Multi-lateral trade agreements are being swiftly signed. Settlement of bilateral trade in national currencies other than the US dollar is rapidly increasing. Supply chain diversion is also powering a manufacturing revival and investment boom outside of China. The last EM boom in the 2000s was driven by China's rapid industrialization phase. Crucially, this new phase extends far beyond China with far deeper participation.

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India, the world's fastest growing major economy and a country that we track closely, is a case in point. Prime Minister Narendra Modi, who was elected for a third consecutive term in June, has focused less on protectionism and more on enhancing India's competitive position globally. This has meant more integration with other nations, positioning itself as a viable alternative in global supply chains and encouraging foreign investment while building domestic capabilities. Unsurprisingly, the country's trade with other nations is soaring. The most important result has been India's upswing in its capital expenditure cycle. Long deficient in critical infrastructure, the investment share of GDP has recently reached 35%, a record high, and among the highest in the world (for comparison, China reached 45% during its blistering industrialization phase). More interconnectedness has led to higher growth.

Where Does Protectionism Lead?

What key theme can we pull out of all this? At the risk of stating the obvious, protectionism is not a positive trend for global growth. Trade restrictions hurt economies as they tend to raise production costs while inviting costly retaliation from trading partners. Although many politicians are appealing to voters by fixating on the negatives of globalization, adopting anti-trade policies would also unwind the positives of world integration and lead to a painful long-term economic adjustment process.

Tariffs, specifically, are also economically illiterate, prescribing bilateral remedies for more complex problems. Consider that America's massive trade deficit reflects imbalances with over 100 countries. In a world with globalized supply chains, slapping tariffs on China simply diverts trade to higher-cost foreign producers — the equivalent of a tax hike on US consumers.

This is already in play. A set of "connector countries" are rapidly gaining importance and serving as a bridge between the US and China, reducing efficiency but keeping supply routes viable. Ironically, this has brought resilience to global trade and activity but at the cost of higher inflation and higher private sector borrowing costs in tariff-imposing countries. Protectionism, contrary to recent claims, consistently results in self-inflicted economic harm.

Investment Implications

One of the most important questions arising from the current geopolitical landscape is the direction of the US dollar. The consensus suggests that a US-led trade war would boost the currency. We caution against that view. If the US were to impose more aggressive tariffs on its major trading partners — a likely outcome regardless of the November election results — it would directly weaken US consumption and increase US inflation relative to other countries. Both of those factors are US dollar bearish.

Over the long-term, protectionism would also undermine the US dollar's status as the world's primary reserve currency. In the shorter-term, however, political instability alone can drive capital flows away from the US. We have already observed this with the weaponization of the dollar following the outbreak of war in Ukraine, which quickened moves by various countries to avoid US dollar assets in favour of gold and assets within their own borders.

All of this is unfolding at a time when the US dollar index is over-valued at comparable levels with past secular peaks in 1985 and 2002. Additionally, the currency's traditional safe-haven role appears to be diminishing, recently declining alongside other risk assets during the August market sell-off.

Adding it all up, the best strategy for investors is to maintain broad diversification across multiple foreign currencies. This approach aligns with our investment team's objective in Forstrong's flagship Global Balanced strategy, which launched as an ETF on the TSX this week (FGBL) and seeks to capture the significant income and growth opportunities worldwide, while tilting towards the currencies with the most favourable fundamentals.

Tyler Mordy, September 2024

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