

# Understanding markets in the new world order

**A geopolitical framework for investors**

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Geopolitics and its impact on markets have been increasingly in focus over the past year, as trade policy, industrial policy, and military conflicts have dominated headlines. Even before that, the Russia–Ukraine war (2022–present), the Israel–Gaza conflict (2023–present), and rising U.S.–China tensions were among many investors’ top concerns. At the same time, a growing body of geopolitics-related investment research has emerged, along with a range of new geopolitical risk indices and indicators. But do these actually matter for most investors? Which geopolitical forces move markets, and what should investors be paying attention to?

The short answer is: it depends on the time horizon. For hedge funds and other short-term arbitrageurs responding to overnight moves in markets and currencies, day-to-day developments in the Middle East can matter. For long-term investors, however, we generally advise focusing on important structural shifts rather than short-term, impermanent noise.

In the history of geopolitics, the 2020s marks a crucial structural break. Massive changes are occurring in the global political order.

In this paper, we go beyond single conflicts or individual headlines, and identify the long-term forces we believe investors should pay attention to.

### **Key takeaways for our long-term geopolitical views include:**

- We are moving away from familiar territory and entering a new world order, one with important implications for the growth–inflation mix, and for long-term investment outcomes.
- The continued fragmentation of the global order damages the supply side of the global economy.
- The resulting stag-flationary impulses require repeated fiscal interventions by governments to mitigate their effects, with high sovereign debt burdens eventually creating a drag on macroeconomic performance as borrowing costs creep up over time.

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Discusses potential effects on asset class returns and risks, and draws out practical considerations for strategic asset allocation.

# What geopolitical risk is, and isn't

As clients increasingly seek to integrate geopolitical risk into their investment decision making, it is useful to define it, versus other types of risk. Our definition of geopolitical risk is as follows: a transnational risk to economic activity or cross-border trade and capital flows emanating from political actors. This includes all forms of violence (e.g. low-intensity conflicts, assassinations, terrorism, and wars), as well as non-violent diplomatic measures (e.g. transit or border closures, boycotts, and sanctions). On the flip side, there are positive geopolitical events such as milestones in conflict resolution, geopolitical integration, or alliance building.

Notably, military conflicts and wars are among the most scrutinized categories of geopolitics partly due to the first-order effects on the economies involved. Wars can devastate economies (for example, occupied France in World War II, Iraq in the 2000s, and Ukraine in 2022); however, wartime spending can also boost economic growth, as in the U.S. during World War II.

## Heterogeneity in market responses

Focusing on the past half century, Figure 1 summarizes major geopolitical conflicts, the largest market drawdown (proxied by the S&P 500 using daily price returns), and time to recovery. One key observation is that responses vary widely: shocks like the 1973 oil embargo and the 1979 Iranian oil crisis had more persistent effects on economies and equity markets, while events such as the 2003 invasion of Iraq, the 2011 Arab Spring uprisings, and Russia's 2014 annexation of Crimea were absorbed by investors relatively quickly. Several events had no clear impact on the S&P 500, including the 1986 U.S. bombing of Libya, the 1989 U.S. invasion of Panama, the 2008 Russian invasion of Georgia, the 2011 Arab Spring, the 2017–2018 U.S.–North Korea escalation, and the January 2026 U.S. intervention in Venezuela.

**Figure 1: Responses to market-impacting geopolitical (military) events are not uniform**

	Drawdown (Return, %)	Time to Max Drawdown (approx)	Time to recover to pre-conflict Level (approx)
1973 Oil Crisis	-43.50	1 year	6 years
1979 Iran Oil Crisis	-10.10	3 weeks	4 months
1990 Iraq invasion of Kuwait	-19.90	3 months	8 months
2001 September 11 / US invasion of Afghanistan	-11.60	2 weeks	1 month
2003 US invasion of Iraq	-3.40	< 1 week	1 month
2014 Russia Annexation of Crimea	-3.30	6 weeks	2 months
2022 Russia Invasion of Ukraine	-22.00	9 months	1.5 years
2026 US/Israel-Iran War	-7.80	1 month	6 weeks

Source: State Street Investment Management. Drawdown is calculating as the maximum price decline (maximum loss) of the S&P 500 Index using daily data from the start of the conflict. The column showing Time to Max Drawdown corresponds to the period the drawdown is calculated for.

## Rarely a lasting imprint

A second key point is that, in aggregate, major geopolitical events have tended to have short-lived effects on global markets—with the 1973 oil embargo as a notable exception. Impacts can be enormous in locally affected markets. Overall, equity selloffs after geopolitical shocks have usually been brief; prolonged drawdowns have been the exception, not the rule.

That said, investors shouldn't ignore geopolitics. Over short to medium horizons (roughly 6–12 months), geopolitical shocks can materially move markets. In a previous study,<sup>1</sup> we used an event-study approach, and found meaningful effects on equity and currency markets in the days and months after a shock.

- Currencies often react quickly—especially to negative news.
- Positive surprises tend to be reacted more gradually by currency markets.
- Equity markets have historically reacted more symmetrically to positive and negative events.
- In addition, equity markets have in the past reacted over longer time windows than currencies.

Importantly, many well-telegraphed, pivotal global events occur do not necessarily fall within the scope of geopolitical risk. What's important is the event's potential and realized escalation into the international playing field; in other words, where geopolitical risk is characterised as a systemic risk.

**“ Overall, equity selloffs after geopolitical shocks have usually been brief; prolonged drawdowns have been the exception, not the rule.”**

# Beyond short-term risks: Determining the durable and long-term geopolitical shifts that matter

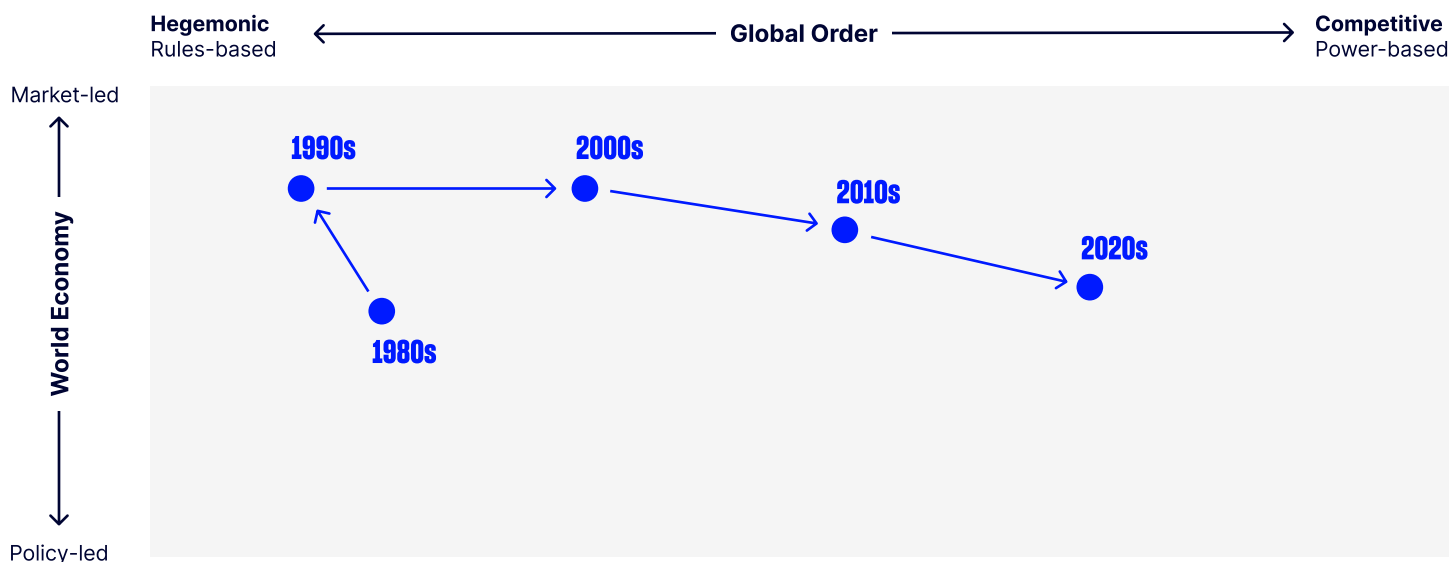
There has been no shortage of conflicts for news outlets to report on in recent years. Wars, terrorism, kidnappings, and various telegenic military or intelligence operations as well as trade and border disputes, have reinforced a sense of a world in disorder, amplified by real-time news cycles. It's easy to miss how the global order is evolving in permanent and structural ways.

## Why it's different now

This decade differs fundamentally from recent history, and therefore, a new framework for geopolitical risk is required (Figure 2).

Figure 2 illustrates how the world has evolved in recent decades. It places each decade along two intersecting axes: a vertical axis running from market led (top) to policy-led (bottom), and a horizontal axis that moves from a hegemonic, rules based global order on the left to a competitive, power-based order on the right. The historical trajectory depicted—1980s, 1990s, 2000s, 2010s, and finally the 2020s—moves diagonally downwards and rightwards. This path indicates a gradual but persistent weakening of the global rules based order and a simultaneous increase in the role of domestic policy intervention relative to market forces.

**Figure 2: The 2020s are unlike other decades and trending away from familiar territory**



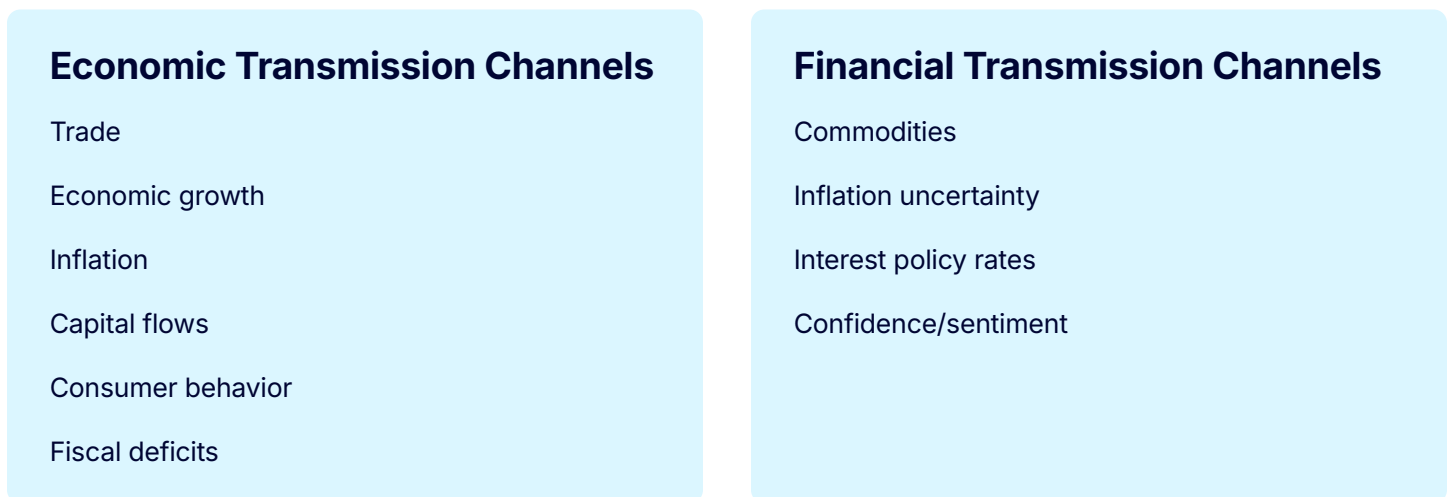
Source: State Street Investment Management, as of March 31, 2026.

## Historical evolution, by decade

In the 1980s and 1990s, the global environment was broadly characterised by U.S.-led hegemony, expanding trade liberalization, and deepening globalization. Markets largely dictated outcomes, capital moved across borders with increasing ease, and multilateral institutions—from the WTO to the IMF—played a stabilizing and rule setting role. Figure 2 shows these decades in the upper left quadrant, signalling an environment in which markets, rather than states, set the rhythm of economic growth, and where the global order was coherent, predictable, and anchored in shared rules. This backdrop optimally played to a classic 60-40 portfolio, as market prices maximized efficiency, correlations were consistent and known, and conventional portfolio hedges worked as expected.

As we progressed to the 2000s and 2010s, we entered a period that is represented by the markers shifting modestly downward and rightward. The 9/11 terror attacks and the 2008 financial crisis were accelerants of this shift. G7 governments expanded interventionist policies, particularly in monetary and regulatory spheres, while China's economic ascent challenged the Washington consensus. Consequently, while globalization continued, it no longer deepened at the same pace, and the consensus around a rules based order began to fray.

**Figure 3: Geopolitical risk and market transmission**



Source: State Street Global Advisors, ECB, as of March 27, 2026.

The 2020s started with the Covid-19 pandemic, exacerbating the need for state involvement in the economy and the divergence of experiences for China and G7 economies. The current decade marks a decisive shift toward a policy-led global macro regime embedded within a competitive, power-based global order.

One feature of this new world is the formation of geopolitical blocs and the return of proxy wars, as states prioritize supply chain security, technological sovereignty, and strategic autonomy over global integration. Another is the erosion of global rules, treaties, and organizations, such as the declining effectiveness of the WTO and the reduced authority of judicial or arbitrational bodies like the International Court of Justice (ICJ). These changes reflect not only geopolitical rivalry, but also ideological divergence, economic nationalism, and regional re-alignment.

**“ The 2020s marks a decisive shift toward a policy-led global macro regime within a competitive, power-based global order. ”**

## How will the new political order shape markets?

Critically, geopolitical risk is not market risk. The question is, which geopolitical events will impact markets via transmission channels such as rates, inflation, or supply side shocks. We highlight the main transmission channels in Figure 3.

### Economic transmission

#### Weaponization of trade, finance, and technology

Increased attention to security implies the weaponization of economic flows. In other words, the dependencies that were created as the result of decades of global integration have become vulnerabilities to be exploited and managed. The classic policy response is to disrupt existing networks of trade and exchange, creating cross border commercial frictions, and raising hurdles to trade, investment, and technology knowledge transfer.

#### Increased supply shocks and higher transaction costs

The new world order also means larger and more frequent supply shocks (e.g., Russian natural gas to Europe, or US-China mutual sanctions on semiconductor chips and rare earths). The consequences include higher transaction costs, reduced predictability, and an environment in which political risk is embedded in almost all global economic interactions.

#### Expanded state intervention and industrial policy

At the domestic level, a parallel shift has taken place that is characterized by the erosion of independent institutions, including central banks and regulatory bodies, as governments assert more direct control over economic management. This erosion blurs the boundaries between public and private sectors, especially in strategic industries such as semiconductors, energy, defense, and data driven technologies. As a result, state intervention and quasi industrial policies have expanded, with governments increasingly using subsidies, restrictions, and strategic investment tools to steer economic outcomes.

## Long-term drag on productivity and growth

The overall consequence is a formidable trade-off; namely, states become better at resource mobilization, but at the cost of less efficient capital allocation. The global duplication of the semiconductor supply chain is an obvious example. All else equal, that should lead to lower global productivity growth and lower average growth in the long term.

### Financial transmission

The transmission to financial markets primarily travels via impairment of the supply side. Given the vagaries of global politics, we do not know precisely when or how the next supply shock will unfold, and we also do not know how international crises get resolved in the current order. We do know that the frequency of events is higher and the uncertainty range greater. How should this be priced into financial markets?

#### Higher sovereign risk and term premia/Stag-flation

The unpredictable timing and magnitude of supply disruptions should gradually raise long-term inflation uncertainty. In addition, supply side weakness necessitates repeated fiscal intervention (e.g., household and business support during the pandemic; energy subsidies in Europe following Russia's invasion of Ukraine etc.). This loose fiscal stance structurally increases large deficits and promotes high debt burdens. It also puts upward pressure on inflation, not only via direct spending, but also indirectly as central banks increasingly need to take into account the sovereign balance sheet and allow average inflation to trend higher. In some states, the risk of outright financial repression rises too, as the sovereign seeks captive buyers of its debt.

The ultimate result is a repricing of sovereign risk, presumably via higher term premia, as the longer-term range of outcomes becomes wider and markets price in this higher uncertainty.

## A new landscape for energy

Looking at oil specifically, energy only represents ~7% of CPI (fuel and household energy).<sup>2</sup> But energy price rises do spill over and pull other costs up in the process, leaving even core PCE slightly elevated for longer than the actual shock period. Energy shocks can also lead to additional delayed inflationary impulses from higher fertilizer and petrochemical prices, which would show in higher food and materials costs 2–3 quarters late.

Long term, the energy complex will have a new pricing system. First, there will be a permanent risk premium on Gulf energy as Iran risk will not go to zero. Second, we expect higher inventory and redundancy costs globally. Third, there could be renewed tailwinds for oil/gas alternatives, ranging from nuclear, alternatives and even preserving local coal production. This is basically a mini energy transition.

# Portfolio implications in the short and long run

Geopolitics has become a meaningful tail risk as investors try to balance return objectives with increasing market risks. In the near term, periods of heightened uncertainty may prompt a focus on approaches and assets that have historically helped manage downside risk, such as gold. For the long term, new macro and market risks suggest more weight to assets considered safe havens, and an emphasis on resilient performance.

## Rethinking of the traditional 60/40 portfolio

The changing global order is putting pressure on the traditional 60/40 framework. Stock-bond correlations have become less reliable—at times remaining positive or shifting unpredictably—as markets adjust to a prolonged transition. Government bonds may therefore offer less consistent diversification than they have historically, leading some investors to prioritize inflation-hedging exposures alongside, or in place of, a larger core bond allocation.

## A larger role for inflation-hedging assets

Inflation uncertainties may increase demand for assets perceived to offer inflation protection. Depending on objectives and risk tolerance, this exposure may include public equities, commodities, and real assets. Gold's sharp rise—up 65% in 2025<sup>3</sup>—highlights this shift, reflecting growing interest in both inflation-hedging and safe-haven assets.

## Reduced tolerance for long-duration fixed income

Long-term bonds may have higher risks attached to them when uncertainty around inflation, fiscal policy, and geopolitics remains elevated. Because these bonds are more sensitive to changes in interest rates, they must offer sufficient yield to justify that risk. Otherwise, portfolios may need to have less exposure to long-duration fixed income than in prior macro regimes—particularly given the greater impact yield shocks tend to have at the long end of the curve.

## The bottom line

Over the longer term, a shifting global order may imply a structurally higher risk premium and less reliable diversification from traditional 60/40 allocations alone. In this environment, investors may benefit from focusing on portfolio resilience, thoughtful diversification, and selective use of safe-haven assets.

## Glossary

**Energy shock:** a sudden, significant change in energy supply or energy prices (most often a sharp rise in oil or natural gas prices) that disrupts the economy.

**G7:** Countries including Canada, France, Germany, Italy, Japan, United Kingdom, United States are part of the Group of 7, or G7 countries.

**IMF:** The International Monetary Fund, or IMF, is an international organization founded in 1944 that advises countries on economic policy, provides loans/other funding to countries, and monitors global economic developments.

**Inflationary impulse:** Tendency for the economy to experience rising prices.

**International Court of Justice:** The International Court of Justice (ICJ) is the principal judicial organ of the United Nations. Its main role is to settle legal disputes between states and give advisory opinions when requested.

**PCE Personal Consumption Expenditures (PCE):** is an inflation index that measures price changes in consumer goods and services. It excludes food and energy to remove the volatility caused by movements in these product prices to reveal underlying inflation trends. It is maintained by the Bureau of Economic Analysis of the US Department of Commerce and considered the Federal Reserve's preferred inflation measure.

**Risk premium:** The return that is above the risk-free rate of return a given investment is expected to deliver. It is a way to measure the reward investors can be compensated for taking on extra risk.

**S&P 500 Index:** A popular benchmark for US large-cap equities that includes 500 companies from leading industries and captures approximately 80% coverage of available market capitalization.

**60/40:** Shorthand for an asset allocation approach that combines equities and fixed income, with 60 percent in stocks and the remaining 40 percent in bonds. The combination is meant to balance potential to generate capital gains (and losses) associated with stocks with the capacity to protect principal inherent in income-generating bonds.

**Stagflation:** An economic condition characterized by slow growth and relatively high unemployment as well as inflation leading to an overall decline in gross domestic product. Stagflation prevailed for much of the 1970s amid rising oil prices and stalled productivity gains.

**Tailwinds:** Positive factors for a particular market.

**Term premia:** The difference in the returns an investor expects to earn from buying and holding long-term debt such as a 10-year Treasury bond, versus allocating to short-term debt.

**WTO:** The World Trade Organization, or WTO, is an international organization founded in 1995 that sets and administers global rules for trade between countries.

## Endnotes

- 1 Petrov, Alexander; Hentov, Elliot; Zumbo, Fabrizio. "How Does Geopolitics Affect Financial Markets?" State Street Global Advisors, August, 2018. To collect data, we compiled a large sample of events across four different markets, subject to specific criteria. We selected markets with sufficient liquidity, well-functioning financial systems, and an exchange rate regime that is not pegged and responds to market forces. Also, we excluded commodity producers, as the intention was to gauge a 'pure' form of geopolitical risk that doesn't transmit via commodity export prices. Finally, we selected markets that are geopolitically exposed in order to gather sufficient evidence for the study. In this regard, only four EM markets met all the above criteria: India, Israel, South Korea.
- 2 Bureau of Labor Statistics, as of April 10, 2026.
- 3 Yue Li, Yvonne; Ryan, Jack; Xie, Yihui. "Gold Investors Stay Bullish After Record Rally in 2025." *Bloomberg*, as of January 10, 2026.

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\* This figure is presented as of December 31, 2025 and includes ETF AUM of \$1,950.80 billion USD of which approximately \$173.02 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Investment Management are affiliated. Please note all AUM is unaudited.

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