PRESSURE POINTS

How are geopolitical events affecting global markets?
A sharp increase in volatility revisited markets in the second half of 2015 and extended into the first quarter of 2016. It followed an extended period of relative calm that began after the global financial crisis and had, perhaps, lulled investors into a false sense of security. In a lower-for-longer environment, the prospect of higher volatility can be even more challenging for investors’ portfolios.

While volatility is fueled by a range of factors, the focus in 2016 has been on a series of geopolitical events that have rattled markets, or at least have the potential to over the remainder of the year. Elections, government policy activities and regional conflicts pose significant pressure points for markets over the coming months. Here we highlight some key concerns.

Europe

Dominating many headlines to date has been the Brexit debate – the UK’s referendum to decide whether to remain a member of the European Union (EU), which it has been since 1973, or to exit. Regardless of the outcome, longer-term concerns surrounding the functioning of the EU appear set to intermittently unsettle markets.

The common currency, the euro, has contributed to a dichotomy of growth between the continent’s southern countries and the north, Germany in particular. Meanwhile euroskeptic political and protest groups are gaining prominence as migration concerns are exacerbated by a refugee crisis that stems from war in Syria and poverty in Africa. Divisions between member states about how to resolve these problems pose ongoing risks to stability.

US

In the US, the presidential election provides another focus for markets. While we do not believe the election poses much of a risk for markets, the nomination campaign perhaps represents an archetype for global political stress, and is a reflection of an undercurrent of voter dissatisfaction adding to uncertainty. Governments and political parties are under increasing scrutiny from disaffected voters.

Politicians and parties tapping into the mood of voter disquiet have gained momentum, including Republican nominee Donald Trump and perhaps Bernie Sanders at the other end of the political spectrum. This disquiet is echoed in Europe by the rise of right-wing parties in Austria, France and Greece.

China

In China, the government’s handling of and intervention in the economy remains closely monitored. Of particular focus is its capacity to navigate a slowdown in growth while trying to execute a program of reform of state-owned enterprises (SOEs). The shorter-term positive view is that the government has a plan and is attempting to slowly repurpose a massive economy. The negative view is that their recent track record with the currency devaluation, stock market regulation and the general regulatory framework has been inconsistent, generating substantial market turmoil. The effective management of stimulus programs and the flow of credit will be crucial to stability in China and, ultimately, globally.

Middle East

In the Middle East, the Sunni and Shia divide is likely to continue to deliver volatility into global markets for years to come. The majority-Sunni Saudis are grappling with a lower oil price, a resultant unbalanced budget, a narrowly-focused economy, military intervention in Yemen, a loss of assets through sovereign wealth fund liquidations, and the re-emergence of old foe Iran. The return of US oil self-sufficiency also means the Saudis are less sheltered by cover of US power, contributing to regional divisions and conflict, including the war in Yemen.

The implication for markets is that there is little chance Saudi Arabia will reduce oil production. Similarly Iran, long banned from global markets and desperately short of credit, is likely to pursue higher oil production. While oil prices have rallied recently from multi-year lows at the start of the year, this is likely to stimulate production and work to cap the price. The risk here is unknowable but the chance of a major event looms large.
US presidential election campaign ongoing
Closely monitored, but unlikely to pose a risk to markets

SYRIA
- Ongoing conflict and refugee crisis
- 4 million displaced people, up from 10,000 in 2010
- Over 2.7 million Syrians have fled to Turkey and 1 million to Europe
- Number of refugees up 12% in 2015

EUROPE
- UK referendum on EU membership
- Syrian and African refugee crises highlighting EU policy divisions
- Euroskeptic parties gaining prominence
- Growth disparity across continent adding to social unease

MIDDLE EAST
- Lower oil price pressuring budgets
- Economies too narrowly focused
- Saudi military intervention in Yemen
- Sovereign wealth fund liquidations
- Severed diplomatic relations between Iran and Saudi Arabia

RUSSIA
- Under pressure from recession, sanctions and low oil prices
- Geopolitical tensions from activity in Syria and Ukraine remain
- Government response remains unpredictable

CHINA
- Government intervention to stimulate economy
- Management of housing sector and credit growth under scrutiny
- Property speculation continues
- House prices surged over 30% in 2016, and sales were up 44% YoY in April
- Ongoing state-owned enterprise reform

Source: SSGA, as at 31 May 2016.
For nearly four decades, State Street Global Advisors has been committed to helping our clients, and the millions who rely on them, achieve financial security. We partner with many of the world’s largest, most sophisticated investors and financial intermediaries to help them reach their goals through a rigorous, research-driven investment process spanning both indexing and active disciplines.

With trillions* in assets, our scale and global reach offer clients unrivaled access to markets, geographies and asset classes, and allow us to deliver thoughtful insights and innovative solutions.

State Street Global Advisors is the investment management arm of State Street Corporation.

*Assets under management were $2.3 trillion as of March 31, 2016.