BENJAMIN F. EDWARDS®
INVESTMENTS *for* GENERATIONS®

We are providing the enclosed material prepared by an outside firm. Please refer to the last page for important disclosures from Benjamin F. Edwards & Co. related to the enclosed material. If you have questions regarding any of these disclosures, please contact your Financial Advisor.

2024-2081 Exp. 08/31/2025

Confluence
INVESTMENT MANAGEMENT

Bi-Weekly
Geopolitical Report
By Patrick Fearon-Hernandez, CFA

August 5, 2024

The US Geopolitical and Economic Bloc as an Investment Region

More than a decade ago, we at Confluence began describing how United States voters have become more reluctant to shoulder the costs of global hegemony. We've shown how increased populist isolationism in the US and other Western nations helped embolden Chinese General Secretary Xi, Russian President Putin, and other revisionist authoritarians to become more assertive in their efforts to undermine the US-led world order. As the resulting geopolitical tensions prompted leaders around the world to seek military, economic, and cultural allies to preserve their security and prosperity, we noted a clear fracturing of the world into relatively separate geopolitical and economic groups or "blocs." We think this global fracturing is bound to have big implications for investors.

To better understand the new blocs and gauge how they might impact investors, we developed an objective, quantitative method to predict which bloc a country would adhere to in the coming years. We first published our findings in our *Bi-Weekly Geopolitical Report* from May 9, 2022. In our report today, we update the analysis. We will also do a deep dive into the attractiveness of the US bloc as an investment region, the prospects for the bloc staying together after the US elections in November, and the implications for investment strategy.

Our Bloc Analysis: An Update

As in our initial analysis in 2022, we sought to assign 195 significant countries across the globe to the US-led bloc, a US-leaning bloc, a neutral bloc, a China-leaning bloc, and a China-led bloc. To predict where each country would land, we assigned it a score based on the same 13 geopolitical, economic, and cultural indicators that we used two years ago. Most of our criteria reflect countries' formal relationships as they stand today, such as their membership in mutual defense treaties like the North Atlantic Treaty Organization (NATO), general cooperative groups such as the Shanghai Cooperation Organization (SCO), intelligence-sharing arrangements such as the "Five Eyes" group, and free-trade deals like the US-Mexico-Canada (USMCA) agreement or the European Union (EU). We chose these criteria based on the idea that such deep, long-lasting relationships offer a certain comfort level between countries that will be hard to abandon.

Other criteria we chose reflect a country's own political, cultural, and economic idiosyncrasies, such as their score in the Heritage Foundation Index of Economic Freedom and whether they are considered "advanced" by the International Monetary Fund (IMF). Our thesis is that countries scoring similarly on these criteria will have a stronger affinity for each other. Finally, since we think economic and trade interests will be a key consideration for aligning with a bloc, we also include criteria that address a country's relative economic dependence on exports to the US versus exports to China over the preceding 10 years.

As in 2022, a few significant countries had such little data available that we could not score them. The two most important in this group were North Korea and Cuba. However, because of their ideological stance and non-market economies, we feel comfortable assigning them to the China-led bloc. We also excluded a number of very small countries, such as some Caribbean Island states, for ease of calculation and data presentation. We suspect those countries would lean toward the US bloc.

Table 1 below provides a sample of each bloc's updated membership as of August 2024; the complete list is at the end of this report. As in our initial analysis, the US-led bloc essentially consists of today's rich, highly industrialized, technologically advanced liberal democracies as well as a few closely related emerging countries. The US bloc is generally characterized by strong rule of law, protections for private property, free markets, and economic flexibility. The China-led bloc is much different as it is entirely made up of emerging and frontier markets. The governments in the China bloc tend to be authoritarian, and, just as important, the countries tend to be big commodity producers. (Given the increasingly close relations between Beijing and Moscow, we often refer to their group as the China/Russia bloc.)

Table 1

Representative Countries in Confluence's Projected Geopolitical and Economic Blocs

U.S.-Led Bloc	U.S.-Leaning Bloc	Neutrals	China-Leaning Bloc	China-Led Bloc
United States	Malaysia	United Arab Emirates	India	China
United Kingdom	Mauritius	Algeria	Indonesia	Russia
Canada	Tuvalu	Tunisia	Solomon Islands	Belarus
Germany	Nepal	Lebanon	Saudi Arabia	Iran
France	Qatar	Ukraine	Azerbaijan	Iraq
Italy	Oman	Serbia	Kyrgyzstan	Kazakhstan
Sweden	Egypt	Vietnam	Djibouti	Uzbekistan
Finland	Libya	Cambodia	Nigeria	Turkmenistan
Poland	Ghana	Maldives	Zimbabwe	Tajikistan
Israel	Senegal	Sri Lanka	Mali	Pakistan
Japan	Malawi	Kenya	Zambia	Myanmar
Australia	South Africa	Tanzania	Côte d'Ivoire	Congo
New Zealand	Argentina	Mauritania	Mozambique	Angola
South Korea	El Salvador	Brazil	Mongolia	Gabon
Mexico	Dominica	Venezuela	Afghanistan	Niger

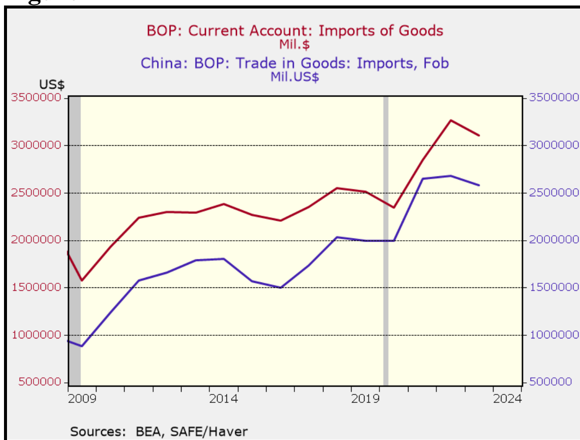
Compared with our initial analysis in 2022, dozens of countries have now shifted to a different bloc, some moving into or toward the US bloc and others moving into or toward the China bloc. On balance, the membership of the US bloc has increased to 70 countries in this update, up from 60 in our initial analysis. The US-leaning bloc has grown by four. In contrast, the size of the neutral bloc was almost unchanged, while the China-leaning bloc shrank by 10 and the China bloc shrank by six.

Almost half the country shifts into or toward the US bloc came from a correction: In our initial analysis, we neglected to score more

than a dozen Latin American countries for signing the Rio Treaty, a mutual-defense pact with the US completed in 1947. Correcting those countries' scores pushed many of them into the US bloc or the US-leaning bloc.

Overall, however, most of the shifts into or toward the US bloc came from our trade dependency criteria. From 2009 to 2019 (the trade data used in our initial analysis), Chinese imports grew at a compound annual growth rate of 8.5%, while US imports grew at a rate of just 4.6%. That disparity made many countries relatively more dependent on China than on the US for their export volumes and/or export growth. In the data for 2012-2022 used in this update, Chinese import growth slowed sharply to 4.9% per year, reflecting China's recent economic doldrums. US import growth slowed only modestly to 3.6% (see Figure 1). This made many countries less reliant on China for their economic wellbeing. Under our methodology, it also tilted many country scores away from China and toward the US.

Figure 1



The US Bloc as An Investment Region

It may seem strange that our methodology assigns more than half the countries in our sample to the US and US-leaning blocs. However, we think that merely reflects the fact that the US has been the global hegemon and biggest economy for decades. Countries big and small, all around the world, have had enormous incentives to ally with the US in various ways. From our perspective at Confluence, the salient characteristic of the US bloc is that it constitutes an enormous, capitalist-oriented, free market-driven economic space where private firms can flourish and investors can earn attractive returns on their capital.

For an investor domiciled in the US bloc and able to invest freely across its countries, the potential economic opportunity in the bloc is enormous indeed. As shown in Figure 2, the US bloc alone accounts for almost two-thirds of the global economy. On top of that, the US bloc is extraordinarily productive on a per-capita basis. As shown in Figure 3 (next page), its average per-capita GDP in 2023 was about $49,800 per year, almost 2.5 times the figure for the China bloc. Other indicators of economic *prospects* are also especially positive for the US bloc. For example, the countries in the US bloc have an average score of 66.9 in the Heritage Foundation's latest Index of Economic Freedom (in which higher scores point to greater protections for private property, reduced regulation, lower taxation, etc.). That compares with scores of 58.1 for the US-leaning bloc, 55.8 for the neutral bloc, 51.6 for the China-leaning bloc, and just 51.0 for the China bloc.

Figure 2

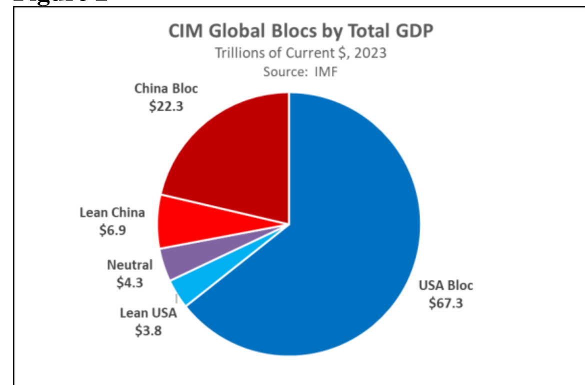
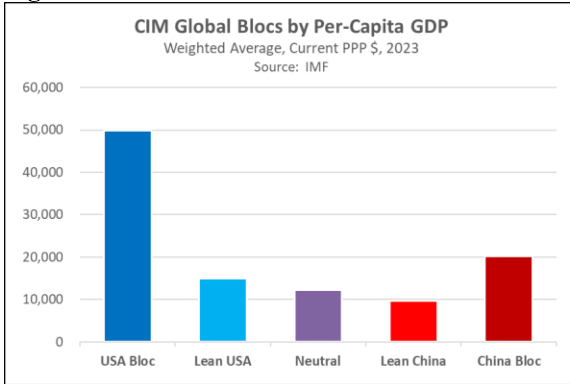
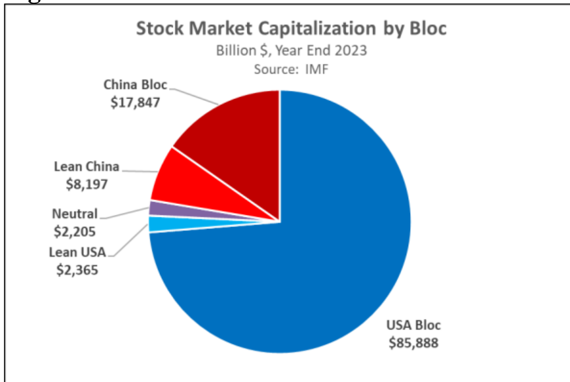


Figure 3



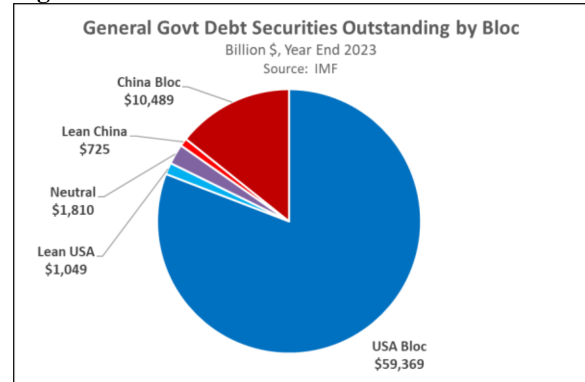
The US bloc's capital markets are also extraordinarily large, liquid, well developed, and well regulated. For example, data from the World Federation of Exchanges and other sources suggest the US bloc as a whole had a total stock market capitalization of $85.9 trillion at the end of 2023, equivalent to about 73.7% of total world market cap. The US bloc has about six times the market cap and share of the China bloc (see Figure 4). Similarly, by our count, the US bloc had more than 31,000 stock listings, making up 56.0% of the global total. Some of those were probably dual listings, where a firm lists shares on more than one exchange. Nevertheless, the total was much higher than the 16,100 listings in the China bloc.

Figure 4



The world's debt market is also dominated by the US bloc. Based on data from the Bank for International Settlements, the value of total government debt outstanding in the US bloc stood at some $59.4 trillion at the end of 2023, making up 80.8% of the global total (see Figure 5). Of course, this is one reflection of the historically high debt loads that the US and other developed countries have been carrying since the Global Financial Crisis and, more recently, the coronavirus pandemic. On a more positive note, however, the vast, highly liquid government bond markets in the US bloc reveal why central banks around the world still see them as the key place to park their foreign currency reserves. The attractiveness of the US bloc's bond markets helps explain why central banks in rival blocs can't quickly dump the dollar or other Western currencies, even if they now want to invest more in gold and other hard assets to avoid the risk of US financial sanctions.

Figure 5



Will the US Bloc Stay Together?

As noted in our introduction to this report, we have long argued that rising populist nationalism has been an important driver of the current global fracturing. Along with the worsening threats from authoritarian leaders in the China/Russia bloc, populist nationalism has been a key reason why the three-decade period of globalization after the Cold War has come to an end. It has therefore helped spawn the evolving bloc system described here.

Going forward, it's fair to ask whether the centrifugal force of populist nationalism could prompt further disintegration, potentially even to the point of breaking up the US bloc. For example, former President Trump has pilloried allies in the US bloc for "taking advantage" of the US, and he has floated plans to impose a blanket 10% tariff against most of them and possibly withhold US military support from them if he is re-elected. Naturally, many allied countries have begun to rebuild their own independent defense capabilities and prepare for reduced trade with the US. Separately, in the European Union, right-wing nationalists have gained significant political power and plan to use that influence to wrest control from Brussels and give it back to the nations' capitals.

It isn't clear yet how far this trend of isolationism and nationalism could go. What is clear is that the global fracturing to date has had big economic and financial implications. Governments have begun to put up barriers to the flow of goods, services, capital, technology, and even tourism between the blocs. Faced with greater geopolitical and economic risks, firms have begun to shorten their supply chains, bringing production back home or at least back to friendlier countries, even if it's more costly to do so. As we have argued before, these moves have probably made countries and firms more resilient going forward, but they will probably also result in lower corporate margins, higher and more volatile price inflation, higher and more volatile interest rates, lower stock valuations, and a long bear market for bonds.

- If this fracturing trend continues to the point where even the US bloc breaks up into its constituent parts or small groups, the negative impacts of less efficient supply chains, higher inflation and interest rates, and the like would probably be even worse. An isolated US economy or North American economic region would offer companies and investors much more limited opportunities than what are available today.
- To show how an even more fractured world could change the investment universe for a US entity, Table 2 provides key economic and financial data for the US alone, for the whole US bloc, and for the entire globe. If further disintegration were to erect big, new barriers to international capital flows, this simplistic analysis suggests that a US investor might theoretically lose access to 81% of the population in today's US bloc, 59% of the bloc's GDP, 43% of its current stock market capitalization, 82% of its stock market listings, and half the bloc's government bond market. Clearly, such an outcome could be quite negative for a US investor.

Table 2

What's Your Opportunity Set?
Key Indicators by Investment Universe
Sources: IMF, BIS, World Federation of Exchanges

Indicator	Investment Universe		
	US Alone	Total US Bloc	Total World
Population (Millions)	335.1	1,739.9	7,842.0
Pop. Growth Rate, 2018-2023	0.5%	0.6%	0.9%
GDP (Trillion $)	27.4	67.3	104.6
Stock Market Cap (Trillion $)	49.0	85.9	116.5
Stock Market Cap to GDP	1.8	1.3	1.1
Stock Market Listings	5,706	31,379	55,993
Govt Bonds Outstanding (Trillion $)	29.5	59.4	73.4

Investment Implications

For now, we can't estimate how long the US bloc will hold together. After all, in the face of military and economic threats from the authoritarians of the China/Russia bloc, allies of the US may ultimately bow to the

"America First" demands of a re-elected President Trump merely to maintain some hope of defense and trade cooperation in a more dangerous world. Even if the US and/or other blocs ultimately break up, it could be a slow process. For now, it probably makes sense for US investors to keep thinking of the entire US bloc as their main investment universe.

In the three decades of optimistic, exuberant globalization after the Cold War, a US investor could assume that essentially the whole world was his or her investment universe. Many US investors still have that perspective and recoil at the idea of permanent new barriers to trade, technology, and capital flows between the various blocs. All the same, we think such barriers have become significant indeed. Even worse, the spiral of tensions between the US bloc and the China/Russia bloc looks set to continue. On any given day, a US company manager or a US investor with interests in the China/Russia bloc could wake up to a sudden, unexpected new restriction on cross-border trade or investment, whether it's imposed by Washington, Beijing, or some other allied capital. That would especially be the case if military tensions keep rising between the blocs. Because of those risks, US investors are likely to increasingly favor the US bloc as their main investment universe and consider investing in the other blocs mostly on an opportunistic basis.

Investors accustomed to thinking globally will likely be concerned about losing access to other blocs, especially the China/Russia bloc. Many investors remember China's fast economic growth earlier this century and the way many of its firms quickly came to dominate certain industries. For a US investor, the main implication of rising trade and capital barriers between the blocs is that it will become harder and riskier to invest in the China/Russia bloc. However, China's economy has hit major structural headwinds, such as weak consumer demand, excess capacity, high debt, poor demographics, disincentives from the Communist Party's intrusions into the economy, and decoupling by the West. Facing these headwinds, China seems unlikely to return to the high growth it enjoyed earlier this century, and that will likely weigh on the returns of its listed companies. Coupled with the geopolitical and economic limitations of Beijing's allies, the darker new prospects for China mean that losing free access to the China/Russia bloc may not be a big loss for US investors.

As we've discussed in detail elsewhere, the global fracturing to date will have big economic and financial impacts in the US bloc. Shorter, more resilient supply chains will require firms to hike capital spending, accept higher operating costs, and possibly suffer lower margins, at least temporarily. Inflation and interest rates are likely to be higher and more volatile than in the past, which will likely weigh on stock valuations and hurt bond values. All the same, we think the democratic, capitalist, market-oriented economies of the US bloc are well positioned to eventually adjust. Reindustrialization and recent labor market trends alone will probably offer many opportunities for companies and investors in the US bloc, as will the development of artificial intelligence and other exciting new technologies. Global fracturing will pose challenges and risks in the coming years, and developed countries will continue to face structural issues such as high debt, but we think the US bloc will remain a preferred investment region going forward.

Patrick Fearon-Hernandez, CFA
August 5, 2024

CIM's Global Geopolitical and Economic Blocs, 2024

Sources: IMF, UN International Trade Centre, etc.

US Bloc		US-Leaning		Neutral		China-Leaning		China Bloc	
Country	GDP (Bil. $)	Country	GDP (Bil. $)	Country	GDP (Bil. $)	Country	GDP (Bil. $)	Country	GDP (Bil. $)
United States	27,357.8	Argentina	654.9	Brazil	2,173.7	India	3,572.1	China (incl HK, Macao)	18,086.1
Germany	4,457.4	Thailand	514.9	United Arab Emirates	504.2	Indonesia	1,371.2	Russia	1,997.0
Japan	4,212.9	Bangladesh	446.3	Vietnam	433.7	Saudi Arabia	1,067.6	Iran	403.5
United Kingdom	3,344.7	Malaysia	415.6	Algeria	244.7	Nigeria	374.9	Pakistan	338.2
France	3,031.8	Egypt	393.9	Ukraine	177.2	Venezuela	97.1	Kazakhstan	260.5
Italy	2,255.5	South Africa	377.7	Ethiopia	159.7	Côte d'Ivoire	80.0	Iraq	254.4
Canada	2,140.1	Peru	267.6	Kenya	108.9	Azerbaijan	76.6	Kuwait	161.8
Mexico	1,788.9	Qatar	234.2	Tanzania	79.4	Congo, Dem. Rep.	67.3	Ecuador	120.2
Australia	1,741.9	Oman	109.1	Serbia	75.2	Zimbabwe	32.2	Angola	94.4
Korea	1,712.8	Ghana	76.3	Tunisia	51.3	Zambia	28.4	Uzbekistan	90.9
Spain	1,581.2	Libya	45.0	Cambodia	41.9	Sudan	25.7	Turkmenistan	77.1
Netherlands	1,117.1	Nepal	41.0	Bosnia and Herzegov.	27.2	Mozambique	21.4	Belarus	71.8
Turkey	1,108.5	El Salvador	34.0	Benin	19.4	Mali	20.7	Myanmar	64.5
Switzerland	885.1	Senegal	31.4	West Bank and Gaza	18.6	Burkina Faso	20.4	Cameroon	49.0
Poland	808.4	Georgia	30.5	Yemen	18.4	Mongolia	19.9	Bolivia	46.5
Taiwan	756.6	Trinidad and Tobago	28.1	Moldova	17.1	Kyrgyz Republic	12.8	Papua New Guinea	31.0
Belgium	630.1	Botswana	20.4	Guyana	17.1	Togo	9.1	Armenia	24.2
Sweden	593.3	Madagascar	15.8	Rwanda	14.0	Djibouti	4.0	Guinea	23.0
Ireland	545.8	Mauritius	14.4	Namibia	12.3	Solomon Islands	1.6	Gabon	20.5
Austria	519.7	Malawi	13.1	Somalia	11.7	Comoros	1.3	Chad	17.5
Israel	509.5	Montenegro	7.4	Mauritania	10.5	Afghanistan	NA	Niger	16.5
Singapore	501.4	Liberia	4.4	Kosovo	10.5			Lao P.D.R.	15.2
Norway	485.5	Andorra	3.7	South Sudan	7.3			Brunei Darussalam	15.1
Philippines	436.6	Guinea-Bissau	2.0	Maldives	6.7			Congo, Republic of	14.4
Denmark	405.2	San Marino	2.0	Burundi	4.2			Tajikistan	11.9
Colombia	363.6	Samoa	0.9	Cabo Verde	2.5			Equatorial Guinea	10.3
Romania	345.9	Dominica	0.7	St. Lucia	2.5			Sierra Leone	3.9
Chile	335.7	São Tomé and Príncipe	0.7	Gambia	2.4			Suriname	3.8
Czech Republic	332.0	Kiribati	0.3	Lesotho	2.2			Bhutan	2.9
Finland	300.5	Tuvalu	0.1	Seychelles	2.2			Central African Republ	2.6
Portugal	287.4			Antigua and Barbuda	2.0			Timor-Leste	2.3
New Zealand	249.0			Grenada	1.3			Eritrea	NA
Greece	238.3			Vanuatu	1.2			Cuba	NA
Hungary	212.6			St. Kitts and Nevis	1.1			North Korea	NA
Morocco	144.0			St. Vincent and Gren.	1.0				
Slovak Republic	132.1			Palau	0.3				
Dominican Republic	120.0			Nauru	0.2				
Guatemala	102.0			Lebanon	NA				
Bulgaria	101.6			Sri Lanka	NA				
Costa Rica	86.5			Syria	NA				
Luxembourg	85.8								
Panama	83.4								
Croatia	82.0								
Lithuania	77.9								
Uruguay	77.2								
Slovenia	68.2								
Uganda	51.8								
Jordan	51.0								
Bahrain	44.7								
Paraguay	43.9								
Latvia	43.6								
Estonia	40.8								
Honduras	34.9								
Cyprus	32.2								
Iceland	31.0								
Albania	22.7								
Haiti	21.5								
Malta	21.0								
Jamaica	18.9								
Nicaragua	17.4								
North Macedonia	14.8								
Bahamas	13.8								
Barbados	6.4								
Fiji	5.5								
Eswatini	4.9								
Aruba	3.9								
Belize	3.1								
Tonga	0.5								
Micronesia	0.5								
Marshall Islands	0.3								

This report was prepared by Patrick Fearon-Hernandez of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.

Confluence Investment Management LLC

Confluence Investment Management LLC is an independent Registered Investment Advisor located in St. Louis, Missouri. The firm provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates the firm's evaluation of market cycles, macroeconomics, and geopolitical analysis with a value-driven, company-specific approach. The firm's portfolio management philosophy begins by assessing risk and follows through by positioning client portfolios to achieve stated income and growth objectives. The Confluence team is comprised of experienced investment professionals who are dedicated to an exceptional level of client service and communication.

ImportantDisclosures

This material is for use with investment advisory clients or prospects only

The information contained herein represents the opinions of the author and not necessarily Benjamin F. Edwards®. Benjamin F. Edwards® is providing it for informational purposes only, not as investment advice or a solicitation for the purchase or sale of any security or class of securities. Benjamin F. Edwards® & Co. (BFE) is a dually-registered broker-dealer and investment adviser and member of FINRA and SIPC, and its affiliate Benjamin F. Edwards SM Wealth Management, LLC, d/b/a Edwards Wealth Management (EWM) is an SEC-registered investment adviser. BFE and EWM are affiliates through their common ownership by Benjamin Edwards, Inc. Depending on the context, the name Benjamin F. Edwards® refer to either EWM, BFE or both.

As a registered investment adviser, Benjamin F. Edwards offers clients a variety of advisory portfolio options. Any portfolio discussed is offered at Benjamin F. Edwards as an investment advisory account. To participate, investors must sign an investment advisory agreement, select a manager, and pay an advisory fee. For additional information regarding fees, please refer to the third-party asset manager's (asset manager) applicable disclosure documents and Benjamin F. Edwards' disclosure documents, which may be obtained through your advisor or found on Benjamin F. Edwards' website, www.benjaminfedwards.com, under the Important Disclosures section.

Participating in advisory programs may cost the client more or less than if the client were to implement his or her selected program separately, such as by using a different program sponsor, pursuing the strategy through a brokerage account, or investing directly with the asset manager. Some factors that might impact the total cost to a client who implements a program separately include the frequency of trading activity; whether a client might be successful in negotiating a lower fee with a sub-advisor; rate of commissions, markups or other transaction-related compensation; or whether account fees, transaction fees or similar charges would be incurred.

Investing in securities entails certain risks, including the potential loss of all or a portion of the proceeds invested. Individuals should consider their specific financial needs, investment objectives and risk tolerance before making an investment. Investments can be significantly affected by certain events, including international political and economic developments, inflation, and other factors. Dividends are not guaranteed and are subject to change or elimination.

Exchange traded funds (ETFs) and mutual funds are sold by prospectus only, which should be read carefully before investing. Please consider the investment objectives, risk, charges and expenses before investing. The liquidity of ETFs may not reflect the level of liquidity of other instruments on listed exchanges such as well-recognized, large cap stocks. The prospectuses, which contain this and other information, can be obtained from your advisor.

Investing in fixed-income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high-yield or "speculative-grade" bonds, which have lower ratings and are subject to greater price volatility. All fixed-income investments are subject to availability and change in price and may be worth less than original cost upon redemption or maturity.

There are special risks associated with an investment in real estate, including credit risk, interest rate fluctuations and the impact of varied economic conditions. Distributions from REIT investments are taxed at the owner's tax bracket.