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Are global portfolios prepared for regime change?

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Summary

- Global investors are heavily concentrated in US assets, reminiscent of an erstwhile unipolar world.
- The April sell-off was a significant warning that the old regime is changing, when US equities, the Dollar, and US Treasuries, all sold off together.
- Additionally, we believe global positioning understates the reality that we are indeed in a Multipolar world, with increasing risk of US fiscal dominance.
- Both Multipolarity and Fiscal Dominance require different asset allocation than the Unipolarity and Monetary Dominance of the past.
- Portfolios are likely to do better with greater diversification into global assets, precious metals, and commodities.

Global equity positioning

Investors remain very heavily invested in the US, but flows suggest this may be changing. According to BoFA, the US's share of equity flows year-to-date is 45% versus a 65% benchmark weight. If the current trend continues, the US share of global equity market cap will reduce to the benefit of the remaining 35% made up by Foreign Equities.

A recent research report from JP Morgan suggested that global investors have around 5% allocated to Emerging Markets, compared to a 10% benchmark weight. Global allocators have 65% of their equity assets in the world's largest economy, and less than 3% in the world's second largest economy, China. That is despite Chinese leadership in a range of innovative technologies, Chinese household deposits of $22 trillion, with some of it being deployed into equities, while Chinese corporates are increasing buybacks at a record pace, from a low base.

Multipolar world

Geopolitical analysts seem to agree that we are officially in a Multipolar World, and this is the case for the first time since before WWI.

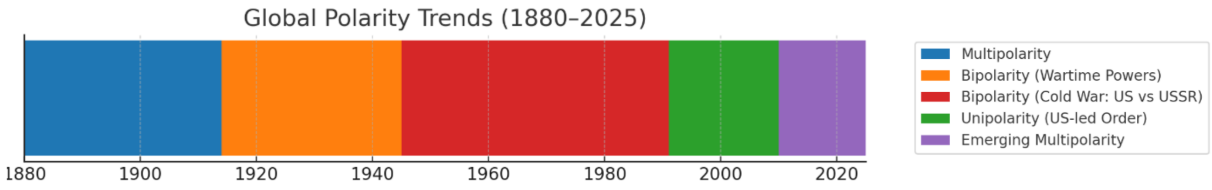


Chart by ChatGPT Plus

The transition from a unipolar world to a multipolar world is all about a loss of trust in the unipolar power, and in our view started with the Global Financial Crisis, driving the establishment of BRICS in 2009, and gaining renewed momentum when Russian Central bank assets were frozen in 2022.

Multipolarity has been accelerated by the recent US trade war against long-term alliance partners, driving foreign nationalism, and a greater need for national self-sufficiency. The resulting increase in fiscal impulse outside of the US should benefit a number of foreign countries.

The reduction in trust has also driven diversification from the erstwhile risk-free rate, US Treasuries, towards alternative reserve assets, like gold. The combined sell-off in US equities, US Treasuries, and the Dollar in April 2025 was a watershed event for many an asset allocator.

Multipolarity brings with it a more volatile geopolitical landscape, a greater need for defence spending as alliances become more fluid, while reshoring drives duplication of infrastructure, and inventory, consequently driving commodities demand higher.

Financial markets become less correlated, and balance sheets become more capital heavy, as seen with record increases in capex by US AI companies.

Overall, multipolarity requires broader portfolio diversification compared to the last 15 years of portfolio unipolarity. Trade wars are capital wars.

Globalisation boosted US margins to record highs. The end of globalisation is likely to pressure the record margins of the largest globalisation beneficiaries. Apple, the greatest beneficiary of globalisation, promised $600bn of investments into the US over coming years. If they follow through, Apple will transform form a capital lite to a very capital heavy business, in future.

Increased capex spend will support commodities and the related reshoring boost to US GDP, will partially offset tariff driven consumer weakness into Q4.

Assets likely to do better in a multipolar world are gold, commodities, foreign equities, emerging markets that produce commodities, and foreign bonds.

Growing nationalism should see repatriation of foreign held Treasury allocations, to finance domestic fiscal deficits, which then drive domestic infrastructure and defence spend. We believe the latter trend will gain traction once German and Pan European bond issuance commence in coming quarters.
Countries such as Australia, Brazil, Canada, Chile, South Africa, Taiwan, and Norway are well positioned to provide the commodities required for an increase in infrastructure and capex spend.
Another potential major change in the global investing backdrop is the move towards fiscal dominance.

The road to fiscal dominance

Fiscal Dominance is defined as a switch of focus by central banks from inflation targeting, to government financing.

A paper by Olivier Jeanne from Johns Hopkins University suggests that *the US is in the second of three stages towards full fiscal dominance*. The US can remain in Stage 2 for an extended period, but politics are increasing the risk of an earlier move towards Stage 3.

The Second Stage tends to start when debt-to-GDP surpasses 100%, and regulations are used to create demand for government debt, as seen with recent stable coin legislation, and likely changes to be made to the Supplementary Leverage Ratio (SLR). Financial historian Russell Napier has long been warning about the inevitability of financial repression.

Actions that could accelerate the move towards Stage 3, Full Fiscal Dominance, are actions that would add to the firing of the head of the Bureau of Labour Statistics due to data deemed unacceptable by the

White House, and the continuous pressure on the Fed chair to cut rates in order to save interest on fiscal debt. This, despite inflation remaining above the Fed's 2% target, and having done so for 52-months.

Should the US move into Stage 3, it would cause far more rapid depreciation in the Dollar, which is relevant for foreign investors, who own a net 85% of US GDP in US assets.

We asked Perplexity.ai deep search to identify the assets do well under Full Fiscal Dominance:

- Foreign Equities
- Emerging Market Equities
- Gold, Bitcoin
- Commodities
- Local currency Emerging Market Bonds

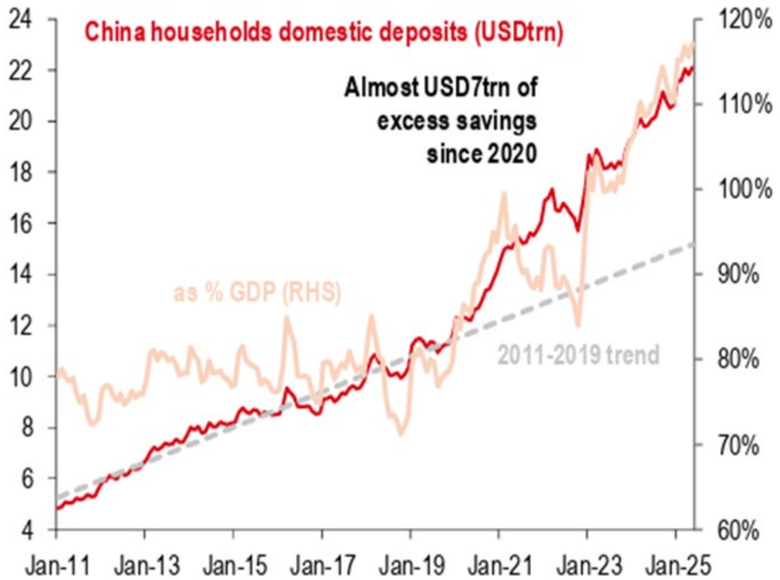
Again, *these are assets that are significantly under-owned after 15 years of US equity outperformance.* I was surprised to learn that despite talk of gold being over-owned, BoFA Private Wealth clients have only a 0.4% allocation to gold, and a 64% allocation to mostly US equities. Additionally, the Van Eck Gold Miners ETF (GDX) has had consistent outflows during the entire gold bull market.

It seems clear that global portfolios are more positioned for Unipolarity and Monetary Dominance than for Multipolarity and Fiscal Dominance. And while global investors avoid Emerging Markets, Chinese investors are buying records amounts of Chinese stocks.

What if domestic investors and corporates buy their own equities, leaving global investors on the sidelines?

The chart by HSBC is one of the most relevant to EM investors. It shows that Chinese Households have accumulated around 115% of Chinese GDP in bank deposits. With the real estate market weak, and confidence in real estate low, their avenues for investment are Chinese stocks, Hong Kong stocks via Southbound Connect, and precious metals.

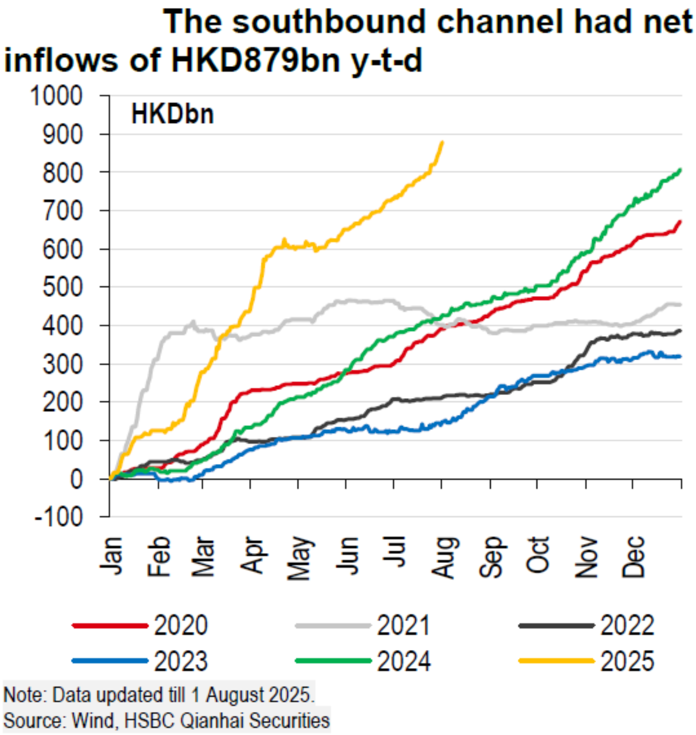
China households have a huge amount of excess savings



Source: Bloomberg, HSBC

Interest on cash and bonds are exceptionally low, which is additionally driving record corporate share buybacks in China. The equity earnings yield in China is well above the yield on cash, and the government is pressuring companies to buy back stock and become more shareholder friendly.
Chinese investors have significantly increased their buying of Chinese equities, while global investors remain on the sidelines.

The chart below shows that year-to-date Chinese investor flows into Hong Kong stocks via Southbound Connect (yellow) is double 2024 levels.



Conclusion

The global investment landscape is rapidly evolving, driven by the emergence of a multipolar world and mounting fiscal pressures that threaten the traditional monetary policy framework.

Despite clear signals of change, most global portfolios remain anchored to legacy US-centric allocations. Current positioning worked well, until April.

To navigate this shift, investors should reconsider asset allocations emphasizing greater diversification across geographies, sectors, and asset classes.

Increased exposure to foreign and emerging markets, precious metals, and commodities, could be beneficial as the era of unipolarity and monetary dominance gives way to a more complex and dynamic global order.

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