

2021: A Year of Great-Power Competition

Geopolitics will remain an important feature of markets and macroeconomics in 2021.

Insight from sub-adviser Wellington Management



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BARRING A SURPRISE, DOMESTIC-POLICY MATTERS—PARTICULARLY COVID-19 MANAGEMENT AND ECONOMIC RECOVERY—WILL DOMINATE POLITICAL AGENDAS IN WASHINGTON, D.C. AND GLOBALLY. Against this backdrop, here are my expectations for five key areas across the geopolitical landscape.

1. Biden Administration Foreign Policy: Great-Power Competition in a Multipolar World

Great-power competition will drive the Biden administration's foreign policy, as it did under the Trump administration. But this will look different, at least in style, as the Biden team will emphasize greater coordination with US allies, particularly in Europe.

President-elect Joe Biden will also attempt to restore US leadership across a variety of multinational institutions, including the World Health Organization, the World Trade Organization, and NATO.

But while much of the globe will welcome US reengagement, this strategy will not be easy to achieve, for two important reasons.

First, the US State Department saw significant personnel losses over the past four years, including experienced professional diplomats and regional and subject experts who craft the nuts and bolts of US foreign policy. Rebuilding US diplomatic capacity will take time.

Second, the levels of trust that America's allies have in the US are at decades-long lows—a fact that one election is unlikely to correct any time soon.

US withdrawals from the Paris Agreement on climate and the Trans-Pacific Partnership trade deal, the scrapping of the Joint Comprehensive Plan of Action with Iran, an activist trade tariff agenda, and other fractious aspects of an "America First" foreign policy have strained relations with key allies, while weakening US geopolitical leadership and, ultimately, influence.

All of this will likely keep the world on a path of increasing multipolarity and deepening great-power competition—a difficult structural backdrop to manage in 2021 and beyond.

Key Points

- Increasing multipolarity and deepening great-power competition will make for a difficult structural backdrop to manage in 2021 and beyond.
- Climate-related policies are likely to take center stage, providing ample opportunities for investors.
- In the current geopolitical environment, companies that learn to adapt and innovate may be best positioned to take advantage of investment opportunities going forward.

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2. US-China Relations: Better, But Not Without Friction

The most important geopolitical dynamic to watch in 2021, of course, will be the US approach to China.

Here I expect some improvement, as the Biden administration is likely to prioritize professional diplomacy over reciprocal tariffs. Or, put simply, expect more talking and less tweeting.

This will help pull the US and China out of their current diplomatic tailspin. From a market perspective, this will likely restore greater policy predictability. This easing of bilateral tensions will also reduce geopolitical risk in Asia and elsewhere—another market and macro positive in 2021.

But the broad outlines of the deteriorating US-China relationship—rooted in national security concerns amid rising competition—will remain firmly in place in 2021 and, indeed, will shape geopolitics for years to come.

We should, therefore, expect supply-chain decoupling in industries deemed “strategic” to this ongoing great-power dynamic—leading with technology, but also encompassing healthcare and biotech in a post-COVID world. We can expect a similar dynamic in capital markets, finance, and other industries that drive national economic and military power.

Another important difference from the previous four years will be an increased focus on human rights and democracy, which will shape US foreign policy to a much greater extent.

Working with allies in a US-led “coalition of democracies” will spark additional geopolitical friction with China in 2021, as well as in Hong Kong, given recent developments, and in Taiwan, which is likely to be in the crosshairs of the emerging ideological split between China and the West.

3. An Opportunity on Climate: However, Fragmentation Makes This a Tall Order

Climate change, the biggest threat to US national security and geopolitical stability over the long run, will be a significant US policy focus in 2021.

The Biden administration will immediately return the US to the Paris Agreement, and we should expect a series of executive actions by President-elect Biden to limit fossil-fuel drilling, strengthen environmental protections, and, broadly speaking, re-regulate the US energy industry.

At the global level, climate also presents an opportunity for the US and China to find mutual areas of agreement, another potential positive for bilateral relations.

But, again, great-power competition and a more multipolar world will present challenges for climate cooperation.

The world’s four largest CO₂-emitting countries — China, the US, India, and Russia—are also the four countries fueling great-power competition.

President-elect Biden will enter the White House facing the most challenging geopolitical backdrop in decades, even as US domestic politics remains deeply divided and dysfunctional.

Continuing geopolitical friction among these key countries will make significant international climate coordination difficult, as will the more fragmented global order that results from this ongoing structural shift.

I therefore expect climate actions in 2021 to remain focused on domestic policies in countries around the world, as global progress on CO2 reduction remains slow and uneven.

4. **Geopolitical Risks to Watch in 2021: the Usual Suspects Plus More “Shadow Wars”**

President-elect Biden will enter the White House facing the most challenging geopolitical backdrop in decades, even as US domestic politics remains deeply divided and dysfunctional.

Risks abound, but here are the ones I’m watching most closely in 2021:

Taiwan: As Taiwan’s future becomes an even larger focus in Beijing and Washington amid great-power competition, this remains the biggest geopolitical risk; expect continuing diplomatic pressure on Taipei from China, more diplomatic and military support from DC, and an elevated and sustained risk of military escalation.

The South and East China Seas: This is another key risk, as China continues its military expansion amid territorial disputes and the US works in closer military coordination with regional allies, particularly with Japan.

North Korea: Geopolitical tensions on the Korean Peninsula are likely to return in 2021, as Kim Jong Un attempts to shift global attention to stalled nuclear talks when the Biden administration takes office; intercontinental ballistic missile launches and new nuclear weapons testing could be dramatic ways to accomplish this goal.

US-Russia relations: Bilateral relations are likely to worsen under a Biden administration, with an increased US focus on shoring up NATO capabilities, particularly in Eastern Europe; President-elect Biden has also called for US government investigations into Russia’s “assault on US democracy” related to the 2016 elections; expect elevated tensions and higher sanctions risk.

“Shadow war” conflicts intensify: As great-power competition deepens, we should expect a more prominent role for national security strategies that fall just short of actual military conflict. These include offensive and defensive cyber operations, bolstered intelligence capabilities, additional covert measures to influence domestic opinion, and the growing use of economic tools, including sanctions, for geostrategic purposes.

5. **2021 Investment Implications: Differentiation and Adaptation**

From my geopolitical perspective, three trends will drive the macro and market backdrops in 2021 and beyond: COVID-19 recovery, deepening great-power competition, and climate change.

All three will likely divide the world into winners and losers, with an increasing degree of differentiation at country, policy, industry, and asset-class levels based on relative exposures to the macroeconomic impacts of the pandemic, a shifting world order, and the national security impacts of climate change.

Through my geopolitics lens, I believe “adaptation” is the best way to conceptualize the investment opportunities this presents in 2021 and beyond.

These ongoing structural transitions are likely to be a net positive for actively managed strategies, particularly those that marry bottom-up investment expertise with the right thematic trends around the world.

Through my geopolitics lens, I believe “adaptation” is the best way to conceptualize the investment opportunities this presents in 2021 and beyond.

Trillions of dollars of capital are likely to be reallocated in the coming years to help governments, businesses, and individuals adapt to a rapidly changing structural backdrop.

This theme will be particularly acute as COVID-19, combined with great-power competition, forces a recalibration of supply-chain vulnerabilities across newly “strategic” industries in healthcare, biotech, and especially national security.

All of this will likely be supportive of defense spending globally, but, in particular, I expect sustained demand and an increased policy focus for “dual-use” technologies now at the heart of shifting military doctrines—including semiconductors, next-generation communications, a variety of space technologies and applications, and especially artificial intelligence as applied to national security, given its potential to alter future economic and military balances of power.

The opportunity for climate adaptation may be even greater.

The best climate science indicates our planet will continue to warm for decades or longer. That fact is already creating demand for new technologies and products that will help humans adapt to this rapidly emerging environmental reality.

These include a variety of adaptations to help societies cope with higher temperatures, water scarcity issues including droughts, increased wildfires, severe storms and flooding, and other key climate-related variables, including looming social dislocations and new geopolitical frictions.

As the Biden administration moves climate to the center of the US policy agenda, and as other countries, including China, do the same, this emerging demand for climate adaptation is likely to grow in 2021 and be sustained for years to come.

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