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Conversations with Commerce Trust podcast
Slobalization | 11/01/2022

David Hagee: Hello and welcome to Conversations with Commerce Trust, our podcast where we share insights on economic and investment topics that matter to you. I'm your host, David Hagee, chief investment officer of Commerce Trust. Today, we're going to discuss the concept of slobalization, or how the world economy is reshaping the way we conduct business and trade with Scott Colbert, our chief economist and director of fixed income management here at Commerce Trust. Welcome to the podcast, Scott.

Scott Colbert: Hello, David. Nice to see you.

David: This has been a topic that I've been thinking about for quite some time, so happy to kick off our podcast series with slobalization, but maybe it'd be helpful to walk through the trend that preceded slobalization globalization. This is the process that we saw global trade increase fairly dramatically, up to about 30, up to a peak in 2008, about 39% of global GDP (gross domestic product) was trade. At that point, you saw an inflection point, but maybe we can talk a little bit about the trend of globalization that started things off. Where are your thoughts on where things started?

Scott: Well, of course global trade has been increasing ever since probably the first two cities started to trade with each other thousands of years ago. But technology clearly advanced it. One of the biggest changes in technology was the advent of the cargo container ship. The deeper ports, those, those little cargo container vessels that you see on the backs of rail cars really help speed up global trade. Collectively global trade as a percent of GDP in 1970 was about 25%, meaning the average country imported and exported about 12.5% of its goods and services.

By 1980, it was 34%. By 2000, it was 45%. And then, amazingly, it had jumped almost 60% prior to the subprime crisis. It's fallen now, though, post the subprime crisis for basically 15 consecutive years rather slowly and then a little bit with a with a, with a big bump down during the pandemic, and then most recently with the invasion of Russia into Ukraine. But now global trade represents only 52% of GDP, which means that the average country imports 26% of its goods and services and exports 26% of its goods and services.

David: And for me, as I think about globalization, certainly you saw the building blocks in place, but at the end of the Cold War, you saw an opportunity for countries to become more dynamic. You certainly saw in Asia: China begins to open up to capitalism throughout the 90s, the Asian Tigers emergence of Korea, Malaysia and Indonesia in that time period. And maybe the crowning moment of globalization was China's ascension into the World Trade Organization, in 2001.

What it meant for U.S. manufacturing on the other side was quite a quite a difference. So, 16% of U.S. GDP was manufacturing based in 1997, dipped down to 11.5% of U.S. GDP by 2009 was in manufacturing. That translated directly into jobs and what we saw is 17.5 million Americans employed in manufacturing in 1990, declining down to 11 million Americans employed manufacturing by 2008. So, a pretty strong drop, and maybe leading to some of the emergence of populism that we've seen today as people were left out in the cold from a jobs' perspective.

Scott: There's a massive peace dividend in aggregate and basically that's what you've referred to here and the opening of China. But of course, certain people benefited, and certain people did not benefit. I'm a product of Ohio and the Rust Belt, and I was 18 and 1979 when basically manufacturing peaked in this country, and we've watched that slow hollowing out.

David: We hit the global financial crisis of 2008/2009. That seems to represent a turning point from globalization to the Slobalization idea. So fundamentally, looking at this, I know we've talked about energy in the past about being part of that transition point. We've also talked about this idea of intellectual capital that has slowly leaked out of this country and is being recaptured. On energy, I mean what's been the driver there?

Scott: In dollar terms, and we've phrased this, this GDP or this slobalization or deglobalization in dollar terms, two things have driven some of it though that that largely go unnoticed. Number one was our ability to import less and less oil in general. Transportation fuel import, or oil from the Middle East essentially, accounted for half of our trade deficit. As we've become much more energy independent basically because we invented the fracking technology and of now one of the three top energy producers in the world with Russia and Saudi Arabia being the other two, we've had to import less dollars of oil. So that has that has helped reduce our trade deficit and it is reduced a little bit of the trade in energy in general.

And then secondly, the rise of the dollar. This has largely gone unnoticed. But, from pre subprime crisis when basically the dollar bottomed against international currencies till today over the last 15 years on a currency weighted basis, the dollar has appreciated about 35% and then probably more importantly with regards to what we're talking about today on a trade weighted basis with our trading partners, the dollar has increased 44%. Of course, energy trades in dollars, so those countries have had to pick up the brunt of that. But largely, the United States has benefited. It probably also has rolled into somewhat indirectly, or at least, when you when you talk about corporate earnings. The lower margins of international companies and emerging market companies in terms of dollars and the increasing margins of the United States technologically driven companies. And basically, created kind of a return differential that's accrued to the United States relative to the rest of the world.

David: The other piece to this is that as we saw world trade wars start to increase around 2016 and as people become more acutely aware of their trading position and you couple that with the pandemic, we've seen this emergence of regional trading blocks. And part of the regional trading blocs I believe are born out of the logistical issues we had in the pandemic. You know you had this big spaghetti bowl of logistics that just didn't unwind properly. And you saw the frailty or the fragility of our supply chains here, that all it takes is one supplier missing a part and you can't get the finished product out.

So, you know that's had some outcomes here as we talk about friends shoring, which I'm going to give you credit for, that's a term we've talked about where these regional trading blocs operate as a mini economy where you have low-cost providers, say Mexico and North America, that will handle a lot of assembly, a lot of manufacturing, and then you'll have, higher cost providers be more focused on service and whatever natural resources, so think Canada in in that perspective. Any other outcomes from the pandemic that you're thinking about in terms of slobalization?

Scott: Well, certainly the two key things that came about because of the pandemic, and then secondly, because of the Russian invasion of Ukraine, is the fragility, as you said of those supply lines, you can't just have a simple supply line. And I think most companies now recognizing that and what they need is a really a supply web. They need redundancies of those nodes that can basically get stalled.

Secondly, we don't talk much about it, but the big focus generally driven by the Japanese companies decades ago on just in time inventory and efficiencies on the lack of cushion. Sometimes I think it's almost every new car no longer has a real spare tire, right. At best they have a tiny little tire, right?

David: They got the donut, yes.

Scott: Some cars don't even have a spare tire at all to lower the price. And in essence, I think that's what basically the supply lines and the just in time you've recognized that you've cut out too much of a cushion and you need to build that back in. Unfortunately, that is temporarily inflationary as General Motors doesn't ask for just one manufacturer to make one screw, but now they need three manufacturers to make that part for them to add the redundancies. So the near-term impact of a lot of this is inflationary.

Hopefully, that part of it can become relatively transitory. But in the near term, it's kind of lowered the standard of living for almost everybody and raised the inflation rates.

David: Yeah, as that transitions to other investment thoughts around this idea of slobalization, we can talk a little bit about domestic markets versus emerging and international markets and certainly some impacts from a very high level there. And then also some industries that this could potentially impact around domestic versus international and maybe more specifically emerging markets. Where do these impacts look like?

Scott: If you combine the entire international market, it's only up about 3 1/2% versus 12 1/2% here. They've underperformed by 9% per year for a decade. And you might think that, boy with all this underperformance, wouldn't there be some great opportunities to invest internationally? But, being our chief investment officer, better than anybody, what do you see from an international perspective going forward that might be changing?

David: Yeah, what we've seen is that as you have the veil of globalization lift, there's a lack of catalysts inside the international markets that gives us some pause in going deeper into international markets at this moment. But at some point, to your point, you're going to see the valuation of international companies be so low that it's just a screaming buy. I'm not sure where they're at that at this point yet. And certainly, with U.S. interest rates significantly higher than the rest of the world, you're going to see dollar dominance continue, which just makes it harder for, say, a European tech company to compete with an American tech company in terms of pricing in the U.S. market.

Scott: The two key catalyst from my perspective that will help us focus on international investing and, perhaps, adding back to it are you mentioned the dollar and the interest rate differential clearly is helping drive the dollar. But we're starting to see now probably a likely slowdown in our interest rate hiking process while they continue to accelerate it over in Europe. Short term rates in Europe are still 1.5% where ours are going to be 4%.

And, then secondly, is likely to be some type of resolution – there won't be any winning the war in Ukraine – but at least a resolution that tends that conflict that would help Europe get back to a much more normalized basis. Those two key things for me are the catalyst to look overseas versus looking domestically near term.

David: Scott, thanks for the great discussion today. For more information about Slobalization, you can download our market perspectives at www.commercetrustcompany.com. Thank you for joining us on Conversations with Commerce Trust. I'm David Hagee, we'll talk again soon.

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November 1, 2022
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