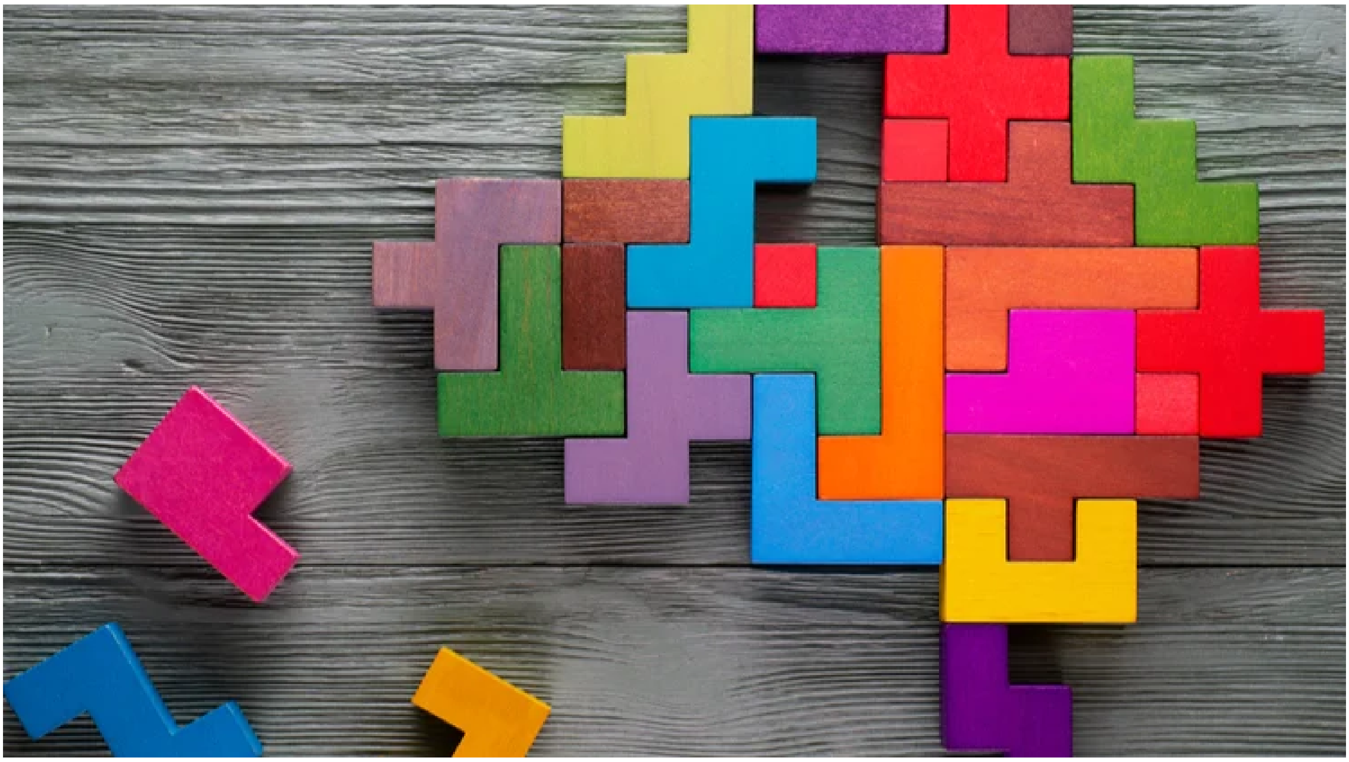
Perpetual Equity Investment Company Limited

Perpetual knowledge bank series: geopolitical risk

9 March 2022



Increasingly interconnected national economies have underpinned the global economy in recent decades, but free trade and financial order cannot be taken for granted. And while it can be debated whether the world is a less stable and more dangerous place than a generation ago, it is clear that the global economy is still very much downstream from global politics. For example, Europe’s reliance on Russia for 40 per cent of its energy is forcing a whole continent to confront big questions about its future energy supply after the invasion of Ukraine.

For investors, it is essential to understand the potential impact that geopolitical events can have on the business activities of companies they are invested in. Examples of geopolitical events that put companies at risk include governments that expropriate assets, nationalise property, impose stringent regulatory requirements or limit foreign direct investment. Unstable regimes or upcoming elections may also pose a risk as potential new governments may have unfavourable views towards certain foreign firms. In even more extreme cases, organised crime syndicates, terrorist organisations or rebel groups may threaten the supply chains, assets and personnel of foreign firms.

While geopolitical risk typically refers to issues that come with investing in foreign markets, these can influence market conditions in both industrialised and developing countries. Therefore, the ability to both understand and assess potential macroeconomic challenges before they become problems is an important part of any effective geopolitical risk assessment. And even if they still believe the opportunity is worth pursuing, investors need to ask themselves how much financial uncertainty and volatility – and over what duration – they are prepared to tolerate.