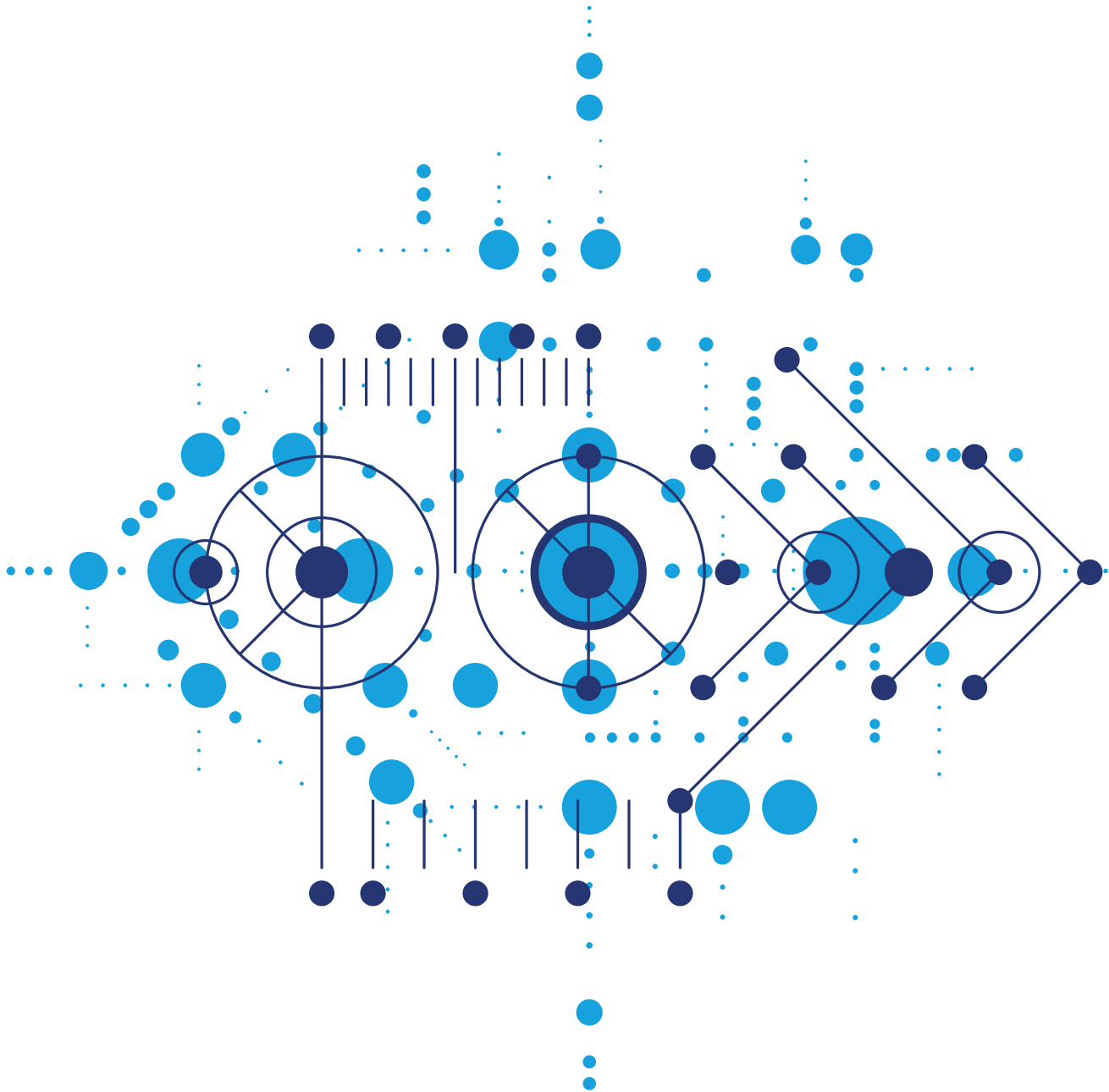


The rise of a bipolar world

Sovereign wealth fund views on the global macro outlook

July 2020



Introduction from the Chief Executive

Duncan Bonfield
Chief Executive, IFSWF



How sovereign wealth funds invest has been of interest to participants in both the listed and unlisted asset markets since they first rose to prominence in 2007. Although these funds are independent and financially motivated investors, their investment decisions are perceived to be small windows into how their government owners view the world. As a result, commentators have tracked sovereign wealth fund investments and extrapolated the wider significance of these decisions.

The COVID-19 pandemic has profoundly disrupted the lives of almost the entire global population by causing the most substantial economic downturn in living memory. For long-term investors, like sovereign wealth funds, the economic impact of the pandemic has forced them to reconsider major risks and their short-to-medium-term forecasts.

As part of our ongoing member programme, we at the International Forum of Sovereign Wealth Funds (IFSWF) are delighted to have worked with Invesco, one of the world's leading asset managers, to examine the outlook for the coming year and help members understand the impact of the COVID-19 pandemic on the global economy. As part of this work, we surveyed IFSWF members about their short-to-medium term macroeconomic views. For the first time ever, the survey results present a comprehensive view of how sovereign wealth funds are thinking about how the global macro environment will develop over the coming year. You can find more details about the survey in the appendix.

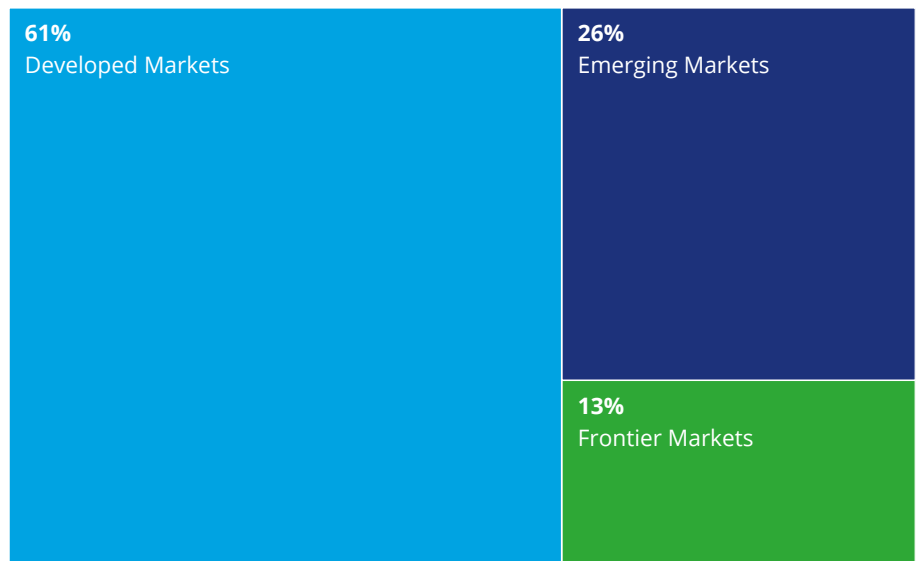
We believe that this research is an important milestone in providing market actors with a truly forward-looking and insightful picture of how sovereign wealth funds are thinking about the world.

We would like to thank Arnab Das, Global Market Strategist, EMEA and Rod Ringrow, Head of Official Institutions at Invesco for their insights and support in creating this project.

A bipolar world

For a decade now, geopolitical and economic analysts and scenario planners have placed the relationship between the United States and an increasingly powerful China at the centre of their analysis. Since the election of President Trump in 2016, this relationship has become increasingly strained and, overall, respondents to our survey expect this tension is going to intensify, against a backdrop of an increasingly bipolar global economy with China and the US dominating.

Which market do you think is best able to return to pre-COVID trend growth?



Over 60% of IFSWF members that responded to our survey believe that developed markets are best placed to recover from the COVID-19-induced recession – yet the same proportion see China as the best-placed major economy to recover. From this we infer an expectation that China may well recover not just more quickly but also more fully than other major economies. China suffered the pandemic and came through it earlier, to the point where stimulus may gain more traction faster than elsewhere, both as lockdown measures trend towards greater relaxation and confidence recovers.

It is true that China's budgetary and monetary policy support is so far smaller than in many other major economies, but the IFSWF membership would not be alone in thinking that private and state firms, local authorities, and consumers may be more responsive to stimulus than in other countries. After all, China seems to have managed the pandemic much more successfully than other major economies, judging by official infection and mortality numbers – both far lower than any other high population country – as well as rapid control of several smaller secondary outbreaks after the initial containment via the lockdowns.

China continues to rise

Pointing to continuing confidence that China's influence in the global economy will keep rising, about a third of respondents expect the renminbi to increase its share of global official foreign exchange reserves, as well as its share in trade invoicing going forward.

Largely, it appears that the respondents expect this trend to arise from China's increasing influence over Asia and other emerging markets. Over two thirds of respondents (67% and 71% respectively) believed that these two groups of countries will align with China, supported by the belief of 86% of respondents that China will continue to open its economy, enabling freer trade and investment opportunities with the rising superpower.

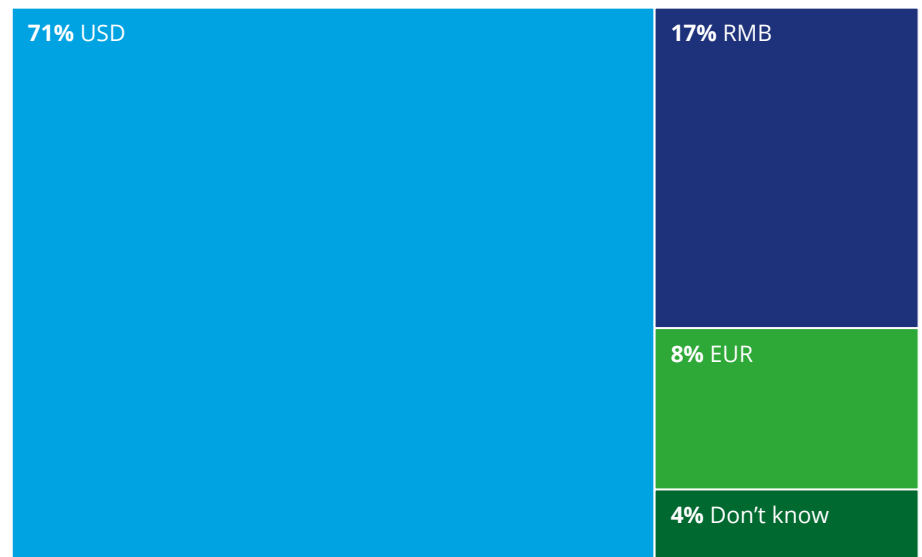
Perceptions that China's global economic influence will increase are also bolstered by a consensus that Asia will do next best in the global growth stakes after China and developed economies as a group: India is seen as the large emerging economy most likely to return to pre-COVID trend growth (57%), followed by Indonesia. Brazil and Russia were not considered by respondents to be able to keep up, suggesting that the respondents expect Asia to drive the global economic recovery following the coronavirus pandemic.

Consistent with these differentiated macro views, a super-majority of participants expect selective outperformance across emerging markets (78%), with relatively small minorities expecting emerging markets collectively to fall behind (13%) or power ahead of developed markets (9%).

America first in financial markets

Although China is seen as the major economy best placed to return to pre-COVID-19 trend growth by a factor of two vs. the US, respondents retain confidence in the US economy and markets, overwhelmingly voting US-dollar bonds and equities to be the most attractive: 71% believe that US-dollar-denominated equity would be the most attractive going forward and 58% that US-dollar-denominated bonds would be the most attractive currency for debt securities.

Which currency of denomination will offer the most attractive investment destination for equity?



Overall, the respondents also believe that the US will also strengthen its influence with the United Kingdom, with 83% saying that the UK will become more aligned with the US in the coming year. Indeed, it seems that this expectation is already being borne out by the UK's latest shift of gears in its relationship with China, through its decision on Huawei.

However, respondents were much less clear about the future of the European Union, which they appear to believe will get caught in the middle of the bipolar tussle: They were split on whether the EU will align with the US or hedge its relationship between the US and China.

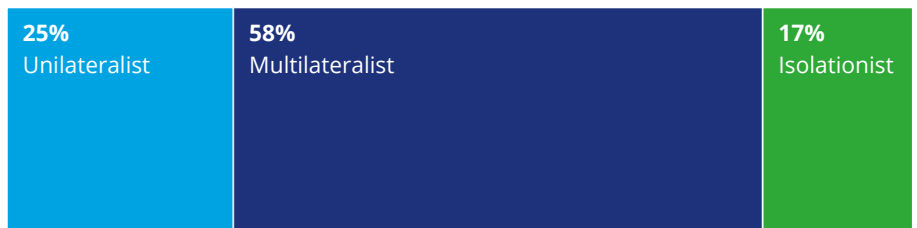
However, in line with their confidence in the capacity of developed markets to recover from the recession, respondents were broadly confident in the EU economy. Only 4% thought the NextGenerationEU package would not ensure the survival of the euro – however, 52% thought that it would guarantee euro survival for the COVID-19 crisis only, with the remainder expecting continued euro survival. Equally, respondents believe that a post-Brexit UK will continue to have a good relationship with the EU (only 22% of respondents believed there would be a hard, no-deal Brexit), suggesting economic integration is expected to continue within Western Europe, despite the challenges of both Brexit and COVID-19.

An 80-trillion-dollar question?

While the respondents were clear that the global economy will become increasingly polarised between the US and China, they believe that the result of (arguably) the most important political event of 2020 – the November US presidential election – will shape the bipolar economy. Respondents were closely divided between who they thought would win – suggesting that they see the direction of US politics and policy as perhaps the most important source of uncertainty in the world.

Will the US be more isolationist, unilateralist or multilateralist in geopolitics and geoeconomics? Who will win the US election?

Biden



Trump

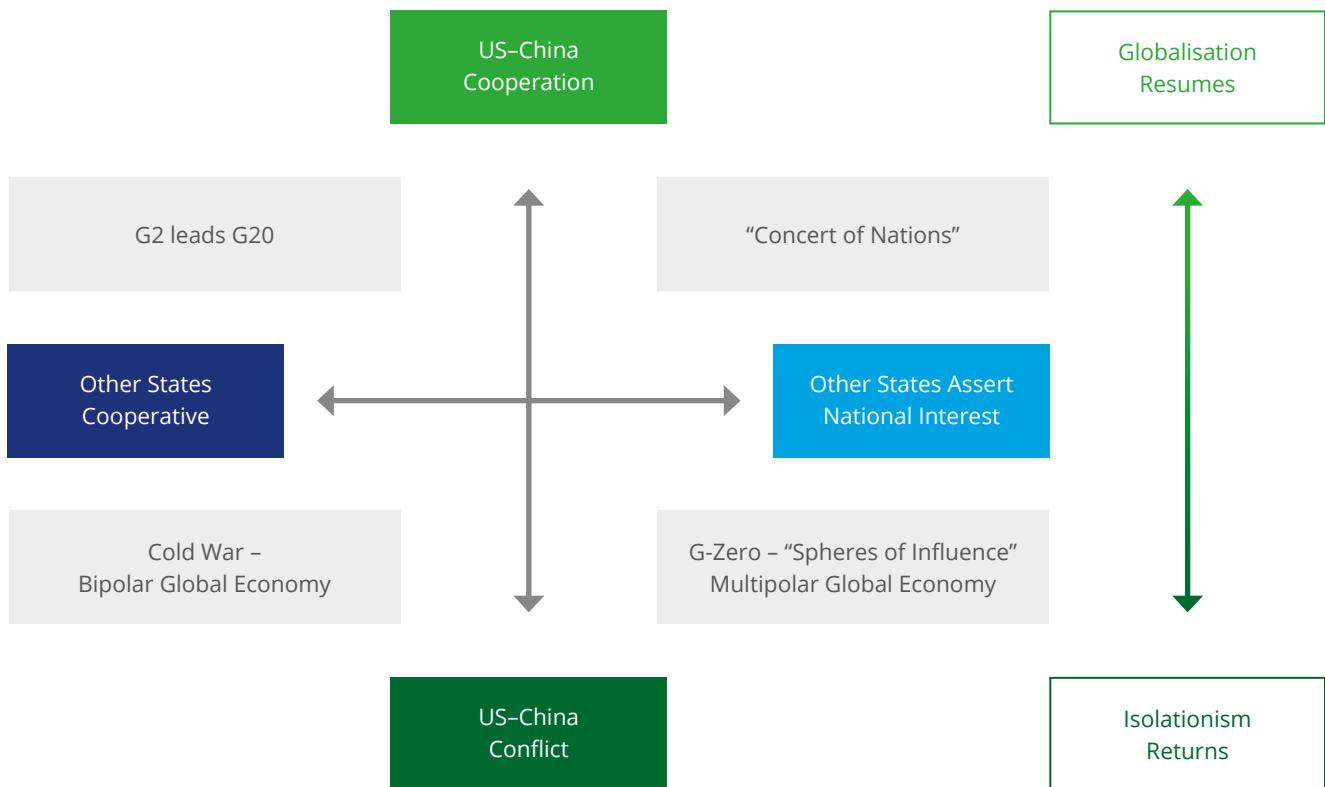


Of the 50% of respondents that believed Joe Biden would win the election, 58% thought that this outcome would see the US returning to a more multilateralist stance. That said, these respondents were evenly split on whether the US would become more inward-looking or not – suggesting that some sovereign wealth funds believe that a President Biden would need to focus on US domestic challenges in the wake of the Trump Presidency and the damage caused by the pandemic.

Of the 42% who expect President Trump to win a second term, 90% believed the US would become more unilateralist or isolationist, and more inward looking, suggesting that though the economy might recover in a second Trump term, it could be harder for sovereign wealth funds to invest there.

Consequently, for sovereign wealth funds, a Trump second term is seen as more likely to push the world towards an economic “cold war” if other countries tend to cooperate with the US or China; or perhaps a more multipolar international system, in which activity, trade and investment are more centred around spheres of influence.

After COVID-19: New Cooperation or Conflicts in the International System?



Source: Invesco. Adaptation from Ian Bremmer, *Every Nation for Itself: Winners and Losers in a G-Zero World* (2012)

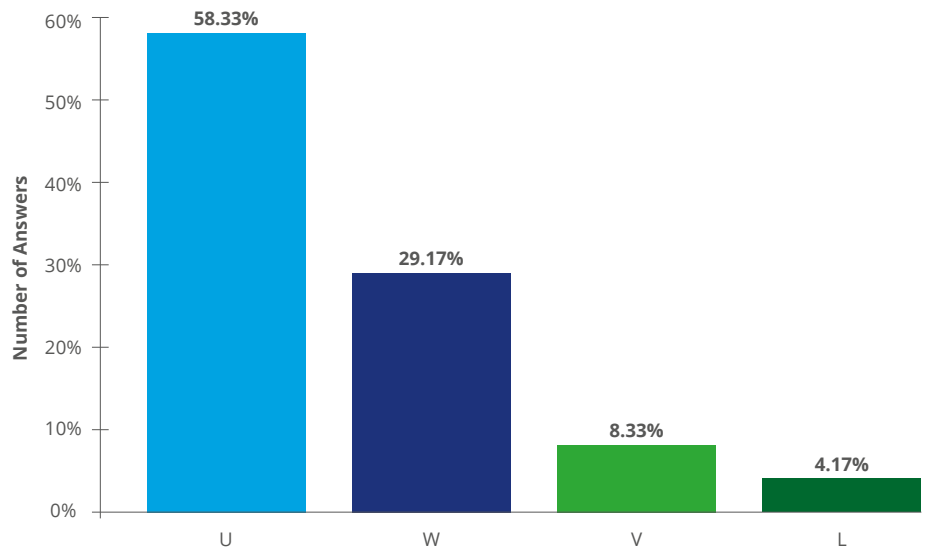
In contrast, a Biden presidency might result in a more cooperative international system, perhaps into a “G2 leads the G20”-type scenario, if US-China tensions are calmed and other major economies are cooperative; or one that resembles more of a Concert of Nations, in which other economies are more assertive of national interests but choose to cooperate on specific issues.

Mounting Headwinds

As IFSWF outlined in *Investing for Resilience*, the 2019 annual review, the investment environment was becoming increasingly challenging even before the COVID-19 pandemic. Geopolitical tensions and the rise of populist nationalism across the world was threatening to raise trade barriers, slowing economic growth, less liquid stock markets and a surfeit of dry powder in the private equity industry all contributed to investors struggling to find pockets of growth.¹

The sovereign wealth funds that answered our survey appeared to believe that the emergence of a bipolar world will continue to pose profound challenges, with over 80% of respondents believing that, in line with the pre-pandemic trend, trade barriers will increase in the short and medium term, potentially restricting their ability to invest overseas.

What type/shape of GDP path do you expect over 2020-22?



These headwinds – alongside the continued COVID-19 pandemic – led 58% of respondents to expect a U-shaped recovery in the global economy. However, their vision of a U shape appears to be rather lop-sided, with a consensus that after a steep drop in global growth, there will be a longer period of slower growth. We expect this prediction to reflect the respondents' uncertainty of the unusual nature of the recession and the factors that could shape the recovery. These might include a second (or third) wave in infections and hospitalisations, the longer-term efficacy of the huge government support packages unveiled around the world to prevent bankruptcies and mass unemployment. Even consumers' (un)willingness to return to the services and hospitality sectors, particularly important in developed economies, but also increasingly in emerging markets. All of these could make the bounce back from this recession slower and less smooth than for previous recessions.

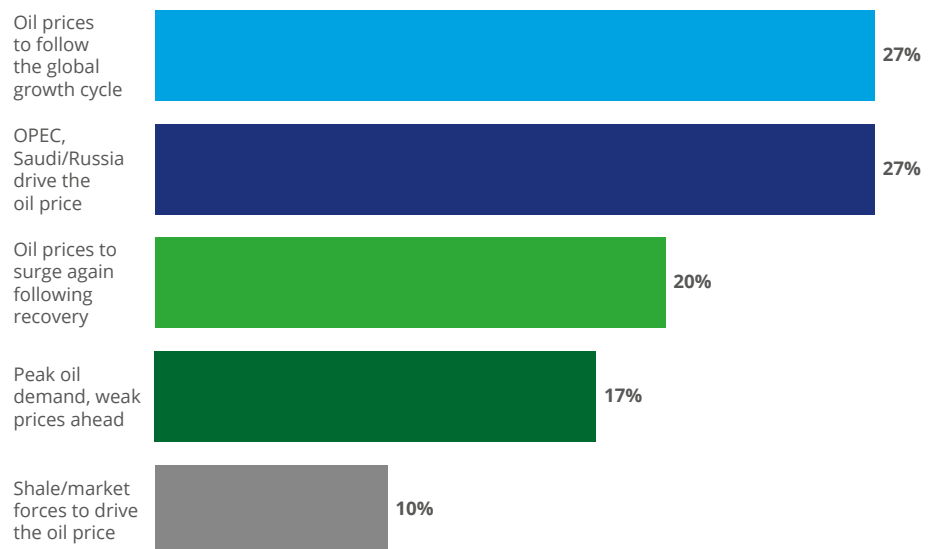
¹ International Forum of Sovereign Wealth Funds, "[Mounting Headwinds](#)", *Investing for Resilience*, June 2020

Oil: A (not-so) green, (not-so) global recovery?

Our survey was not designed to examine sovereign wealth funds' views on long-term trends, such as climate change, but some of the findings did provide some indications on this trend.

The argument for using the unique opportunity of the post-pandemic recovery to decarbonise the world economy and make it more sustainable – to “build back better” – seems to be gaining momentum. However, sovereign wealth funds seem to be less sure that this drive will have a material impact on the demand for oil – perhaps due to the fact that they believe that the global economy will be led by the world's two largest carbon emitters.

The future of oil, in the medium term, do you predict:



Many respondents do not seem to expect oil prices to be held down by declining demand arising from an acceleration of the low-carbon energy transition. Most said that they expected oil prices to increase in line with economic recovery. That said, they do expect OPEC+, including Saudi Arabia and Russia, to regain influence over the oil market and oil price, leading to some stabilisation.

As over 60% of respondents believe that China was the best-placed major economy to recover from the crisis, the implication seems to be that they believe that oil demand in the future will be driven by China. A suggestion supported by the fact that almost half of respondents believe that the renminbi will increase its share of oil transactions.

A bumpy road ahead

The results of our survey of sovereign wealth funds' global macro outlook may appear to be broadly pessimistic. But it is important to factor in two considerations when assessing these results. The first is recency bias, which leads people to extrapolate current and recent historical events in their vision of the future. Given already major economic and geopolitical challenges that seem to have been magnified by the pandemic, it would be surprising if our respondents had not expressed important concerns.

The second consideration is that this survey was designed to gauge sovereign wealth funds' short-to-medium-term views and did not examine their attitudes on the effects of long-term mega-trends on the global macro environment. Sovereign wealth funds may, indeed, view the opportunities afforded by the need to tackle climate change and the energy transition, the recent acceleration of digitally driven business models exacerbated by the coronavirus crisis, shifting demographics and the impact of the resulting evolution in social values on business as having a positive influence on the future shape of the global economy.

Regardless, however, sovereign wealth funds do see a few bumpy quarters ahead, and we would expect to see a continuation of the investment trends pointed to in the IFSWF 2019 annual review – lower direct investment activity, increasing allocations to defensive sectors, and continued investment at home. However, considering the outlook provided by sovereign wealth funds, we may also see increased investment into Asian markets and into the US.

Appendix: The Survey

The International Forum of Sovereign Wealth Funds works with several partners to provide an ongoing programme of high-quality, relevant content for members. As part of our drive to ensure that content is as relevant as possible, we decided to gauge members' views on the current global-macro environment to help inform an Invesco online presentation on 29 June.

The survey was written by the Invesco team and sent out digitally to all 38 IFSWF member institutions on 17 June 2020, requesting completion by 25 June. The survey was answered anonymously by 24 members (63% of the total membership). We, therefore, believe the results to be a representative view of the IFSWF membership, and even of all sovereign wealth funds, as it represents a third of all sovereign wealth funds globally.²

² For a full list of sovereign wealth funds, please visit About [Our Data](#)

Contributors

About the International Forum of Sovereign Wealth Funds (IFSWF)

The International Forum of Sovereign Wealth Funds (IFSWF) is a global network of sovereign wealth funds (SWFs) established in 2009 to enhance collaboration, promote a deeper understanding of SWF activity, and raise the industry standard for best practice and governance. For more information, visit ifswf.org

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