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Briefing

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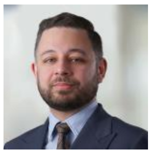
Elections everywhere, all at once: Geopolitics and risk

Author:



Zuhaib Butt

Head of Investment Risk Strategy and Management

London

Roughly 60% of the world's population lives in countries facing major elections in 2024, markets representing 65% of the institutional investable real estate universe.[1] Elections are, of course, the cornerstone of the democratic process, which in turn underpins the appeal of the most transparent, investable markets; that said, elections come with the possibility of policy changes that may impact returns. Today's geopolitical risks, whether they be this continuing election super-cycle (see *LaSalle Macro Quarterly*, or LMQ, page 4), or the various ongoing conflicts and trade disruptions, prompt important questions about how to manage investment risks related to these themes.

One of the protagonists in the Oscar-winning film *Everything Everywhere All at Once* says that being "'right' is a small box invented by people who are afraid." LaSalle's risk management philosophy emphasizes optimising risk/return trade-offs rather than minimizing risk-taking, while recognizing the limitations of point-estimate predictions and base-case scenarios — that is, attempts at "being right." Today's geopolitical events are especially likely to confound any forecaster seeking to be exactly right.

How should an investor manage their assets in the context of "unknowables" about which engaging in guesswork is tempting, but being "right" is elusive? What frameworks do we have to mitigate geopolitical risks? We propose six recommendations to keep in mind for investors taking stock of the many elections, and several conflicts, that may impact markets in 2024.

1 **Be mindful of the tendency toward overreaction.** There are many examples of *ex ante* predictions of elections' investment implications having been overstated. For instance, leading up to the 2016 US presidential election, there were widespread predictions that the US economy would be significantly negatively impacted by Donald Trump's anti-immigration and protectionist stance were he elected.[2] In the event, equity markets rebounded strongly after a short-lived hit and the US economy proved resilient to the changes in rhetoric and policy that came with a new president.[3]

[1] LaSalle analysis of data from *Time* and our proprietary investable universe estimates. See LMQ page 5 for more detail.

[2] Sources: "What do financial markets think of the 2016 election?" Brookings Institution paper, Wolfers and Zitzewitz, 2016. The article predicted that "a Trump victory would trigger an 8-10% sell-off". See also "The Consequences of a Trump Shock," a Project Syndicate article by Simon Johnson, 2016. He predicted Trump's election would "likely cause the stock market to crash and plunge the world into recession."

[3] On the news of the 2016 election result, Standard & Poor's 500-stock index initially fell 5% but ended the day up more than 1%, according to Refinitiv. The US avoided a recession until the emergence of the COVID-19 pandemic, according to Oxford Economics.

Looking ahead to the US elections later this year, almost certainly a rematch between Biden and Trump, coverage of the candidates' differences should be accompanied by awareness of their similarities. Both candidates seek to prioritize domestic production, which could lead to greater levels of on- or near-shoring of supply chains.[4] Moreover, election prediction odds (see LMQ page 6) suggest divided control of the two houses of Congress and the presidency is likely; divided government has typically been associated with relative stability in domestic policy, which is generally positive for markets.[5] Both of these factors — at least in isolation — point to the potential for news cycle hype to overstate long-term market impacts of this particular election.

2 **Consider an asset's "geopolitical beta."** Financial theory tells us that systematic risks are undiversifiable.[6] Systematic factors are those with significant, far-reaching implications that affect the price of all assets. But financial theory also entertains that different assets may have different sensitivities to the same set of factors; an asset's "beta" signifies the responsiveness of its price to a given factor. This is a useful way to think about an investment's sensitivity to political and geopolitical events. For example, a property in a metro area whose economy is heavily driven by government spending would likely have a high sensitivity to political changes. Another example could be that a property located in the Baltic States, ex-Soviet countries on the border with Russia, is likely to be especially sensitive to developments concerning relations between Russia and the West. Investors should be mindful of assets' expected sensitivities to geopolitics, whether assessed empirically or, as is more often the case given a lack of data, estimated through intuition.

3 **Avoid excessive focus on catastrophic risks.** Systemic risks go beyond systematic factors; they involve severe shocks that have the potential to re-align entire markets in unpredictable ways. An example of such an extreme event is the remote but non-negligible potential that today's so-called "proxy wars"[7] escalate into a broader active conflict between great powers[8]. The challenge of incorporating such eventualities into investment decision making is not only estimating appropriate probabilities that such events may occur, but establishing ideal strategic responses should they do so. Catastrophic shocks are exceedingly rare and have the potential to create winners and losers in asset markets that are difficult or impossible to predict.[9] It may be more fruitful for investors to focus on more

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[4] Source: "Biden vs Trump: Key policy implications of either presidency," Economist Intelligence Unit, 2023.
[5] Sources: "What to Expect From Divided Government." PIMCO article, Cantrill, 2022. According to the article, "the equity markets historically have tended to do well in years of split government."
[6] Source: The Handbook of Risk Management: Implementing a Post-Crisis Corporate Culture. P. Carrel, 2012. "Systematic or market risk refers to the inherent danger present throughout the entire market that cannot be mitigated by diversifying your portfolio. Broad market risks include recessions, periods of economic weakness, wars, rising or stagnating interest rates, fluctuations in currencies or commodity prices, and other "big-picture" issues like climate change. Systematic risk is embedded in the market's overall performance and cannot be eliminated simply by diversifying assets."
[7] According to the Oxford Dictionary, "proxy wars are the replacement for states and non-state actors seeking to further their own strategic goals yet at the same time avoid engaging in direct, costly, warfare." Various observers have argued that the Russia-Ukraine and Israel-Gaza conflicts are proxy wars. For example, see "IKs the ware in Ukraine a proxy conflict?" Kings College London report, Hugues (2022).
[8] According to a research brief by RAND: "Great power wars — conflicts that involve two or more of the most powerful states in the international system. These have historically been among the most consequential international events."
[9] Source: "What a third world war would mean for investors," *The Economist*, 2023. The article highlights the virtual impossibility of positioning an investment portfolio to outperform through prior world wars, even if the investor had correctly predicted that these conflicts would occur.

incremental—and more likely—eventualities that have the added benefit of being easier to model.

4 **Do not neglect local political risks.** Media coverage naturally tends to focus on the national and trans-national arenas, but local political developments can be especially impactful for real estate investments. Such issues can fly under the radar, especially given many of the most relevant ones are only of interest to a specialist audience. For example, changes in policy around topics like the planning process, property taxes and transfer taxes (a.k.a. stamp duty) can have direct, measurable and immediate impacts on property cash flows and thus values. The distraction of the bright shiny lights of global geopolitics should not be allowed to excessively overshadow the critical local issues that impact real estate.

5 **Practice diversification but engage in "pattern recognition."** To a certain extent, political risks can be managed through diversification. This is especially true when they involve isolated events that impact one country or subnational division such as a specific city, province or state. But often political events are part of a broader arc with potentially far-reaching consequences. A smattering of small seeds can grow from obscurity into a thicket. Nothing illustrates this better than the rise of populism, nationalism and protectionism around the world, themes set to dominate elections this year and beyond. The very notion of "globalized nationalism" may sound like an oxymoron, but it has become a fact.[10] While diversification is an essential portfolio construction concept that helps manage many types of risk, including political risk, care must be taken to recognize when what may appear to be "specific" risks are part of a broader pattern that is difficult to "diversify away."

6 **Conduct "what if" exercises around potential impacts.** Geopolitical and political risks are difficult to incorporate into traditional financial analysis. We find that thinking through scenarios can be helpful in identifying investment themes that may emerge from geopolitical trends. These can point to strategies to avoid — as well as potential new ones to pursue. The "Looking Ahead" section of this note expands on some of the key themes we have been tracking.

As geopolitical events are difficult to control and plan for, one may conclude, similarly to that same protagonist in the *Everything Everywhere* film, that "nothing matters." But uncertainty is no excuse for ignoring geopolitical risks. We do stop short of directly feeding geopolitical themes into our formal risk management program, where the focus is on the specific risks that can actively be managed for our clients.[11] However, it remains important to observe and understand macro conditions from a holistic perspective. The work done in our regional research teams — particularly that focused on capital markets,

[10] For further discussion of the global spread of nationalism, see "How cynical leaders are whipping up nationalism to win and abuse power", *The Economist*, 2023; "Demonizing nationalist parties has not stemmed their rise in Europe," *The Economist*, 2022; "The new nationalism," *The Economist*, 2016.
[11] We do, however, utilize tools that correlate to geopolitical risk. For example, the JLL Global Real Estate Transparency Index (GRETI) supports our monitoring of evolving investment conditions around the globe. Whilst the model does not explicitly consider political risk, the two are inexplicably linked through the inclusion of a number of governance and regulation data points.

the signals that foreshadow potential inflection points and the local political themes that impact real estate — is critical to this effort.

LOOKING AHEAD

We have argued that political and geopolitical risks are difficult to incorporate into investment processes, but that considering "what ifs" can be useful in uncovering relevant investment themes. Below are three potential real estate implications of the current geopolitical backdrop that we are monitoring today:

- Policy uncertainty widens the corridor of possible market outcomes, and has been empirically shown to translate into greater volatility in financial markets and decreased investment decision-making in the real economy.[12] There are likely impacts on both broader investment at the macroeconomic level, as well as real estate transactions activity specifically. We continually monitor key indicators of policy uncertainty (see LMQ page 7).

- Geopolitical factors should be assessed for their potential impact on inflation and monetary policy. To the extent these interrupt cooling inflation trends and thereby slow the rate at which interest rates moderate, there could be an impact on the trajectory of the real estate recovery. For example, continued attacks on the critical Red Sea shipping route (LMQ Page 10) have caused a five-fold increase in the cost of shipping goods from Asia to Europe. Estimates suggest the impact of this is likely small, temporarily adding just 0.3% back to global core inflation in the first half of 2024,[13] but it does serve as a reminder of the volatility that geopolitics can trigger.

- On a longer timescale, geopolitical fracturing could lead to increased levels of on- and near-shoring and could thus lead to the duplication of supply chains.[14] This is less efficient than a fully globalized world where countries' exports are specialized according to comparative advantage, and is therefore likely to correspond to higher long-term inflation.[15] That said, analysis by LaSalle suggests that the localization of supply chains could be beneficial for real estate demand, particularly in the logistics sector and in politically aligned, lower cost markets adjacent to major ones, such as along the Mexico-US border.

[12] Source: "A global economic policy uncertainty index from principal component analysis," *Finance Research Letters*, Peng-Fei Dai, 2019.
[13] Source: "What are the impacts of the Red Sea shipping crisis," J.P. Morgan, 2024.
[14] Source: "The Great Rewiring: How Global Supply Chains Are Reacting to Today's Geopolitics," Center for Strategic & International Studies, 2022.
[15] Sources: "The business costs of supply chain disruption," Economist Intelligence Unit, 2021 and "Why Deglobalization Makes US Inflation Worse," Project Syndicate, Moyo, 2022.