

# The era of globalization has ended - and even bottom-up investors need to worry about what comes next



**GEORGE ATHANASSAKOS** >  
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Traders work on the floor of the New York Stock Exchange during morning trading in New York City, on March 25.

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Over the last 30-plus years, the world experienced a bull market in stocks, bonds and real estate owing to the advent of globalization and the ensuing low inflation and low real interest rates. Globalization shrank the world. Free trade in products and services; unencumbered movement of people, ideas and capital; open capital

markets; production and technological innovations; public support for global trade; and adherence to international law all reached record levels, and the world economy and stock markets thrived.

But wars tend to lead to an end of, or challenges for, globalization. We're in such a period now.

The wave of globalization in the 19th century ended by the time the First World War broke out in 1914. Protectionism and instability followed the war. After the Second World War, there were efforts to improve economic co-operation with the creation of institutions such as the International Monetary Fund and the World Bank. But the absence of the Soviet Union and China from those organizations made globalization and economic co-operation difficult.

The fall of the Berlin Wall, the breakup of the Soviet Union from 1989 to 1991 and the end of the Cold War then ushered in the new era of globalization. The admission of China to the World Trade Organization in 2001 completed globalization in recent times.

But, in my opinion, the secular trend toward globalization has now ended. Notice the similarities with previous end-of-era periods for globalization and renewed geopolitical conflict: a global pandemic that was likened to a war, Russia's war with Ukraine and conflict in the Middle East, challenges to the world order by large players such as Russia and China, and rising protectionism, economic instability and secular inflation.

All of these will now intensify the trend toward deglobalization. As if this were not bad enough, the election of a new president in the United States has added another nail to the coffin of globalization.

As deglobalization has slowed down large economies, the last thing the world needed at this point was a tariff war. The tariffs imposed by Donald Trump and reciprocation by affected countries will bring us back to the future. One reason the Great Depression of 1920s and 1930s went out of control is because of what the economics literature refers to as "beggar thy neighbour" policies and competitive

currency devaluations by countries around the world. Such policies worsened economic declines.

A beggar thy neighbour economic policy benefits the country that implements it while harming that country's neighbours (such as Canada) and trading partners. It takes the form of a tariff on imports and/or a devaluation of the domestic currency, which makes domestic goods cheaper for foreigners to buy, thus increasing the exports of domestic goods abroad.

Legendary Scottish economist Adam Smith believed that free trade would produce long-term gains that would outweigh the short-term benefits possibly derived from the protectionist policies. Economists thereafter confirmed that adopting protectionist policies would likely trigger trade wars. Countries would repeatedly retaliate against each other by raising tariffs on each other's products. Trade wars and reciprocations limit trade and are normally harmful to economic growth.

Value investors are agnostic about the macroeconomic picture. They argue that it is far more rewarding to focus on valuation and bottom-up analysis rather than the big picture. For example, Warren Buffett has repeatedly mocked investors who try to forecast the stock market by forecasting the economy.

Value investors address firm-specific risk by applying the margin of safety. However, if the stock market as a whole is overvalued, then even statistically cheap stocks will also fall. In a severely overvalued market, a value investor working for himself or herself may lose clients when the market corrects. But a value investor who works for a mutual fund company and competes against other portfolio managers may not only lose assets under management, but also his or her job.

For this reason, risks at the macro level must also be addressed within the value investing approach and, when appropriate, hedged. What will hurt investors is not just things that they know they do not know, but things that they do not know they do not know. High-impact macro events such as 9/11, the 2007-08 credit crisis, COVID-19 and so on that result in economic deterioration fall in this category.

Such risks can be minimized using put options on market indexes, something that Nassim Nicholas Taleb, author of *The Black Swan*, advocates for because it can

provide immensely asymmetrical returns in bear markets. (A put option is a contract between two parties that can be bought and sold through brokers and is essentially like buying an insurance policy against possible adverse outcomes.) Prem Watsa, the iconic founder of Fairfax Financial Holdings, also seems to advocate such an approach and used it with great success during the Great Recession of 2008-09.

These days, with the well-known geopolitical risks and beggar thy neighbour policies, I worry about the market. And I believe that investors, even though they should invest bottom up, should also worry top down.

*George Athanassakos is a professor of finance and holds the Ben Graham Chair in Value Investing at the Ivey Business School at Western University. He is the author of the recent book, Value Investing: From Theory to Practice.*

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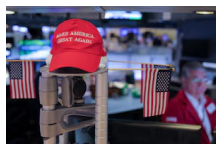
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