FCLTGLOBAL
FOCUSING CAPITAL ON THE LONG TERM

REPORT

Storm Clouds & Silver Linings:

LONG-TERM INVESTING IN AN AGE OF GEOPOLITICAL UNCERTAINTY

Focusing capital on the long term to support a sustainable and prosperous economy.

Millions of people around the world are saving money to meet personal goals—funding a comfortable retirement, saving for someone's education, or buying a home, to name a few.

The funds to support these goals are safeguarded by institutional investors—pension funds, sovereign wealth funds, insurers, and asset managers—who invest in companies for the prospect of growth and security. These savers, their communities, and the institutions that support them make up the global investment value chain, and each benefit from long-term decisions in different ways.

Data shows that long-term-oriented investors deliver superior performance, and long-term-oriented companies outperform in terms of revenue, earnings, and job creation. But despite overwhelming evidence of the superiority of long-term investments, short-term pressures are hard to avoid. A majority of corporate executives agree that longer time horizons for business decisions would improve performance, and yet half say they would delay value-creating projects if it would mean missing quarterly earnings targets.

Today, the balance remains skewed toward short-term financial targets at the expense of long-term value creation.

FCLTGlobal's mission is to focus capital on the long term to support a sustainable and prosperous economy. We are a non-profit organization whose members are leading companies and investors worldwide that develops actionable research and tools to drive longterm value creation for savers and communities.

MEMBERS

AIA, AIMCo, AON, apg, Baillie Gifford, BainCapital, Bank of America, Barclays, BlackRock

Blackstone, Bloomberg, bp, Bridgewater, Brookfield, Brunswick, Bunge, CalSTRS, Carlyle

CDPQ, Cisco, CPP Investments, Dow, Edelman, EQT, euroclear, Evercore

EY, Federated Hermes, Fidelity Investments, futurefund, GIC, Goldman Sachs, Hillhouse, Hines

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EXECUTIVE SUMMARY

The world has never been more connected than it is today – communications, technologies, years of expansive trade, and supportive institutions have expanded the boundaries of commerce. Investment portfolios have evolved to mirror this interconnectedness. With fewer barriers to the flow of capital, investors diversified portfolios in search of growth and expanded their operations to source investment opportunities in fast growing markets.

We are now at a moment when global rivalry is running hot and support for globalization is cooling. The resulting opportunity set for investors is shrinking as global security and economic alliances rewire. This rewiring of globalization requires specific attention to strategy, governance, and integrated processes to bring geopolitical views into investment decision making. Doing this effectively requires deep integration between geopolitical and traditional investment analysis.

By focusing on the long term, investors improve their ability to withstand geopolitical shocks and disruptions. At first, it's the jolt of adjusting to a new reality: the ripple effects of war, terrorist attacks, abrupt policy changes. But with the right amount of preparedness, investors can learn to be proactive instead of reactive in a new era of geopolitical risk and uncertainty. National interest may come as an unwelcome addition to investment mandates, but it's becoming increasingly difficult to avoid using a national security lens when making investment decisions.

Executives and investment committees can take several steps to improve their organization's and portfolio's resilience to geopolitical risks:

Govern: We propose the Top Ten Questions for committees to refer to, organized by portfolio, reputational, and organizational risks. A Review Guide for Investors delves further into these three critical areas to help identify risks and opportunities.

Take concrete action: We propose actions that executives and committees can take now to realize opportunity and improve resilience. These include practices for filtering signal from noise, right-sizing exposures, engaging with governments, and strategic foresight.

Engage with portfolio companies: Re-underwrite the investment thesis for investing in a company, given geopolitical headwinds. What are the company's competitive advantages, and how are they dependent on a global footprint? Long-term outcomes may not be clear, but a company's long-term objectives should be.

Geopolitical storm clouds

"A change in the weather is sufficient to recreate the world and ourselves."[1]

Marcel Proust penned these words in 1920, during a time of rapid change and modernization. Besides its more philosophical meaning, the quote is a reminder of the ever-changing nature of our external environment, and how these changes can profoundly affect the world as we know it. It's also a reminder that there are forces beyond our control, and that we must focus on what we can change in order to adapt and continue to thrive.

In the current landscape of pivotal geopolitical transitions, executives and board members of sovereign wealth funds, pension funds, insurance companies, and asset managers face a challenging question: how to manage risks and take advantage of opportunities in a clouded geopolitical future.

A recent McKinsey Global Survey found that geopolitics continue to overshadow all other risks to global growth, with executives citing geopolitical instability and conflicts more often than they have in the past.[2] An EY survey of 1200 global CEOs found that 99 percent said geopolitics are affecting their decision making; 40 percent said geopolitics are delaying planned investments, and 37 percent said geopolitics are forcing them to stop planned investments.[3] Based on recent convenings of FCLTGlobal member CEOs and geopolitical experts[a], geopolitical risks and uncertainties are a top concern for investors and the CEOs of their portfolio companies.

Competing economic and security blocs are emerging, fraying trade relations, fueling political divides, and threatening economic stability. Business-as-usual no longer seems the default scenario. In our discussions with members, we've learned that CEOs assess geopolitics mostly in terms of risks – commercial, reputational, and organizational – and the trajectory of those risks. In order to continue to thrive, companies and investors must consider the nature and size of risks, relevant time horizons, as well as opportunities arising from disruption. Risk management, strategic foresight, governance, decision-making frameworks, and stakeholder engagement are all tools to develop in order to strengthen an organization's resilience and response to geopolitical disruption.

This report provides practical solutions for executives, board, and committee members of investors to navigate geopolitical uncertainties. Toolkits are presented in the last section and are followed by tear-out versions at the end of this report.

The nature of geopolitical risks and opportunities is changing

Geopolitical events historically have had a transitory impact on markets and economies, yet today we see geopolitics as a persistent market driver, with direct and long-lasting effects.[b] Investors had become trained to expect that crises were short lived and mean reverting. As one member CEO put it, "Geopolitical events were previously buying opportunities for investors. They always created good opportunities. That has changed."

The history of previous geopolitical events certainly supports this notion, especially for long-term investors with the patience to ride out volatility. A recent analysis from BlackRock finds that of the 68 risk events since 1962, the average market response to unexpected geopolitical shocks has historically been relatively modest and short lived. The S&P 500 Index fell almost 12 percent in the first week of trading after the 9/11 attacks of 2001. Yet the stock market recovered those losses by 25 business days after the event.[4]

Historically, the most impactful market events tended to be macroeconomic in nature rather than geopolitical, such as significant economic imbalances, banking or debt crises, often leading to sovereign defaults, corporate defaults, or currency devaluations. "Sudden stops" – particularly in emerging markets – consisted of an abrupt reversal of foreign direct investment as investors headed for the exit at the same time, exacerbating crises. The 1997 devaluation of the Thai baht triggered a deep financial crisis in East Asia, with spillover effects in other emerging markets.[5] Sometimes macroeconomic imbalances can take years or even decades to recover. Since its stratospheric climb in the 1980s, it has taken 34 years for Japan's stock market to regain its high-water mark set in 1989.

[a] FCLTGlobal convened member CEOs in Singapore in November 2022 at GIC Insights, "Taking Action to Navigate a World in Transition" to discuss how organizations can balance resilience and agility to deliver long-term performance, in Davos in January 2024, on how to make long-term decisions despite the current volatile geopolitical landscape, and at our Annual Summit in February 2024. FCLTGlobal convened a working group in January 2024 comprised of experts from our global membership to discuss how investors can confront the issue of geopolitics using practical tools related to geostrategy, governance, and decision making.

[b] We define geopolitical risks broadly as events or crises stemming from conflict or sudden policy changes as well as longer-term trends like deglobalization that impact the risk/return profiles of investments, reputation, or organizations. Geopolitical risks and uncertainties can emanate from many sources including across political divides within markets, and across global markets.

But one thing that has remained true over the past few decades is that the institutions that enabled globalization remained largely intact and supportive – trade policies, open markets, and relatively stable security and political regimes. No matter what the event, this predictability allowed investors to diversify portfolios across markets, largely as a way to reduce risks and seek opportunities for growth. By example, pension funds, particularly large funds based in small domestic markets, have historically invested a substantial amount in foreign markets.[6] With the conditions underpinning markets relatively intact, investors weathered geopolitical and macroeconomic storms.

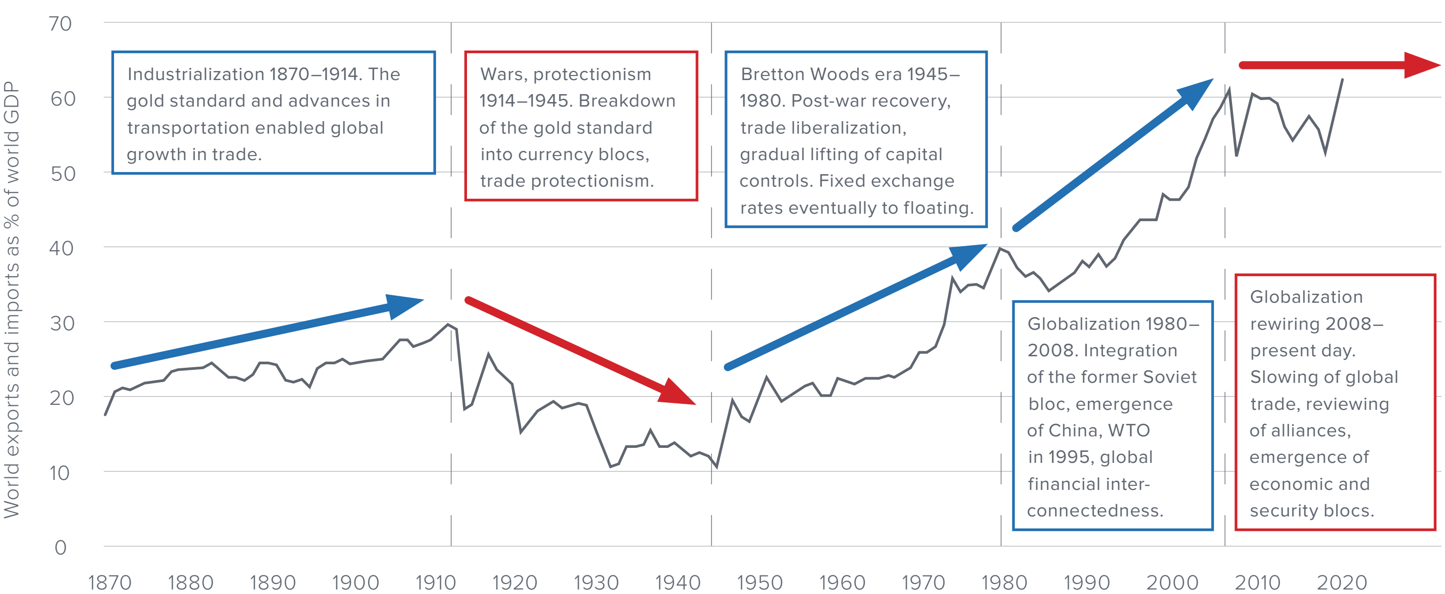
Exhibit 1 describes different eras of globalization. Each of the chart's five main periods was characterized by different configurations of economic and financial powers, and different rules and mechanisms for economic and financial ties between countries.[7] During the period WWI to WWII, globalization was disadvantaged but throughout the rest of this history, globalization has been a tailwind.

Recent memory may evoke the advantages of globalization that has helped raise incomes almost everywhere since the 1980s.[8] Exports, as a percentage of GDP, have doubled since 1990; trade in intangibles, data, and intellectual property has grown twice as fast as goods; and cross-border talent flows are at an all-time high.[9] Companies expanded operations and entered new markets: by 2020, 66 percent of Coca-Cola's revenue derived from international markets.[10] Not to be overlooked is the rise of China's economy and influence in global markets over this time period. The McKinsey Global Institute has built an online tool that visualizes global trade, where the growing influence of China is evident, especially in areas like electronics and textiles.[c] Today, as the cooperative post-Cold War era recedes in the rearview mirror, world powers are competing to mold the era that will replace it.[11]

Globalization rewired

Since the global financial crisis in 2008, the pace of liberalization has slowed, with indications of a rewiring in economic and financial relations. Now, the "geopolitical thicket" looks more like sanctions, repatriation bans, export and import controls, conflict (direct and proxy),[d] abrupt policy changes, and even data localization requirements, affecting companies and investors alike. For investors, they present as constraints to a global investment footprint, limiting the investible universe. The number of trade restrictions on goods, services, and investment has increased fivefold over the past ten years.[12] We are now witnessing the highest number of violent conflicts since the Second World War.[13] Domestic political divides are key contributors to policy uncertainty for investors as polarization drives policy reversals and volatile outcomes.

Exhibit 1. Eras of globalization



Source: IMF, "Charting Globalization's Turn to Slowbalization After Global Financial Crisis"; Our World in Data, "Trade from a Historical Perspective" - Klasing and Milionis (2014) and Penn World Trade (2021), https://ourworldindata.org/trade-and-globalization, The World Bank, FCLTGlobal.

[c] https://www.mckinsey.com/mgi/our-research/global-trade-explorer?sector=0ag

Some investors have already taken action in response to growing risks. Foreign firms operating in China are not only declining to reinvest their earnings but — for the first time ever — they are large net sellers of their existing investments to Chinese companies and repatriating the funds.[14] In October 2023 Vanguard sold its stake in Ant Group, completely exiting the Chinese market.[15] Under intensifying scrutiny from US lawmakers, venture capital funds are reportedly dialing back on investments in Chinese start-ups.[16] Yet some investors still see opportunities. Europe's largest asset manager, Amundi SA, sees tremendous potential in China's fledgling pension market.[17]

Translating Geopolitical Theory into Practical Investment Decision Making

Executives and investment committee members see the issues of geopolitics coming at them, yet some organizations are ill-prepared to confront geopolitics. CIOs, portfolio managers, and investment analysts have always had strong processes for macroeconomic analysis. Now, geopolitical considerations need to be layered in. It is an obvious point but well worth stating: geopolitics provides an additional source of risk and opportunity requiring a different but complementary set of skills.

New skills for new risks and opportunities

Investment committees are being asked to translate short-term news events into long-term investment decision making. A common challenge raised by FCLTGlobal's members was how to distinguish short-term noise from long-term signals. Anticipating how the geopolitical environment may shift requires analyzing how economic power, political influence, and military power may change and then how these changes could impact investment decision making, financial analysis, and organizations.

By focusing on the long term, investors improve their ability to withstand geopolitical shocks and disruptions. Reviewing skills and organizational capabilities requires examining past practices, investment policies, internal talent, and sources of information. Recognizing a transition to a new era is having the presence of mind to question core beliefs, like diversification, and asking what will work in the future as opposed to what has worked in the past.

The diversification dilemma

"Diversification used to mitigate risk, now it's a source of risk" – FCLTGlobal investor member

Portfolio diversification is a gnawing question at the center of geopolitics. Diversification is one of the most powerful ideas in finance, and probably the only "free lunch" available to investors.[18] Different countries have different economic cycles, comparative advantages, and industry mixes, so global diversification has long been considered a staple of a strong investment portfolio. These beliefs are deeply engrained in the policy portfolios of long-term investors to balance risk and reward.

Today, however, investing in certain countries is seen as increasing risk – and work. First, geopolitical events have become larger and more frequent. Multiple crises – Russia invading Ukraine, the Israel-Hamas war, conflict in the Red Sea – seem to be compounding one another. Second, many important global political relationships have been deteriorating and there is lower conviction that they will mend for the foreseeable future. This raises concerns about the returns to long-term investments and particularly the ability to protect investments and repatriate capital.

It doesn't help that broad geographical diversification has been a losing strategy over the past few years. Driven by exceptionally high returns, the weighting of the US equity market in the MSCI All Country World Index (a proxy for the global stock market) recently topped 63 percent. Emerging markets account for less than 10 percent of the index. Meanwhile the top ten companies, all based in the US, comprised over 19 percent of total index capitalization. Losing your entire investment in Apple Inc. would be far worse than writing off the entire United Kingdom index weight.

With the extent of geographical representation so diminished in the most common global equity benchmark, more countries become easier to completely avoid without significantly impacting total return or tracking error. FCLTGlobal members with large volumes of capital to deploy are increasingly finding that the investable universe of markets is shrinking, to roughly 8-15 core markets.

[d] Instead of direct conflict between adversarial powers, conflicts like the war in Ukraine, the Israel-Hamas war, and conflicts in the Red Sea are being waged through proxy forces, with countries supplying weapons and support through security alliances.

Yet it's tempting to take the opposing view. With less apparent diversification available in the global benchmark, true diversification is that much more valuable. Contrarians make the case that with certain pockets of the investment universe out of favor and undervalued, a truly long-term investor should take the other side.

Tail risks

One thing that is certain is that the biggest problems for investors occur when diversification fails to protect against risks, as happened during the subprime loan crisis in 2007-2008. It's not difficult to imagine black swan events – low probability but high impact – stemming from geopolitical tensions that boil over and cause panic. Potential examples include the political implosion of a major economy; the forcible removal of a leader or a government; a significant regional military conflict; or even another pandemic.[19] In contrast, "gray rhinos" are probable events with high impact: we see these risks out there in the distance, but we don't clearly perceive their full dimensions.[20] Unsustainable debt levels or climate change are examples.[21] In the geopolitical sphere, tension between the US and China is the top risk scenario causing investors to lose sleep.

Beyond risk to addressing uncertainty

Frank Knight, in his book *Risk, Uncertainty, and Profit* (1921)[22], described an important distinction between risk and uncertainty that points to the significance of strong governance in addressing geopolitics. Geopolitical risk can be described as unknown outcomes, governed by known probability distributions at the outset. In this way, higher risk raises required returns. This type of risk differs significantly from geopolitical uncertainty, where not only are the outcomes unpredictable, but the probability distributions are also unknown. Uncertainty delays and complicates decision making.

As Knight saw it, uncertainty in an ever-changing world brings new opportunities for investors to make profits, but it also means we cannot reasonably specify the likelihood or severity of future events.[23] This appears evident in geopolitics where terrorist attacks, cyber-attacks, and wars frequently offer little forewarning to enable preparation.

Navigating Geostrategic Spheres: Addressing The National Security Mandate

Before hitting the reset button on diversification, sweating tail risk events, and hiring a whole new team to cover geopolitics, some simple and straightforward actions will be helpful to develop a game plan for tackling geopolitical risks and opportunities. We offer tools in this report that enable investors to reflect on their organization's abilities and preparedness to respond, by considering governance, strategy, and engagement as central elements to good practices.

How should investment leaders sort out this tangled knot of geopolitics? We provide first a framework for navigating geopolitical spheres as national interest and security become inseparable from capital allocation decisions. We then provide a toolkit for investment committees to focus on governance and identify geopolitical pain points in their organization. Potential actions put strategy at the center of responding to geopolitical risks and opportunities. A review guide for investors delves deeper into identifying portfolio, reputation, and organizational risks. Finally, we provide a toolkit for investors to engage with portfolio companies as their response to geopolitics will be critical to support long-term value creation.

"Going forward, it will be increasingly difficult to separate economic issues from broader considerations of national interest, including national security." – U.S. Treasury Secretary Janet Yellen[24]

At FCLTGlobal's annual Summit, held in January 2024, US Secretary of Commerce, Gina Raimondo, echoed the words of Secretary Yellen, reinforcing that national security interests and business interests are mutually dependent. In January 2024, the European Commission proposed new initiatives to strengthen economic security in the European Union.[25] This may come as an unwelcome addition to investment mandates. As one participant put it, "We have to reconsider our portfolio through a national security lens, forcing us to invest in fewer countries."[26] Indeed, it seems that governments are treating private sector investment as an instrument of national power.

Geostrategic spheres of influence

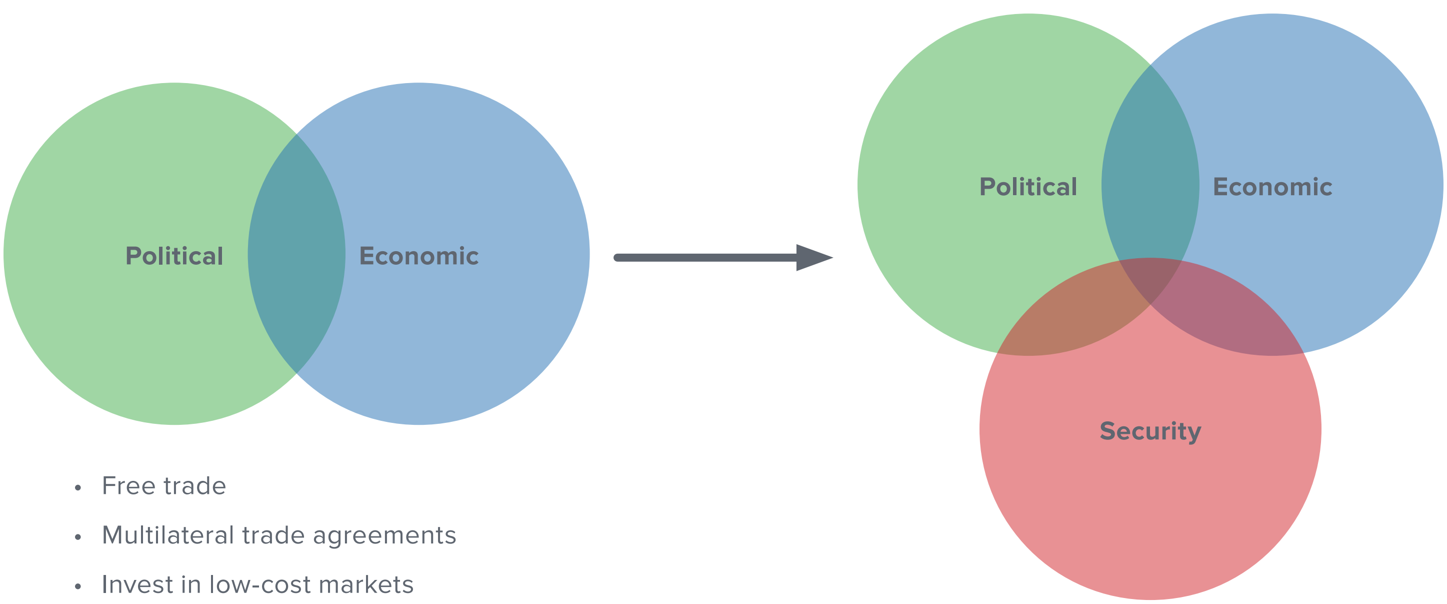
In the past, national security and national interest were barely a consideration for investors. Investors considered politics and economics in making investment decisions as depicted on the left of Exhibit 2. 'Free' trade is becoming 'free but secure' trade. Now, dominant economic powers like the United States, the European Union, and China are disrupting national security and defense ties. Regions like the Middle East are stepping in and growing in importance. Investors are confronted with the right of Exhibit 2 where there is an additional filter to apply for investment decision making. There are even fewer cross-border opportunities between countries when security is added to the mix. Indeed, it appears that economic security and national security are blurring together as governments prioritize access to critical resources, food, energy, and healthcare to ensure social stability.

The increasing importance of geopolitical risk arising from national interest has important implications for cross-border investment opportunity. In a world without geopolitical risk, expected returns and risk are the same for all foreign investors considering an investment in a common third-party country. In a world with geopolitical risk, this is no longer the case. Expected returns and risk vary bilaterally between source and destination. For instance, insiders face lower risk of expropriation and greater ease of doing business than outsiders. Outsiders thus demand a higher risk premium than insiders and may be priced out of those markets. Therefore, investors should be assessing whether they are on the "inside" or "outside" of investment destinations today and how that might change over the lifetime of the investment.

"The Four Ds"

For investors, adding national security to mandates creates clear tradeoffs in portfolios. Exhibit 3 (page 10) presents a 2x2 matrix featuring national interest alignment on the vertical axis and fiduciary risk-adjusted return on the horizontal axis. "Destinations" are attractive on both dimensions while "Deadweight" is unattractive on both dimensions. "Diversions" do not contribute to investment return objectives in a meaningful way but align with national interest regulations or responsibilities. It may be a diversion from where capital would have been deployed absent national interest. "Diversifiers" offer attractive investment opportunities while presenting reversal or reputation risks due to misalignment with national interest.

Exhibit 2. Free trade is becoming "free but secure" trade

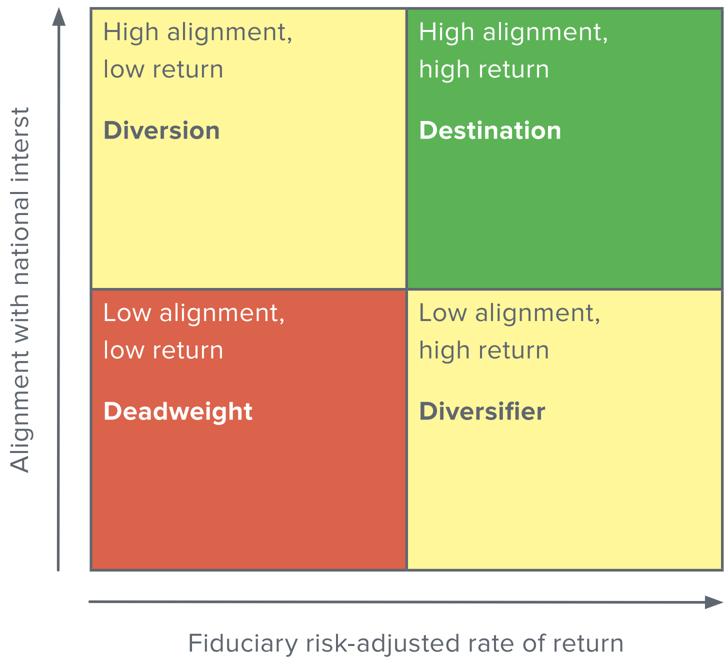


- Free trade
- Multilateral trade agreements
- Invest in low-cost markets

- Free but secure trade
- Bilateral or plurilateral trade agreements
- Friendshoring

Source: FCLTGlobal

Exhibit 3. The four Ds: Mapping a grid of alignment and return objectives



Source: FCLTGlobal

Alliances and home markets

In this emergent multipolar world, networks and alliances are growing in importance. Much of this rewiring will be built at the national level, but investors have an opportunity to be active participants by building networks and alliances or working to influence those that are built through national institutions. Consider opportunities presented by "swing states" that play both sides, acting as economic connectors in a fragmenting world. Vietnam, Poland, Mexico, Morocco, and Indonesia are benefitting from the reshuffling of supply chains in response to US-China tensions.[27] Saudi Arabia has officially joined the BRICS bloc of countries.[28] Secretary Yellen said of free but secure trade, "Favoring the friend-shoring of supply chains to a large number of trusted countries will lower the risks to our economy, as well as to our trusted trade partners."

Indeed, in this new world, the definition of "home" may not be easy to define. A firm may truly consider itself global. Or a subsidiary and its parent may be located in different countries with opposing views on an issue or on their stances towards a foreign government. Asset owners have emerged as significant players with whom companies, asset managers, and even countries can work to find common ground.

At FCLTGlobal's recent Summit, when asked what responsibility investors have to invest in companies or industries that are strategically important to their home country, answers from participants ranged from "none whatsoever" to the acknowledgment of a new dual mandate that accounts for global trade concerns. Global investors are certainly feeling pressure from governments. In Canada, the House of Commons special committee studying Canada-China relations is urging the federal government to introduce new measures to prevent Canadian pension funds from investing in Chinese companies implicated in human rights abuses, corruption, or threats to national security.[29] In the United Kingdom, the Treasury will require pension funds to publicly disclose how much they invest in UK businesses as part of government efforts to boost their investments in UK assets.[30]

Confronting Geopolitics Through Governance

Tackling the complexities of geopolitics and distilling it into investment decision making can seem a daunting task. Proactive organizations build a culture of readiness for the future, putting strategy at the center of resilient portfolios and organizations. Investment committees and boards also need to see that appropriate committee structures and oversight responsibility are assigned for geopolitical risks and opportunities. An empowered individual, function, or committee at management level could be assigned responsibility for geopolitical risk management.[31]

FCLTGlobal has engaged with global CEOs on the topic of geopolitics over numerous occasions, most notably at member CEO Roundtables and the annual FCLTGlobal Summit. Based on inputs from members, we present a set of questions for investment committees to methodically scan their investment organizations and portfolios, and narrow the conversation to better focus valuable resources and time. Geopolitical forces are beyond our control, but we can focus on what we can change in order to adapt and continue to thrive. Below, the ten questions are grouped by *portfolio*, *reputation*, and *organization*. These questions are reproduced as a toolkit (*Top Ten Questions and Actions for Investment Committees*, page 14) in tear-out form at the back of this report.

Portfolio

- How have cross-border return premiums available to us changed for various countries?
- How different are required return premiums by asset class or tenor of the asset (e.g., infrastructure, illiquid assets, liquid assets)?
- What is the strategic importance of various countries or industries to our institution, and to national interest, and what is the trajectory of that importance?
- Are we evaluating geopolitical risk with a mean reversion mindset or an options mindset?

Reputation

- Do we have investments that might cause reputational damage but have limited upside for the portfolio?
- Could we tolerate a complete write-off of investments in a particular country?

Organization

- Do we have unique insights into certain geopolitical issues or unique disadvantages such as the risk of sanctions from our home government?
- What changes to governance processes or engagement with governments or other key stakeholders are needed, if any, to be prepared for geopolitical events?
- Do we have a clear plan for how to diagnose and respond to organizational impacts of sudden geopolitical events?
- Have we established strong relationships with government officials and stakeholders to ensure the lines of communication remain open during critical events?

This list is meant to be a starting point for investment committees to identify potential pain points, and to set governance frameworks to stay ahead of potential issues. Executives and staff may be called upon to provide committees with detailed information about portfolio and organizational exposures, or recommendations for potential actions.

Investment committees too can take specific actions to gain better insight into geopolitics, and to steer the organization through geopolitical weather:

Filter the noise: Headlines can be a distraction, or an indicator of a real problem. To tell the difference, seek alternative views to assemble critical intelligence from history, economics, politics, and international affairs by working with companies, other investors, governments, ex officials, the military, and academics. There are always at least two sides to a story. Tease out the implications for the region, the historical context, and cross reference to exposures. Disruption to global balances of power are the longer-term elements to watch. Russia's invasion of Ukraine in April 2022 and subsequent sanctions caught many off guard. There were signs and warnings of Russia's intensions months in advance.

Know the exit plan before you enter: Embed operational and financial exit plans into asset valuation, especially in illiquid assets such as private equity or infrastructure. Select European PE firms now reportedly require new investments in China to include separate exit provisions for foreign capital, such as through buybacks.[32] With geopolitical tensions clouding long-term investment outlooks, strategies to avoid stranding of assets, including building local networks of potential buyers, can be done in advance.

Right-size exposures: Consider reviewing and trimming assets that incur limited upside, but outsized reputational risk. A tiny position in an investment that contributes little to total fund performance but is a source of geopolitical and reputational risk is probably better to eliminate than fret about. In 2021, a number of large institutional investors made headlines with exposures to investments linked to Myanmar's military – a whole lot of headline risk for what amounted to a rounding error in total fund performance.

Engage with governments: There is no time for introductions when you need something. Make sure that they know you, you understand their interests, they understand your interests, and the lines of communication are open. Investors speak with their feet. Institutional investors have a responsibility to help governments make good investment policy decisions. It is better to tell governments what you do and do not like to help them learn and understand the long-term investor point of view. This includes building relationships with domestic and foreign governments and politicians.

Embed strategic foresight: Shift the mindset and culture of your organization further towards the future to better anticipate underappreciated opportunities and challenges. This can include identifying strategic themes, scanning for changes, analyzing megatrends, and developing novel scenarios.[33] In 2020, Raphael Arndt, the CEO of Australia's Future Fund, felt that the external investment environment was changing rapidly, and that the fund needed to adapt. Future Fund launched an internal survey for every employee, asking what is changing in the world and what is important.[34] The resulting 70 ideas were grouped into ten areas of strategic importance and published in a white paper.[35] This exercise ultimately led to important pivots in investment strategy for the fund.

Stretch your organization's ideas: Test hypotheses and ideas through wargaming, hiring outside expertise, and stress-testing your stress tests with third party scenarios. Wargaming can be used as a tool to gain insight, experiences, and to find potential resolution of complex problems in advance.[36] Knowing the organization's limits is also important, and external expertise can fill in critical knowledge gaps.

Communicate clearly and frequently with stakeholders: Over the last decade, as governments retreated from cooperation, investors and the business community have been moving in the opposite direction – coming together to address common challenges while still competing vigorously in the marketplace.[37] A driver of this movement has been the desire of investors to cultivate relationships with key stakeholders such as employees and beneficiaries. It is the long-term investment view on markets that ultimately aligns with that of beneficiaries, and geopolitics is no different from climate or sustainability in that regard. Sharing with stakeholders how you expect to steer the organization and portfolios through geopolitical headwinds will help to build confidence that savings are protected for the long term.

Strategies for Portfolio and Organizational Stability

FCLTGlobal convened members in January 2024 to help investors focus leadership and staff on the challenges stemming from geopolitical upheaval. In doing so, we have developed a framework to help investment executives and management prioritize critical elements of geopolitical risk and opportunities while managing day-to-day operations, demonstrating how governance and culture need to change to enable longer-term decision-making. This approach is again grouped into three primary strategic areas:

Portfolio: Mapping exposures to geopolitical risks and uncertainties is a top priority for investors and a primary focus of this toolkit. Developing methodologies to quantify risks, their likelihood of occurring, and potential loss severities is a crucial piece of information for the decision-making process.

Reputation: Instances where investment decisions become misaligned with the expectations of stakeholders or sponsors increase reputation risk, even if geopolitical events do not materialize. Sponsors and stakeholders can be significant factors when they pressure investors to act without fully understanding the impact on beneficiaries.

Organization: Asset owners and asset managers, through global offices and/or visiting employees on the ground, may have direct exposure to geopolitical risks. Managing organizational risks is about prioritizing the safety of employees and minimizing disruptions to operations, while putting in place effective governance in case something does go wrong.

The corresponding toolkit at the back of this report (*Geopolitical Review Guide*, page 15) offers a series of questions and potential actions related to portfolios and investment decision making, reputation, and the organization itself.

Assessing Companies' Geopolitical Resilience

Aligning investments with politics, economics, and security is not just about capital invested in a specific market or foreign currency. It requires an understanding of individual portfolio company and investment exposures or vulnerabilities to geopolitical pain points such as supply chain, critical natural resources, intellectual property, talent, access to markets, and physical capital. It's about how individual companies respond to geopolitical risks, and how investors understand their strategies to manage short-term volatilities and long-term risks and opportunities across key areas.

Strategy: Re-underwrite an investment thesis for investing in a company, given geopolitical headwinds. What are the company's competitive advantages, and how are they dependent on a global footprint? Long-term outcomes may not be clear, but a company's long-term objectives should be. Questions for investors to ask include:

- How are geopolitics creating short-term and long-term risks and opportunities for the corporation?
- What methodology does the corporation use for evaluating short-term and long-term geopolitical risks and opportunities?
- Given these risks and opportunities, how has geopolitics changed corporate strategy?
- Are there tradeoffs – or not – in balancing efficiency with resilience to geopolitical risks and uncertainties, and are the expected capital expenditures and costs matching firm strategy?
- What actions are you taking? What is your timeline?

Governance: Identify how a company manages key stakeholder relationships, including with domestic and foreign governments. In particular, companies that operate in strategically important industries like semiconductors, artificial intelligence, and healthcare should share a clear vision of what their responsibilities are to governments and stakeholders. Questions for investors to ask include:

- What responsibilities does the corporation have to stakeholders outside its home country?
- What responsibilities does the corporation have to the government of its home country?
- What are current corporate governance practices (e.g., risk management, crisis response)? How do they need to change?

Operations: Identify company pain points, exposures, and vulnerabilities to geopolitics. Are these risks well understood and explained in relation to potential impact to firm performance? Questions for investors to ask include:

- Where are the corporation's specific operational risks to employees, operations, PP&E, supply chains, and customers?

Reputation: Identify the types of risks that keep CEOs and boards up at night. In today's hyperconnected world, seemingly no risk is too small to be overlooked. Questions for investors to ask include:

- What are the corporation's specific reputational risks?

These questions are reproduced as a toolkit (*Top Ten Questions from Long-Term Investors for Companies*, page 20) in tear-out form at the back of this report.

Conclusion

A rewiring of globalization requires specific attention to strategy, governance, and integrated processes to bring geopolitical views into investment decision making. Doing this effectively requires deep integration between geopolitical and traditional investment analysis. In conducting this research with members, several things stood out:

- A proactive instead of reactive mindset to geopolitics is needed to anticipate geopolitical risk events and stay ahead of important trends.
- Portfolio, reputation, and organizational risks are the top concerns of long-term investors. We propose governance, setting strategies, and engagement as solutions to address risks and identify potential opportunities.
- Engagement with companies is a necessity in order to fully comprehend geopolitical risk and opportunities – how companies respond to geopolitical headwinds will be instrumental in driving portfolio outcomes.
- Investors have typically not engaged with governments regarding investment, yet this gains new significance as both parties seek mutual reassurance on the trajectory of capital flows and policy.

TOOLKIT: TOP TEN QUESTIONS AND ACTIONS FOR INVESTMENT COMMITTEES

Navigating the complexities of geopolitics is essential for forward-thinking organizations aiming to create resilient portfolios through strategic planning and readiness. It is crucial for investment committees and boards to incorporate structures and oversight for managing geopolitical risks. FCLTGlobal has collaborated with global CEOs to create a set of questions for investment committees to streamline their focus, optimizing resource allocation and time management to adapt and excel despite uncontrollable geopolitical forces.

Portfolio

1 — How have cross-border return premiums available to us changed for various countries?

2 — How different are required return premiums by asset class or tenor of the asset (e.g., infrastructure, illiquid assets, liquid assets)?

3 — What is the strategic importance of various countries or industries to our institution, and to national interest, and what is the trajectory of that importance?

4 — Are we evaluating geopolitical risk with a mean reversion mindset or an options mindset?

Reputation

5 — Do we have investments that might cause reputational damage but have limited upside for the portfolio?

6 — Could we tolerate a complete write-off of investments in a particular country?

Organization

7 — Do we have unique insights into certain geopolitical issues or unique disadvantages such as the risk of sanctions from our home government?

8 — What changes to governance processes, engagement with governments, or other key stakeholders are needed, if any, to be prepared for geopolitical events?

9 — Do we have a clear plan for how to diagnose and respond to organizational impacts of sudden geopolitical events?

10 — Have we established strong relationships with government officials and stakeholders to ensure the lines of communication remain open during critical events?

Investment leaders and their teams prioritize geopolitical risks and opportunities amid their daily tasks. This strategy emphasizes the need for adaptability in governance and culture to support long-term decision-making, focusing on three strategic areas – Portfolio, Reputation, and Organization – and offers practical questions and actions for addressing these aspects effectively.

Portfolio

How are we evaluating the impact of geopolitics on investment risks?

Critical questions	Potential actions
What are the largest known risks? How are we addressing uncertainties and unknown risks?	Identify geopolitical exposures Develop scenarios for geopolitical risks and uncertainties and apply them to portfolios Assess portfolio risks based on criteria like regions, asset classes, industries, or factors Incorporate a full suite of portfolio risks (e.g., volatility, tail, liquidity, counterparty) across the portfolio in public and private markets Re-underwrite a selection of investment vehicles to ensure appropriate liquidity and asset control with geopolitical changes Measure upstream and downstream portfolio company exposures and risks (e.g., supply chain, customer) Build a dashboard for oversight bodies that presents data on geopolitical portfolio exposures and risks

How are we evaluating the impact of geopolitics on investment opportunities?

Critical questions	Potential actions
What are the largest known opportunities? How can we prepare for unknown opportunities?	Consider relative strengths in comparison with investment partners given geopolitical events Examine opportunities arising from scenarios for geopolitical risk and events Build gameplan to benefit from market dislocations Consider opportunities from proactively or reactively onshoring and friend-shoring Evaluate alternative ways to source exposure (e.g., public/private, asset class, strategy) Review exposure to strategic industries given their political focus

How should short- and long-term capital market expectations be adjusted?

Critical questions	Potential actions
How does geopolitical risk impact expected returns and risk? How do assumptions vary by horizon (e.g., mean reversion, secular trends)? How do assumptions vary for geopolitical winners and losers?	Assess impact of increased risk on required expected return and risk premia Estimate what the market has priced Adapt strategic asset allocation assumptions to vary with country of saver and country of investment
Does a credit model better capture left tail losses arising from loss of market access, expropriation, and inability to repatriate capital?	Consider a supplementary credit framework comprising loss probabilities and loss severities for all asset classes
How would deglobalization, increased regionalization, or formation of economic blocs impact diversification across and within markets, regions, and blocs?	Run portfolio simulations based on changing correlation assumptions; test diversification benefits as correlations shift

How are we managing geopolitical risks and opportunities strategically?

Critical questions	Potential actions
Where do we have a competitive advantage in formulating investment theses related to geopolitical risks and opportunities?	Know your organization's ability to improve outcomes by actively managing geopolitical risk
What are the roles of portfolio managers, risk managers, and legal/compliance in decision-making? What additional portfolio risk controls should be put in place?	Revisit roles and responsibilities of portfolio managers, risk managers, and legal/compliance at portfolio and firm level
What are the key strategic themes? Should we increase home market bias? Avoid geopolitically risky markets? Allocate more abroad? How does this vary across asset classes and strategies? How does this vary by degree of liquidity (e.g., public vs private)? How does this vary across geopolitically strategic sectors?	Review long-term strategic asset allocation in light of geopolitical risks and opportunities
How do we manage unknown geopolitical risks?	Consider position limits, hedging, and risk mitigation instruments

How are we measuring and monitoring the progress of geopolitical risks and opportunities?

Critical questions	Potential actions
Where do we have a competitive advantage on gathering political and market intelligence? Should we invest in our ability to gather this intelligence? Would this improve our ability to influence investment geopolitical outcomes? What third party sources could provide better intelligence?	Know your organization's limits on collecting intelligence directly Seek efficient ways to improve political and market intelligence

Reputation

How are we preparing to respond to geopolitical risks and communicate with stakeholders?

Critical questions	Potential actions
Who are the critical stakeholders? What are their interests?	Identify and integrate reputational risks (e.g. human rights) into investment decision making
What responsibilities or obligations arising from geopolitics do we have to these stakeholders? How have they changed?	Complete the Conversation Guide for Investment Trustees and Executives to Fulfill Responsibilities, *Ripples of Responsibility*
How can we ensure we are meeting our responsibilities to stakeholders?	Review the organization's Statement of Purpose and Responsibilities, *Ripples of Responsibility*
How can we continue to balance fiduciary duty with external pressures, particularly from sponsors and governments?	
What adjustments to strategy are needed to address these pressures?	
What is the most effective way to communicate with shareholders and stakeholders?	

Organization

What are key exposures of the organization to geopolitical risks?

Critical questions	Potential actions
How can we ensure operational continuity? What decisions need to be made about opening and closing global offices, branches, or subsidiaries? How can we ensure the safety of employees and stakeholders?	Develop operational contingency plans Conduct wargaming to build processes to ensure safety of stakeholders
What compliance and legal issues might arise? How can we ensure information security?	Review the organization's policies and practices in light of geopolitical disruption

What changes to governance processes are needed?

Critical questions	Potential actions
Are the responsibilities of management and the investment committee/trustees clearly defined?	Ensure that ownership of decision making is clear and that incentives are not counter productive Ensure timely access to accurate information
Do the investment policy statement, risk appetite statement, and investment beliefs need to be reviewed?	
Are incentives (compliance, legal, risk, portfolio management) properly aligned with strategy?	
Do portfolio companies have a plan or strategy for managing geopolitical disruptions?	Put in place processes that recognize when to escalate issues with portfolio companies to the executive/board level
How can we best avoid a fire-sale situation and capitalize on emergent opportunities? Are management and the investment committee/trustees able to filter noise from actionable signals?	Review policies as needed (e.g. investible universe, rebalancing, absolute constraints, opportunistic investments)
What changes to investment mandates are required?	Review investment mandates (e.g. benchmarks), *Institutional Investment Mandates*

TOOLKIT: TOP TEN QUESTIONS FROM LONG-TERM INVESTORS FOR COMPANIES

Integrating investments with the realms of politics, economics, and security extends beyond mere capital allocation in markets or currencies. It demands a firmer grasp of how portfolio companies and investments are exposed or vulnerable to geopolitical issues, including supply chain disruptions, critical natural resources, intellectual property, talent acquisition, market access, and physical assets. These questions will enable investors to better understand how portfolio companies navigate geopolitical risks.

Strategy

1 — How are geopolitics creating short-term and long-term risks and opportunities for the corporation?

2 — What methodology does the corporation use for evaluating short-term and long-term geopolitical risks and opportunities?

3 — Given these risks and opportunities, how has geopolitics changed corporate strategy?

4 — Are there tradeoffs – or not – in balancing efficiency with resilience to geopolitical risks and uncertainties, and are expected capital expenditures and costs matching firm strategy?

5 — What actions are you taking? What is your timeline?

Governance

6 — What responsibilities does the corporation have to stakeholders outside its home country?

7 — What responsibilities does the corporation have to the government of its home country?

8 — What are current corporate governance practices (e.g., risk management, crisis response)? How do they need to change?

Operations

9 — Where are the corporation's specific operational risks to employees, operations, PP&E, supply chains and customers?

Reputation

10 — What are the corporation's specific reputational risks?

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