MEGATRENDS

PGIM GLOBAL ASSET MANAGEMENT

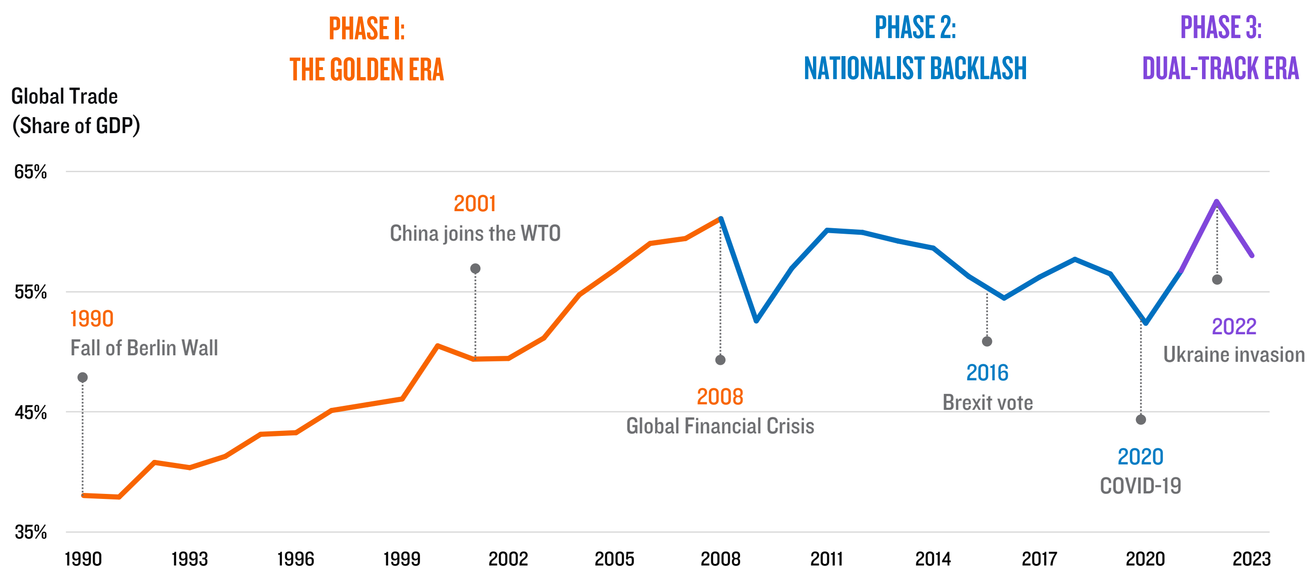
EXECUTIVE SUMMARY

A NEW ERA OF GLOBALIZATION

Shifting Opportunities in a Dual-Track World

Globalization has entered a new phase. On the surface, the swirling headlines around beggar-thy-neighbor trade restrictions, migration crackdowns, aggressive industrial policy and supply chains aligning along geopolitical fault lines – would suggest the high-speed globalization train barreling down the tracks since the 1990s has been utterly derailed as the world de-globalizes.

Three phases of modern globalization



Note: Total trade is the sum of total exports and imports. Source: PGIM Thematic Research, World Bank.

PHASE 1: THE GOLDEN ERA (1990-2008)	PHASE 2: NATIONALIST BACKLASH (2008-2021)	PHASE 3: DUAL-TRACK ERA (2021 – PRESENT)
• Berlin Wall falls, China enters the WTO, and the internet goes mainstream • Supply chains are borderless and manufacturing shifts to the lowest-cost producers • Global trade's share of GDP nearly doubles to over 60%	• The GFC causes the era of unfettered globalization to unravel • Backlash against globalization gains momentum and nationalist movements gather force • Growth in global trade slows significantly	• Covid-19 pandemic exposes supply chain vulnerabilities • Great power rivalry and national security concerns usher in a new era of industrial policy • Russia's invasion of Ukraine leads to threat of energy crisis in EU

However, today's reality is far more nuanced. We argue instead that the world has entered a new era where globalization has essentially splintered into two distinct and separate tracks.

The **first** track of globalization, which has sharply decelerated if not come to a sputtering halt altogether, currently represents just 25% of global GDP but captures nearly all the media and political focus.[1] Sectors in this so-called "small yard, high fence" approach include AI and high-end semiconductors, 5G networks, critical minerals, fossil fuels, EVs and batteries, as well as military technology. It is in these areas that de-globalization is occurring – most strikingly between China and the US.

The **second** globalization track, rarely mentioned in sensationalist media stories and often ignored in political discourse, continues to move forward at a high speed and represents roughly 75% of global GDP. On this track, a vast array of goods and services are still traded across borders based on comparative economic advantage – regardless of geopolitical rivalries and growing protectionist instincts.

INVESTMENT IMPLICATIONS

Sectors Caught in the Crosshairs of a New Era of Globalization

In sectors at the heart of great power rivalry and protectionist industrial policy, a new set of investment opportunities and risks are emerging. Some investors presume the mere presence of tariffs and industrial policy drastically reduces investment opportunities in affected sectors. However, we believe that four sectors – semiconductors, EVs, real estate and minerals –offer ample opportunity despite a range of tariffs and restrictions:

1) Semiconductors and AI amidst great power rivalry

Advanced computer chips are essential for cutting edge AI models and applications and have therefore become a centerpiece of the great power rivalry. But two aspects of advanced chipmaking differ significantly from most other manufacturing processes and should guide investors' portfolio decision.

1. The industry is all about capital and technology – not labor. The complexity of building out fabrication infrastructure and building the skills of the workforce needed to operate the facility requires lots of time and capital.
2. The industry has a "winner-take-all" dynamic with persistent advantages. This is primarily because of the emphasis on leading-edge technology and the short cycles for next-generation chips. If a company's chip is even slightly better than its competitors, it typically captures the bulk of market share and revenues.

Incumbents, therefore, may be more difficult to replace and investors smay wish to focus on companies that have a diverse set of customers across multiple segments of technology while also expanding their geographic footprint to address regional fragmentation.

TSMC, for example, as a leading fabricator of semiconductors, may be positioned to adapt to the changing globalization landscape in the industry. While its dependence on production in Taiwan presents a geopolitical vulnerability, the company provides important components to companies focused on AI technologies and applications as it produces infrastructure components that are essential and are currently difficult to source from alternative providers.

2) Winning the EV race

Industrial policy has reshaped several industries deemed critical for economic or national security, but it may have made the greatest impact in the EV market.[2] And while the world is shifting towards EVs, countries and companies are doing so at different speeds. Today, China is both the largest consumer market for EVs as well as the largest producer of them. In 2023, the country accounted for nearly 60% of EVs sold globally and more than half of the EVs in operation around the world are on Chinese roads (Exhibit 2).

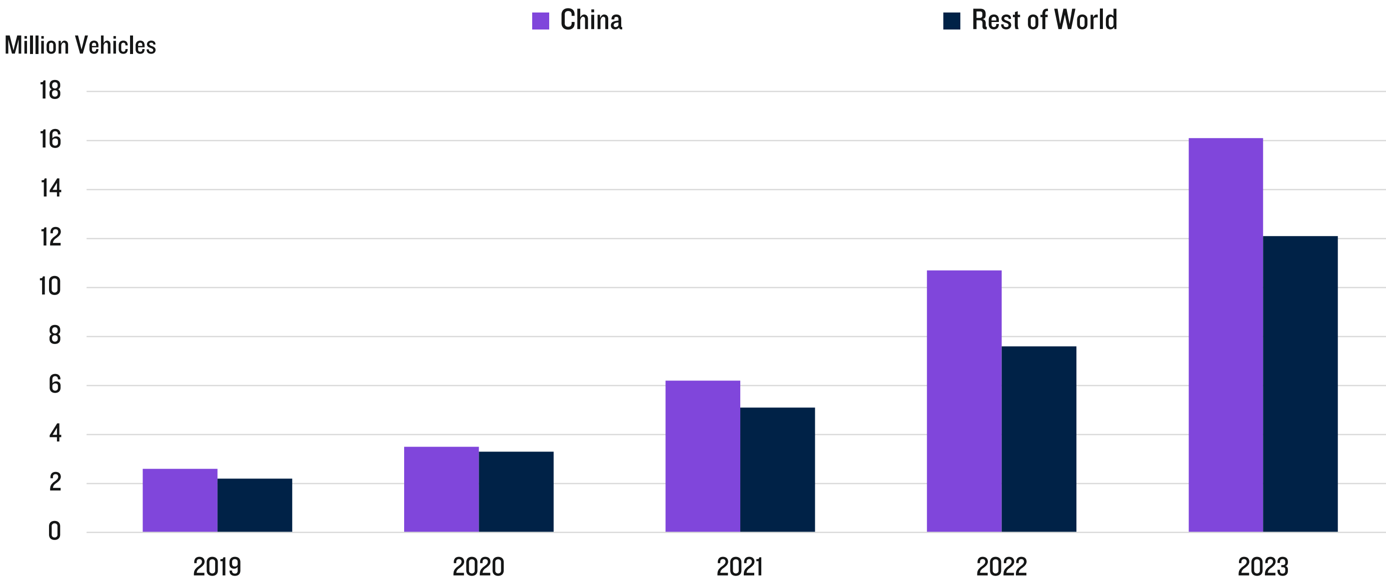
Going forward, the two companies currently leading the EV market – BYD and Tesla – are likely to capture different segments of the market across regions. Even though both companies may be affected by rising tariffs and regionalization, they each have durable comparative advantages over their peers and offer stable opportunities for growth that will prevail in this new era.

BYD is expanding into regions that are less restrictive with regards to EV tariffs – such as Southeast Asia or Latin America, for example. They are also increasingly pushing into higher-margin luxury EVs and have already shown early success in gaining market share in the Chinese market segment.

1. See the full report for more details around this 25% of global GDP and the sectors falling into the first track.
2. In this paper, the terms "electric vehicles" and "EVs" refer to both battery-electric vehicles and plug-in hybrid vehicles.

China's EV sales outpace the rest of the world

Annual EV sales



Note: EV refers to both electric vehicle and hybrid models.
Source: International Energy Association. As of January 2025.

Similarly, while Tesla is already a big player in the US and Europe, it is increasingly looking towards Latin America as an opportunity to grow its market geographically. The company is also looking towards the next evolution of the automobile market by concentrating its efforts on making robotaxis. In their vision, these self-driving taxis will be the mass-market cars of the future.

3) Real estate opportunities on both sides of the US-Mexico border

The combination of near-shoring momentum and the United States-Mexico-Canada Agreement's regional content requirements create a strong tailwind for industrial real estate on both sides of the US-Mexico border.

For investors, industrial real estate in Mexico can be attractive given the strong fundamentals of manufacturing to export to the US. For investors unfamiliar with industrial real estate in Mexico, it is important to note that lease agreements there are denominated in US dollars, and are usually with large, multinational manufacturers like Nissan, Medtronic or Honeywell.

While the industrial real estate opportunities in Mexico are well-known, the opportunities created on the US side of the border are often overlooked. Specifically, the need to re-freight cargo from Mexico on US soil provides a steady and often overlooked source of demand for industrial real estate like logistics and transport hubs within a few miles of the US-Mexico border. This need for re-freighting of goods on the US side of the border could demand for specific logistics facilities to enable this intermediary step – especially border cities like El Paso and Laredo in Texas and San Diego in California.

4) Copper remains king: No way around critical minerals and metals

A handful of metals and minerals play an outsized role in the energy transition and new technologies. Copper, nickel and lithium, for example, are vital inputs for electrification, batteries and clean energy.

Great power rivalry and export restrictions certainly complicate the investment thesis for many areas of investments in metals and minerals. However, there are several reasons why copper may present an intriguing investment opportunity.

First, it is essential for multiple growing industries – from construction to telecommunications and renewable energy – and its difficulty to substitute provides a solid base for future demand.

Second, despite the current global demand for it, production of copper has been less affected by great power rivalry. The fact that copper has the demand trajectory it has and has thus far been less affected by great power rivalry makes for a potential consideration for investors in this new era of globalization.

PORTFOLIO-WIDE IMPLICATIONS

The International Monetary Fund views geopolitical tensions and financial fragmentation as serious threats to global financial stability.[3] And prominent corporate leaders cite these same trends as creating "the most dangerous time the world has seen in decades."[4] To prepare themselves for the ongoing tussle between globalization and nationalism, CIOs need to consider the various ways these tensions could ripple across their investment portfolios and potentially create new risks and opportunities. Here we lay out four cross-portfolio implications that we believe should be at the top of a CIO's agenda when considering the impact of the new Dual-Track Era of globalization.

1. The new era of globalization is changing national winners	• Countries that already have some manufacturing capabilities in place today are often more attractive as friend- or near-shoring candidates in the future. Investors should consider industrial real estate as well as transport and power providers in these countries. • Investors should focus on countries with privileged access to free-trade zones such as Poland and Mexico, or countries with comparative advantages in business environment or labor cost like India or Vietnam.
2. Energy and food present hidden import vulnerabilities for some countries	• Investors need to ensure their sovereign risk framework evaluates a country's vulnerability to price shocks arising from disruptions to food or energy supply chains. • Current risk methodologies may not fully account for rising risks of supply chain disruptions, and investors should consider a framework to identify countries with elevated vulnerabilities to commodity price shocks.
3. Dual-track economy may require supplementing current risk frameworks for portfolios	• Investors should consider conducting geopolitical stress-tests on their portfolios as the new era of globalization will likely lead to divergent outcomes across both sectors and countries. • A stress-test would enable investors to (i) understand the magnitude and breadth of their exposure to at-risk sectors and countries; (ii) assess whether they are adequately compensated for that exposure and (iii) act accordingly.
4. In an era of volatile inflation and markets, investors should consider option-based portfolio strategies	• To counter rising geopolitical risk and the market volatility it can create, CIOs should consider additional approaches to protect their portfolios from the idiosyncratic risks around a fragmenting global economy. • While option-based strategies are not alpha-generating, they may offer CIOs an additional way of managing their portfolio risk.

EXPLORE THE FULL PAPER

3. Catalan, Mario, et al, "Geopolitics and Fragmentation Emerge as Serious Financial Stability Threats," International Monetary Fund, April 3, 2023. https://www.imf.org/en/Blogs/Articles/2023/04/05/geopolitics-and-fragmentation-emerge-as-serious-financial-stability-threats
4. O'Donnell, Katy, "JPMorgan's Dimon: 'The most dangerous time the world has seen in decades'," Politico, October 13, 2023. "https://www.politico.com/news/2023/10/13/jpmorgans-dimon-wars-impacts-00121422"

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