

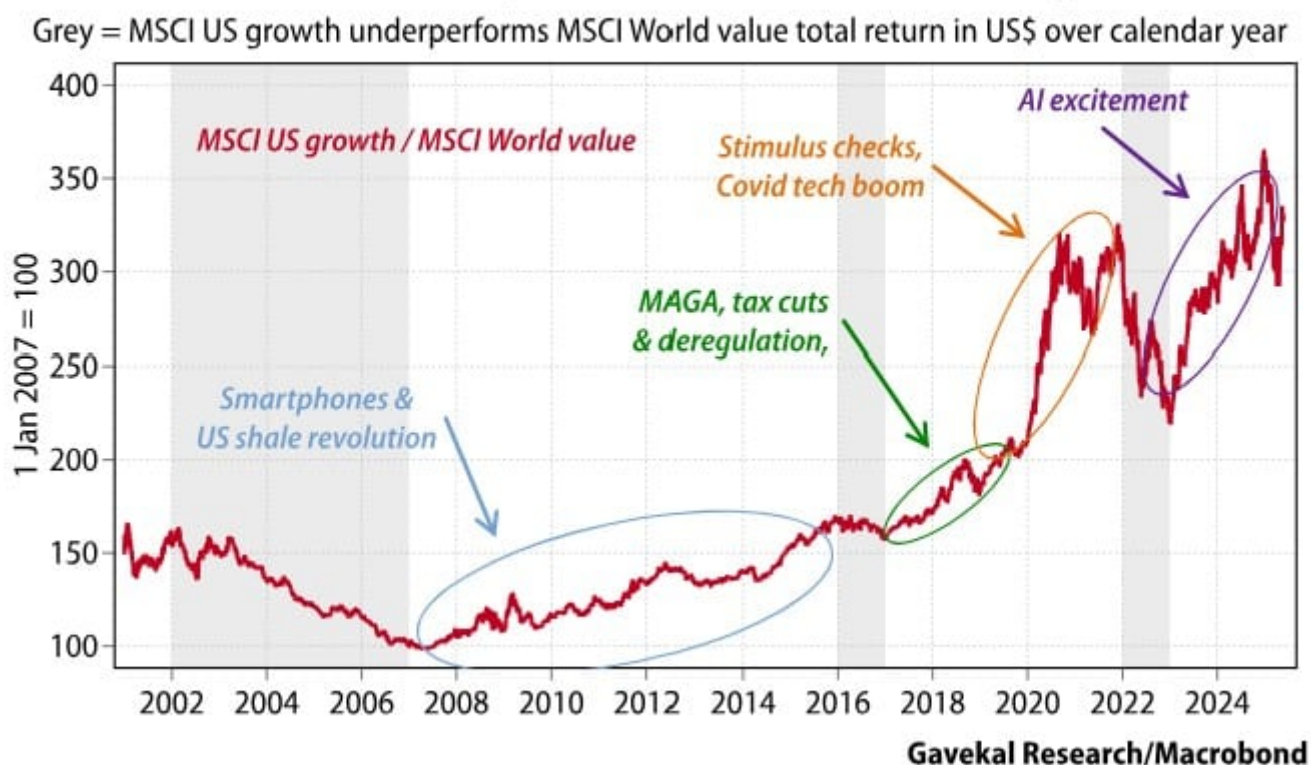
## What Will 2025 Be Remembered For?

### [Take Our Compatibility Survey](#)

In past reports, we have often argued that **the most traumatic events are not always the events that end up casting the longest shadows**. For example, anyone aged over 30 remembers where they were on 9/11. Suddenly, it felt as if the world had changed. Yet, economically speaking and in terms of long-term market impact, the most important event of 2001 was not the terrorist outrage, nor was it the unfolding tech bust, or even the Enron fraud. Instead, what changed the world in 2001 came exactly three months after the attacks on New York and Washington DC: China joining the World Trade Organization.

It was the same story with 2008. Back then, the US mortgage crisis felt like it might trigger an irreversible crisis of capitalism. However, the 2007-08 period also marked the start of the US shale oil production revolution, and the birth of the smartphone—two events that would drive financial markets for the following 15 years. The fact that the US would go from producing 5.5mn barrels of oil a day to 13mn/bbl a day in less than a decade (see my 2011 book [Too Different for Comfort](#)), that the US would enjoy a much lower cost of energy than any other major economy and the fact that major US corporates like Apple, Alphabet and Meta would end up controlling the broader smartphone ecosystem set the stage for the following 15 years of massive US equity outperformance.

### Successive narratives have powered the bull market in US growth stocks



#### 1) What is the key event of 2025?

With all this in mind, if we project ourselves five or 10 years into the future, what will investors

look back on as the key event of 2025? Consider the following possibilities:

- The release of DeepSeek, since the Chinese large language model suddenly showed that—unlike the smartphone ecosystem—the artificial intelligence ecosystem would not remain a US monopoly.
- The breakout in Japanese government bond yields, which is clearly an important shift from the situation of the past 30 years.
- China embracing the biggest budget deficits in its modern history.
- Europe abandoning any pretense of fiscal austerity.
- The shift in US fiscal policy from “DOGE cuts” to “running it hot”.
- The end of the Asian currency carry trades.
- The “liberation day” tariffs.
- The pledge by Middle Eastern kingdoms to invest big sums in the US.
- China’s breakthroughs in electrifying the country and developing ever-cheaper nuclear energy and thorium-based nuclear reactors.
- The US’s decision to export high-end chips to the Middle East in order to build massive AI centers there.
- The performance of Chinese jet fighters against French Rafales in the recent Indo-Pakistan military conflict.
- The denial of visas to Harvard’s foreign students; a move which possibly undermines the US’s greatest export (education), and one of its greatest strengths (its ability to attract the world’s best and brightest).

Undeniably, it has been a busy year, with much to write about. In our modest way, we hope that through our published reports, videos, podcasts and seminars, Gavekal readers feel that we have stayed on top of these events. And to be sure, these developments all have a valid claim to posterity.

Still, if I were forced to make a choice as to what will go down as marking a key shift in the global macro environment, I would highlight three game-changing speeches delivered in recent months:

1. Vice President JD Vance’s [speech](#) at the Munich Security Conference
2. President Donald Trump’s [speech](#) in Riyadh
3. Erik Prince’s [speech](#) to Hillsdale College in February 2025

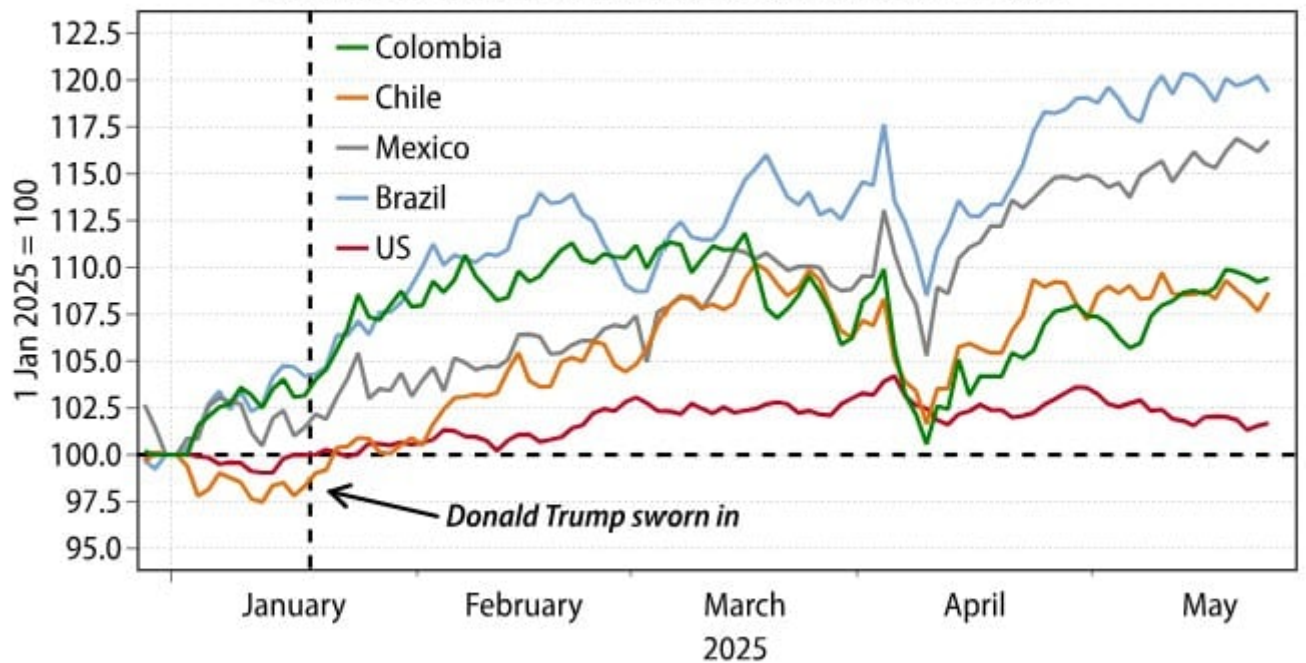
## 2) The folding of the US security umbrella and LatAm assets

I have already written on all three speeches. **But the guiding thread between all three speeches is that the US is folding its global security umbrella.** Most importantly, and to Erik Prince’s speech, the US is folding this security umbrella not because it wants to, but because in a new age of drone warfare, **shooting million-dollar missiles at ten-thousand-dollar drones to protect billion-dollar ships no longer makes sense.**

Concretely, this means that the US is now folding back unto the security of “Fort Monroe”, or the Americas. It also implies that the US will now aim to exert greater control over the broader Western hemisphere, from Greenland to Tierra del Fuego, and less elsewhere. **This is inherently very bullish for Latin American assets.** And sure enough, so far this year, LatAm bonds are outperforming all other bond markets quite handsomely, and LatAm equities are doing the same.

### LatAm bonds have outperformed their US counterparts...

Government indexes, all maturities, total return in US dollars



BofAML, Gavekal Research/Macrobond

### ...and so have LatAm equities

MSCI all caps, total return in US dollars

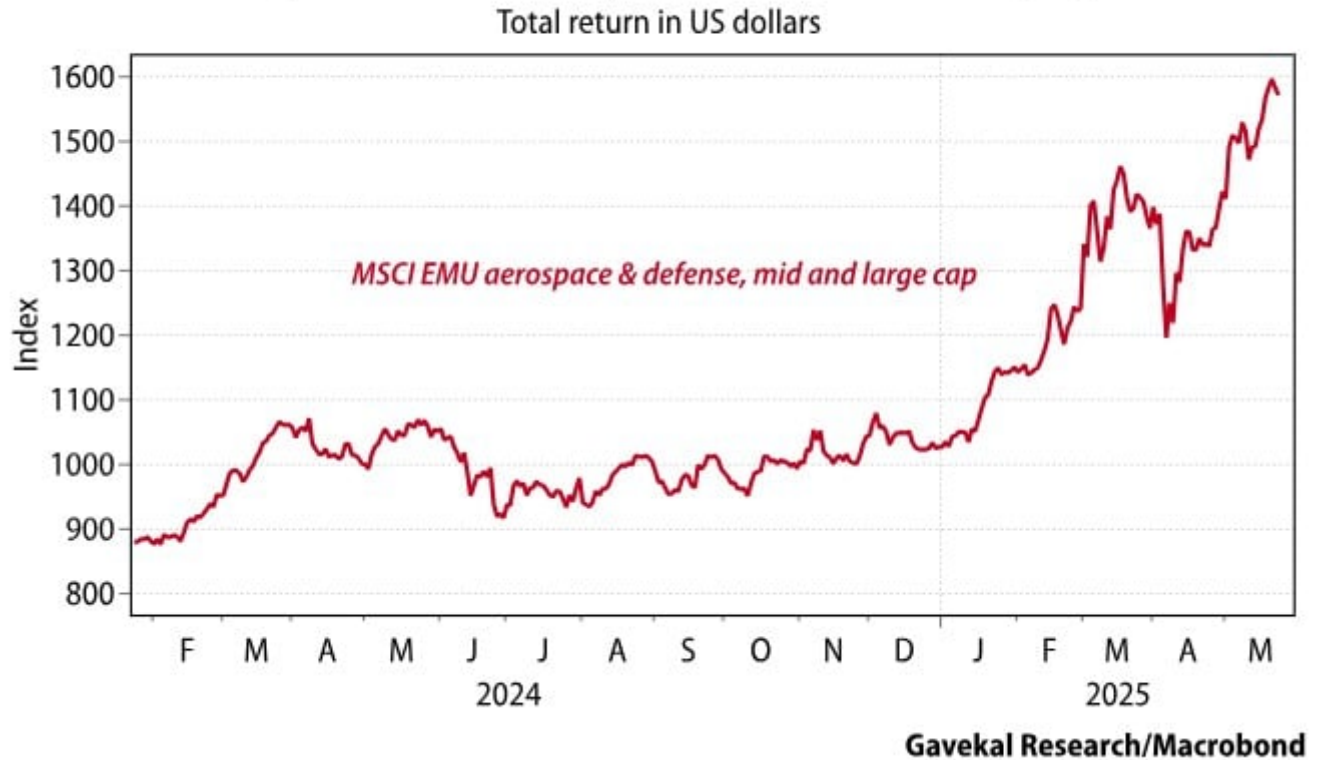


Gavekal Research/Macrobond

### 3) The impressive rally in non-US defense stocks

Interestingly, the immediate market response to the folding of the US security umbrella has been to bid up European and Japanese defense stocks. The logic seems obvious enough: in a world in which the US no longer provides free security, Western democracies will themselves have to cough up money to do so.

## European defense companies' stocks are riding high



But is this just “first order” thinking? If it no longer makes sense for the US to send million dollar missiles at ten-thousand-dollar drones to protect billion dollar ships, should we expect Europe to build the same billion-dollar ships and million-dollar missiles? Moreover, if erstwhile US allies like Europe and Japan were to go out and spend a fortune on their armed forces, would this not be to mistake where their vulnerabilities truly lie?

Indeed, in the post-World War II era, the US essentially provided friends with two essential services. The first, and most obvious one, was the security umbrella. The second was the safety of global oceans.

### 4) Will commodity prices now diverge around the globe?

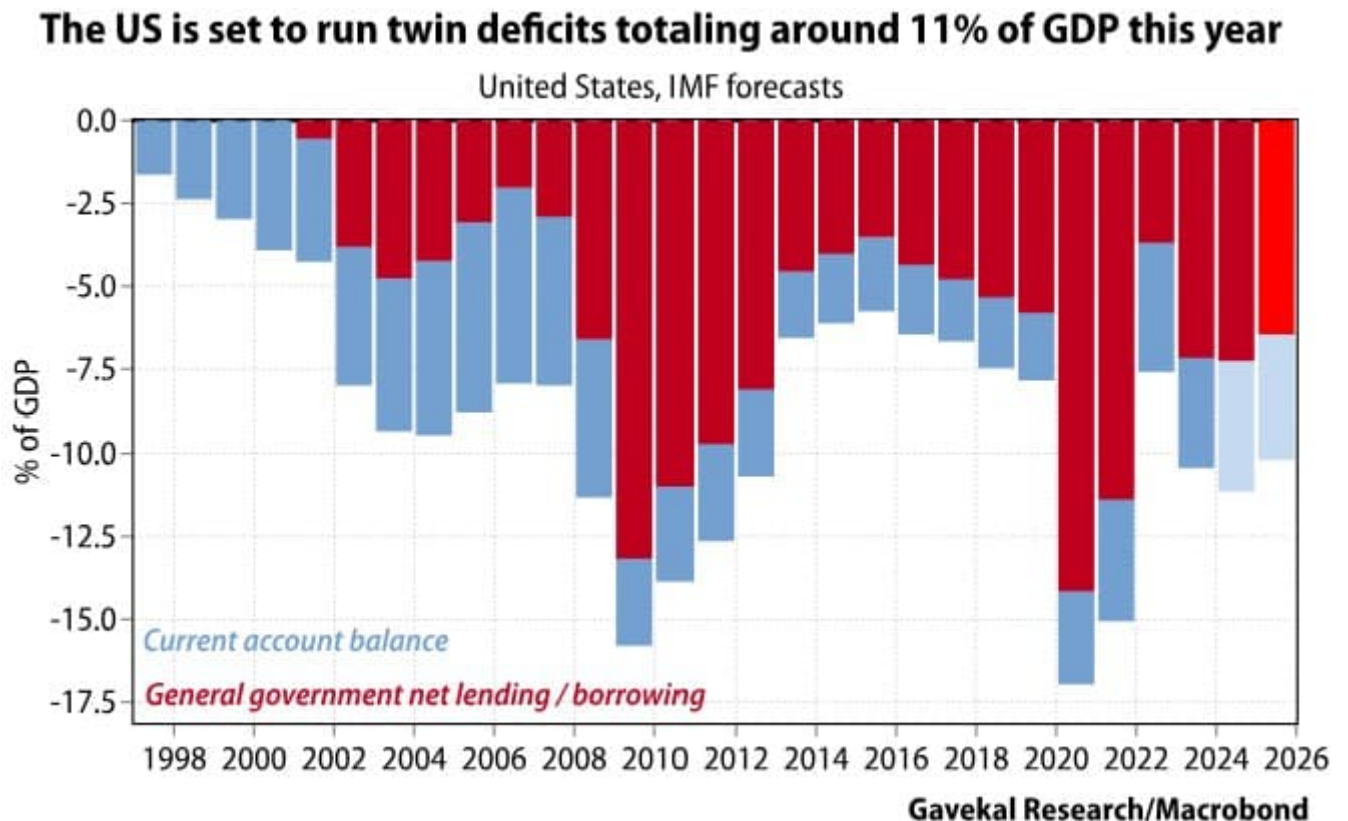
The fact that one could always count on commodities flowing from Latin America to Europe, or from Africa to China, or from Australia to Japan on oceans patrolled by the US Navy meant that, for the past 80 years, the world has essentially operated with one common price for all commodities. Sure, there have been small differences between oil prices in Japan and Brazil, or between copper prices in South Africa and South Korea. But these small differences essentially reflected transportation costs. When the price differences between countries or regions started to become too meaningful, firms such as Glencore, Trafigura, or Vitol would step in to arbitrage them away.

Fast forward to today and in a world in which the US is essentially signaling that it will no longer patrol the oceans or, at the very least, no longer patrol the oceans for free, **can we still assume that the world's major commodity prices will stay uniform across the globe?** And if so, does this not have massive implications for reserve management?



## 5) Central bank reserve management in a riskier world

For most of the decades that followed World War II, and definitely in the decades that followed President Richard Nixon's breaking of the US dollar's peg to gold, the US has run large twin deficits.



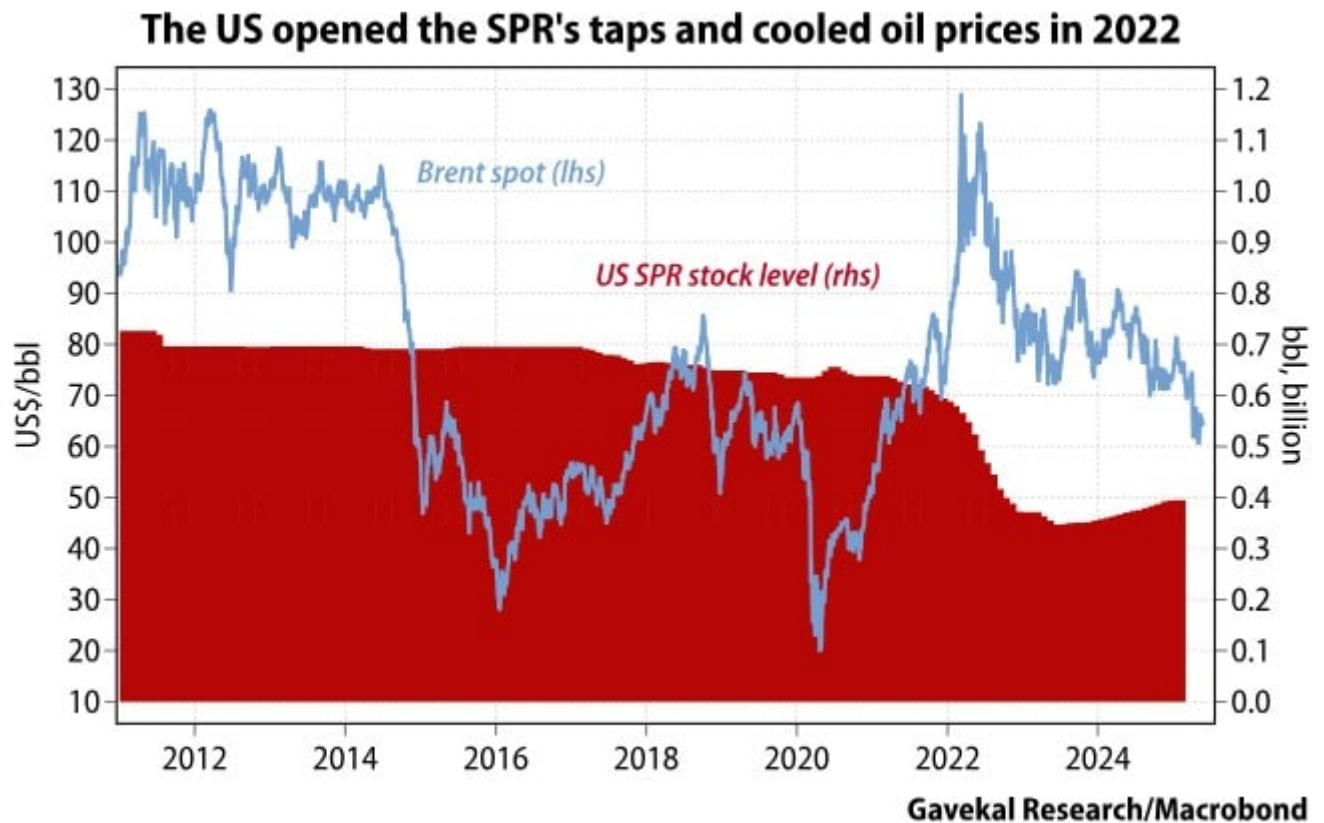
This situation essentially meant that the US kept exporting US dollars to the rest of the world. And when the rest of the world earned these excess US dollars, the default mode was to send the dollars back into the US by buying US treasuries. This made ample sense. For most countries, saving in treasuries meant that if a crisis occurred (maybe a tsunami, an earthquake, a civil war or even a full-on war), they could always count on the US Navy to deliver the food, energy, or weapons (as needed) by simply transforming US treasuries into the above goods and commodities.

However, if one can no longer count on the US Navy to deliver such goods, and/or the US states that, in a crisis, it will not hesitate to squeeze every pound of flesh from the country on the ropes (e.g. the Ukraine minerals deal) or, worse yet, the US adopts a confrontational stance against countries that run the biggest trade surpluses (e.g. China), then saving in US treasuries may no longer be such an obvious course of action.

Hence the unfolding sell-off in US government bonds, and in the US dollar. Even as Trump boasts of trillions of dollars set to leave the Middle East for US shores, bonds and the US dollar are still struggling.

To illustrate the above point, let us go through a hypothetical scenario.

In 2022, when Russian troops entered Ukraine, the oil price promptly surged from US\$70/bbl to US\$130/bbl. For the US, this was not that big a deal. Indeed, with the US being energy self-sufficient, rising oil prices just meant moving money from blue states (New York, Michigan, Illinois) to red states (Texas, Oklahoma, Louisiana, Alaska, North Dakota). Meanwhile, for Europe, Japan, South Korea and most American allies, the spike in oil prices risked pushing fragile economies into recessions. Joe Biden's administration duly released oil from the Strategic Petroleum Reserve and oil prices rapidly came back to more affordable levels.



Now let us imagine that, for whatever reason, a similar price spike happens in the near future. Consider two different ways that Trump could respond:

1. Release the remaining half of the SPR in a bid to save European and Asian economies.
2. Forbid the export of US energy in a bid to keep US energy prices low, while simultaneously telling industrialists all over the world that, if they wish to benefit from a cheap energy price, they should move their factories and production lines to the United States.

Given everything we have seen in recent months, does not the latter option seem far more likely?

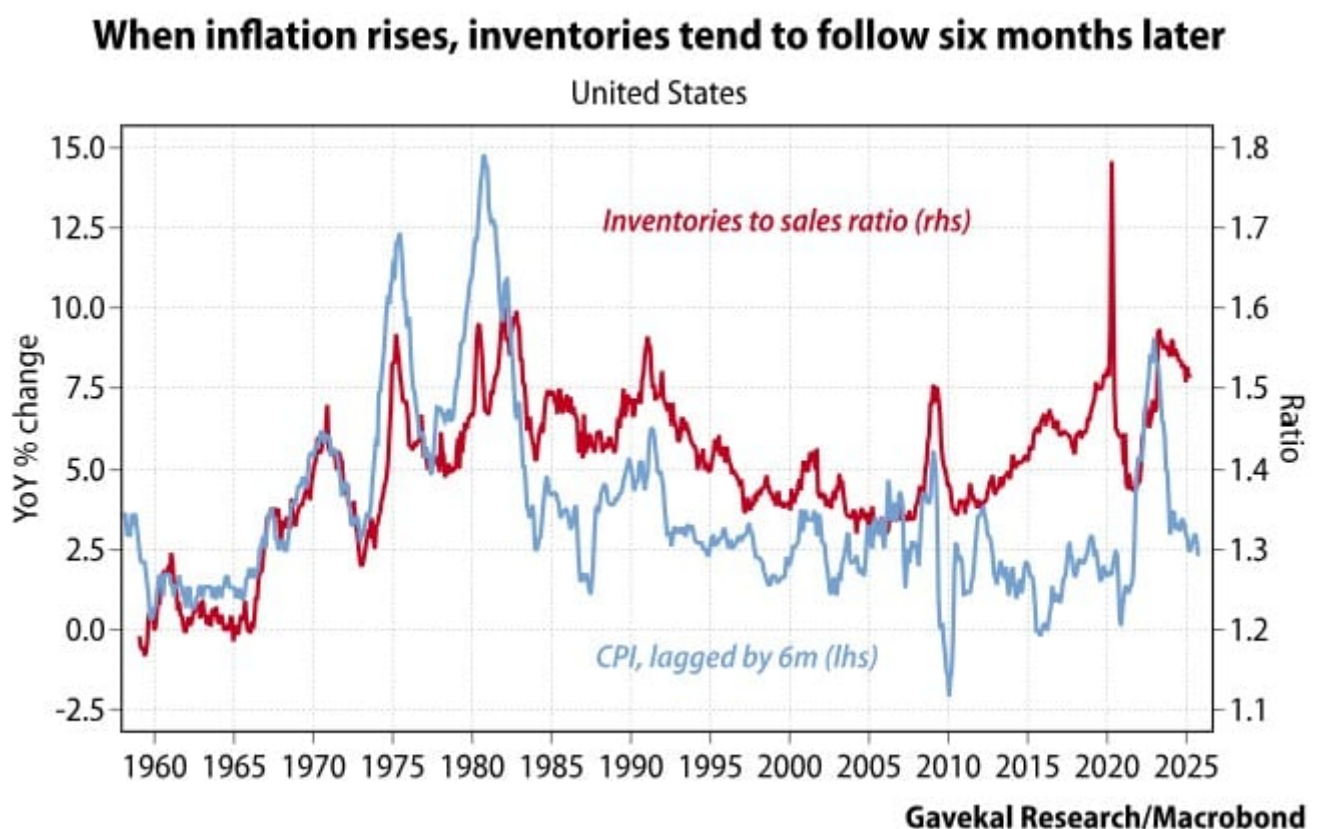
This brings us to the quandary that should keep every European and Asian policymaker awake today, namely whether the big risk in the coming years is that Russian or Chinese troops end up walking down the streets of Paris, Berlin, Seoul or Tokyo. Or alternatively, whether in the next energy crisis, triggered by who knows what, their own countries find themselves cut off from energy supplies.

If the bigger risk is the Russian/Chinese troops, then spending one's excess dollars on weapons (that may already be obsolete) may conceptually make sense. Otherwise, spending money to rebuild dated energy grids, building up commodity independence, preparing stockpiles of important materials (whether oil, soybeans, copper, nickel, uranium or whatever else individual countries may today be looking abroad for) would seem to be a much better use of capital.

## 6) Building up inventories across the board

This unfolding “trade war” uncertainty, combined with the increased likelihood that the US is done patrolling the world's oceans for free, means that all economic actors will have to build up bigger inventories: countries will have to accumulate inventories of key resources; companies will need to maintain higher inventories of spare parts and consumer goods; even individuals may wish to have better stacked pantries, spare electronics, and perhaps even spare vehicles.

This raises the question: if the “just in time” era seen in the past 30 years was inherently deflationary, will the “just in case” period that is unfolding be structurally inflationary? Perhaps not, if only because the relationship historically seems to have gone the other way around: when inflation accelerates, six months later companies typically start to raise inventories.

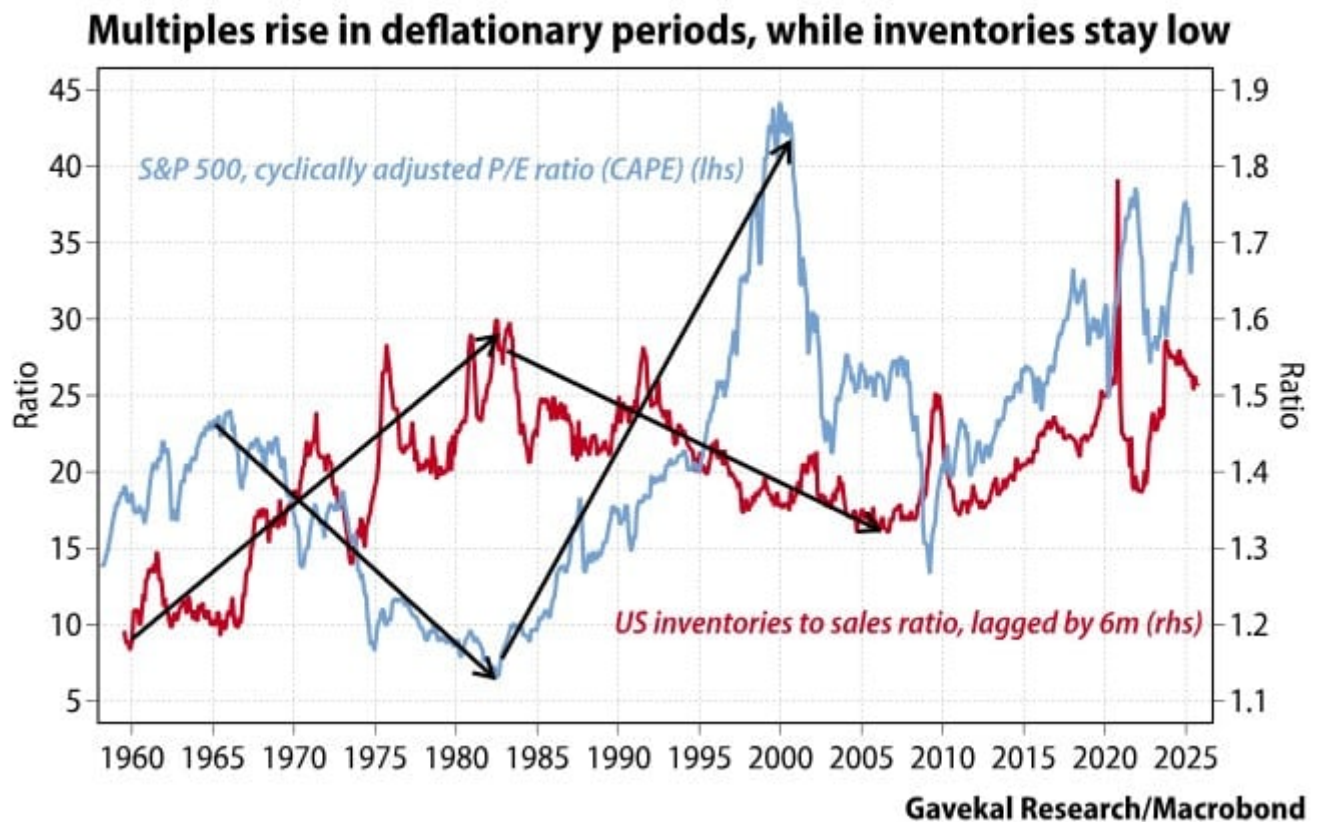


But at the very least, **it will mean more volatile growth.**

Indeed, the inherent problem with inventories is that they add complications to business management. Goods and commodities can be bought at the wrong time. Companies can also order the wrong things. This can mean inventories having to be liquidated for a loss. It adds up to inventories adding risk to a business and distracting the management.

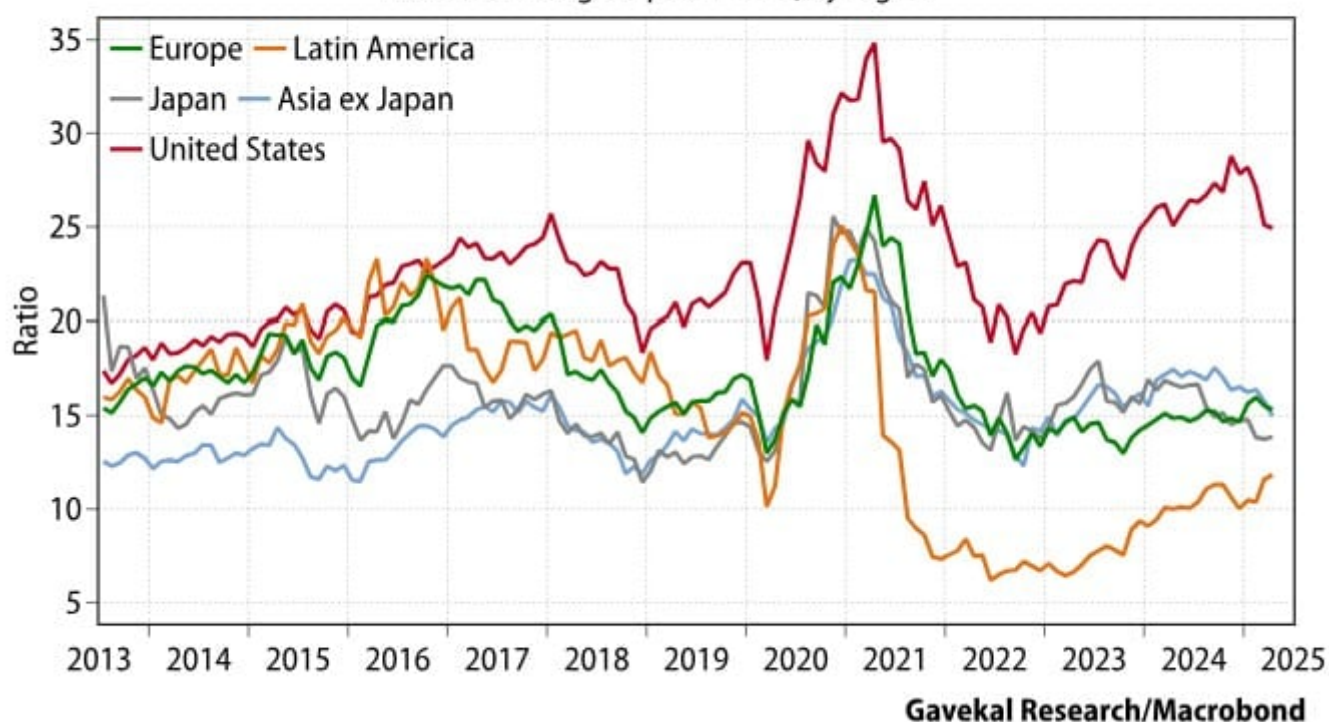


This is partly why in inflationary periods (when company managements spend much time worrying about inventories), equity-market multiples tend to be low, and in deflationary periods (when inventories are “just in time”), multiples tend to be high—as shown in the first chart below. Today, multiples are high in the US, and decently low everywhere else, as seen in the second chart.



## Multiples are relatively high in the US

MSCI mid & large cap P/E ratios, by region



### Conclusion: winners and losers

If the above takeaway—namely that the US is folding its security umbrella and withdrawing from patrolling the world's oceans—is right, it would seem that the obvious beneficiaries should be:

- **Latin American assets.** Today, anyone looking to tap into cheap labor to manufacture goods destined for the US consumer has to look first and foremost at Central and South America.
- **Commodities.** Those that are easy to warehouse/store should see strong demand. This would obviously include precious metals but also industrial metals.
- **Commodity trading firms and brokers.** Commodity trading firms typically thrive when commodity prices dislocate, since such episodes typically offer up attractive arbitraging opportunities. In a world in which price dislocations are more likely to occur, so will outsized profit opportunities. In that regard, maybe commodity trading firms become the new “anti-fragile” asset of choice.
- **Commodity currencies and commodity-producing countries.** In a world in which uncertainty increases, owning assets in commodity-producing countries such as Australia, Canada, Norway and South Africa makes sense.
- **Companies involved in the upgrading of electricity grids.** Whether in Europe, Japan, or China, this is where the largest increase in government spending should occur. Such investment should take priority over that seen for new military hardware.
- **Commercial banks.** For centuries, the first business of banks has been to fund inventories—a fairly uncomplicated and not very risky business. As inventories expand all around the world, so will bank loans. Incidentally, in almost all major markets, banks seem to be outperforming.

## Banks are outperforming across the world

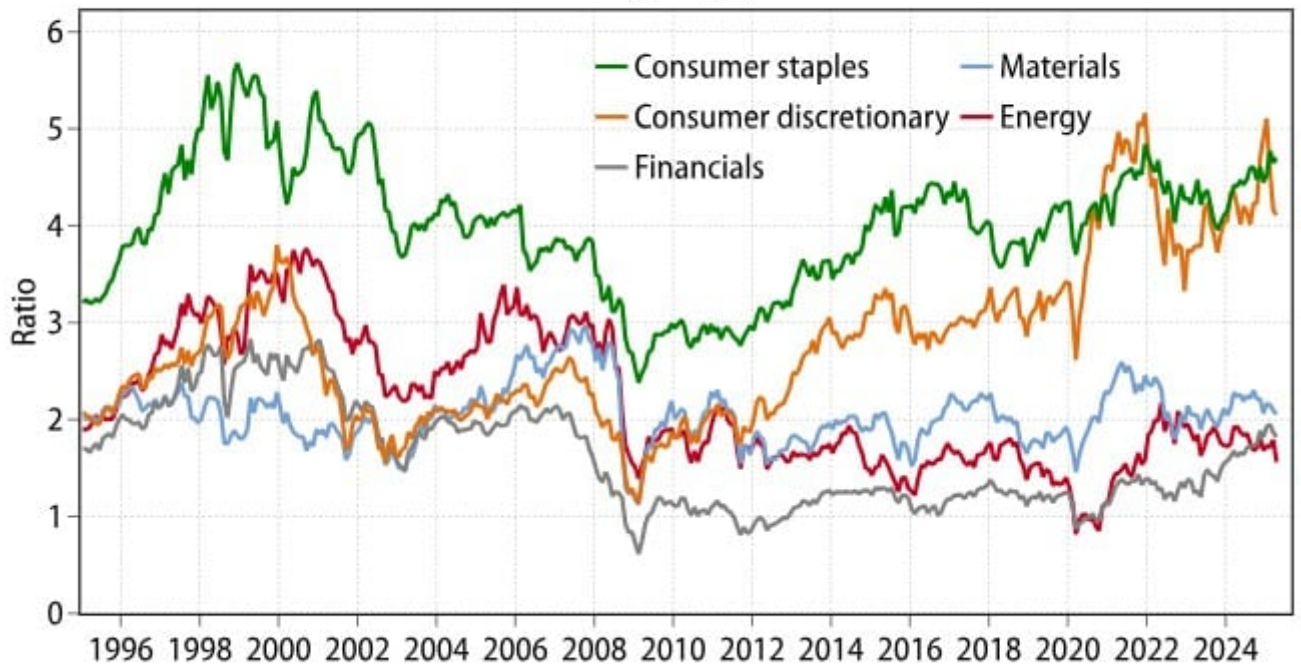
MSCI banks mid and large-cap, total return in US dollars



This list is not meant to be exhaustive. There are likely to be many winners and losers if the US no longer stays involved in the Middle East to ensure that Europe and Asia remain provisioned with oil. The good news is that, as of now, investors do not need to pay up for the above assets. Most are trading at roughly average, or slightly below average, historical valuations.

## Most global assets are priced at roughly their average price-to-book...

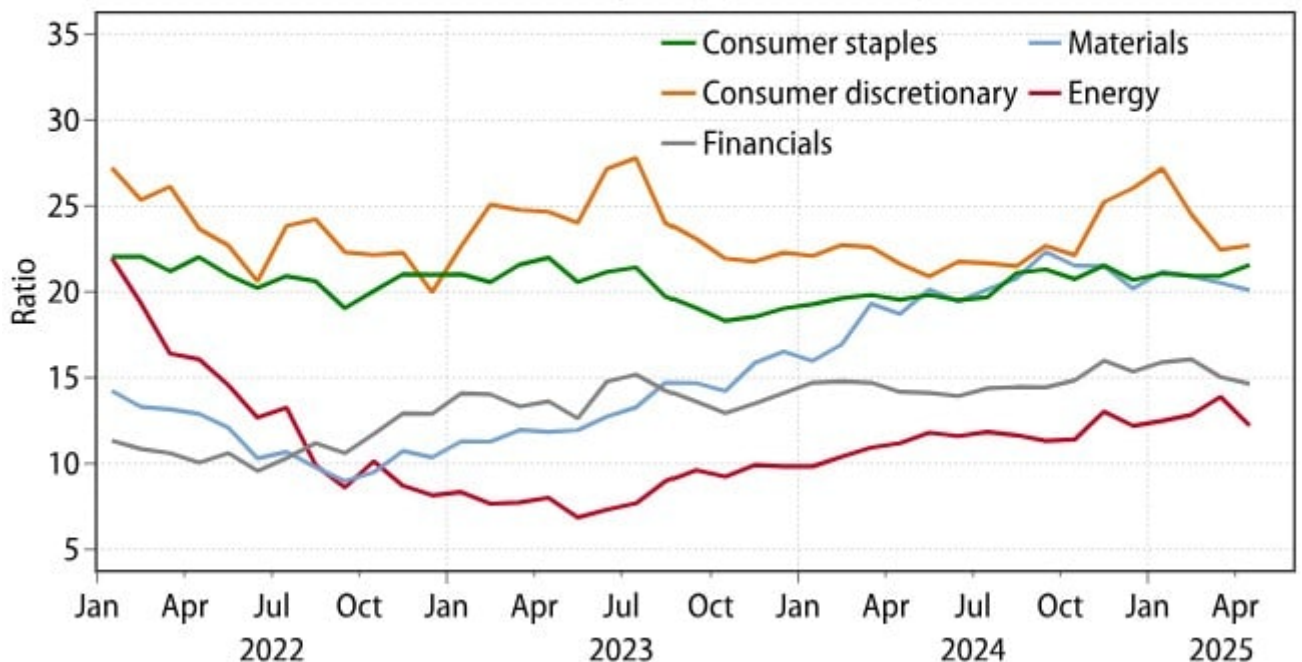
MSCI World mid and large-cap, price to book value



Gavekal Research/Macrobond

## ...and price-to-earnings ratio

MSCI World mid and large-cap, price to earnings ratio



Gavekal Research/Macrobond

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