



NAVIGATING INVESTOR CONCERNS AMIDST WESTERN ALLIANCE CHALLENGES



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The question of “how concerned should investors be about the Western Alliance” is being raised on both sides of the Atlantic following recent statements by former President Donald Trump regarding NATO, in which he indicated a willingness to support Russia in its actions against NATO members who fall short on defense-spending goals.

UKRAINE & RUSSIA DYNAMICS

President Trump’s impact on the Republican Party is evident, as House Speaker Mike Johnson (R-La.) blocks legislation to provide Ukraine with military support when Russia is gaining an advantage on the battlefield.

David Ignatius of the Washington Post observes that the message at the Munich Security Conference couldn’t have been clearer: “Russia is advancing, Ukraine is struggling to survive, and the West needs to provide more military support now.”

IMPACT ON EQUITY INVESTORS

Equity investors have not reacted to these developments thus far owing to favorable U.S. economic developments and looming Fed rate cuts. However, former U.S. Treasury Secretary Larry Summers contends that markets may be underestimating the risks posed by populist politics in the U.S. and abroad that could undermine the post-World War II order.

GEOPOLITICAL RISKS

I recently had a conference call with former Wall Street colleagues. Our discussion centered on geopolitical risks, including the lack of U.S. support for Ukraine, which could encourage Russia and other adversaries.

While Trump’s supporters have been quick to dismiss Trump’s NATO remarks, his recent views are similar to those he espoused during his first term. His over-arching theme was that America has been taken advantage of by its Western allies.

1. First, when the European Union ran chronic trade surpluses with the U.S.
2. Second, the EU consistently fell short of meeting its goal of spending 2 percent of GDP on defense.

FREE-RIDING ALLIES

Trump is not the first U.S. president to criticize free-riding allies, and many observers believe the EU should increase defense spending. However, The Economist notes the concern that Trump is “turning a democratic alliance into a mobster’s racket: no money, no protection.”

The question that many world leaders are asking now is whether Trump would withdraw the U.S. from NATO if he were elected president. According to John Bolton, Trump’s former national security advisor, “we’d almost certainly withdraw from NATO.”

Some observers believe this possibility is mitigated by legislation enacted in December that included language to block any U.S. president from leaving NATO without approval from the Senate or an act of Congress. However, Trump could make NATO “dormant” by reducing U.S. troop presence in Europe, withholding payments to support NATO, and recalling NATO’s supreme allied commander, who has always been an American admiral or general.

POTENTIAL AMERICAN WITHDRAWAL FROM NATO

A Foreign Affairs article that documents what is happening to prepare Europe for a possible American withdrawal notes that the first Trump era spurred the EU toward greater self-reliance, including establishing a European defense fund and providing financial assistance to Ukraine that now exceeds the support of the U.S. Last year, the EU also reached its 2 percent military spending target for the first time.

Still, the article maintains that the EU needs to do more to become self-reliant: "It needs to Trump-proof its future." But the question remains whether Europe is capable of defending itself.

Professor Jakub Grygiel of Catholic University asserts that the solution isn't a stronger European Union. He maintains that those who favor a reinvigorated EU, including a common army, centralized weapons procurement, shared defense ministry, and an EU-level military command, fail to recognize why it has not already happened. The reason is that many European countries are preoccupied with their own interests rather than the defense of the EU.

WHERE DOES THIS LEAVE THE UNITED STATES?

Throughout most of the post-World War II period, there was bipartisan support for America to play a leadership role globally; now being tested, however, as isolationism and nativism have taken hold. Consequently, those who favor America's role as a world leader face two key challenges.

1. The first is reminding the public of the reasons that the U.S. was committed to rebuilding a decimated Europe after World War II. Both the Marshall Plan and the creation of NATO in 1948-1949 helped set the stage for the peace and prosperity that ensued by creating a rules-based international order.
2. The second is to explain what is at stake if America abandons its commitment to NATO. Vladimir Putin recently told Russia's political elite that claims that he intended to attack Europe were "nonsense." However, he also warned of a wider conflict over Ukraine when he mentioned that an increase in Western support for Ukraine "really risks a conflict using nuclear weapons, which means the destruction of all of civilization."

If U.S. leadership wanes, investors will need to consider how these geopolitical risks will impact financial markets.

ENERGY MARKETS AS WARNING SIGNALS

Although there is no simple answer, my take is they should focus on the energy markets as an early warning indicator. When Russia invaded Ukraine two years ago, for example, financial markets sold off as prices for oil and natural gas spiked. These price pressures subsided as European countries reduced their dependence on natural gas supplied by Russia.

On the first anniversary of the conflict, Ukraine appeared to be gaining the upper hand on the battlefield due to military assistance from Europe and the U.S.

The tables could turn again if Congress does not come through with added support. If so, its failure to act would mark a low point in U.S. leadership globally.

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