The Saudi-Canada Spat Proves That This Factor Will Play a Bigger Role for Investors in the Future

Description

The S&P/TSX Composite Index was down over 200 points as of morning trading on August 15. Only cannabis stocks were able to keep pace following a gigantic investment from a United States-based company. The index appears to have extended its weakness after Saudi Arabia called to dump Canadian stocks last week. A major downturn in the Turkish economy has also dragged down global stocks.

What can investors glean from this August rout?

In September of last year, I'd discussed a warning from Ray Dalio, the founder of Bridgewater Associates, one of the largest hedge funds in the world. Dalio warned that politics would play a much larger role in determining market shifts going forward. Domestic politics in the United States would play an especially major role, even more than "classic monetary and fiscal policies," Dalio predicted.

Events in 2018 have vindicated this forecast. The emerging trade wars between the United States, China, and even its major allies have driven investor anxiety to start the year. Economic news has been very strong in the U.S., but most of its major indexes have failed to generate the momentum seen in 2017. Canada has suffered even more from this uncertainty.

The TSX rallied in mid-April as NAFTA negotiations appeared to be improving. However, talks quickly collapsed in May, and the Trump White House elected to impose steel and aluminum tariffs on Canada, Mexico, and its European allies. Although Canadian companies were confident that this hurdle could be overcome, the major threat of auto tariffs still looms. Some analysts and economists have forecasted that auto tariffs up to 25% could plunge Canada's economy into a recession.

The diplomatic dispute between Canada and Saudi Arabia is not only indicative of this new development for investors, but also in a global realignment. Internal fissures for top Western nations and anemic growth following the financial crisis has resulted in the rise of populist nationalist parties and a turn toward protectionism.

Mercantilism and great power competition dominated global politics before the world wars. Nations will have to adapt to this new reality. That means that even smaller powers will be keen to defend their prestige on the world stage. Saudi Arabia has also garnered the favour of the Trump administration in its war against Iran, which explains why the administration is unwilling to publicly denounce Saudi Arabia's actions, even for its "closest" partner in Canada.

The precipitous drop in the Turkish lira is behind the current global rout. As I explained in this recent article, this development also stems from a political crisis. Pressure was generated from higher U.S. interest rates in Turkey and even harsher tariffs placed on Turkish steel and aluminum: 50% and 20%, respectively.

How can investors respond to this new paradigm? **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) is a safe option for those looking for significant exposure south of the border. This can mitigate the negative effects of Canada's already troubling investment flight issues. TD Bank also stands to benefit in the long term from recent U.S. tax reform.

Investing in military and defence is also a great bet at this juncture. Nations are spending more and more on defensive capabilities. Companies like **CAE** (TSX:CAE)(NYSE:CAE) stand to gain from the increase in spending in the U.S., Canada, and Europe.

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