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Higher geopolitical volatility not as harmful as headlines suggest

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Geopolitical uncertainty is rising across the world, but for markets, what matters more is how strongly it feeds through to the economy and business. For now, equities continue to benefit from structural growth, while bonds in many countries are under fiscal and inflationary pressure.

Was everything really better in the past? The short answer is "no." Many key aspects of our lives—such as education, prosperity, quality of life, life expectancy, and equality—have improved markedly over recent decades. At the same time, the world feels faster, more conflict-ridden, and more complex now. Investors are therefore likely to ask two key questions: Is the amount of geopolitical tensions really on the rise? And if so, can equity markets still continue to outperform traditionally more defensive bonds?

Empirically, there is a strong case that geopolitical and political uncertainty has increased. The Uppsala Conflict Data Program recorded a total of 61 active state-based conflicts in 2024—the highest level since 1946. The ACLED Project also points to a very high global level of organized violence. Additionally, the Stockholm International Peace Research Institute found that global military spending rose to USD 2.718 trillion in 2024—a record high and the steepest increase in decades. This shows that the amount of geopolitical tension has increased, and that states are responding visibly.

For markets, however, what matters the most is not the number of conflicts but their economic reach. In a more fragmented world, wars, sanctions, export controls, energy disruptions, and trade conflicts have a more direct impact on prices, supply chains, and corporate decision-making. The *Global Risks Report* by the World Economic Forum describes the present as an

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era of growing division, in which geopolitical and geoeconomic tensions are deepening. This transmission is also evident in the data, for example in the recent rise in the UBS Supply Chain Stress Index following the Iran war.

At the same time, geopolitical tensions are not the only market-relevant driver. Equities are currently benefiting from structural growth, particularly through substantial investment in artificial intelligence (AI). The Stanford AI Index shows sharply rising private AI investment and rapidly increasing AI adoption across businesses. Leading platforms have also made notable progress in monetization in recent months—a trend we believe can continue. Since markets are not only discounting present but also future productivity gains, high margins, and robust earnings growth, their constructive stance on equities remains rational despite heightened geopolitical tension, in our view.

In addition, uncertainty does not affect asset classes equally. While equities benefit from the positive outlook for technological innovation, many bond markets are struggling with inflation, higher term premia, and rising government debt. The "IMF Global Debt Monitor 2025" and the "OECD Global Debt Report 2025" show that high and rising public debt increases financing needs, expands the supply of government bonds, and keeps pressure on long-term yields elevated. So, geopolitical uncertainty alone does not automatically make bonds more attractive. If structural growth supports equities while fiscal risks weigh on bond yields, equities can outperform in relative terms even in a more unsettled world and deliver attractive absolute returns. In addition, traditional bonds increasingly face competition from alternative asset classes such as infrastructure investments and commodities, especially precious metals.

Our conclusion: The world has become more volatile in some respects, but in many ways we are significantly better off today than in previous generations. For equity markets, greater political uncertainty and geopolitical volatility are not necessarily a drag. As long as they continue to benefit from structural growth—driven, for example, by investment in AI, digitalization, and electrification—while bonds suffer from high government debt and inflation, rising issuance, and higher term premia, equity markets' absolute and relative strength can remain intact.

Appendix

Non-traditional asset classes are alternative investments that include hedge funds, private equity, private credit, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. **An investment in an alternative investment fund is speculative and involves significant risks.**

Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- **Hedge Fund Risk:** There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.

- **Managed Futures:** There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.

- **Real Estate:** There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.

- **Private Equity:** There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.

- **Private Credit:** There are risks specifically associated with investing in private credit. This could include losses stemming from defaults on loans, which in significant adverse circumstances could result in a substantial loss of investment.

- **Foreign Exchange/Currency Risk:** Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

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