Confluence Investment Management

Bi-Weekly Geopolitical Report

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US Foreign Policy: Comparing the New vs. the Old

In our *Bi-Weekly Geopolitical Report* from January 26, we posited that the United States under the new administration has adopted a foreign policy quite distinct from that of the previous eight decades. We showed how the new US policy is a type of neo-imperialism with elements of neo-colonialism. We emphasized that our characterization of the new foreign policy is not meant to be pejorative. It is merely descriptive, to help us understand how it works and what its implications might be. After all, the new foreign policy could well be positive for US citizens, and especially the working class, which shouldered much of the costs of the old policy focused on maintaining the US role as global hegemon. In this report, we look closer at the differences between these policies and their implications for investors. We show that the politics and economics of the two policies suggest very different investment strategies.

The Politics

Since the start of the new administration in early 2025, we've highlighted how President Trump has managed to build extraordinary political power. Trump's power stems from a range of factors, including his strong political instincts, his deliberate, methodical, and unflagging effort to build power, and his unflinching will to use it.

In our view, Trump arrived on the scene at an especially opportune time for his style and focus. As we've argued before, the policies previously adopted to build and maintain US hegemony had imposed significant social and economic costs on the US working class. In addition, after the end of the Cold War, a business ethic of unfettered markets and capital flows facilitated the deindustrialization of the US, while globalization helped raise the returns to education and the "knowledge industry." These changes left many US citizens struggling economically in low-paid service jobs even as they perceived that foreigners and immigrants were faring better than they were.

President Trump relies on a broad political coalition that includes groups we have labeled "Tech Bros," "Wealthy GOP," "China Hawks," and others (see Table 1, next page). Some of these coalition groups — especially the Tech Bros — have been very successful in shaping the administration's policies. They've reaped many benefits in foreign policy, domestic regulatory policy, tax policy, and the like.

All the same, we think the tenor and essential spirit of the administration is populist, and it will continue to honor the interests and preferences of the working class, which we refer to in the table as the "Blue Collar / Trade Hawk" group. Even if the president has often had to shift his focus among the members of his coalition, we doubt that he can abandon the blue-collar, working-class element of it. Indeed, given the large size of the working class and how energized many of its members are in support of the president, we think he will always need to emphasize policies that seem to advance working-class interests.

Table 1

Trump's 2nd-Term Political Coalition
Source: Confluence Investment Management

Constituent	Wins to Date	Disappointments to Date
Tech Bros	Crypto deregulation, crypto reserve, TikTok remains in US, scrapped AI chips limits, H-20	Uncertainty over China, no EU backdown over tech regs yet, continued social media anti-trust, Musk exile
Wealthy GOP	Tax relief efforts, deregulation, stock market recovery	Tariff Volatility, continued high interest rates
Small Business	Tax relief efforts, deregulation	Loss of immigrant labor, tariff volatility, weakness in some economic sectors
Blue Collar/ Trade Hawks	Tariffs, anti-DEI, immigration reform	Deregulation, continued high price inflation, Medicaid cuts, war participation
China Hawks	Tariffs on China, maintaining a hard line in the face of weaker economy, abandoning EU	Uncertainty around Taiwan, DOD/intel personnel cuts, Signalgate, losing Waltz, Wong, H-20
Millennial/ Gen X Newbies	Kennedy in HHS, crypto deregulation	Home prices still elevated
Evangelicals	Anti-DEI, anti-trans, MAGA takeover of Kennedy Center board, support for Israel, DOJ Anti-Christian bias, reversing on same sex marriage	No national abortion restrictions

If we're correct that populist, pro-worker policies are an essential part of President Trump's policy set, we can compare the ***politics*** of the traditional, hegemonic US foreign policy to that of the new, neo-imperialist, neo-colonial policy as follows:

The Politics of Old Policy. One main pillar of the post-World War II foreign policy was for the US to provide the public good of international security and free, open sea lanes (i.e., to be the "global policeman"). This required huge defense budgets and sometimes led to long wars, as in Vietnam, Iraq, and Afghanistan. Especially in the latter two wars, those who fought came mostly from a relatively narrow slice of society, largely from the working class, and many of them had to endure multiple combat tours as the rest of society remained out of harm's way.

The other key pillar of traditional "soft power" foreign policy was to make the dollar the world's reserve currency (another public good), largely by keeping the US open to foreign imports and free capital flows. That became especially problematic after China joined the world trading system in 2001. This policy pillar helped to deindustrialize the US and undermined economic opportunity for many US citizens, while seemingly helping other countries prosper. For these reasons, much of the president's populist, working-class base is dead set against long, deep foreign military operations and unfettered international trade.

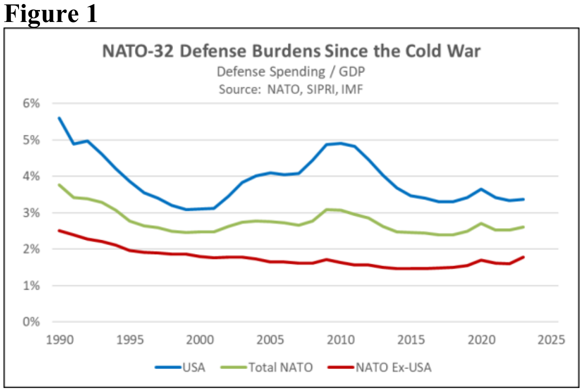
The Politics of the New Policy. The new US foreign policy is built largely on the basis of hard power, punishing perceived slights to US honor, aggressively seizing economic advantages for the US, and shifting the costs of global security and prosperity away from the US. To date, this policy has often been wielded to benefit US businesses, such as the technology and energy industries (the US seizure of Venezuelan President Maduro being a key example). However, the president has been careful to couch these moves as 1) punishing other nations for daring to tax or regulate US firms, or 2) helping to reindustrialize the US by bringing industrial production back home. So long as any associated military action is short, successful, and casualty-free, such initiatives can be painted as reestablishing US honor and benefiting its working classes.

The Economics

Of course, a key question is whether the new policy will really offer ***economic*** benefits to the US and its working class. The new focus on hard power is often aimed at extracting political benefits from weaker nations, but here we focus on the economic aspects of the new policy. We see the neo-imperialist and neo-colonial aspects of the new policy as aimed at reducing the provision of expensive public goods and forcing a favorable balance of demand versus supply for a wide range of goods and services.

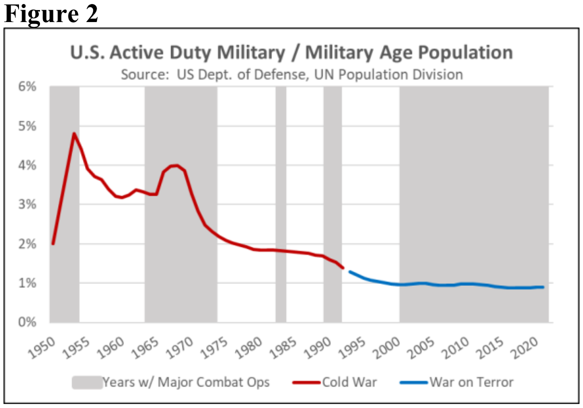
The Economics of the Old Policy. As noted above, the old policy of hegemony required shouldering enormous defense budgets, fighting bloody wars, and accepting deindustrialization. For example, US defense spending as a share of gross domestic product averaged 3.9% from 1990 to 2023, but just 1.8% for the rest of the members of the North Atlantic Treaty Organization (see Figure 1).

Figure 1



This ensured a large, innovative US defense industry that spawned important new technologies, products, and services, but it distorted public budgets. The massive US defense effort also diverted many youths away from private industry, especially during the Cold War. The share of population serving in the military was much lower during the War on Terror, but those personnel were more at risk of being deployed to a combat zone (see Figure 2).

Figure 2



Just as important, free trade and capital flows boosted the US supply of goods and services, especially after 1980. That helped cap goods prices (see Figure 3) but at the expense of millions of industrial jobs (see Figure 4).

Figure 3

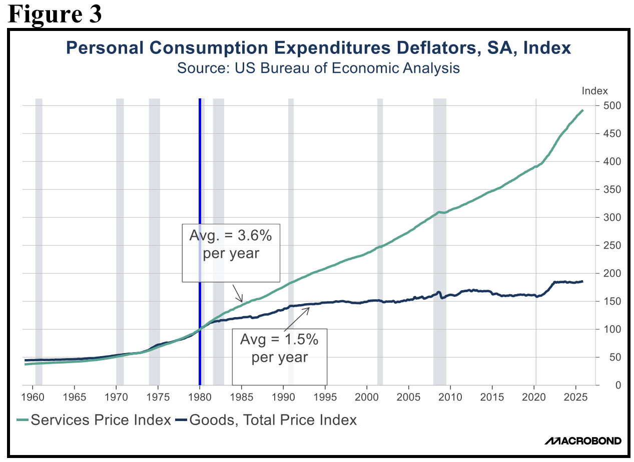
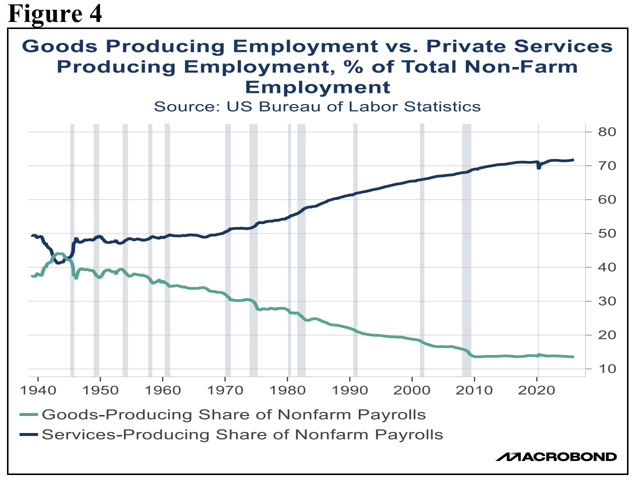


Figure 4

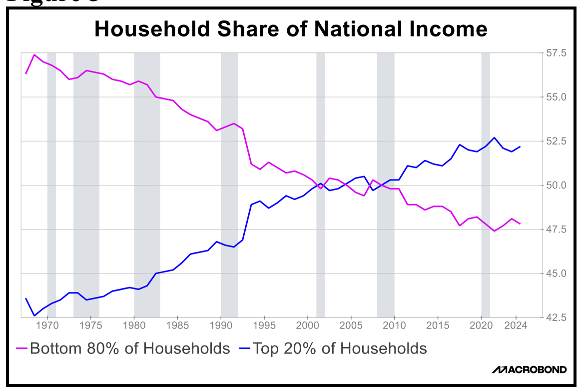


The Economics of the New Policy. It's still too early to know exactly how the US's new neo-imperialist, neo-colonialist policy will develop over time, but the trends so far suggest it will be geared toward forcing open foreign markets to US-produced goods and services, which in turn could boost demand and allow US producers to operate at a more efficient scale, just as China managed to do in the early 2000s. The policy also aims to ensure secure access to needed raw materials and industrial and technological subcomponents from abroad, and perhaps to deny those inputs to adversaries such as China. The policy seems geared especially toward ensuring cheap supplies of energy and critical minerals.

However, while these changes could create more numerous, more secure industrial jobs within the US and help reduce the US trade deficit, the results may not be as economically advantageous to the working class as expected, for several reasons:

- Since modern manufacturing is so efficient, it isn't clear how many new domestic industrial jobs would be created by a neo-colonialist system. Besides that, producing in the US with restricted supply chains is likely to be more costly than with the worldwide supply chains of the Globalization era, which could also crimp production and industrial jobs. The higher cost of domestic output could also lead to higher and more volatile price inflation.
- In addition, greater imports of foreign raw materials, especially energy, could take business away from US producers, reducing their output and employment.
- Even if the US's new neo-imperialist, neo-colonial system does create a lot of new jobs without pushing the cost of living too high, it's not clear how much that would boost working class incomes. Capital owners and higher-income households could continue to reap most of the rewards from economic growth, leaving relatively less benefit for the working class (see Figure 5)

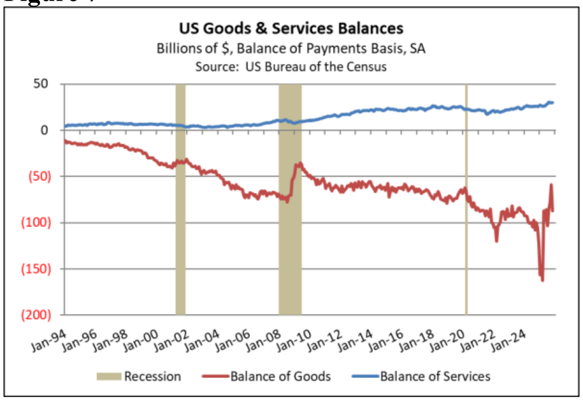
Figure 5



- Finally, if China or another rival establishes its own closed neo-colonial system with captive markets and suppliers, the scope of US export-production would be curtailed (see Figure 6). If the reordering of the world's geopolitical system doesn't give the US better access to large, rich foreign markets, it would likely fail to significantly cut the trade deficit, especially for goods (see Figure 7).

Figure 6

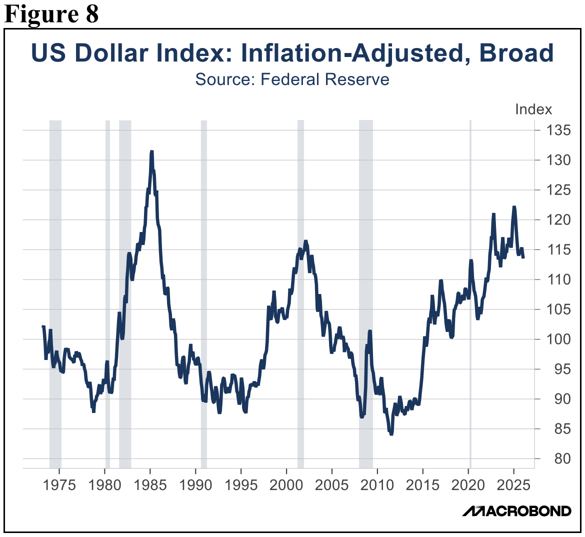
Figure 7



A Note on the Dollar

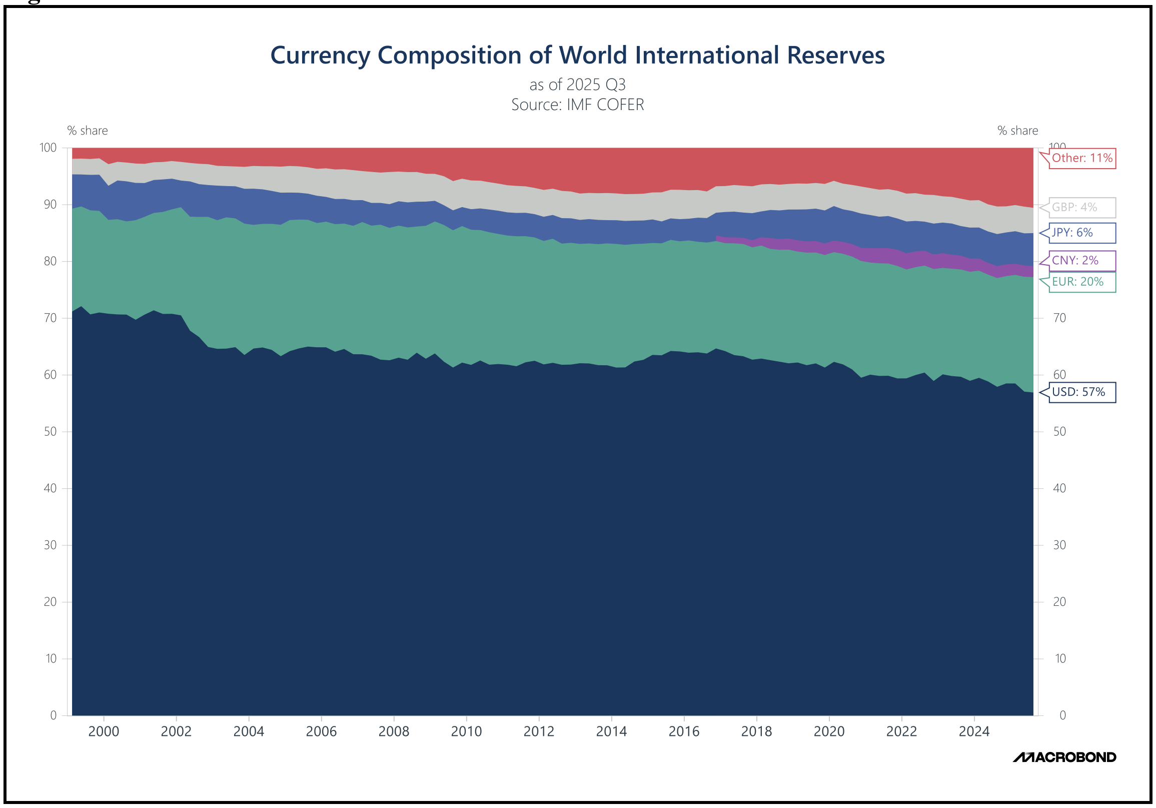
In theory, the gaping trade deficits during the latter decades of the US's previous hegemonic foreign policy should have undercut the value of the dollar. However, several other factors can buoy the value of a currency, such as interest rate differentials and relative rates of price inflation. The dollar's role as the reserve currency ensured long periods of strength, especially as foreigners sought to park their savings in ultra-safe US Treasury securities. In fact, the dollar was in a prolonged bull market from 2012 to 2025 (see Figure 8).

Figure 8



On the other hand, the economic growth of foreign countries and the associated growth in the use of their currencies has prompted foreign central banks to gradually reduce their share of reserves held in the greenback (see Figure 9, next page). This shift has prompted investors to worry about the long-term value of the dollar. Investors have also started to become more concerned about the US's large budget deficit, growing federal debt, and potential for elevated price inflation. Coupled with the shock many foreign investors feel from the dramatic policy changes being put into place by the new US administration, we think these forces will likely push the dollar into an extended bear market in the coming years. However, if the US successfully builds a neo-imperialist, neo-colonial system, it could well pressure the countries in its system to make greater use of the dollar, limiting any decline in the demand for the greenback. The result could be to put a floor under the dollar and keep it from falling as far as it otherwise would.

Figure 9



Investment Implications

In sum, the new US foreign policy of neo-imperialism and neo-colonialism could well be embraced by many voters in the US's large working class. That's especially the case given the negative impact of the previous foreign policy, which focused on maintaining the traditional role as global hegemon. We think many in the US working class will embrace the new foreign policy on the belief that it can't be any worse than the previous one and that its focus on hard power is attractive. If that is indeed how things play out, the new foreign policy could have staying power, with lasting effects on economics and the financial markets for years to come.

As we have recently published, we believe that many of our investment themes remain valid amid the administration's efforts to reshape US foreign policy. For example, we presume the administration's ongoing criticism of European leaders and their policies will continue to raise concerns about the US commitment to allied defense. Alongside the US's recent support for right-wing European politicians, this should reinforce the region's trend toward more stimulative economic policies, deregulation, and increased defense and infrastructure spending. In turn, these dynamics are likely to give a further boost to economic growth and strengthen ***European stock*** values.

The disorienting shifts in US foreign and domestic policy could also sustain central bank and investor demand for ***precious metals***, buoying prices. Finally, the administration's drive toward greater US economic sovereignty is consistent with our thesis for prolonged global fracturing and supply chain disintegration, which should undermine efficiency, increase costs, and contribute to higher and more volatile inflation and interest rates. In this environment, ***bonds*** still seem positioned to decline in value, as we have long argued.

All the same, the US's new foreign policy raises some novel implications. For example, the administration has signaled that it intends to prioritize economic opportunities for US businesses, which would especially benefit large, well-run US firms that derive a lot of their profits from foreign sales, particularly those currently burdened by foreign regulations. Those companies will now probably have the full backing of the US government as they work to expand foreign sales and profits. We therefore expect ***US large cap equities*** to outperform small caps, especially those large businesses operating in the ***energy, technology, and digital services*** sectors.

In the more immediate term, the administration's efforts to reach a temporary détente with China should ease geopolitical tensions with this major power. Any such decline in tensions would be bullish for both US and ***Chinese stocks***, in our opinion, although we still anticipate that the ongoing competition for resources and spheres of influence will rekindle US-China tensions in the future.

Finally, the US's focus on dominance in the Western Hemisphere will likely place pressure on Latin American nations to align their economic policies with current US priorities. If they acquiesce, these countries could benefit from preferential trade relations with the US, providing a boost to ***Latin American equities***. That said, it's important to note that, over time, US firms may simply acquire the most attractive firms and economic assets in the Americas, leaving fewer and less competitive local firms. Nevertheless, this may be a more distant development in the future.

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