By the Confluence Macroeconomic Team

June 22, 2026

Mid-Year Geopolitical Outlook

As the first half draws to a close, we typically update our geopolitical outlook for the remainder of the year. This report is less a series of predictions than it is a list of potential geopolitical issues that we think will dominate the international landscape for the rest of 2026. The report is not designed to be exhaustive. It focuses on the "big picture" conditions that we think will affect policy and markets going forward. We list the issues in order of importance.

Issue #1: Sea Lanes and Hegemony
Charles Kindleberger was an economic historian and author. His book *Manias, Panics, and Crashes*[1] is a masterwork and a useful addition to any investor's library. In his book on the Great Depression,[2] he outlined the concept of hegemonic stability theory, which postulates that the world functions best when it has a competent hegemon, i.e., a strong, dominant country that provides international order. The hegemon provides two broad public goods — global security and financial stability. To maintain the former, it dampens regional rivalries to prevent large military conflicts and provides security to shipping routes. To supply the latter, it supports a reserve currency/reserve asset system that facilitates global trade. By providing both goods, the hegemon fosters free trade and globalization. In the absence of a hegemon, trade and international investment tend to regionalize, which leads to a world of reduced investment opportunities, weaker economic growth, and inflation.

In Kindleberger's view, securing the sea lanes requires the hegemon to have a powerful navy that can prevent local actors from interfering with shipping. The US took on this role after World War II for three reasons. First, US leaders at the time believed the collapse of free trade following World War I was a key factor in causing the second one. Thus, those leaders were convinced that, at least in the "Free World," trade barriers and shipping restrictions would be steadily reduced. Second, after World War II, the US was particularly situated to fulfill this role because it had built such a large navy to prosecute the war. Third, and perhaps most importantly, US policymakers were deathly afraid of communism, viewing it as incompatible with progress. Washington was willing to go to extraordinary lengths to contain communism, viewing its ideology as an existential threat.

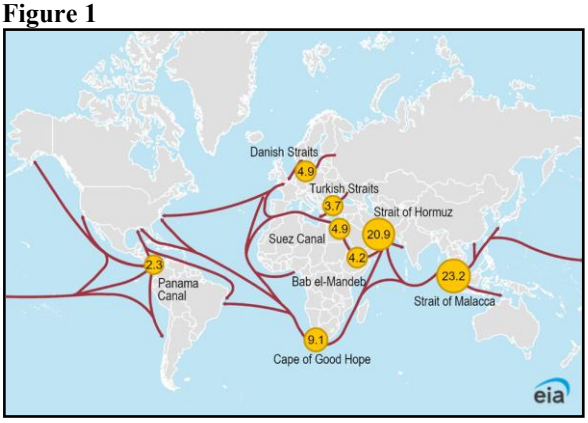
During the Cold War, the US built a fleet of large nuclear-powered aircraft carriers. These ships carried a significant level of firepower and proved capable of projecting US power around the globe. For example, in 1996, the US sent two carrier groups to the Taiwan Strait during a period of heightened tensions between China and Taiwan. This expression of force showed China how

[1] Kindleberger, Charles P. (1996). *Manias, Panics, and Crashes: A History of Financial Crises* (3rd ed.). New York, NY: John Wiley & Sons, Inc.
[2] Kindleberger, Charles P. (1986). *The World in Depression, 1929-1939* (2nd ed.). Berkeley, CA: University of California Press.

useful these carriers were in enforcing US goals. It should be noted that during this period of tensions, when China launched missiles just offshore Taiwan, shipping through the Taiwan Strait was halted. It was the US show of force that helped relieve the situation and allowed shipping to resume.

The map below shows the world's major geopolitical "chokepoints" and the millions of barrels of crude oil per day that pass through them. Other goods pass through these chokepoints as well. These geographic features are critical to global trade. There is a body of international law that governs these chokepoints and restrict what nations surrounding them can do to manage vessel traffic. But international law really only matters if some power is willing to enforce it. Generally, that power has been the US.

Figure 1



Key global chokepoints. (Source: US Energy Information Administration)

After the aforementioned incident with China and Taiwan, Beijing embarked on a military buildout designed to reduce the effectiveness of US carriers. China has devised missiles specifically to deny the US close access to its shores. Although other nations surrounding critical chokepoints haven't necessarily been able to duplicate the sophistication of China's missile array, the advent of drone technology has enabled Iran and non-state actors such as the Houthis the capacity to affect shipping through the Strait of Hormuz and the Bab el-Mandeb. China's anti-access missile development and the use of drones and missiles by Iran and the Houthis give credence to the idea that the US is no longer capable of keeping these sea lanes open for general use. At this writing, Iran controls the Strait of Hormuz and is demanding "tolls" for safe passage. The fear is that this action will give other nations that border these chokepoints the idea that they, too, can collect revenue. For example, although there is no evidence that Malaysia, Thailand, and Indonesia are considering similar actions at the Strait of Malacca, the temptation will likely increase. We note that although Panama has formal control over the Panama Canal, the US is pressing for influence to keep this waterway "friendly."

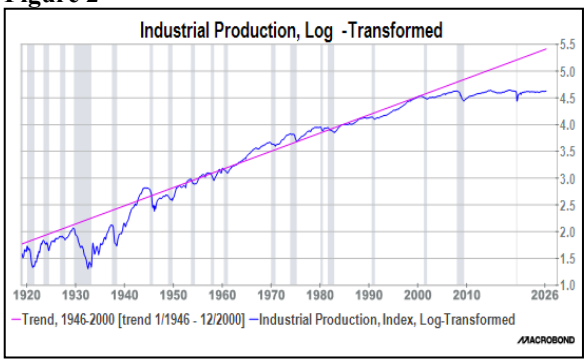
We draw two key conclusions from this situation. First, the US no longer has the undisputed power to use force to open these critical waterways. The US Navy is still impressive, but its recent behavior shows it is unwilling to put its major vessels at risk. There's also little evidence that the US is willing to commit ground troops to open up contested chokepoints. In the future, the US may develop sufficient countermeasures to offset drone technology, but for now, our conclusion is that the US is unable to fully supply one of Kindleberger's hegemonic public goods. Second, in a world where free transit is in question, globalization as it has evolved since the end of World War II is now uncertain. We think globalization will continue to deteriorate and trade will become more regional over time, which will tend to raise price levels, all else held equal.

– BOG

Issue #2: Re-industrialization or Reserve Currency Status

The chart below is rarely seen in the media, but we think it may be of utmost importance for US policymakers. It shows the US's Index of Industrial Production starting in 1921. We have transformed the data logarithmically and added a trendline that represents the period from 1946 through 2000. Clearly, there was a collapse in output during the Great Depression, and production didn't get back to the trendline until well into the defense buildout of World War II. It was this excess capacity that allowed the US to become the "arsenal of democracy" during the war. After the war, output generally followed the trend until China's entry into the World Trade Organization (although production did fall below trend after 1990 and only briefly touched trend at the end of the 1990s). Since China's entry into the WTO, industrial output in the US has mostly been flat.

Figure 2



The flattening of US industrial output has many causes, but one key contributor is the US reserve currency/reserve asset status. Of course, hegemons have fostered the reserve currency throughout history, but their systems were based on gold. In other words, nations would typically use the reserve currency to conduct trade but hold excess funds in gold. The US set up a quasi-gold standard via the Bretton Woods agreement of 1944, but when President Nixon ended the gold link in 1971, there was a period without a fully accepted reserve asset.

This problem was resolved in the twin recessions of 1980 and 1981-82 when Fed Chair Paul Volcker sent interest rates soaring in a bid to contain inflation. Volcker is widely credited with "slaying" inflation, but in our opinion, this claim is overstated. The deregulation and globalization of the 1980s and beyond played a much bigger role. What Volcker proved to the world was that the US was willing to implement policy austerity to protect the value of US Treasury debt. From the 1980s onward, the world's reserve currency/asset system shifted from a dollar/gold foundation to a dollar/Treasury framework.

There were huge advantages in ending the extensive use of gold as a reserve asset. Treasurys are easy to create, liquid, and pay interest. Because of their elasticity, global trade greatly benefited from the move away from gold. And as long as US policymakers were willing to use policy austerity, there was faith in the new system.

Like everything in economics, there are downsides to this system. Foreign nations quickly realized that they could boost their economic development by constraining domestic consumption, using that saving to build productive capacity, and selling to the US consumer to acquire Treasurys when the inevitable trade surpluses developed. But in their zeal to develop trade surpluses, these foreign countries subjected US producers to withering competition. In fact, this trade is "unfair" at its core, because foreign nations are essentially trading "stuff" for Treasurys. Domestic industries facing this competition are at a significant disadvantage because foreign nations will go to great lengths to acquire Treasurys.

The problem isn't that the dollar is the reserve currency, per se. The problem is that Treasurys are the reserve asset. For the first time in human history, we have a global trading system based on a single nation's debt. This structure is causing distortions that lead to currency overvaluation and, as the chart above shows, de-industrialization.

If the US is going to rebuild its industrial base (something we think is critical to US national security), some changes in the reserve asset system need to occur. Perhaps we're already seeing one such change. The extensive use of financial sanctions has led central banks to buy gold instead of Treasurys for reserve purposes. If the US were to put up "tolls" on foreign Treasury buying, it could raise borrowing costs to the government. But if American industry is going to recover, it will likely need a weaker dollar and creating impediments to foreign official Treasury buying is one obvious avenue to accomplish this goal.

The market implications would initially suggest higher US interest rates, some degree of policy austerity, and/or perhaps higher inflation. We do think the US Treasury and the Fed will, at some point, work in concert to contain US interest rates and force an adjustment on the exchange rate. But we may need an interest rate shock before this outcome occurs.

– BOG

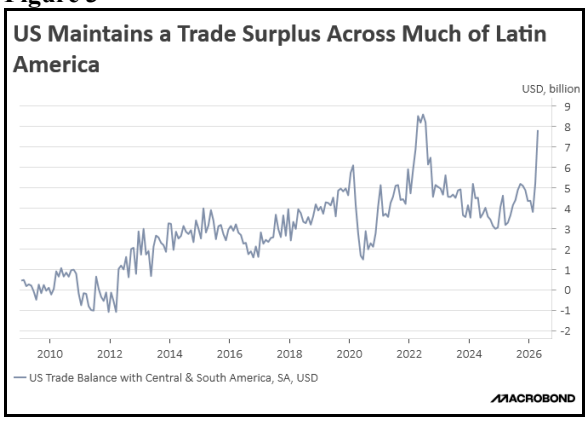
Issue #3: The Donroe Doctrine

While much of the world remains focused on the US conflict with Iran, there are growing signs that the White House is tightening its grip on Latin America to ensure regional loyalty. Since the start of the year, Washington has adopted a markedly more assertive strategy to draw countries into its orbit, shifting from indirect maritime pressure to direct action. A major inflection point occurred when the US detained Venezuelan President Maduro on drug trafficking charges. This escalation has since broadened into a sustained coercive posture across the region, including what now amounts to a fuel blockade of Cuba.

This application of hard power reflects a new willingness from the US to force foreign nations into friendlier relations. Rather than imposing immediate regime change through chaos, Washington has combined aggressive diplomatic pressure and sanctions with strategic attempts to reset relations under its preferred political conditions. Similarly, regarding Cuba, the White House has not entirely ruled out more drastic measures, maintaining that its restrictive policies and embargoes will remain in place until Havana alters its governance and reconsiders its strategic partnerships with nations hostile to US interests, such as China, Iran, and Russia.

Elsewhere, Washington is utilizing a more moderate but still coercive economic playbook. In Brazil, the US is leveraging intense trade pressure to influence the upcoming presidential election, aiming to replace the Beijing-friendly incumbent, Luiz Inácio Lula da Silva, with right-wing candidate Flávio Bolsonaro, who enjoys close ties to the Trump administration. To advance its preferred candidate, the White House proposed sweeping 25% tariffs on Brazilian imports following a Section 301 investigation, while additionally targeting Brazil over deforestation. Given that the US runs a trade surplus with Brazil — and considering the White House's general skepticism toward climate policy — these synchronized efforts reflect a calculated strategy to disrupt the Brazilian economy to elect its preferred candidate.

Figure 3



Meanwhile, countries with right-leaning governments continue to enjoy closer ties with Washington and more favorable economic conditions. Chile and Argentina are primary examples. Last year, US Treasury Secretary Bessent described Argentina as the beacon of Washington's Latin America strategy, a view that justified a massive $20 billion currency swap and bailout for the country. Chile appears to be on a similar trajectory after the recent election of far-right leader José Antonio Kast. Washington has moved swiftly to deepen ties with Santiago, signing a joint declaration on critical minerals and bilateral security. Both nations have gained significant strategic importance due to their rich reserves of essential materials — such as copper and lithium — which are critical to the expanding global AI infrastructure.

The new US approach to Latin America should be a net positive for regional equities, in our opinion. Nations that strengthen their ties with the US stand to benefit from preferential trade treatment and are increasingly well positioned as nearshoring investment destinations, especially as Washington seeks to support the development of local energy sectors. Growing US influence in the region could also provide a meaningful tailwind for domestic equities by encouraging technology companies to diversify their supply chains and secure access to critical resources closer to home.

– TW

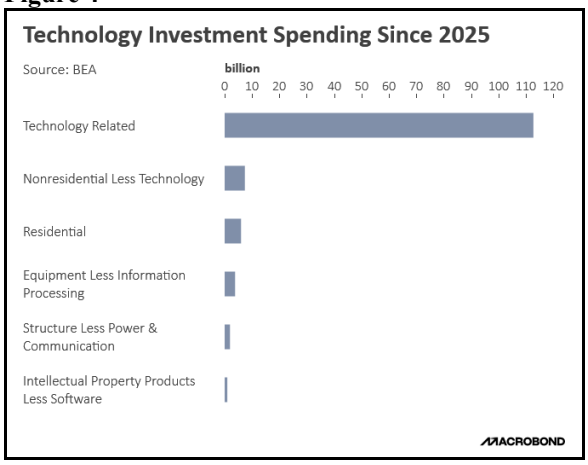
Issue #4: AI's Non-Laissez-Faire Effect

Last year, we highlighted the US government's expanding role in the economy and the potential implications for corporate balance sheets. That trend now appears to be accelerating. In recent months, policymakers have taken a more active stance in markets, seeking to retain influence over companies deemed critical to national security. This has included direct support for semiconductor supply chains and strategic commodity production, but the scope of intervention is likely to broaden.

In June, President Trump suggested the federal government may take ownership stakes in major US firms involved in artificial intelligence (AI), signaling a further shift toward interventionist policies. The remarks come alongside growing evidence that the administration views winning the AI race as a strategic priority, with data centers and related infrastructure being progressively treated as systemically important to the country's long-term economic and geopolitical position.

Over the past year, AI has emerged as an increasingly important driver of overall economic activity, suggesting that abrupt policy shifts could carry meaningful implications for growth. There are growing signs that technology investment — and especially AI-related capital spending — is starting to crowd out capital flows to other sectors, while also helping to offset a broader slowdown in consumption. As a result, the economy is becoming more dependent on AI-driven investment, elevating its systemic importance.

Figure 4



While the government has not yet settled on a formal mechanism for investing in AI, Intel likely provides a useful template. In 2025, the Trump administration used CHIPS Act support to secure a roughly 10% equity stake in Intel, establishing a precedent for deploying public funds to acquire ownership in strategically important companies.

There are also indications that the administration has actively supported Intel's commercial position, helping to underpin its strong equity performance this year. The company is reportedly close to a preliminary chip-manufacturing agreement with Apple, and major cloud providers are increasingly looking to Intel for advanced AI and data-center chips.

In addition to potential support on the equity side, there is growing speculation that the government could be viewed as an implicit backstop for these firms as they build out capital-intensive AI infrastructure. Last year, OpenAI's CFO even alluded to the possibility of an implicit government guarantee tied to the financing of its chips and data centers. Although the company's CEO subsequently clarified that they do not seek taxpayer safety nets for private data centers, the initial remarks reinforced the market perception of a de facto public safety net forming around key AI players.

While the government has shown a willingness to support strategically important firms, it has also signaled that it doesn't intend to reward shareholders in the process. For example, the president has warned defense contractors against using government-derived revenue to fund share buybacks or dividend increases. At the same time, bondholders could face significant losses if the government is forced to bail out these companies.

In the second half of 2026, we think any significant reversal in the AI rally could prompt some form of policy support. While this is not our base case, we see a plausible scenario in which the government steps in as a lender of last resort following a sharp drop in sentiment. Such support would likely take the form of loans or guarantees, although in more extreme circumstances it could involve direct equity stakes. Even if this proves supportive for markets in the near term, we believe it would likely come at the expense of long-run earnings and growth.

– TW

Issue #5: Russia Falters in Its War Against Ukraine

As the Russia-Ukraine war approaches its fifth year, the balance on the battlefield has shifted more clearly in Ukraine's favor, even as the conflict shows little sign of rapid resolution. After a prolonged period of attrition that appeared to benefit Russia's greater manpower and industrial depth, Ukraine has regained tactical momentum through the large-scale, cost-effective use of unmanned systems. Air, sea, and ground drones now underpin Ukraine's battlefield strategy, enabling persistent surveillance, precision strikes on Russian armor and artillery, and a growing campaign against military and energy infrastructure deep inside Russia.

Ukraine's drone advantage lies not only in technology, but in its scale and speed of innovation. Domestic production of first-person-view (FPV) and long-range drones has expanded dramatically, allowing Ukrainian forces to impose losses on Russian units at a fraction of the cost of conventional weapons. Long-range strikes on oil terminals, refineries, airfields, and logistics hubs — including high-profile attacks near St. Petersburg — have slowed Russia's advances at the front while simultaneously imposing economic costs at home. These strikes have periodically disrupted energy revenues, forced Moscow to redeploy air defenses away from the battlefield, and underscored Ukraine's ability to bring the war directly to Russia's political and commercial centers.

The military pressure from Ukraine's evolving tactics coincides with mounting economic and financial strain inside Russia. After several years of growth driven by wartime spending, Russia's economy has begun to lose momentum. Moscow has sharply downgraded its growth outlook for 2026, citing labor shortages, sanctions, and excessive state spending. Budget pressures are intensifying as defense and security now account for roughly 40% of federal outlays. The government is on track to overspend its war budget by at least $28 billion this year, with officials warning that further overruns are likely. The result is a widening deficit and increasingly difficult trade-offs as resources are diverted away from investment, infrastructure, and social programs.

Complicating matters further, Russia is grappling with financial imbalances that limit its room to maneuver. High interest rates — held elevated to contain inflation fueled by state spending — are weighing on domestic credit and investment. At the same time, the ruble has strengthened to its highest level in more than three years, boosted by energy exports and restricted capital outflows. While a strong currency helps curb inflation, it has reduced the competitiveness of non-energy exports and, paradoxically, undermined budget revenues by lowering the ruble value of oil and gas receipts. These dynamics are increasingly acknowledged by Russian officials and business leaders as structural constraints rather than temporary distortions.

Whether these pressures will force President Putin to curtail the war remains uncertain. Russia has shown a high tolerance for economic pain, and the leadership continues to prioritize military objectives over broader economic health. However, the combination of slowing growth, persistent budget overshoots, and rising financial imbalances raises the probability that Moscow may eventually seek to freeze the conflict or move toward negotiations to stabilize the domestic economy.

For investors, Ukraine's improving battlefield position and Russia's growing constraints point to a war that is becoming more economically consequential but also more strategically bounded. Ukraine's ability to deny Russia decisive gains and impose sustained costs strengthens its negotiating leverage, but outright military victory remains unlikely in the near term. Market implications include continued episodic volatility in energy prices, structural support for defense stocks and drone-related industries, and, over time, the prospect of reduced escalation risk. A shift toward negotiation would also lay the groundwork for substantial reconstruction investment in Ukraine. In mid-2026, the conflict resembles a grinding rebalancing rather than a binary outcome — one with

material but more predictable implications for global markets.

– PFH

Issue #6: Quantum Computing and the Next Technological Arms Race

An emerging front in the US-China rivalry is quantum computing, a technology still poorly understood by the broader public but increasingly viewed by governments and companies as potentially transformative. The importance Washington now places on the sector was illustrated recently at an event of the Intelligence and National Security Alliance (INSA), where a senior official from a quantum firm described to us how his company secured a roughly $100 million federal government investment in just two months — a remarkably rapid process compared to the normal pace of defense contracting. The conversation suggested not only a push by the administration to streamline strategic investments, but also a deepening sense of urgency in Washington that the US cannot afford to lose the global quantum race to China.

At its most basic level, quantum computing seeks to harness the strange properties of quantum mechanics to perform calculations far beyond the practical capabilities of today's computers. Traditional computers process information as binary bits — zeros and ones. Quantum computers instead use "qubits," which can exist in multiple states simultaneously. In theory, this allows some quantum systems to process immense numbers of potential solutions at once, dramatically accelerating certain types of calculations involving optimization, simulation, cryptography, logistics, and AI.

Quantum computing is still in a relatively early stage of development, but momentum behind it has accelerated sharply. In May, the federal government announced it had provided $2 billion to support quantum firms using the 2022 CHIPS and Science Act. About half the funds went to computing giant IBM, while smaller amounts went to firms such as GlobalFoundries, Rigetti, and Quantinuum. Many of the deals reportedly involved direct government equity stakes, an unusual step reflecting the strategic priority now attached to the field. Senior officials describe the effort as necessary to preserve US leadership in what they now view as a technology that is critical to national security.

China, however, is pursuing the same goal with enormous state-backed resources. Beijing has invested heavily for years in quantum communications, quantum sensing, and quantum-computing research, while integrating those efforts into broader industrial and military modernization programs. Multiple assessments from US policy institutions now warn that quantum technologies may become one of the defining determinants of geopolitical power in the coming decades. Much as AI and semiconductors have become central to economic and military competition, quantum technologies are steadily viewed as potential force multipliers capable of reshaping the global balance of power.

The most immediate geopolitical concern relates to encryption. Most of the world's financial transactions, military secrets, intelligence communications, and state databases rely on encryption methods that would be extraordinarily difficult for today's computers to crack. A sufficiently advanced quantum computer could in theory break many current cryptographic systems at speeds previously unimaginable.

Governments therefore increasingly fear a future in which the first country to achieve practical quantum superiority gains massive

intelligence and cyberwarfare advantages. Even before the technology fully matures, foreign intelligence services are reportedly already harvesting encrypted data in anticipation of future quantum decryption capabilities.

Quantum computing could also produce major economic disruptions. The technology may eventually revolutionize areas such as pharmaceutical development, advanced materials, battery chemistry, energy systems, logistics optimization, and financial modeling. Some researchers believe quantum-enabled breakthroughs could sharply accelerate AI development itself by vastly improving processing power for certain complex calculations. IBM's leadership recently stated that commercial applications may emerge within only a few years, with the sector potentially generating hundreds of billions of dollars in economic value by the 2030s.

Of course, important technical hurdles remain. Quantum systems are still highly error-prone, expensive, and difficult to scale. Skeptics argue that practical large-scale commercialization could take much longer than optimistic forecasts suggest. Nevertheless, the tone among industry participants that we've talked with increasingly resembles that of the AI industry from several years ago, expressing the belief that the transition from research project to commercial breakthrough may occur faster than many investors expect.

For investors, the broader implication is that quantum computing is evolving from a speculative niche into a strategically important sector sitting at the intersection of technology, industrial policy, national security, and geopolitics. As with semiconductors and AI, the competition will likely spur rising government subsidies, export controls, alliance-building, and restrictions on technology transfer. Quantum computing will therefore likely exacerbate US-China tensions. Domestically, since the AI-investment frenzy has arguably left many stocks in that sector overvalued, any major unexpected breakthrough in quantum computing could spark a sell-off in AI assets as investors rotate toward quantum firms.

– PFH

Summary

As we noted in our introduction, the discussion above is not a set of predictions. Rather, it is a listing of issues that we think will be important drivers of the global economy and financial markets over the rest of the year. The analysis is also not comprehensive as some important issues simply didn't warrant full coverage in the space available. For example, now that the Japanese government has jettisoned its decades-long prohibition on exporting lethal weapons, the country is already coming into its own as a major arms exporter.

Nevertheless, the discussion in this article shows the issues that we're especially focused on as we enter the second half of 2026 and continue to assess the prospects for the world's financial markets.

Patrick Fearon-Hernandez, CFA
Thomas Wash
Bill O'Grady

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