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Growing Fragility in the US Bloc and Prospects for a Break-Up

We at Confluence have written extensively on the end of post-Cold War globalization and the fracturing of the world into various geopolitical and economic blocs. We've noted that the large, rich bloc led by the United States is an attractive place for investors, but fractured supply chains and rising international tensions may produce a range of economic and financial market problems, from elevated consumer price inflation to higher and more volatile interest rates. In this report, we explore what could happen to the US bloc as President Trump pursues his aggressive policies to push the costs of Western security and prosperity onto the US's traditional allies. As we've noted before, those policies run the risk of reducing US influence with its allies and undermining cohesion within the US bloc. We assess in this report that reduced cohesion probably won't splinter the US bloc in the near term. Nevertheless, we begin laying out how the world could change if the US bloc does disintegrate, and we discuss the economic and market implications if it does.

Our Bloc Analysis: A Recap

We launched our original bloc analysis in 2022 after realizing that rising geopolitical tensions were fracturing the countries of the world into various groupings or camps. Our analysis sought to assign 195 significant countries across the globe to the US-led bloc, a US-leaning bloc, a neutral bloc, a China-leaning bloc, and a China-led bloc. To predict where each country would land, we assigned it a score based on 13 different geopolitical, economic, and cultural indicators. Most of our criteria reflect countries' formal international relationships, such as their membership in mutual defense treaties like the North Atlantic Treaty Organization (NATO), general cooperative groups such as the Shanghai Cooperation Organization (SCO), intelligence-sharing arrangements such as the "Five Eyes" group, and free-trade deals like the US-Mexico-Canada (USMCA) agreement or the European Union (EU). We chose these criteria based on the idea that such deep, long-lasting relationships offer a certain comfort level between countries that would be hard to abandon.

We also chose other criteria that reflect a country's own political, cultural, and economic idiosyncrasies, such as its score in the Heritage Foundation Index of Economic Freedom and whether it is considered "advanced" by the International Monetary Fund (IMF). Our thesis was that countries scoring similarly on these criteria will have a stronger affinity for each other. Finally, since we thought that economic and trade interests would be a key consideration for aligning with a bloc, we included criteria that address each country's relative economic dependence on exports to the US versus exports to China over the preceding 10 years.

For each country, we assigned a subscore from +2 to -2 for each of the 13 indicators, with higher positive numbers reflecting closeness to the US and larger negative numbers reflecting closeness to China. We summed each country's subscores into a total score. A few significant countries had such little data available that we could not score them. The two most important in this group were North Korea and Cuba. However, because of their ideological stances and non-market economies, we felt comfortable assigning them to the China-led bloc. We also excluded a number of very small countries, such as some Caribbean island states, for ease of calculation and data presentation. We suspect those countries would lean toward the US bloc.

Since a country's political, military, economic, and cultural relationships can change over time, we updated our analysis in 2024 with the latest available information. Table 1 provides a sample of each bloc's membership. As in our initial analysis, the updated US-led bloc essentially consists of rich, highly industrialized, technologically advanced, liberal democracies as well as a few closely related emerging countries. The US bloc is generally characterized by strong rule of law, protections for private property, free markets, and economic flexibility. The China-led bloc is much different, as it is entirely made up of emerging and frontier markets. The governments in the China bloc also tend to be authoritarian. Just as important, the countries in the China bloc tend to be big commodity producers. (Given the increasingly close relations between Beijing and Moscow, we often refer to their group as the China/Russia bloc.)

Table 1

Representative Countries in Confluence's Projected Geopolitical and Economic Blocs, 2024

US-Led Bloc	US-Leaning Bloc	Neutrals	China-Leaning Bloc	China-Led Bloc
United States	Malaysia	United Arab Emirates	India	China
United Kingdom	Mauritius	Algeria	Indonesia	Russia
Canada	Tuvalu	Tunisia	Solomon Islands	Belarus
Germany	Nepal	Lebanon	Saudi Arabia	Iran
France	Qatar	Ukraine	Azerbaijan	Iraq
Italy	Oman	Serbia	Kyrgyzstan	Kazakhstan
Sweden	Egypt	Vietnam	Djibouti	Uzbekistan
Finland	Libya	Cambodia	Nigeria	Turkmenistan
Poland	Ghana	Maldives	Zimbabwe	Tajikistan
Israel	Senegal	Sri Lanka	Mali	Pakistan
Japan	Malawi	Kenya	Zambia	Myanmar
Australia	South Africa	Tanzania	Côte d'Ivoire	Congo
New Zealand	Argentina	Mauritania	Mozambique	Angola
South Korea	El Salvador	Brazil	Mongolia	Gabon
Mexico	Dominica	Venezuela	Afghanistan	Niger

Finally, since the US-led bloc encompasses so many rich, innovative economies with relatively low regulation and good private property protections, it accounts for the large majority of global output. The US-led bloc also accounts for the bulk of global stock market capitalization and an even greater proportion of the global bond market. As a result, even though the post-Cold War period of globalization has now given way to global fracturing, we thought that US businesses and investors could still look with optimism to the trade and capital market opportunities available in the US-led bloc, at least until now.

Will Trump Splinter the US Bloc?
The US-led bloc as it stands today may still be attractive for businesses and investors, but as we noted in our *Bi-Weekly Geopolitical Report* from January 27, 2025, President Trump's foreign and economic policies are targeting many of the key countries in the group. As Trump works to push more of the costs of Western security and prosperity onto the US's traditional allies, one key question is whether he might splinter the US bloc. In this section, we examine the risks of that happening. To assess the risks as rigorously as possible, we used our bloc-analysis methodology to examine two key scenarios, as described below.

Eliminating US Trade Deficits. One of President Trump's key goals is to erase the gaping US trade deficit. To see how that might affect the US camp, we ran our bloc analysis in a scenario assuming the US had eliminated each of its bilateral trade deficits by 2022 (the final year in the decade of trade data we use in our most recent bloc analysis). We assumed that each US bilateral trade deficit was eliminated by both an increase in US exports to the subject country and a decrease in US imports from it, in equal measure. We then calculated the value of the country's exports to the US in such a scenario and the implied average annual growth rate of those exports over the previous decade. We used those figures to generate two of our most important trade subscores for each country: 1) exports to the US as a share of GDP versus exports to China as a share of GDP, and 2) the 10-year growth rate of exports to the US versus the 10-year growth rate of exports to China.

- To our surprise, feeding the resulting subscores into our methodology had only a minimal effect on most countries' total scores. In part, that's because the scenario changed only two of the 13 subscores that we use. It also reflects the fact that our methodology uses average export growth rates over 10 years, which minimizes the growth rate adjustment needed to eliminate the trade deficit over that period. Finally, it also reflects the fact that China already dominates the exports of many countries, which means weaker export growth to the US has only a muted effect.
- In any case, only one country dropped out of the US bloc in this scenario: Fiji.

The US Exiting NATO. Based on President Trump's strong criticism of other NATO countries and his threats to ignore the alliance's mutual-defense obligations, we also examined a scenario where the elimination of the US's bilateral trade deficits was accompanied by the US pulling out of NATO. To express a US exit from NATO under our methodology, we simply zeroed out the NATO-membership subscore for each country in the alliance.

- Reflecting this adjustment, each NATO member's total score was reduced. However, we only found a few cases where the reduced score was enough to kick a country out of the US bloc.
- The additional countries that fell out of the US bloc in this scenario were all in southeastern Europe: Romania, Hungary, Albania, and North Macedonia.

In Table 2, we summarize the change in the number of countries in each bloc under each scenario. The table shows that even Trump's trade war against US allies and a potential US exit from NATO might not be enough to splinter the US bloc. We think this makes sense, since the strength of the relationship between any two countries depends on more than just trade or military alliance. Even if Trump wants to quickly impose his policies, the many different common interests between countries in the US bloc would probably slow its disintegration.

Table 2

Bloc Membership in Key Scenarios
Source: Confluence Investment Management

Bloc	Original, 1/1/2025	No US Trade Deficits	Change	No US Trade Deficits & No NATO	Add'l Change
US	69	68	-1	64	-4
US-Leaning	31	27	-4	29	2
Neutral	40	40	0	41	1
China-Leaning	20	23	3	24	1
China	35	37	2	37	0
Totals	195	195	0	195	0
Countries shifting out of the US bloc:			Fiji		Hungary Romania Albania No. Macedonia

Importantly, even though this analysis doesn't necessarily point to a near-term splintering of the US bloc, it does confirm our fears that the administration's policies may make the bloc less cohesive. We know that because the average country score for the US bloc fell substantially under the two scenarios we considered. As a reminder, our methodology uses a scoring system where positive country scores point to closer relations with the US and negative scores point to closer relations with China. As shown in Table 3, the average score for countries in the US bloc falls from 4.70 in our base case to 4.49 in our "no trade deficits" scenario and to 3.75 in our "no US trade deficits or NATO" scenario. In our view, this implies that even if the administration's policies aren't splintering the US bloc just yet, they are probably making the grouping less cohesive, raising the risk of a future rupture.

Table 3

Average Bloc Scores in Key Scenarios
Source: Confluence Investment Management

Bloc	Original, 1/1/2025	No US Trade Deficits	Change	No US Trade Deficits or NATO	Change
US	**4.70**	4.49	-0.21	**3.75**	-0.74
China	**-3.11**	-3.08	0.03	**-3.08**	0.00

Finally, our analysis suggests that even if the administration's policies push countries out of the US bloc, they won't necessarily "change sides" to join the China bloc. Our analysis shows that countries repelled by the US bloc are more likely to shift into the US-leaning bloc, rather than the neutral bloc or the China-leaning bloc. Table 3 also suggests there would be no appreciable change in the cohesion of the China bloc in either scenario.

A World with No US Bloc

The analysis above suggests that the US's new foreign policies won't necessarily splinter the US bloc in the near term, even if they make the group less cohesive. Indeed, that's probably what President Trump and his advisors are gambling on as they threaten sky-high tariffs, demand much higher defense spending, insist on ceding territory to the US, and excoriate allies for their regulatory and social policies. Despite the strong rhetoric and tough tactics, Trump ultimately might be content to keep the US bloc intact but unload more of its security and economic costs to other countries. The problem is that if those other countries push back too weakly, Trump could be encouraged to keep pressing for advantage, potentially until a breaking point is finally reached. In this section, we begin to flesh out what a break-up scenario might look like.

As far as we know, neither Trump nor any official in his administration has issued a complete, authoritative statement of the president's overall foreign policy goals, priorities, and strategies. As noted above, the ***economic*** goals and strategies in Trump's foreign policies are relatively well understood. His broader international goals and strategies are the ones that aren't yet clear. In fact, Trump may still be deciding on them. Nevertheless, if Trump's policies do splinter the US bloc, whether by design or by accident, the president's statements and actions to date have given us some clues about the kind of world order he would prefer in place of the current one. We think he would prefer something like one of the following three structures:

- ***Spheres of Influence.*** In this system, the US, China, Russia, and perhaps a few other large "civilizational" powers such as India and Turkey would tacitly or explicitly agree to let the other major players have free rein over their respective geographical regions. We suspect Trump would seek a US sphere of influence running from Japan and the Philippines through the Americas and Greenland to some outposts in the Middle East, such as Israel. China would likely get a sphere of influence over at least mainland Asia and Taiwan. Russia might be granted a sphere of influence over all of Europe. In any case, each major power would respect the other powers' right to behave as they wished in their own sphere, therefore avoiding war or other conflicts and facilitating some trade and capital flows between them. Trump's softer-than-expected approach to China so far and his relative deference to Russian President Putin suggest he may want this kind of system.
- ***Great Power Competition.*** While the sphere-of-influence system aims for stability, a Great Power system would be more fluid, with all the leading countries actively jockeying for power among themselves. Here, the more aggressive and powerful nations would have more room to maneuver, so they could hope to exploit a range of countries around the world, rather than just those in their neighborhood. Trump's pressure on Ukraine for a tough mineral deal is one sign that he could embrace this type of system.
- ***Populist Dominance.*** Finally, we can envision a system marked by nationalist populist governments respecting and working with each other simply out of their leaders' political and personal affinity. This system wouldn't necessarily require all the cooperating countries to be authoritarian. Rather, the common thread could be strong nationalism, conservative policies, and powerful executives. Perhaps the best evidence that this could be on Trump's mind is his strong criticism and aversion toward the liberal, progressive governments of Western Europe, even as he seems more respectful of authoritarian populists such as President Putin.

As noted above, it's still not clear how far Trump really wants to go in restructuring the world order. He may not really be willing to walk away from Europe and traditional US allies. But if he is, it isn't clear what kind of world he's looking to build in place of the current one. The three systems described above are merely possibilities. Like everyone else, we are continuing to watch the Trump administration's words and deeds to gauge where things are going.

Importantly, we might not have a definitive understanding of Trump's global goals for some time. For now, we think it may be better to focus on understanding what Trump's ***priorities*** are, since those priorities might give us a better idea of where he wants to take the world. Every president comes into office with a set of priorities, but he usually finds in the first few months of power that he has to focus on only a small number of them, and the rank order is key. In our view, we think Trump's policy priorities may be as follows:

- ***Avoid a Major War.*** Even though Trump has often wielded US military power, it has typically been against relatively weak opponents, such as Iran and the Houthi rebels in Yemen. In contrast, he is showing himself to be much more deferential to China and Russia. He has openly expressed his desire to avoid World War III and to slash spending on the US military. His push for the non-US members of NATO to spend more on defense could partly reflect a desire for them to do any necessary fighting against Russia so the US can keep out of the conflict. After all, avoiding war would facilitate Trump's desire to re-industrialize the US economy and support his working-class base. If this is indeed Trump's top priority going forward, he probably would lean toward the stable sphere-of-influence or populist dominance systems described above.
- ***Fix the US Trade and Budget Deficits.*** This goal isn't just about stabilizing the US economy. Rather, if successful, it would provide long-term benefits to the US working class by bringing down interest rates. It would also go hand-in-hand with Trump's program to use tariffs and a weaker dollar to rebuild the US manufacturing base, which also would help the working class. To the extent that this is one of Trump's goals, it may be more consistent with the Great Power and populist dominance systems described above, since those systems may allow the US to seek and build economic relationships and markets beyond its own geographical region.
- ***Create "Fortress America."*** Trump's rhetoric about annexing Canada, Panama, and Greenland suggests he is focusing US foreign policy on our own hemisphere. This may be in part because of a sense that relative isolationism would help avoid war and enhance the US's access to natural resources from the Americas. If this turns out to be a Trump priority, it would likely imply a new sphere-of-influence system.
- ***Punishing the Europeans.*** Based on the consistently anti-European statements from President Trump, Vice President Vance, and others in the administration, punishing the Europeans for supposedly taking advantage of the US over the decades may itself be a top priority for the president. If so, pulling back from supporting the Europeans and leaving them to fend for themselves against an aggressive Russia may make sense to Trump. To the extent that this is a top priority, it would be especially consistent with a sphere-of-influence world in which Russia is given free rein over Europe.

Investment Implications

As we've noted in the past, the US-led geopolitical and economic bloc as it currently exists is attractive for the US investor. Not only can US companies trade with the world's richest, most innovative, and politically stable countries, but capital can also flow easily to and from those countries. If we are correct that President Trump's current foreign policies probably won't splinter the US bloc in the near term, it would suggest that investors can continue to expect relative stability and attractive returns not only in the US markets, but also in the markets of Europe and Asia. The problem is that the geopolitical fracturing to date has left inflation and interest rates higher and more volatile than in the past. If the US bloc stays intact, we would expect the favored asset classes to be equities (especially non-US defense firms), uranium, and gold.

All the same, our analysis shows that the new administration's policies are likely making the US bloc less cohesive, raising the risk of future disintegration. Over time, if it becomes clear that Trump's priorities and plans call for a more radical restructuring of the world into something like spheres of influence, Great Power competition, or populist nationalism, then trade and capital flow patterns are likely to be further disrupted. In that world, the returns from US or foreign stocks, bonds, and commodities may well depend on the home countries of those assets. In each of the potential world systems we explore above, it appears that European defense stocks might remain quite attractive in the near term, but broader European stocks and bonds would be at risk if conflict spreads throughout the Continent.

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