

# What investment risks does autocratization in the US entail?

A SCENARIO ANALYSIS INDICATES THAT CURRENCY RISK IS THE GREATEST RISK

*Jitzes Noorman*

## INTRODUCTION

A major topic of discussion among Dutch pension funds at the moment is exposure to US equities.

This discussion is prompted by concerns regarding the high weighting of the US in stock portfolios, the high valuation, and the policies of President Donald Trump. Furthermore, the United States is beginning to exhibit more autocratic traits.

The latter is the subject of this article.

In this article, after discussing the definitions of

Democracy and autocracy, the democratic quality of the United States assessed based on several external sources. This is followed by a scenario analysis of the risks to financial instruments in the event of autocratization.

This is done from both a theoretical and an empirical perspective. The article concludes with some nuances.

## DEFINITIONS OF DEMOCRACY AND AUTOCRACY

A **democracy** is a form of government in which power rests with the people. This form of government is characterized by free and fair elections in which citizens can choose their representatives. A fundamental principle is the separation of powers, whereby the legislative, executive, and judicial branches function independently of one another. The rule of law forms the basis, which means that everyone is equal before the law and that the government must abide by the law.

In addition, freedom of expression and freedom of the press are guaranteed, so that citizens can express themselves freely and share information. The protection of human rights is another essential feature, as is the accountability of government officials to citizens.

An **autocracy**, on the other hand, is a form of government in which power is concentrated in one person or a small group. This system is characterized by the absence of free elections, leaving citizens with no real choice in their leadership. There is no separation of powers, as the executive branch dominates all other branches.

Civil liberties, including freedom of speech, are severely restricted. Autocratic regimes often use violence or repression to maintain their power, and leaders are not accountable to the people.

## DECLINED DEMOCRATIC SIZE VS

Since President Trump began his second term, democracy in the US has been under pressure and the United States is beginning to exhibit increasingly autocratic traits.

There are several important examples of actions that are seen as undermining American democracy.

For instance, there is political persecution of opponents, in which the Department of Justice, among others, has reportedly been deployed against individuals such as James Comey and Adam Schiff. Additionally, the separation of powers is being undermined by the marginalization of Congress and the reallocation of funds without the required approval. The judiciary is also under fire, for example through public attacks on judges and attempts to limit their powers. Furthermore, there is potential abuse of presidential powers through the intensive and far-reaching use of executive orders. At the same time,

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free press and civil institutions put under pressure through attacks on media and universities, the revocation of licenses, and legal action against critical platforms. Finally, reference is made to the military action in Venezuela that took place without prior approval from Congress, which places constitutional checks under further strain.

According to several institutions, the US is formally still a democracy, but there are worrying trends and deteriorating democratic scores:

**Freedom House<sup>1</sup>:** This institute reports annually on political rights and civil liberties. With a 'Freedom of the World Index' score of 0–100, countries are classified as Free (70-100), Partly Free (35-69), or Not Free (0-34). The final assessment of the US is based on information up to and including the end of 2024. The US has the status "Free". With 84/100, the US scores above 70, but lower than, for example, Finland (the only country in the world with a perfect score of 100), Norway (99), the Netherlands (97) and Germany (95). At the other end of the spectrum are China (9) and Russia (12). Both receive the status "Not Free". assigned.

The US score has been stable since 2021 (in 2024 there was even a 1-point increase). During Donald Trump's first presidency (January 2017–January 2021), the score dropped significantly. In the first year from 89 to 86 (Freedom House cited, among other things, the mixing of government and private affairs, and executive orders) and in the final year from 86 to 83 (Freedom House cited, among other things, Donald Trump's refusal to concede his election defeat).

In the latest report, Freedom House cites the erosion of democratic institutions, political polarization, pressure on the electoral process, the dysfunction of the criminal justice system and the immigration system, and growing disparities in wealth, economic opportunities, and political influence as concerns.

**V-Dem Democracy Report<sup>2</sup>:** The "Varieties of Democracy (V-Dem)" Institute (part of the University of Gothenburg, Sweden) maintains a highly detailed dataset for all countries (600+ indicators, since 1789). This is done partly through global collaboration between academics. The goal is to understand democracy. V-Dem measures, among other things, electoral integrity, media freedom, the rule of law, and participation.

The latest report, which relates to data from 2024, indicates that the level of democracy worldwide has been declining for approximately twenty years.

For the first time in twenty years, there are now fewer democracies (88) than autocracies (91), and three out of four people worldwide now live in an autocracy.

Based on 2024 data, V-Dem assigns the United States to the highest of the four categories, namely "Liberal democracies". The "Liberal Democracy Index (LDI)" score for the US is 0.75 (on a scale of 0.00 to 1.00). For reference, Norway, the Netherlands, and Germany score 0.84, 0.79, and 0.76, respectively. China and Russia score 0.04 and 0.06, respectively.

Ten years ago, the US had a V-Dem score of approximately 0.85. This dropped abruptly from 0.83 to 0.74 in 2017 – the first year of Donald Trump's first presidency. During Biden's subsequent presidency, the score rose slightly again.

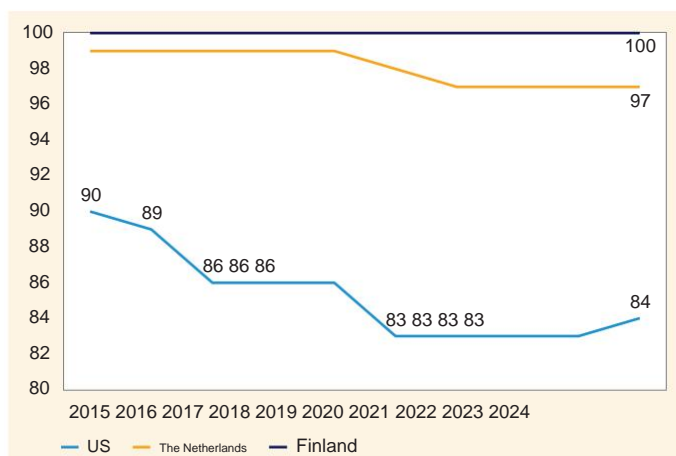
In its latest report, V-Dem indicates that the US is an autocratizing country and that recent concerning developments are not reflected in the V-Dem data covering dates up to the end of 2024. For instance, the report includes a special box titled "USA – A democratic breakdown in the making?", which states that the United States is experiencing the fastest autocratization in modern history under Trump's second term, with Trump attacking democratic institutions at unprecedented speed by undermining the rule of law, dismissing independent officials, and restricting press freedom.

These systematic attacks on "checks and balances" lead analysts to fear a possible democratic collapse.

**Protect Democracy / Authoritarian Threat Index<sup>3</sup>:** A lesser-known but more current index is the "Authoritarian Threat Index". This is published by "Protect Democracy" – an ideological nonprofit group – together with (over 1,000) independent experts from the "Authoritarian Warning Survey".

Based on six perspectives, an assessment is made of the degree of threat to democracy on a scale of 1 ('healthy democracy') to 5 ('total dictatorship'). The United States scores 3.4 (as of October 2025). In other words, there is already a 'serious threat' to democracy. This places the US significantly worse than, for example, Germany and Canada (both: 1.5) and roughly equal to India (3.5).

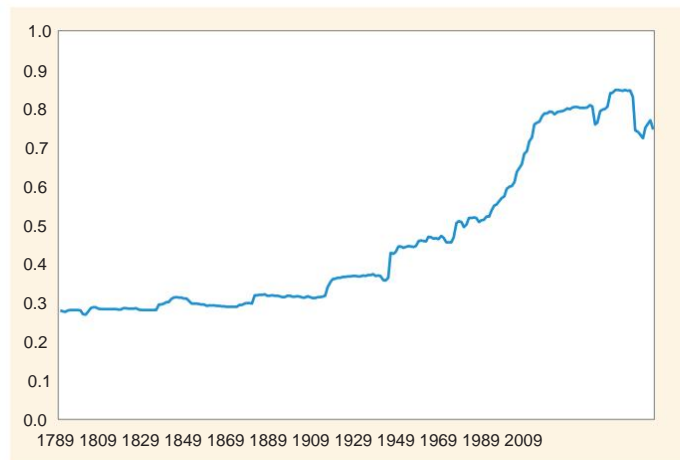
Figure 1  
Freedom House scores over the past ten years



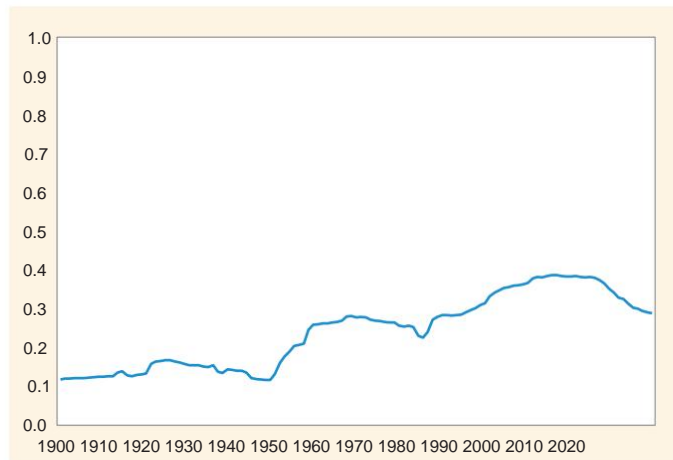
Source: Columbia Threadneedle Investments, Freedom House, 2025

Figure 2  
V-Dem "Liberal Democracy Index" score (until 2024)

United States



World (population-weighted)



Source: Columbia Threadneedle Investments, V-Dem Institute, 2024

## RISK ANALYSIS – STOCKS IN AN AUTOCRATIC SCENARIO

Given the increasing risks to democracy in the US, the question is what risks a transition to an autocracy entails for American financial instruments.

In this section, that question is addressed from a theoretical and an empirical perspective.

### THEORY

A transition from a democracy to an autocracy theoretically entails risks for investments in US stocks. A weakening of the rule of law undermines confidence in the judiciary and, consequently, the investment climate.

This typically leads to lower economic growth and lower valuations—factors that both put pressure on stock prices. A restriction of press freedom and transparency also has negative consequences. When information becomes less reliable, the required risk premium rises and capital is allocated less efficiently. This is likewise detrimental to stock market valuations.

In addition, political instability can lead to higher volatility, rising risk premiums, and even capital flight. Autocratic policies can also provoke trade restrictions or consumer boycotts, with negative consequences for the export position and profitability of US multinationals, and consequently for their shares. Furthermore, ESG risks increase when a

autocratic regime violates human rights or causes environmental damage. This can prompt foreign investors to withdraw their capital, putting additional pressure on the stock market.

Finally, in such a scenario, both the US dollar and US government bonds come under pressure.

An outflow of capital theoretically leads to a weaker dollar and higher long-term interest rates. Moreover, if the independence of the Federal Reserve is compromised, this could

further strengthen dynamics. Higher interest rates and a weaker currency subsequently weigh on the profit margins of American companies, thereby creating additional headwinds for stock prices.

In short, in theory, a transition to an autocracy could turn out negatively for American stocks, US government bonds, and the US dollar.

### EMPIRATION

In this section, some relevant historical examples are presented.

of countries featured that transformed from democracies to autocracy. This addresses the consequences this had for economic policy and financial assets.

#### Russia (2000-2012)

**Political developments:** following the fall of the Soviet Union in 1991, Russia was a democracy. In 2000, Putin won the presidential elections. From 1991 to 2004, Freedom House classified Russia as "Partly Free". Due to the suppression of independent media and opposition parties, Freedom House has used the "Not Free" classification for Russia since 2005.

leadership of Putin. Since 2007, most political scientists have labeled Russia a full autocracy. The relationship with the rest of the world deteriorated due to the annexation of Crimea in 2014 and the invasion of Ukraine in 2022.

**Economic policy:** From 2000 onwards, there was a relatively conservative fiscal policy, partly thanks to oil revenues.

However, the debt ratio has risen slightly in recent years due to sanctions and sharply increasing defense spending. Nevertheless, the debt (as of 2024) still amounts to no more than 20% of GDP. Inflation averaged roughly 10% since 2000, with peaks of 17% in 2015 and 2022. Until 2014, currency policy was focused on a peg to a basket of hard currencies. Following the invasion of Crimea, a shift was made to a floating exchange rate to counter capital flight and thus preserve reserves. The central

## Box: Is international revenue exposure good or bad?

### Exposure to US stocks

Discussions were previously held with pension funds regarding exposure to US equities. This was prompted by concerns about the weight of the US in equity portfolios, high valuations, and President Trump's policies. Based on investment convictions, practical feasibility, and certain nuances, most pension funds have decided not to adjust the (market-weighted) weight of the US in their equity portfolios.

One of the nuances was that the country weights of stocks based on market capitalization do not correspond to economic exposure. For instance, many large American companies generate their revenue outside the US, and 35% of the revenue of companies in the MSCI ACWI Index is generated in the US. That is significantly lower than the 63% weight of the US based on market capitalization.

That tempered concerns regarding the high weighting of the US in stock indices combined with potential negative economic consequences of President Trump's policies.

The fact that American companies generate a significant amount of revenue outside the US makes them less vulnerable to a potential recession in America caused by US policy.

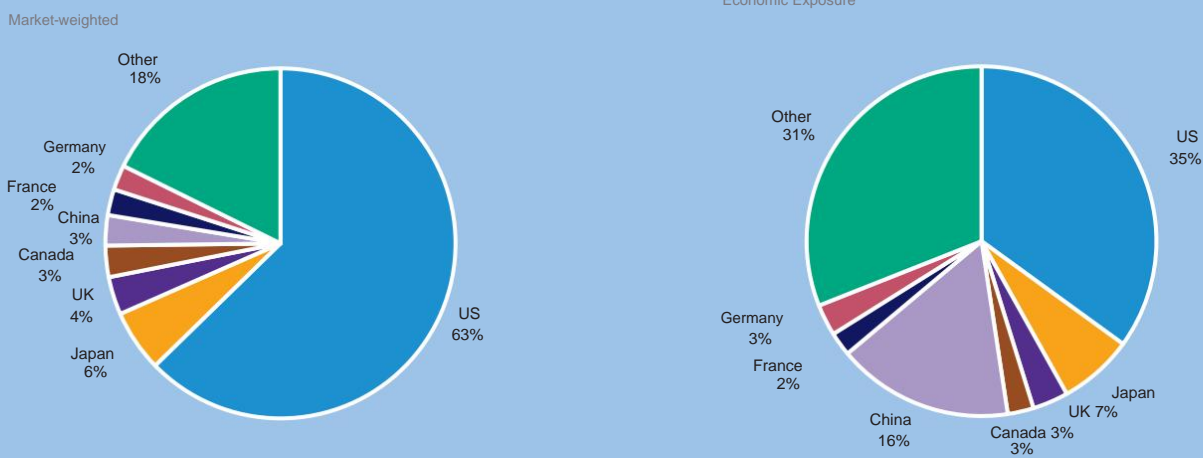
From the perspective of this publication—a potential transition to an autocracy—the heavy reliance on revenue outside the US could actually make American stocks vulnerable. A (tail) risk is, in fact, that precisely those foreign revenues are 'at risk' should the US become the target of sanctions by other countries, or in the event of a boycott of American products and services by consumers or governments.

In short, the answer to the question of whether the fact that American companies generate a lot of revenue outside the US is 'good' or 'bad' depends on the perspective. Is the investor fearful of Trump's unpredictable economic policies and is the primary fear an American recession, or is the fear that the US is becoming more autocratic and imperialistic?

### What are the alternatives to market-weighted equity portfolios?

Should an investor wish to deviate from a market-weighted equity portfolio and reduce the weight of the US, this opens the door to a series of operational and methodological questions. If, for example, investments are made in developed market equities through a single fund, the weight of the US cannot simply be adjusted. An "MSCI World ex. USA" fund or, for instance, a 'Europe' fund would then have to be added to reduce the weight of the US at the aggregate level. In the case of a discretionary mandate, this is easier to achieve. However, even then, some arbitrary choices remain, namely: what limit should be applied to the weight of the US (50%?)? Or should an alternative weighting methodology be chosen? For instance, in addition to the regular market-weighted 'MSCI World Index', "GDP-weighted" and "Equal-weighted" variants of the MSCI World Index are available. However, these do not always align well with investment convictions. Furthermore, these alternative indices have performed lower over the past ten years, while exhibiting higher volatility and a higher turnover rate. In short, deviating from market weights presents significant obstacles.

Figure 3  
Composition of the MSCI ACWI Index based on various metrics



Source: Columbia Threadneedle Investments, MSCI, May 31, 2025

Figure 4  
Currency developments against the euro



Source: Columbia Threadneedle Investments, Bloomberg, October 2025

The bank does not apply artificially low interest rates, but focuses on combating inflation and preventing capital flight.

For example, the Russian central bank briefly raised interest rates sharply in both 2014 and 2022 to 17% and 20% respectively (currently 17%).

**Financial markets:** the Russian ruble has since Putin

came to power in 2000, and lost roughly -70% of its value against the euro. The yield on Russian government bonds in the JPM EMBI index showed a decline from 15/25% to around 3% between 2000 and 2021 due to fiscal discipline, with temporary peaks of around 8% to 12% in 2008 (GFC) and 2014 (Crimea). In February 2022, however – following the Russian invasion of Ukraine – the EU imposed sanctions, banning EU investors from trading in new Russian government bonds.

Index providers then followed with the message that Russia was being removed from bond indices. Bond prices plummeted.

And many investors were unable to sell their positions. Many investors ultimately valued their Russian bonds at zero.

Russian stocks had been part of the MSCI Emerging Markets Index since the 1990s, but were removed from the index in March 2022 following the invasion of Ukraine and EU sanctions. Trading on the Moscow stock exchange was suspended for non-residents, and many European funds wrote off their Russian equity exposure to zero. Nevertheless, the return on Russian stocks had been positive from 2000 until the Russian invasion in February 2022, at a time when the country was transforming into a total autocracy under Putin. Annualized

the return was well over 12% in local terms and nearly 7% in euro terms (without currency hedging). That was also higher than the return of the broad MSCI EM index over that period of roughly 6% (annualized, “euro unhedged”). In other words, the Russian invasion of Ukraine and the EU sanctions have led to

led a disastrous stock return, and not the transition to a dictatorship under Putin.

## Turkey (2002-2017)

**Political developments:** The AKP came to power in Turkey in 2002 through free elections, after which Erdogan became Prime Minister in 2003 and President since 2014. Under his rule, democracy came under pressure (concentration of power, purges in the judiciary and military), and following the failed coup in 2016, a constitutional referendum followed in 2017 that drastically expanded presidential power. Since then, an autocracy has prevailed.

Freedom House downgraded Turkey from “Partly Free” to “Not Free” in 2017.

**Economic policy:** budget deficits under Erdogan fluctuated from -1% to -4% of GDP, but the national debt (currently roughly 25% of GDP) remained manageable due to high growth rates (averaging around 5%). The central bank initially operated relatively independently, but since 2018 there has been interference by Erdogan through artificially low interest rates and the dismissal of several central bankers. This has led to several sharp inflation shocks (25% in 2018 and 85% in 2022).

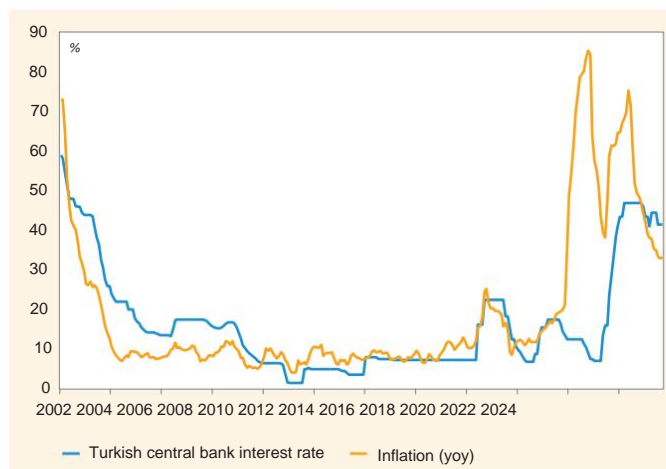
The Turkish lira has also depreciated sharply as a result, despite interventions in the foreign exchange market since 2018 through capital restrictions and currency guarantees.

Since 2023, there has been a turnaround, with the central bank raising interest rates and intervening less in the foreign exchange market.

**Financial markets:** the Turkish lira has been with since late 2017 depreciated by no less than -90% against the euro. The 10-year government bond yield has been substantially higher since Turkey became an autocracy – varying between 10% and 35% – than in the preceding period. Turkish government bonds have yielded a cumulative return of -70% from late 2017 through November 2025 (“euro hedged” basis). The credit rating (from S&P) is BB-.

Share prices have risen significantly in local terms since late 2017 due to inflation. Shares of companies in Turkey are part of the MSCI Emerging Markets (EM) Index. Expressed in euros on an “unhedged” basis, the cumulative return of the MSCI Turkey Index is -5%.

Figure 5  
Turkey: inflation and monetary policy since the Erdogan era



Source: Columbia Threadneedle Investments, Bloomberg, October 2025

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In absolute terms, that is not too bad, but relatively, the index has lagged behind the MSCI EM Index, which has yielded approximately +50% cumulatively (expressed in euros without currency hedging). During the transition period leading up to 2017, Turkish equities did manage to keep pace with the MSCI EM Index.

## Hungary (2010-2020)

**Political developments:** Under Viktor Orbán and his Fidesz party, institutional bodies in Hungary have been hollowed out since 2010. In 2020, a law granted Orbán extensive power to rule by decree. Since 2020, Freedom House no longer labels Hungary as “Free,” but as “Partly Free,” and in 2022, the European Union officially declared that Hungary can no longer be considered a full-fledged democracy.

**Economic policy:** under Orban, there are government deficits (partly due to infrastructure spending), but this was already the case before he took office. Until the COVID pandemic in 2020, the national debt ratio was declining due to a growing economy. Subsequently, it rose to 75% (2025) due to increasing deficits and low growth. Inflation temporarily rose to 25% in early 2023 during the energy crisis in Europe, but was not excessive in the remaining years. The central bank operates formally independently, but Orban has openly criticized the excessively high interest rate level, and he also exerts influence through appointments. Regarding the forint, there is a flexible exchange rate.

**Financial markets:** the Hungarian forint has fallen roughly -30% against the euro since Orban took office in 2010 (October 2025). The 10-year Hungarian government bond yield fell from roughly 8% to 2% in the period 2010-2020, in line with central bank rates, a declining debt ratio, and international interest rate movements. Since the inflation shock and rising deficits, however, the interest rate has risen to 6.76%. The credit rating (from S&P) stands at BBB-, the same as when Orban took office.

Shares of companies in Hungary are part of the MSCI Emerging Markets Index. Since Orbán came to power in April 2010, the MSCI Hungary Index has yielded a cumulative return of 300% in local terms (9.4% annualized). Expressed in euros without currency risk hedging, the annualized return was +6.6%. That was higher than the broad MSCI EM index (+5.7% annualized, “euro unhedged”). Furthermore, since Hungary has been considered merely “Partly Free”, the MSCI Hungary Index has outperformed the broad MSCI EM Index (22% annualized versus 11%).

## Venezuela (1999-2017)

**Political developments:** Until 1999, Venezuela was considered a democracy with strong institutions. When Hugo Chavez came to power, the country gradually moved towards an autocracy.

That accelerated in 2013 when Nicolas Maduro came to power after his death and, among other things, suppressed protests with violence. In 2015, the opposition was sidelined despite holding a majority. Freedom House has classified Venezuela as “Not Free” since 2017, and the European Union has not recognized Maduro as a legitimate president since 2019. [And on January 3, 2026, President Maduro was transferred to the US via a US military action to be tried there].

**Economic policy:** under Chavez and Maduro, there was substantial government spending on social programs. Oil revenues were insufficient to cover this, necessitating the issuance of significant debt and the deployment of money creation. The loss of central bank independence, artificially low interest rates, and explosive money growth led to hyperinflation. Currency controls were in place, resulting in large discrepancies between official and black market rates, and ultimately multiple devaluations of the Venezuelan bolivar.

**Financial markets:** the Venezuelan bolivar has been since 1999

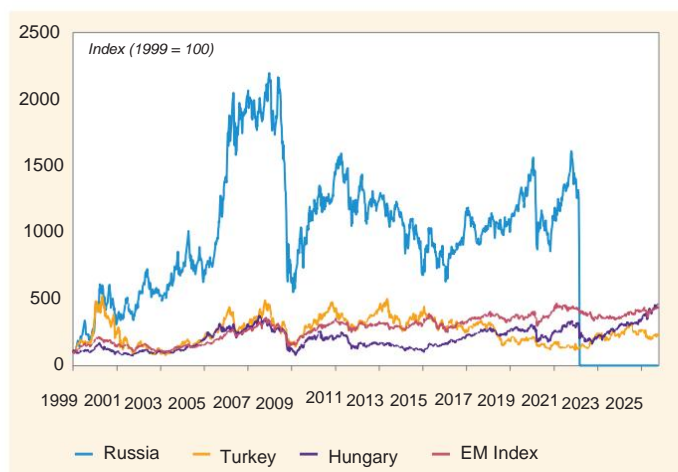
lost virtually its entire value against the USD and the euro.

The yield on Venezuelan government bonds (source: JPM) initially showed a decline from approximately 14% in 1999 to 7% in 2007. In 2017, however, a level of more than 50% was reached.

and in 2022 temporarily even more than 600%. Venezuela defaulted on its foreign debt payment obligations in November 2017. Since then, S&P has also stopped issuing credit ratings. Shares of Venezuelan companies were part of the MSCI until 2018.

Emerging Markets Index. Subsequently, Venezuela was gradually removed from the Index, first via a “standalone market” status and then completely. In local terms, the stock market in Caracas shows enormous price increases, but expressed in hard currency, Venezuelan stocks have lost almost all their value since 1999 due to hyperinflation and an implosion of the bolivar. (Incidentally, over the past twelve months there has been a substantial rally in local terms (+700%) driven by dollarization, the easing of capital controls, and speculation on political change.)

Figure 6  
Price development of stock indices (euro basis, unhedged)



Source: Columbia Threadneedle Investments, Bloomberg, MSCI (EM, Hungary, Turkey), FTSE (Russia), October 2025

## SUMMARY OF EMPIRICAL ANALYSIS

The empirical perspective regarding the impact on financial assets of a transition from a democracy to an autocracy

can be summarized as follows:

**Currencies:** in all four countries there was significant currency depreciation, ranging from -30% (Hungary) to virtually a total loss (Venezuela).

**Government bonds:** these showed varying results in countries during transitions to autocracy, depending on fiscal discipline and potential international sanctions and hyperinflation. Government bonds became worthless for euro investors in the case of Venezuela ("default") and Russia (sanctions). Turkish bonds lost significant value due to inflation and depreciation. Finally, interest rates on Hungarian bonds remained relatively stable and even declined during the transition period.

**Stocks:** in a few cases, these still performed positively during the transition from a democracy to an autocracy, such as in Hungary (absolute and relative versus the EM index), or in Russia (also absolute and relative) until the moment of the invasion of Ukraine. After the invasion,

Russian stocks written off to zero. Turkish stocks performed in line with the EM Index during the transition, but have performed negatively since 2017 (absolute and versus the EM index). Finally, Venezuelan stocks lost almost all their value for foreign investors due to hyperinflation and a currency implosion.

Based on this analysis, a transition from a democracy to an autocracy poses the greatest risk to currency markets. Government bonds follow then, and only after that stock markets. The extent to which autocratization negatively impacts government bonds and stocks depends to a significant degree on the extent to which the independence of the central bank comes under pressure and the degree to which fiscal discipline is abandoned.

## NUANCES

Although the picture outlined for American stocks is negative if the US slides further towards an autocracy, some nuances are also in order.

For instance, the United States is so important economically, financially, technologically, and militarily that sanctions by the EU are not very likely should the situation deteriorate further. Furthermore, the consequences for the US of further autocratization will differ from those for small countries, due to the key role the US dollar and US government bonds play in international reserves, the global financial system, and international trade. And because of the interconnectedness of international financial markets and economies, a potential further slide towards autocracy will not only harm American assets but could have negative consequences worldwide. In other words, by selling US stocks, European investors are not immune to a potential further erosion of democracy in the US.

Finally, it is worth noting that China scores very low as a democracy and is classified as a full autocracy by Freedom House, the Economist Intelligence Unit, and V-Dem. Nevertheless, there are no sanctions imposed by the EU, for example. Nor does it constitute an obstacle to the inclusion of Chinese investment instruments in market-weighted equity and bond indices from reputable index providers such as MSCI, FTSE, and JP Morgan.

Furthermore, most European institutional investors are invested in Chinese stocks and Chinese government bonds.

### Notes

- 1 <https://freedomhouse.org/about-us>.
- 2 [https://v-dem.net/documents/61/v-dem-dr\\_\\_2025\\_lowres\\_v2.pdf](https://v-dem.net/documents/61/v-dem-dr__2025_lowres_v2.pdf).
- 3 <https://protectdemocracy.org/threat-index/>.