

Weekly Perspectives

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A Weekly View of Global Economies

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The increase in risk appetite that was in evidence at the beginning of the month waned after investors were served with a cocktail of higher oil prices, unimpressive tech company earnings and conflict in the Middle East. The conflict we are referring to is, of course, the Israeli military action against Lebanon.

Apart from that dangerous flare-up, there are other conflicts that are also simmering and could possibly come to a boil at some point. In Iraq, and further afield, in Afghanistan. The latter country is not strictly part of the Middle East, being a neighbouring state. But the term "Middle East" is itself out of date. It goes back to the days of the British Empire when whole swathes of territory in Asia were referred to as Near, Middle and Far East.

Far from being homogeneous, the "Middle East" is as complex and diverse an area as you can find on this globe. It is strategically important and, from the evidence, subject to a lot of foreign interference. Much of what passes for analysis of the region's many problems is simple and misleading, often deliberately so - no history, no balance and no admission of policy errors. The portrayal of a fantasy world, far removed from the real one.

But reality is biting back. The low-level civil war in Iraq shows no signs of abating. In Afghanistan, resurgent Taliban forces have established a foothold. Many of their successful techniques in warfare have been tested in the Iraqi insurgency. Meanwhile, the American rhetoric over Iran's nuclear programme could become confrontational, with spill-over effects on surrounding countries.

Given the concerns over geopolitical instability, it is not surprising that the price of gold has been rising, in conjunction with oil. Riskier assets have been hurt, as investors look for safe havens such as government bonds. At some point, the newsflow about the conflicts may become less negative and investors' comfort levels may increase. However, the possibility of a flare-up is always there because none of the political issues are anywhere near settlement.

Political risk is something that not just investors but also corporations have to face. Assessing political risk has always been around, but is perhaps even more relevant in an increasingly interdependent global economy.

Many big corporations have in-house professionals who monitor political risk and suggest strategy. The rationale for doing these calculations is that it can have a big impact on the bottom line. But getting it right is not easy. It has both a quantitative and a qualitative dimension.

The quantitative part is simpler. You look at a slew of statistics such as the incidence of strikes and the number of government changes. But it is the qualitative analysis that is the really hard part and is crucial to deriving optimal decision rules. It requires insight and understanding of political and social structures, as well as history and culture.

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But even big corporations can't afford to keep a large team of political-risk analysts to cover all the countries in which they operate. So what they do is to pay for the services of specialist firms that have links to academic and other "experts" who can provide in-depth analysis on any particular topic, however specialised.

Let us say that the client corporation wants to extend operations in Siberia and wishes to make an assessment of the stability of the Russian government and possible bureaucratic hurdles. The firm providing the political-risk analysis will set up a liaison with a number of specialists on this particular topic.

Each one of the experts will provide a detailed analysis, and there may also be discussions involving all the participants. So you have the advantage of getting a number of different viewpoints rather than a single view. The difficulty is that you have to sort out the assumptions and biases, both explicit and implicit in each presentation.

It remains for the strategy group at the corporation to summarise the analysis, critically examine the different viewpoints, assess the assumptions and come up with a strategic decision. This is not as simple as it sounds, requiring broad knowledge and a critical mind.

Ultimately, the decision has to be approved by top executives, and this opens up the possibility of a subjective bias regarding which option is finally selected. However, this bias is likely to be minor compared with what happens in government decision-making. In the latter case, decisions are thoroughly political, in the sense that subjective elements dominate objective analysis.

The political and ideological agenda of the government and the influence of important pressure groups determine the strategic choice, which is then "sold" to the public as being in the national interest. The media play a major part in selling the message.

In totalitarian states the role of the media in propagating government policy is straightforward. In many democracies, the liaison and coordination is often more subtle and indirect. The links are hidden from view.

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