

Weekly Perspectives

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A Weekly View of Global Economies

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Geopolitical risk isn't a factor that is of primary concern in the daily decision-making of market participants. However, some institutional investors monitor it quite closely and have risk management plans in place should the scenario diverge from their base-case outlook. Others have little regard for this category of risk and only react when a crisis breaks out.

Some geopolitical changes take place at a relatively slow pace and gradually alter the environment in which businesses and markets operate. Other political events are of a shorter-term nature and have a limited impact.

Engaging in geopolitical risk analysis is hard because the system under study is complex and much of the argument is conducted in a qualitative mode, requiring background knowledge from the audience for it to be fully comprehensible. And there is an ideological barrier that needs to be surmounted. Most people have strong likes and dislikes that are rooted in their belief system.

By its nature, it is very difficult to change such views by means of rational argument. This has been the case through the ages. Not too many years ago, during the cold-war period, people took sides in favour of capitalism or communism, and interpreted reality to fit their preconceptions.

In a sense, political analysis is less "scientific" than economic commentary and analysis. When presenting a case, let us say for slower growth, one can marshal a host of statistics to support the contention. But in political analysis, one has to rely primarily on the presentation and interpretation of events.

A number of years ago there was a great deal of chatter in the media that the United States was the sole superpower with no rivals in sight. The substantial degree of unanimity was enough to perk up one's critical faculties. It is usually a clue that the peak has already been reached and we are already on the down-slope.

In the past few years, China has arisen as the principal challenger to America's superpower role. Some observers, like the former hedge-fund manager and world traveller Jim Rogers, think that the trends favour China as a rising power. In terms of size, economic momentum and political unity it has to be said that a better case can be made for China than for the European Union. That said, it is unwise to make linear projections. The pace of change in China is rapid and could, at some point, result in internal political tension and conflict.

As for the European Union, it has failed to project its power on a global scale and provide substantial rivalry to the United States. What we have in Europe is a collection of nation-states failing to find a collective voice, still less a forceful one. In recent years, one of those European states, Britain, has acted to advance American interests and ambitions rather than to bolster Europe's position on the world stage.

The febleness demonstrated by European countries is in sharp contrast with the Chinese stance. China looks and acts like a great power and is expanding its reach on all continents. However it is principally in Asia that the rivalry for superpower status will be played out.

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The Americans haven't been standing around idly over the past few years. They have identified China as their principal competitor and have moved aggressively in the Middle East, South Asia and East Asia, to counter China's rising power.

For those who have studied past imperial rivalries, they should note that there is a major difference, this time around. The global economy is much more interdependent in terms of trade, investment, financial flows and production activities than ever before. Superpower rivals who possess a measure of rationality have a stake in preserving the relative stability of the global system.

Currently, America's geopolitical problems are of its own making. US strategy in the Middle East has gone badly wrong. It is evident that the invasion of Iraq was a grave miscalculation. The attempt to establish a client state has failed. Saddam Hussein's system of terror has been replaced by a system of chaos. Elsewhere in the Middle East, the Bush administration's policies are causing instability.

The Baker-Hamilton proposals were aimed at limiting any further losses and preserving as much of American influence and prestige as possible. But it appears that George Bush and his advisers have learned nothing from their mistakes and are intent on causing more mayhem in the Middle East.

Policy-making in the Bush administration is controlled by a small group of ideologues centred on the vice-president. The advisers are not held accountable for their mistakes and appear to have a slim grasp of the difference between illusion and reality. This is brought out clearly in the case of Ahmad Chalabi, the exiled Iraqi opponent of Saddam Hussein, who masterfully fed their illusions and got what he wanted, the toppling of the Baath regime. He had no intention of becoming an American puppet.

Harold Macmillan, the Conservative British prime minister, recounts in his memoirs that when he was visiting Washington John Kennedy showed him the plans for Vietnam and asked him what he thought of them. Macmillan replied that he didn't think they were worth anything, and he advised Kennedy that it would be a mistake to engage in a war in Asia. Unfortunately, Kennedy did not follow the advice.

Kennedy's advisers were a group of talented technocrats, with no ideological axe to grind. But they still got it wrong. In contrast, Bush's coterie is short on pragmatism and long on ideology. And Macmillan's advisory role has been taken up by a British prime minister that the press routinely refers to as a poodle.

Those who have seen Stanley Kubrick's satirical film, *Dr. Strangelove*, may have the nagging feeling that reality may indeed be stranger than fiction.

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