

GPS – Geo-political Standpoint

Report No. 2 | October 2013

Market In-Brief: An independent overview & analysis
of the international geo-political scene

By

John Longhurst
Executive Chairman
Tangent Link Limited

Introduction

The Mirage of Peace

September was a dramatic month, closing with the first direct conversation between the Presidents of America and Iran since 1979.

Overall though, the clear currency winner of late has been Putin, who has learned from Libya and applied lessons in Syria.

What is often overlooked is the 'low level' non-stop violence in key areas such as Iraq. Nonetheless, for every worry, there is hope. Elections in Sri Lanka gave Tamils representation in Parliament for the first time since the ending of the civil war, and the chance of more self-government.

Elections also in Germany and Australia of a much less dramatic nature at least gave visibility on the road ahead. Not so in Italy, with a collapse in government on the cards as ex-Premier Berlusconi faces house arrest. And, even more worrying, the collapse of government in Egypt.

Another worry - Al Qaeda, which is not only in full force in Syria, but has reminded the world that it remains a fully functioning terror force, with the Nairobi shopping centre massacre.

With North Asia quiet for now, all eyes will be on Iran/Syria in the period ahead. Can Obama really get a deal with Iran? How will the civil war in Syria play out, in the face of a chemical weapons deal? Read below for our perspective

The Middle East

Israel & Iran

President Obama is looking at his legacy in three years time. Persia (Iran) and Israel have been dealing with regional rivalries for thousands of years.

The transactional nature of the Obama Presidency works in certain ways, but to the dismay of many experienced statecraft practitioners in the US, America now appears to be on track for allowing Assad to remain in place in Syria under the effective protection of the UN (our interpretation), as well as going down a path that will unwind \$bn's of dollars of Israel-lobby spending.

The upcoming visit by Netanyahu to Washington will be important. Obama said, in contrast to the "Asia tilt" speech of two years ago, that the Arab-Israeli peace process and Iran are the two most important foreign policy aspects of his second term.

Netanyahu's last visit to DC 18 months ago resulted in Obama getting egg on his face as he was told that Israel would continue building settlements and peace talks would have to start around 1967 borders; both non-starters for the Palestinians. Our view is that Obama is prepared to 'lose' on one, but not both of these, and isn't serious about the Palestinian process.

Given the extremely low probability of a West Bank solution, Obama is putting his eggs into a solution with Iran. But, as with Syria, where Obama missed an opportunity to 'call out' Iran for its role in the Syrian Civil War, there are widespread concerns that Obama will start a deal process without first getting a firm offer on the table from Iran re its nuclearisation efforts, before beginning the sanctions unwind negotiation process.

Our bottom-line on this process is that Obama, with few foreign policy 'victories' of any kind during his Presidency (people forget his approach to Iran in his first term ended in embarrassment), he will be keen to get a commitment from Iran not to weaponise its nuclear programme, along with tight UN oversight.

For Iran, living with this for 10-20 years would be a small price for being allowed back into the international system. Khamanei, Rouhani's boss, has already been able to use the

potential for success in this regard to win back control of key elements within Iran from the IRGC.

The prize for keeping nuclear gains thus far, and improved economic conditions, would be the trust of the Iranian population after years of economic hardship.

Israel's hands will be somewhat tied, as an attack on Iran now would provoke the wrath of the US and result in diplomatic isolation. We may be seeing the end of a Golden Period for Israel in terms of regional hegemony, if Iran succeeds in talks with the US.

Obama will need to win a universal agreement from Iran re its sponsorship of 'global terrorism' to have any chance of getting Israeli buy-in. The annoyance for Israel is that it has been essentially untouchable and knows it; it has a 'nuclear triad', chemical weapons and the best anti-missile shield on the planet. Having an economically successful Iran would trouble Sunni allies of the US, Israel and possibly Russia, so Obama will need to spread good deeds broadly to keep allies on side.

It is our expectation that a key Iranian demand will be to make the Mid-East a nuclear free zone, thus placing Obama in a lose-lose situation. Israel will never forego its triad. As such, Iran will have a PR success if nothing else, for Israel has never officially confirmed the existence of nuclear weapons, even though it is commonly understood.

At worst, it gives Rouhani an exit from talks. In the meantime, Iranian centrifuges continue to whirl away, adding to Iran's stockpile.

Syria

With the debate now moving onto Iran talks, our view is that Western 'powers' will seek to have Syria taken off the front pages. There is a realisation that as with Afghanistan in the '90s', getting rid of a leadership the West doesn't like, will result in radicalisation. With a reported 11,000 opposition groups, many with Al Qaeda leaders, getting rid of Assad has suddenly appeared less urgent.

Tragically for civilians in Syria, this means more carnage with no end in sight, and a multi-year refugee problem for neighbouring countries.

North Africa / Oil prices

The cessation of oil exports from Libya is a big deal, and coupled with on-going strife in Tunisia and Egypt, fatally undermines, in our view, the naïve approach taken by 'Arab Spring' evangelists in Washington that were happy for the removal of 'unpopular' heads of State, but with no clear plan on what 'nation' would emerge.

It is these lessons that have started to re-shape the Syria debate (and indeed, the 'regime change' debate re Iran). In Egypt, we see more tragedy, with the Army likely to move to eradicate the Muslim Brotherhood now that the latter appears to have missed its chance for success after decades in the shadows.

The combination of troubles in North Africa, with on-going trouble in Syria and Iraq, will keep oil prices at elevated levels, despite a lowering of the 'bombing Iran' risk.

BRIC slowdown

The major challenge of the largest 'rising' nations, is that mis-allocation of capital, especially for commodity economies such as Brazil, has resulted in poor productivity and rising inflation. Growth of 2% for Brazil in 2014 would have been unthinkable a few years ago. China is having to pull out all the stops to attain >6%.

We are more sanguine about growth in sub-sahara Africa than the BRIC's in '14-15'.

Kenya

Retaliation for Kenya's incursion into Somalia was brutal, as the promised Al Qaeda 'strike' hit Nairobi and the tourist industry. This is unlikely to be a one-off, and whereas we will likely see a slowdown of US drone strikes in Pakistan, Somalia will remain a hot spot for the CIA drones and Intelligence Agencies.

Cyber

The US has now been cast in the role of hypocrite, following the release by Snowden that the NSA has worked for years with leading US technology companies to have built-in secret backdoors and other mechanisms.

We are now likely to see a cessation of discussion of Chinese theft of Western Industrial and military IP, which is genuinely impactful. US technology companies will now be seen with the same suspicion as Chinese companies.

Brazil's President postponed a trip to the US on the back of the revelations that she and various key companies such as Petrobras, had been hacked by the NSA. Even China hasn't suffered such embarrassment.

The clear winners from this are cyber-security companies, and we note the extremely successful stock market listing of a clutch of cyber-IT companies in September.

Global defence spending

We expect US sequestration to continue in 2014 and 2015, which will result in a slow-bleed of US defence capabilities, and the hollowing out of forces, as per the post-Vietnam era.

Past lessons have been forgotten as political expediency and the most partisan Congress since the 1800's, continues to behave with insularity within the walls of Washington DC. In contrast, we expect Russia, Asia and the Mid-East to continue to raise spending.

We also expect UK/French share of global defence exports to see secular decline from this point.

Sincerely,

John Longhurst
Executive Chairman
Tangent Link

Biography - John Longhurst

John spent 28 years as an investment analyst and fund manager, with a focus on global interactive media, industrial, and defence/aerospace industries, as well as broader cyber and geopolitical areas. Starting with James Capel in 1986, John attained No. 1 rankings in competitive polls from 1988 until 1996, when he joined Capital Group Companies of Los Angeles, one of the world's leading fund management companies, managing more than \$1tn of client assets.

After becoming a senior Shareholder there, he moved to PIMCO in 2011, as Head of Emerging Markets equity research. PIMCO is one of the world's top-5 global fund managers by assets, managing more than \$2tn of client assets.

John was recently voted by Defence News as one of the 100 most influential people in the US Defence Establishment and has been actively involved in start-up companies over the past decade.