

**AROUND THE
WORLD IN 8
(or so) PAGES...**

1st QUARTER 2019

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See The World

The world is not a point of view.

ABOUT OUR '8 PAGES' SERIES:

The Librarium Associates monthly 'Around The World In 8 Pages..' series is a quarterly publication created by our team focused on geopolitical and macro economic trends and developments around the World during the last 3 months. As long term thinkers we draw on the lessons of history as a guide to understanding the present and charting the probable paths ahead. There are no crystal balls but in the words of A.W. Pinero: **"The future is only the past again, entered through another gate."** It's our mission to glean valuable insights from history and apply them as a foundation for understanding the journey ahead.

We are constantly engaged in active horizon scanning while adhering to our belief that students of the lessons of history and permanent features such as geographic realities can provide superior insights.

From these broad scenarios we work to identify investable trends and specific opportunities. We find that such a broad approach provides an 'early alarm' system for risk management and an indicator of attractive price/value situations across asset classes.

The intention of our research and the basic premise of this publication is to present rational perspectives based upon a diligent analysis of historical data. Through organizing the data logically, information is created. Through understanding and developing perspectives on the information, knowledge is generated. With knowledge, one can then start to make informed decisions.

The most practical way to imagine the future is to question the expected, this is best done making use of what we call 'critical thinking' – Critical thinking is the careful, deliberate determination of whether one should accept, reject or suspend judgment about a claim and the degree of confidence with which one accepts or rejects it. Critical thinking employs not only logic but a broad intellectual criteria such as the one outlined above. Critical thinking requires extensive experience in identifying the extent of one's own ignorance in a wide variety of subjects which is often captured in the following sentence: I thought I knew, but I merely believed.

As J.F. Kennedy put it: **"Belief in myths allows the comfort of opinion without the discomfort of thought."** Our aim is always to avoid this trap of the mind, when one attempts to look into the future one is better of exhibiting a more intellectually humble approach and challenge one's beliefs and opinions by asking the question: What if we took the opposite view? This leads to a more balanced set of insights in our view.

The insights and opinions offered in this document are meant as a summary of events and our views – not a conclusive or exhaustive overview or for that matter a specific investment recommendation.

We hope it will offer some food for thought and that it can form the basis of conversations between our clients, interested parties and ourselves.

Sincerely yours,

Mr. S.H. Sorensen
Senior Associate

PRE-DEPARTURE BRIEFING:

Napoleon stated that; **"The power of all nations are inherent in their geography."** Combined with slow moving and relatively 'solid' data such as demographic trends, geography forms the foundation for our approach to understanding the world we inhabit. Then you can apply a lens of historical context and an understanding of human and group psychology. With these tools one can distil broad insights on national and global trends and the probable paths forward.

In our opinion too much is made of traditional data, GDP % growth per quarter etc. are simply the short term effects of these underlying forces and should not be considered as the foundation for understanding but merely as a limited and 'noisy' symptom. We look for long-term patterns and potential breaks from the expected linear paths of most observers. As Niccolò Machiavelli puts it in 'The Prince'; **"One change always leaves the tooting for another."**

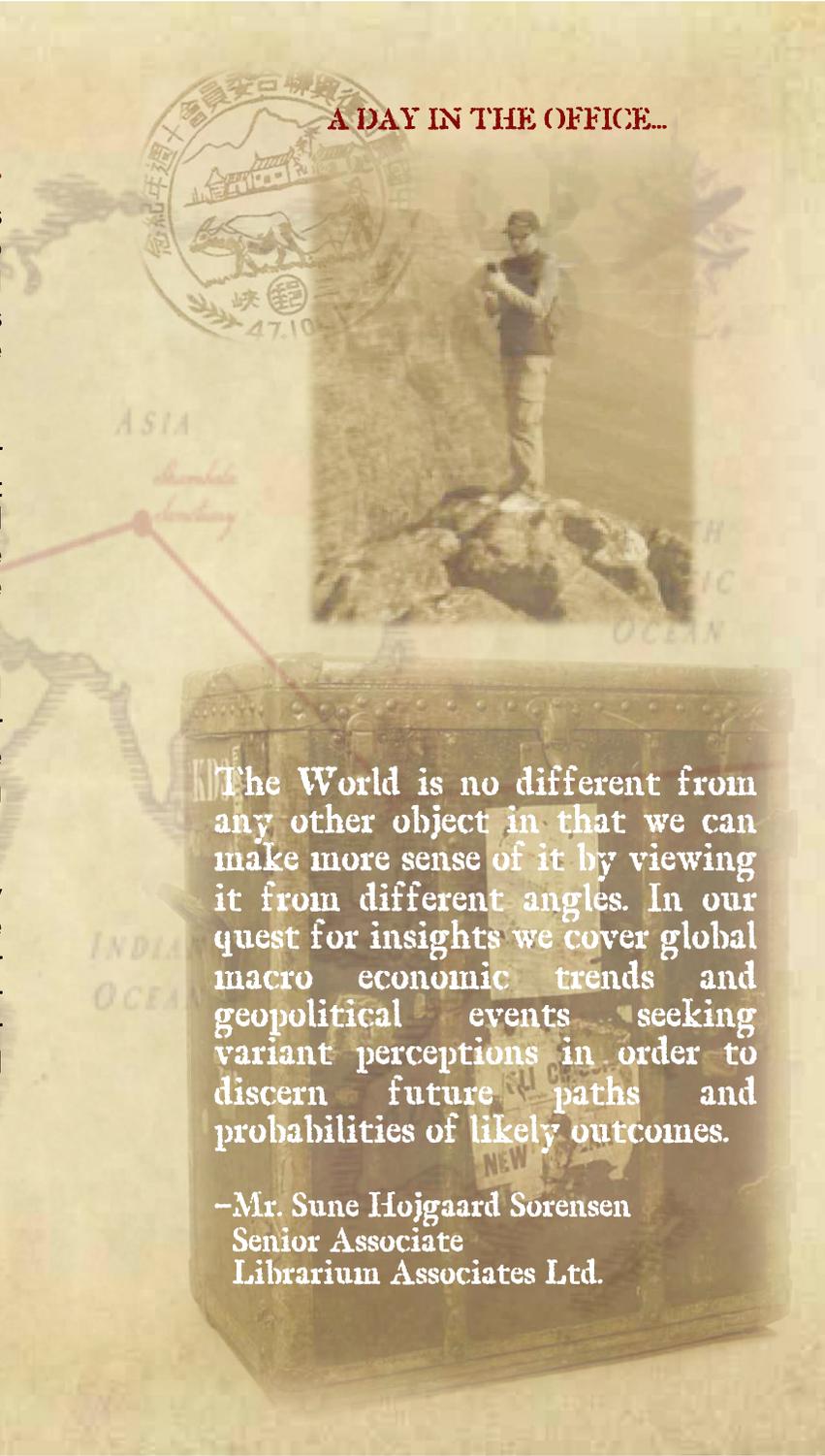
On our whirlwind tour Around the World in 8 Pages we will not offer traditional broad bland descriptions of quarter over quarter economic data but we will offer variant perceptions on the World's key regions as well as individual nations. We will delve into specific trends or events that caught our eye as significant during the last quarter.

As always we hope to inspire our readers to explore the World further by themselves, to ask questions and let people find the answers, to awake a sense of curiosity and a quest for further understanding. We welcome your observations and feedback and hope to meet up with you for a cup of coffee or a glass of wine in the future and mull it all over together. It has been our experience that real learning resides at the intersection of differing informed opinions expressed respectfully between learners.

Let's begin the voyage together...

"Not all who wander are lost." – Tolkien

A DAY IN THE OFFICE...



The World is no different from any other object in that we can make more sense of it by viewing it from different angles. In our quest for insights we cover global macro economic trends and geopolitical events seeking variant perceptions in order to discern future paths and probabilities of likely outcomes.

–Mr. Sune Hojgaard Sorensen
Senior Associate
Librarium Associates Ltd.

SHOULD YOU PREPARE TO FIGHT THE FED OR JUST GO FISHING?



Meet our first brave explorer,
Seth Levine, who will cover the
US leg of the journey with a deep
dive into the fundamentals of
The Way of the Central Bank...

Seth is a professional, institutional investor and the creator of The Integrating Investor. His career spans both the sell-side and buy-side, with the vast majority of it as an analyst in the corporate bond market. Seth's broad industry and markets experience underpins the unique investment framework he's actively refining through blogging. He also holds a Bachelor of Science degree in mechanical engineering from Cornell University and is a CFA Charterholder.

Please note that all of Seth's opinions and views expressed are solely his own and do not reflect those of his current or any former employer.

YOU CAN OBSERVE MORE OF SETH'S
BATTLES FOR GROUND OF BOTH SIDES OF
THE ARGUMENT IN THE PURSUIT OF
UNDERSTANDING VIA HIS SITE:
WWW.INTEGRATINGINVESTOR.COM &
ENGAGE HIM IN SOME VERBAL COMBAT
ON TWITTER: **@SETHLEVINE2**

ENTER THE DRAGONBEAR...

Meet our 2nd guest analyst, the indomitable **Velina Tchakarova**, who will introduce us to her pet: The DragonBear as it roams Eurasia & beyond. She explores the surrounding dynamics with a look at an eagle in a sticky situation, the Helsinki Accords 2.0 & the potential path ahead for the **China & Russia** relationship...

Velina Tchakarova is Head of Institute at the Austrian Institute for European Security Policy (AIES) in Vienna, Austria. She holds a M.A. in political science & political science of South Asia from the University in Heidelberg, Germany and a B.A. in international relations from the University of World and National Economy in Sofia, Bulgaria. Her work includes research, consulting & lectures on the global system transformation and geo-strategy of global actors, particularly the EU's role in Eastern Europe.



Learn more from
Velina on Twitter:
@vchakarova

EXPLORE THE PATH AHEAD WITH **SETH LEVINE**, OUR TRAVELING COMPANION FOR THE US FOCUSED PART OF OUR JOURNEY. HE SETS OUT ON A BRAVE EXPLORATION DEEP INTO THE VERY NATURE OF CENTRAL BANKING, BANKING, MONEY & MUCH MORE...

TO FIGHT THE FED OR NOT...

I have little doubt that the business cycle will eventually turn down. When, of course, is anyone's guess; but the weakening of economic data globally, and the inversion of the yield curve suggests that it may be soon. Perhaps less controversial is the expected course of action the Fed will take upon occurrence. In my view, it will follow in the footsteps of the Bank of Japan (BoJ) and European Central Bank (ECB) by cutting interest rates and relaunching Quantitative Easing—barring a wholesale philosophical change at the Fed. Pigs will sooner fly.

The established playbook for such a scenario should be fresh in investors' minds: **"Don't Fight The Fed!"** To be sure, this was *the* investment strategy over the last ten years. There was no easier way to tarnish one's reputation and career than to ignore this profitable slogan as many respectable money managers learned. That said, while DFTF certainly *had* been successful, I find myself questioning its validity on a prospective basis. Will it work once again, or should we consider those four most dangerous words ("it's different this time")?

In order to examine this question we'll need to unpack the slogan, re-conceptualize some important terms, dive into the inner workings of the Fed, and apply those findings to the economic landscape. Upon doing so, I believe that the Fed might have less of an impact over both the economy and its own actions that many might believe.

Let's review some definitions of the creatures we are likely to encounter on this exploration so that we have a firm foundation upon which to start building our thesis.

What Is DFTF?

For the unfamiliar, "Don't Fight the Fed" (DFTF) is a now common saying in the investment markets. It means to invest aligned with the Fed. If the Fed is "easing" be bullish. If it's "tightening" be bearish. Doing the opposite—i.e. fighting the Fed—is deemed detrimental to one's wallet. There are many famous instances of DFTF's usage in investment lore. Anyone active over the past decade experienced this firsthand. Monetary policy was easy, thus "risk on" trades tended to be the most profitable ones. Those who crossed the benevolent overlords' wishes likely underperformed and may have found themselves out of work.

Is DFTF Axiomatic?

Many take DFTF as axiomatic. It's understandable given the strategy's track record. However, there are times throughout history when DFTF broke down. Perhaps the most infamous example is George Soros's wager against the pound sterling. Other instances are the popular rejections of a local currency. For example, [Ecuador adopted the US dollar in 2000](#) after the Sucre significantly lost its purchasing power. The [Zimbabwean dollar](#) is another notable one.

True, these are extraordinary points in time and incredibly rare. They also don't pertain to the Fed. That is precisely what makes them instrumental. These periods demonstrate the limits to a central bank's power. Markets still have the final say.

What does the Fed actually do?

In order to analyze the DFTF slogan, we first should know what the Fed actually does. Listening to some you'd think it has powers of mythical proportions. However, that is simply not the case. The Fed is just an institution subject to the same realities of cause and effects as everything else.

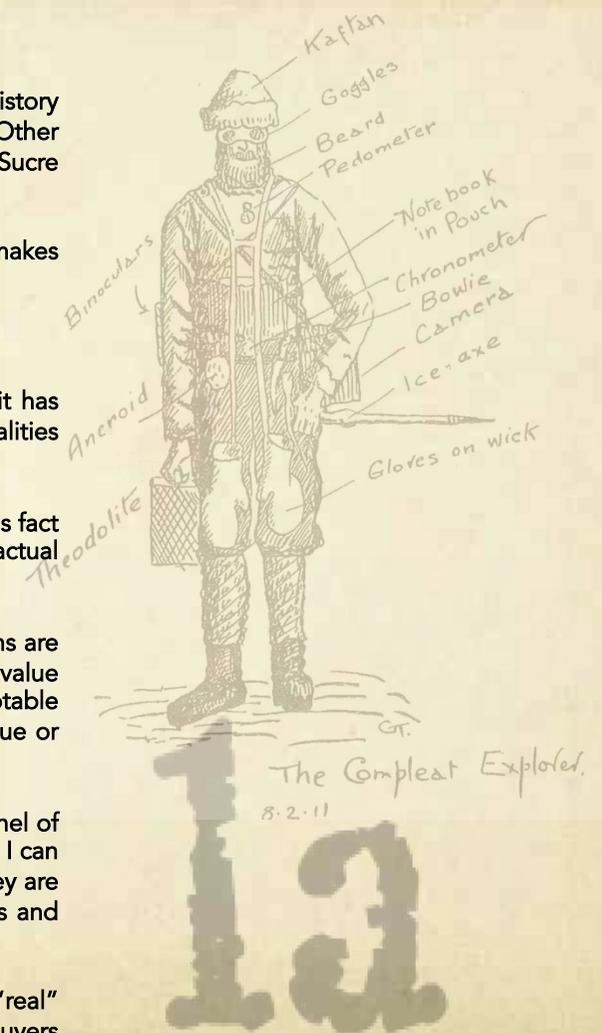
Perhaps the biggest misconception is that the Fed creates money. It does not. Confusing, I know. Coming to terms with this fact—which I did by integrating both Austrian and Keynesian economic perspectives—was my first step in grasping the Fed's actual impact.

Money is simply a standard unit of account for measuring economic value—akin to a minute, meter, or ounce. Transactions are credit-based and money is how we account for them. If I buy your bread, I owe you money; I am indebted to you for the value of the bread. Monetary value is used to account for it. How do we settle the debt? I deliver a physical form of acceptable money to you (dollars, yen, gold, barley, bitcoin, etc.) that extinguishes my obligation. Thus, money is *not* a store of value or medium of exchange (or even gold). It is simply a common unit of account.

Since money is an accounting standard, all production in an economy is monetary production. If I grow and harvest a bushel of corn, I account for its worth in money terms. In a sense, I credit my account for the value of the corn that I produced which I can now use in exchange for other things. Thus, money cannot be created (or destroyed) apart from a productive process. They are one in the same. Today, of course, we exchange our time and output for currency which we use to purchase the goods and services we desire.

From this fact pattern it became clear to me that the Fed cannot create money because it does not interact with the "real" economy. Only private banks (and finance companies) do. By "[facilitating] intertemporal exchange transactions between buyers and sellers" as Robert William Vivian and Nic Spearman note in [Banks and Money Creation 'Out of Nothing'](#), banks finance the creation of additional goods and services that otherwise would not exist. This is both an expansion of economic output and money. The value of "stuff" in the world increased.

A PRE-DEPARTURE EQUIPMENT & DEFINITIONS CHECK...



Getting to grasps with the modern banking model:

I also re-conceptualized my entire view of banking. I thought that banks lend out their excess deposits, a common belief. However, this is erroneous. Banks don't originate loans from piles of idle deposits. Rather, they borrow money in order to lend! Deposits are just one source of funding. Why else would banks pay for them? Today, there is an entire menu of choices available to banks in global money markets.

Thus, banks employ leverage as an operating model. **Banking is simply a carry trade!**

Banking is profitable so long as asset returns are greater than the cost of funding. However, there's no free lunch in the world; banks must assume some risk to earn their profits. There is primarily liquidity risk. Banks must manage cash flows such that the income from their asset portfolios can cover required liability payments. This is where reserves truly play a role. They serve as a buffer against cash flow shortfalls and timing mismatches. Thus, reserves are not raw material for lending. Rather, they are liquidity management resources. A banker's most critical role is to manage liquidity. It is liquidity shortfalls (which can stem from poor underwriting) that create bank failures.

What is the Fed's role in all of this?

If the Fed doesn't create money, what on Earth does it do? Is it important? And should we care as investors?

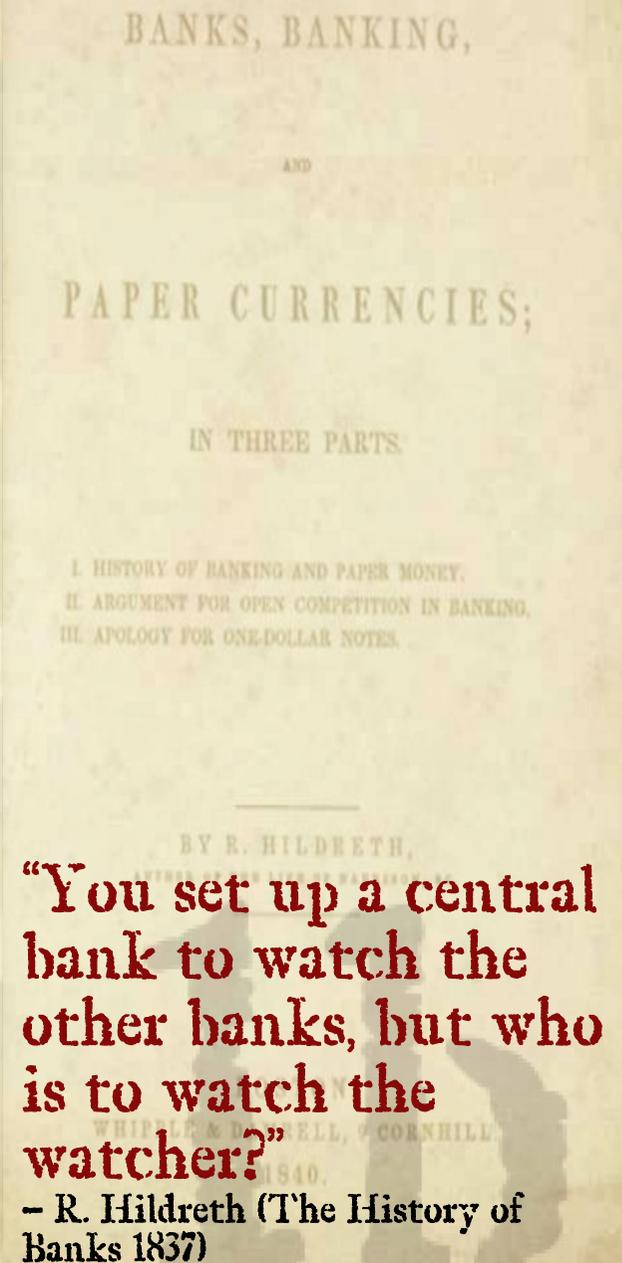
The Fed is a "banker's bank." It interacts with private banks via the reserve accounts they hold with it. These commercial bank reserves are the only touchpoint between the Fed and the rest of the economy.

The Fed's mandate is to promote certain political and economic goals. Realistically, it can only try to influence decisions made by private banks by adding and subtracting reserves to accounts that are held with it. *That is literally it!* This is done by targeting the Federal Funds Rate (FFR) via open market operations (OMO), setting the interest it pays on excess reserves (IOER), and purchasing and selling U.S. Treasuries (UST) and mortgage backed securities (MBS) in its System Open Market Account (SOMA) which is more commonly called Quantitative Easing (QE).

Whichever actions it takes, the Fed cannot create new assets in the market. It can only swap the types of investment vehicles available to banks. For every reserve addition (subtraction) there must be a corresponding sale (purchase) of an investable asset made by the account holder. In a financial system dominated by collateralized borrowing, reserve levels simply don't impact lending decisions all that much.

While the Fed's impact on bank lending is significantly less than in the past, it does have some influence over more commonly used short-term lending rates. There's an undeniable link between the FFR, IOER and other money market rates (such as repo rates and LIBOR). In order to maintain the FFR in the targeted range, the Fed buys and sells short-dated USTs in the open market (i.e. OMO). Various risk, liquidity, and regulatory characteristics ensure that a loose link remains between them all. However, the Fed's reach is limited. Market participants negotiate all other interest rates. The spread between these and the FFR (and now IOER) varies over time. The Fed's ability to influence longer-dated UST rates is even less direct than one would expect, QE notwithstanding.

Most importantly, these are the only channels by which it can impact the economy. **The Fed can't directly promote employment, improve capacity utilization, ease credit conditions, or influence any other commercial activity.** These decisions all rest with private actors. **The Fed's economic power, in my view, is grossly exaggerated.**



Sitting on its perch of privilege makes the Fed 'The Lender Of Last Resort':

Central banks function as a lender of last resort, and the Fed is no different. Technically speaking, any institution can fulfill this role. However, fiat currency erects an insurmountable barrier against private competition. That's right; the Fed has an unfair, competitive advantage—virtually no cost of funds.

The Fed's cost of capital is literally that of a keystroke. It can purchase (sell) assets from member banks at will by simply crediting (debiting) their reserve accounts. The Fed need not fund itself at all! It literally plays by a separate set of rules.

In times of stress, private banks' cost of capital increases dramatically. Borrowing costs rise when risk appetites fall. The Fed, however, is not subject to this reality. Hence it is uniquely positioned as the lowest cost provider of liquidity.

No private bank can compete with the Fed. A bank's most important attribute is its cost of capital. Private institutions are structurally disadvantaged to the Fed. Thus, the Fed is the ultimate provider of liquidity to the financial system by fiat!

Central Bank Activism On The Rise...And So Interestingly Is Debt!

In a fiat currency regime, base currency is virtually free and limitless. The Fed conjures reserves at the cost of a keystroke. Thus, it is always economical for the Fed to swap reserves for yielding assets (i.e. USTs and MBSs). Economics do not dictate decisions. Rather, committees (and politics) do. This not only subjects accessibility to liquidity to abuse and mistakes, but also creates perverse incentives.

In this era of increased central bank activism, there is a policy bias towards interventionism. When economic hiccups develop, the Fed reflexively provides liquidity (not money!). This not only prevents required deleveraging from occurring, but encourages re-leveraging as a remedy. Look no further than the situation in Greece as evidence (while this was the ECB's doing, it is an analogous and starkly illustrative example).

The result of decades of central bank activism is, in my view, debt growth. There are dozens of ways to observe this phenomenon. The seemingly timely interventions by heroic central bankers may have perversely compounded the problems. In my opinion, they tried to arrest the "invisible hand" of markets in order to perpetuate the carry trade that underpins the financial markets. However, what resulted was accelerating debt growth, not wholly a return to prosperity.

Low Interest Rates Are Self-Reflexive:

Interest rate "normalization" is proving to be more difficult than envisioned. Why? I contend that higher rates would catalyze the deleveraging of the banking system and investment markets. Secularly falling interest rates create ideal conditions for those engaged in a carry trade. A falling cost of funds boosts profits and thus incentivizes lending. Cheap liquidity forestalls the necessity to undergo painful deleveraging to address lending mistakes. Rather, the eventual impact is not only delayed, but compounded.

Thus, cutting rates became self-reflexive for policymakers lacking any skin in the game other than reputation. While delaying the inevitable may sell books, the Fed's control over markets and the economy may very well be illusory. The risks are merely mounting below the surface (or perhaps even in plain sight)!

Illusory Control:

The Fed has no super-powers. It can only buy and sell assets, just like everyone else. True, that it creates its own funding and can impact certain prices in certain markets. However, its footprint is limited to the transformation of maturity and liquidity profiles of investable assets available to commercial banks. Taking a step back, it's a rather weak influence on economic performance.

Thus, by no means does the Fed control outcomes. Its consistent failure to hit its inflation target despite unprecedented policy interventions serves as evidence. As always, markets and individuals will have the last say. The Fed is just one actor among many in a diverse and dynamic economy.

Assessing The Landscape:

In my opinion, there will likely be another turn down in the business cycle. This is hardly a profound proclamation, nor is it necessarily useful. Timing is everything when it comes to investing. When a slowdown does occur, I expect the Fed to revert to the staid policies of cutting the FFR to zero (if not lower) and conducting QE. In fact, they've stated so much on numerous occasions. This is, of course, short of a wholesale philosophical change of heart occurring, which seems unlikely for now.

Given the preceding fact pattern, this is how I read the economic landscape in the U.S.:

1. The financial system is comprised of a series of interconnect banks; hence it's constructed as a giant carry trade
2. Leverage ratios have largely deteriorated as debt grew faster than output
3. Interest rates fell secularly
4. The propensity for Fed activism is currently, very high
5. The Fed can only provide liquidity to banks by swapping reserves for USTs and MBSs and set IOER
6. Global growth is decelerating
7. In the event of a slowdown, the Fed will likely cut FFR to zero and reinstate QE

In my assessment, there are two conflicting forces at play: A highly leveraged carry trade and a deceleration of global growth. Thus, the potential for volatility is high should a drop in output force it to unwind. Assessing the interplay between them is, in my view, the most critical macro-economic investment issue. The higher the leverage, the higher the stakes are—and potentially even the reflexivity.

Developing a Playbook:

If this analysis is accurate, **what then should one do? Is a crash inevitable? Can the Fed bailout the investment markets as fabled? Should one "fight the Fed" if it comes to it?**

My answers to all of the above are "I don't think so." This might sound contradictory, but allow me to explain.

A look around the globe suggests that there's scope for both U.S. debt levels to rise and interest rates to fall. Japan's debt-to-GDP ratio is more than twice that of the U.S.'s and interest rates are negative-to-nil. Conditions there, however, are far from catastrophic. Hence, I fully expect policymaker and academic inertia to push us in that direction when the business cycle turns. After all, why address the complicated, underlying causes of high debt when they can simply be delayed? The result will likely be more leverage and lower growth; but not an economic crash.

The Fed is just one of many actors in the markets. I'm skeptical that it can bend reality. I find it unlikely that any Fed actions could fully offset the liquidation of private market participants facing weakening fundamentals. After all, the Fed can only purchase USTs and MBSs. Investment markets in their entirety are much larger.

I think it's more plausible that the Fed could add fuel to the fire of a rally after the fear has subsided and markets have bottomed. This is more consistent with the post-financial crisis experience. The Fed was powerless to arrest market declines during the throws of it all. Rather, it implemented QE during the recovery phase. That said, we don't know what might have happened had QE been available earlier. However, a look at the Japanese stock market's performance over the past 20 years with QE suggests that skepticism is warranted.

"The eye sees only
what the mind is
prepared to
comprehend."

- R. Davies



The ultimate round in this battle for the ground on both sides of the argument of whether: To Fight The Fed Or Not?

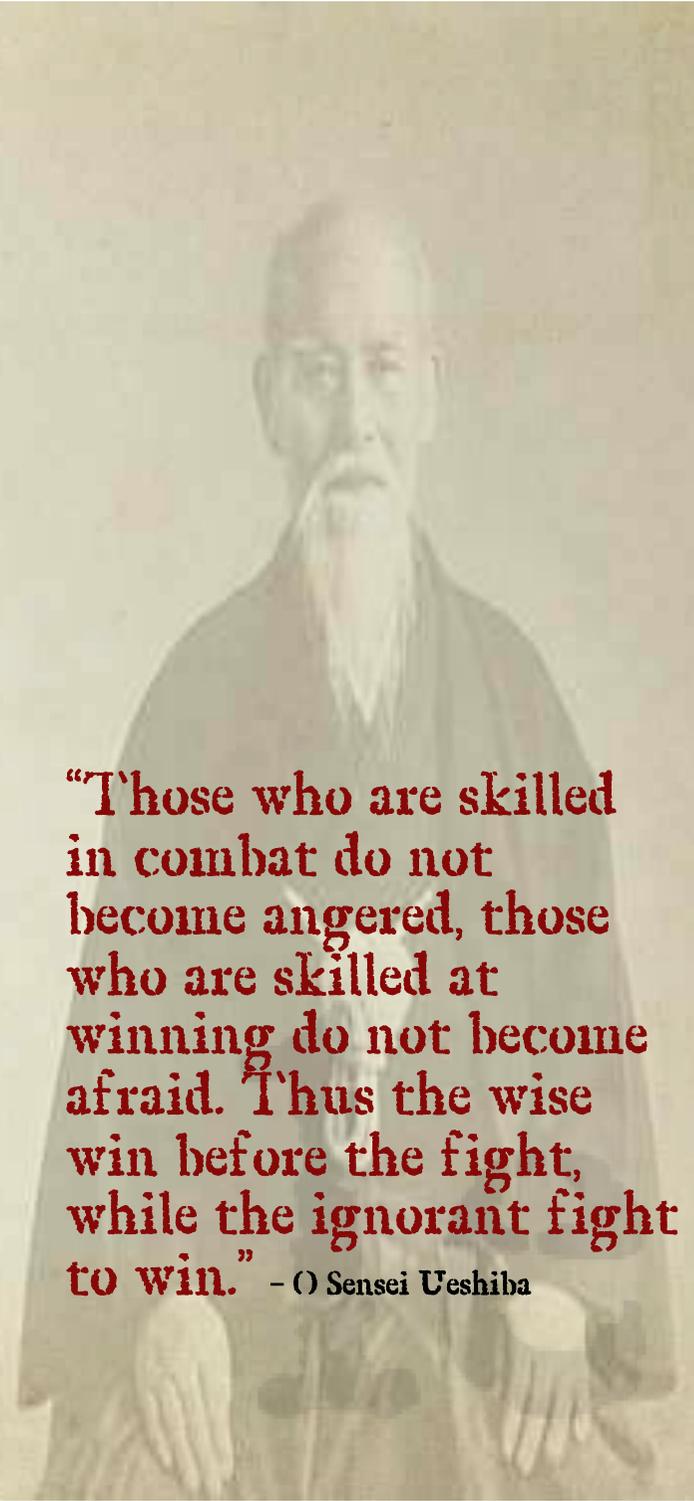
Today, many take DFTF as gospel. To be sure, such a position is well founded in recent history. However, there's no guaranty that what worked in the past will do so in the future. In my view, the Fed's toolkit is very limited and its ability to impact anything beyond the markets it directly touches is debatable.

If I'm correct about the carry trade, the leverage will unwind if growth does not follow. I have my doubts that the Fed can prevent this from happening let alone save the investment markets. Not only is cheap liquidity behind the rising debt levels, in my opinion, but also that it has diminishing returns. I find it more likely that the Fed's policies catalyze the reflation of asset values already underway by private actors reversing course. Thus markets might still decline irrespective of the Fed.

That said, I do not think that the U.S. is at the end of its rope. A look at other countries suggests there's scope for more "can kicking." Economic reality will eventually win out though, as George Soros will tell you. However, it's a matter of timeframes, and this theme's is not necessarily an investable one.

So, in the event of another downturn, should one fight the Fed? Damned if I know. However, I hope to have shed some additional light on just what it is we're fighting with or against. **You can't fight what you can't see.**

"EVERY BUBBLE CONSISTS OF A TREND THAT CAN BE OBSERVED IN THE REAL WORLD AND A MISCONCEPTION TO THAT TREND. THE TWO ELEMENTS INTERACT WITH EACH OTHER IN A REFLEXIVE MANNER." - G. SOROS

A faded, sepia-toned portrait of O Sensei Ueshiba, a prominent figure in Aikido, is visible in the background of the right side of the image. He is shown from the chest up, wearing a dark jacket over a light-colored shirt, with a long white beard and mustache.

"Those who are skilled in combat do not become angered, those who are skilled at winning do not become afraid. Thus the wise win before the fight, while the ignorant fight to win." - O Sensei Ueshiba

THE VIEW FROM SOUTH AMERICA...

In the spotlight: Mexico: En route to a Mexican standoff?

We highlighted in our Q1 2018 version of this report in the segment titled; 'Welcome to TexCalAriNewMexMex:'

"The region along the US/Mexico border is increasingly fluid, some argue that the border is moving north as migration pushes in from Mexico. Others argue that the border is moving south driven by increased investment and integration between the US and Mexico rendering Mexico part of the effective national territory of the US (Economically & in terms of security). If you take a closer look at the 10 border states that run along the frontier (4 in the US & 6 in Mexico), which combined would be the world's 4th largest economy in the world, it becomes even more clear. Together, these 10 states have a combined GDP of \$4.6trillion and a total population of almost 100 million (With a youthful demographic skew)."

On the surface the recent renegotiations of NAFTA was largely beneficial to the collective border region economy & it would seem only to advance these trends further. When you factor in the US Administrations decision to jump straight into a bare knuckle trade fight with China, including implementing a series of tariffs on many goods that Mexico also produces and as such would be ideally set to substitute, the continued integration of the two economies appears set.

However when you start pulling on the strings of the taut web of global trade and geopolitical influence you can end up with unwanted, & to the unprepared, surprising results. Geopolitics is a complicated sphere and in the words of R.D. Kaplan; "Realists know that passion and wise policy rarely flow together." Passions in the political arenas on both sides of the Rio Grande has been flowing high with some consequences starting to surface and plenty of others no doubt in the making.

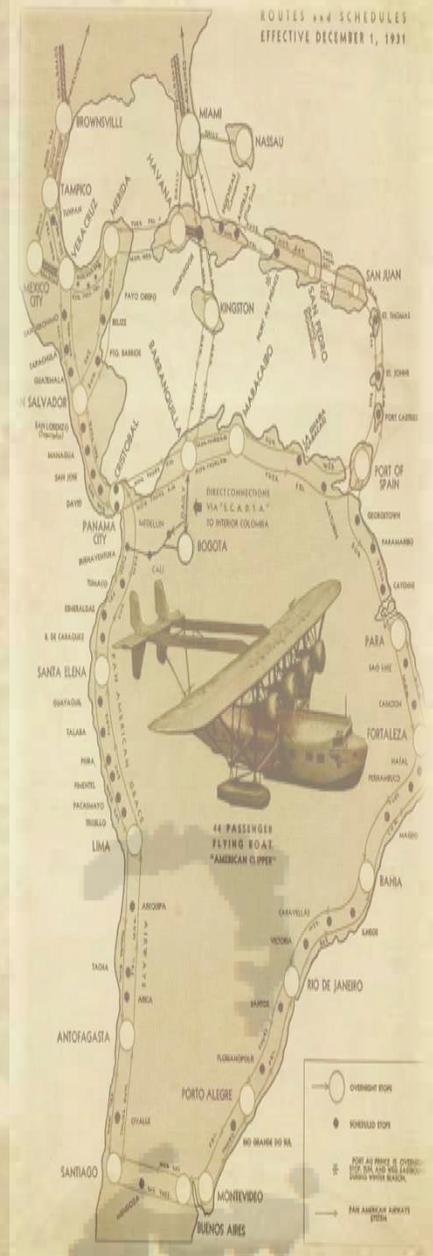
We have seen US imports from Mexico surge the most in seven years as the US policies have led to a shift in supply chains. In all, U.S. imports of goods from Mexico surged 10% to almost \$350 billion last year. That only served to further widen the US' trade deficit with Mexico by 15% to more than \$80 billion. Meanwhile, the growth in shipments from China slowed by about a third. So far the Trump Administration's trade war with China has turned out to be a windfall for Mexico.

The US trade deficit for goods globally hit a record \$891 billion last year as tax cuts boosted demand for imports and retaliatory tariffs weighed on US exports. Given Trump's attacks on Mexico for taking US jobs & his railing against the supposed damaging effects of the neighbor to the South on a whole host of issues, it's an almost ironic turn of events.

The new Mexican administration of Mr. Obrador – no stranger to heated & shortsighted rhetoric himself – has perhaps for obvious reasons been relatively restrained in his approach to the US. However these two supposed populist leaders, with what appear to be confrontational objectives and personalities, will surely find it hard to avoid clashes along the path ahead.

"REALISTS KNOW THAT PASSION AND WISE POLICY RARELY FLOW TOGETHER." – R.D. Kaplan

Heading South...



14.6048° S, 59.0625° W.

Another side effect of the trade conflicts has been China's focus shifting increasingly to Mexico, which in the past had been largely left alone as China picked up more low hanging fruit in the Central and South American regions.

Chinese FDI to Mexico is on the rise from a low base and many Chinese business are moving parts of their operations to Mexico in order to circumvent US Tariffs on Chinese exports and to reap the benefits of the NAFTA 2.0 deal with Mexico. The fraught political climate between the Obrador and Trump administrations is providing a potential opening for China. Taken in combination with Mexico's need for serious levels of FDI for infrastructure, so it can unleash its energy & productivity potential in order to provide the required economic opportunity to its youthful and growing population, it appears likely that China will have a receptive audience in Mexico City. Even if the inherent limitations, due to the integrated nature of the US & Mexico's economic and security situations discussed initially, will always make its scope limited in nature.

China's trade relationship with Latin America is already significant, Chinese trade with the region was close to \$12bln in 2000 and reached a peak of \$260bln in 2013 before settling back to around \$220bln in 2017. Localizing production in Latin American countries allows China to bypass many trade and non-trade barriers that arise from producing those goods in China and shipping them overseas, namely, discrimination against "made in China" products, tariffs, and shipping costs. Recent events are only likely to further enhance this trend and with Mexico as a key target even if it will be more on the margins and for political show at least for now. **It will be a useful indicator for the US' willingness to dust off the Monroe Doctrine & it represents a lever for China to push back on US incursions into its own strategic sphere closer to home. A miscalculation for either side could lead to a classic Mexican standoff.**

Even before Trump's moves, Mexico was becoming more competitive with China, in part due to rising Chinese labor rates and Mexico's proximity to the US, especially important in the e-commerce era of quick shipping. China and US businesses will not be the only ones looking to establish businesses in the border region, as long as Mr. Obrador can keep his anti-business instincts under control and keep a lid on the security situation. Overall Mexico presents an attractive package to global investors but it is obviously heavily reliant on the direction of the US economy and its PMI after posting a solid recovery in February, it showed signs of weakness in March. Total inflows of new work stagnated, while a marginal and slower upturn in export sales was registered.

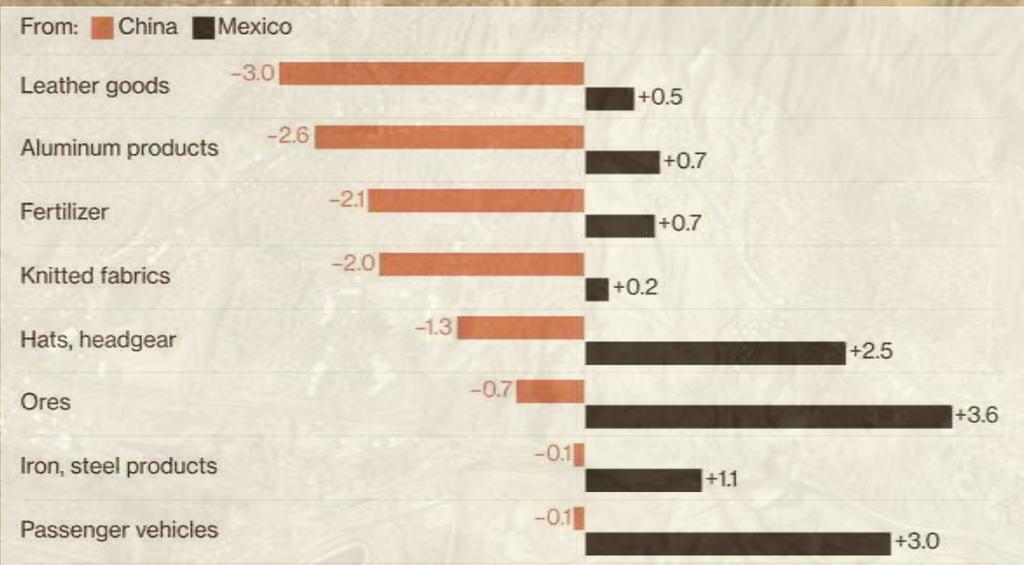
In an integrated global economy no place is an island and if you pull on the strings underpinning it all you may just end up with a series of detrimental and unpredictable results. As to the axiom of Mr. Niccolo Machiavelli; "One change leaves the teething for another."

"ONE
CHANGE
LEAVES
THE
TEETHING
FOR
ANOTHER."

- Niccolo Machiavelli

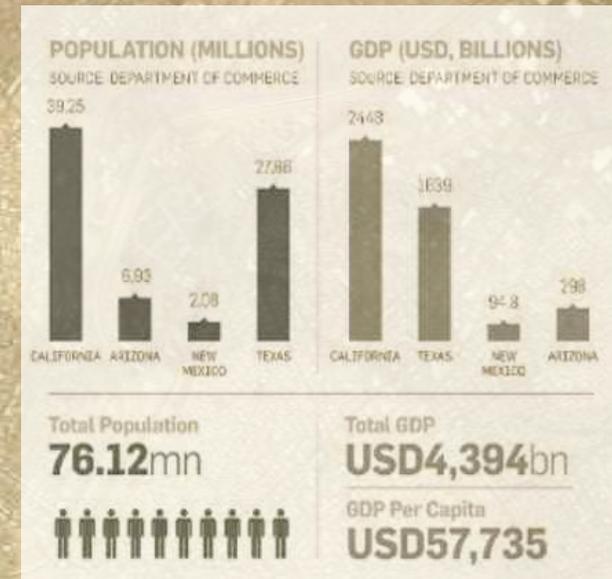
VISUAL ADDENDUM TO PAGE 2: IN THE SPOTLIGHT: MEXICO:

CHINA'S LOSS IS MEXICO'S GAIN... Change in share of US total imports 2017-18 (In %)



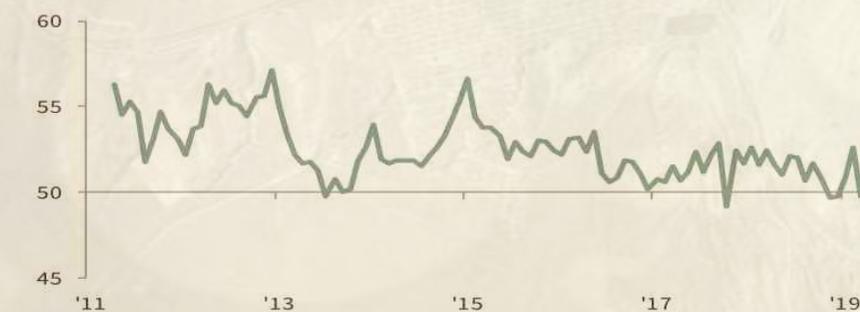
Source: Bloomberg/US Census Bureau.

US SIDE OF THE BORDER ECONOMY...



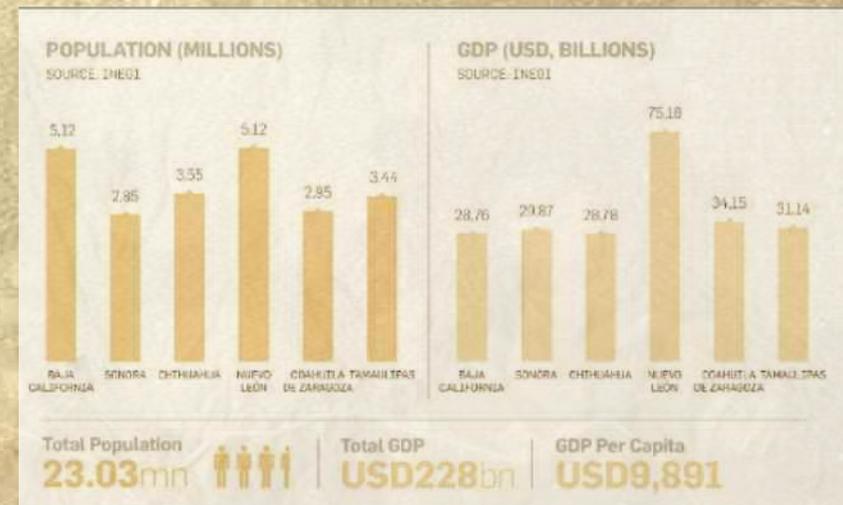
NO ONE IS AN ISLAND IN AN INTEGRATED GLOBAL ECONOMY...MEXICAN PMI HEADING SHARPLY LOWER, A SIGN OF MORE DIFFICULT TIMES AHEAD - ECONOMICALLY & POLITICALLY?

sa, >50 = improvement since previous month



Source: IHS

MEXICO MEXICAN SIDE OF THE BORDER ECONOMY...



THE VIEW FROM EUROPE...

The European Experiment – Perceptions Vs. Reality...

What if someone is always perceived to be seriously ill but never dies? Is that a sign of resilience?

As part of my work of assembling insights that can inform my perspectives on regional trends and triggers for change, beyond my reading, I attempt to listen to as many different views from individuals around the world from different walks of life. Seeking to adopt Felix Somary's practice of "...not seeking out others who will confirm my way of thinking but rather strive to widen my point of view, so that I can attempt some conception of the entire interest of a country that is entirely independent of my own position."

In such conversations, discussing Europe – the EU & the related idea of Europe as an economic, social, cultural and political collective – brings out a bifurcated set of expressions.

Perhaps it's due to the very narrow press coverage of the subject matter that it tends to be two clear camps – the US and UK based observers tend to see the doom and gloom, the apocalypse of the European Project around every corner...While the continental Europeans tend to be more hesitant about the subject, they will outline some regional issues specific to them and their business/job & be more shy about expressing their views more broadly.

While Europeans certainly see and express concerns about many things related to the EU construct in its current format they seem to embrace a broader sense of Europe as a collective and a union of relatively likeminded people with a shared destiny in global affairs. A pragmatic 'live local think global' approach permeates the conversations & the day-to-day actions of people. Beyond the political elite the willingness to express ambition and belief commensurate with the actual scale of the European Experiment is in short supply, unlike the cousins across the Atlantic who seems just as dispersed in their opinions and beliefs but never the less are always open to promoting the exceptionalism & certainty of the American Experiment.

Beyond cultural differences and the power of framing narratives, there seems to be a disconnect between what is perceived as fragile and that which is actually prone to implosions/explosions. It is a disconnect that is not unique to the European question but also raises its head when looking at the current state of democracies vs. centralized oligarchies/dictatorships as governance and leadership models. Appearances can be deceiving when it comes to complex systems like human societies.

Is Italy more resilient than Saudi Arabia? Is the EU or China more fragile? As to the title of this segment; If someone is always perceived to be seriously ill but never dies, is that in truth what resilience looks like for complex systems such as human societies and economies?

It is a question worth exploring to better understand what fragility and the 'Anti-fragile' looks and feels like. It is a question we shall explore further in this segment through the lens of Europe.

Fluctuat nec mergitur: It fluctuates but does not sink
(Latin).

53.0000° N, 9.0000° E

IT'S EVEN WORSE IN EUROPE

A REAL STRESS TEST...

In his book; 'Anti-fragile – Things that gain from disorder.' NN Taleb makes the following observation that is worth considering by all observers of trends and analysts charged with mapping out potential future economic and societal paths:

"Fragility is quite measurable, risk not so at all, particularly risk associated with rare events. (...) Risk management as practiced is the study of an event taking place in the future, and only some economists and other lunatics can claim – against experience – to "measure" the future incidence of these rare events, with suckers listening to them – against experience and the track record of such claims. But fragility and antifragility are part of the current property of an object, a coffee table, a company, an industry, a country, a political system. We can detect fragility, see it, even in many cases measure it, or at least measure comparative fragility with a small margin of error while comparisons of risk have been (so far) unreliable."

So if the inherently fragile can be observed and measured, while predicting specific events set to take place in the future is a fools errand, let us look at some of the signposts of the fragile/antifragile.

In the CIA 'Studies in Intelligence series Vol. 56 from 2012, in a segment titled "Estimating State Instability" by J.E. Margolis he highlights the following;

"Political stability is the degree to which the formal and informal coincide.... When the formal roles and structures set by authority match those constructed by informal social interaction, an object is stable. When either set of roles or structures change so they conflict, an object is unstable to some degree.... Perfect stability is total correlation; perfect instability, the total absence of correlation. The size of the gap between formal and informal roles fairly represents a state's potential for instability.

This is the correspondence between law and custom, between the expectations of the state and the expectations of society. When divided, they place people and institutions in tension and set one role against another, making disruptions more likely.

Governments and societies usually narrow this gap through four stabilizing dynamics that work to realign formal and informal roles.

- The state can enforce its set of roles on society by using its authority. It may pass laws and enforce them with security forces, for example.
- The state can reform its roles to match society through resilience. It may change laws in response to social pressure, for example, or expand its role suddenly to respond to urgent needs in a crisis.
- Society can recognize and accept the roles set by the state through legitimacy. It may accept new challenges such as taxes or rationing, for example, out of a belief in the state's right to rule on such matters.
- Society can enforce its set of roles on the state by attempts at replacement. It may reject incumbents at the polls, for example.

The failure of these four stabilizing dynamics does not automatically lead to instability events, however. Often, opportunity is also needed to convert existing tension into acts of instability. Beyond the gap, some social, economic, and environmental conditions correlate highly with acts of instability. They are not causes, but they are key enablers."

He goes on to say;

"Trigger analysis should focus on contexts instead of specific events. The four clearest practical contexts in which triggers might spark instability are elite division, policy deadlock, public awareness, and social trust. Within authority, a divided elite is much more vulnerable to sudden stresses than a united one. Within resilience, policy deadlock paralyzes a state's ability to respond to change. And, within legitimacy, public awareness and social trust - information and a way to discuss it - facilitate popular mobilization.

These local conditions set the context for trigger events. If conditions would allow a trend enabled trigger to spread, its probability of sparking instability events rises. Conversely, if they would not, an event may occur in a context of vulnerability without developing into a trigger."

EXPLORING THE NATURE OF RAPID CHANGE...

Back in early 2011 I was living in Barcelona and an old acquaintance from my time in London came back into my life briefly – During our time in London we worked in the same building and on occasion shared a few drinks, this was pre families for us both and Claude looked very much like the bland accountant from Strasbourg that he was back then. When our paths crossed in Barcelona Claude was recently divorced and now dressed like if Yves Saint Laurent designed Indiana Jones outfits and had a new young Spanish girlfriend. In his youth he had traveled with his father in the Middle East and he now embraced that spirit of a French explorer again.

It was a time when the so-called Arab-spring was regarded as a time of magical transition and a time when Facebook was going to change the world for the better. Claude - with his new found wanderlust was looking to savor the flavor of revolution, embellish his newfound 'international man of mystery' persona and no doubt impress his new girlfriend - had decided they should travel to Syria and explore the ancient sites around Damascus and Aleppo – ride a motorcycle into the desert and follow the footsteps of Lawrence of Arabia. In short he wanted to get in on the action and saw Syria as the place to go get some adventure.

I saw Claude for a few drinks just prior to them heading out, of course he turned up in full khaki splendor, panama hat & desert boots, ready for anything that may come his way in the bar on the roof terrace of the Mandarin Oriental hotel. He had it all planned out including ideally him starting off the next revolution and fleeing through the desert on a stallion with his girl by his side.

When I next heard from Claude, he was decidedly less electrified and more downcast. The trip had been a disaster, Syria was dull and dreary, the people had no revolutionary spirit and had not wanted to be actors in his Arabian adventure. He was kicking himself for choosing such a stale calm almost sterilized place and to top it all off, his girlfriend had gotten diarrhea on the 2nd day after they arrived, leaving him to skulk around in the hotel bar most of the time.

Around 2 weeks later one of the worst civil wars in recent history kicked off and a conflict, that has now been ongoing for over 7 years with over 400,000 people having lost their lives & millions displaced so far, exploded into being. I had myself travelled in Egypt on a number of occasions in the time leading up to the Arab-Spring and while much less flamboyant and certainly not seeking to start any revolutions I had observed some of the same eerily calm placid waters, that you tend to only find in societies where the public is watched by police with automatic weapons, who are being watched by military personnel with automatic weapons, who are being watched by people with 1000-yard stares, no uniforms and carrying more automatic weapons.

In the subsequent weeks, while thinking about the nature of how revolutions seemed to happen fast but dawn slowly and how societies could leap from one extreme to the other, I came across an article by NN Taleb and M. Blyth titled; 'The black swan of Cairo: How suppressing volatility makes the world less predictable and more dangerous.' It lays out an interesting framework for thinking about these dynamics and the definitions for that which is fragile and on the reverse that which is Anti-fragile.

Messrs Taleb & Blyth eloquently state;

“Complex systems that have artificially suppressed volatility tend to become extremely fragile, while at the same time exhibiting no visible risks. In fact, they tend to be too calm and exhibit minimal variability as silent risks accumulate beneath the surface.

Consider as a thought experiment a man placed in an artificially sterilized environment for a decade and then invited to take a ride on a crowded subway; he would be expected to die quickly. Likewise, preventing small forest fires can cause larger forest fires to become devastating. This property is shared by all complex systems.”

They go on to state:

“Differentiating between two types of countries is useful. In the first, changes in government do not lead to meaningful differences in political outcomes (since political tensions are out in the open). In the second type, changes in government lead to both drastic and deeply unpredictable changes.

Consider that Italy, with its much maligned “cabinet instability,” is economically and politically stable despite having had more than 60 governments since World War II (indeed, one may say Italy’s stability is because of these switches of government).

Similarly, in spite of consistently bad press, Lebanon is a relatively safe bet in terms of how far governments can jump from equilibrium; in spite of all the noise, shifting alliances, and street protests, changes in government there tend to be comparatively mild. For example, a shift in the ruling coalition from Christian parties to Hezbollah is not such a consequential jump in terms of the country’s economic and political stability.

Switching equilibrium, with control of the government changing from one party to another, in such systems acts as a shock absorber. Since a single party cannot have total and more than temporary control, the possibility of a large jump in the regime type is constrained.

It should not fear fluctuations per se, since allowing them to be in the open, as Italy and Lebanon both show in different ways, creates the stability of small jumps.

As Jean-Jacques Rousseau put it, “A little bit of agitation gives motivation to the soul, and what really makes the species prosper is not peace so much as freedom.” With freedom comes some unpredictable fluctuation. This is one of life’s packages: there is no freedom without noise—and no stability without volatility

The artificial suppression of volatility—the ups and downs of life—in the name of stability. It is both misguided and dangerous to push unobserved risks further into the statistical tails of the probability distribution of outcomes and allow these high-impact, low-probability “tail risks” to disappear from policymakers’ fields of observation.”

So are the easily observable signs of perceived fragility in fact signs of enduring outlets or safety valves for buildup issues in free & democratic societal structures? Whereas closed societies with deceptively eerie calm surfaces are signs of volatility repression, that like oil on troubled waters can only control the underlying forces for so long? Is that which appears calm & aligned in fact more fragile than the messy, noisy, often frustrating potpourri of human expressions that is freedom/democracy?

In our Q4 2017 edition of this report I included the following “Useful notes from the trail” segment inspired by NN Taleb’s work;

When assessing nations for fragility look at the following key sources:

- 1: A centralized governing system.
- 2: An undiversified economy.
- 3: Excessive debt and leverage.
- 4: A lack of political variability.
- 5: No history of surviving past shocks.

“...there is no freedom without noise & no stability without volatility.”

EUROPE UNDER THE LENS:

So coming full circle let's look at the European Experiment and it's current iteration the EU through the lens of the various factors we have identified in this admittedly rambling exploration.

Taking **Mr. Margolis' framework**; of the alignment of the formal & informal/law & custom, his 4 levers of societies; Enforcement, Compromise, Legitimacy (through "narrative management" and/or consistent signs of competence) and Replacement (A rules based path to change). We can further consider his rules for "trigger analysis" and the practical contexts in which triggers may spark instability in a society; Elite Division, Policy Deadlock, Public Awareness and Social Trust & the lessons from NN Taleb's extensive work on the subject let's explore Europe.

Alignment of formal & informal/laws vs. customs: On a comparative level European (individual nations, the EU and the interlinking framework of the two) 'laws and customs' are balanced with millennia of smoothing the rough edges on both sides. The EU construct while clunky still defers much to the national/local level (too much to be efficient according to some lines of thinking) while the overall operations are run by committee and mandarins. Some would argue that it is an unnatural ill fitting 'Frankstein's monster' construct while one could see it as a 'work in progress' shifting shape towards what a more global world demands. While the populace may not like the taxes and red tape, they do like the social safety net and consumer protections & appreciate that a collective front is needed to stay relevant in the world today.

The effective use of the 4 levers of societies:

Enforcement: While the media may be full of Gilet Jaune run-ins with French riot police, as was the case in the recent Catalan/Spain confrontations, and the security surveillance state that has been build-out in response to the various terror events over the last couple of years can seem Orwellian, for the most part – at a national & union level Seneca's observation in 'De clementia' - **"Repeated punishment, while it crushes the hatred of a few, stirs the hatred of all...just as trees that have been trimmed throw out again countless branches."** - appears to have been heeded & 'the passing of laws and enforcement' is mostly effective and in keeping with the unspoken social contract. While comparatively low – inequality (Urban/Rural, Educated/Uneducated, Young/Old, North/South & East/West) may become a serious testing ground for this going forward.

Compromise: Here some would argue that many of the frustrations and lack of a powerful vision are born out of too many compromises between the EU apparatus and the nations, between industries and internally in the individual nations. Certainly as to the old saying; **"A camel is a horse designed by committee."** it has not proven to be a path to efficiency & effectiveness. However in the interest of assessing build-in resilience it appears to be an evolving yet effective series of safety valves to release buildup tensions and a way to avoid wild swings to the extremes that has plagued this old continent all too often in the past.

Legitimacy ("Narrative management" and/or consistent signs of competence): At national levels (all around the world) there appears to be a stern assessment of 'Legitimacy' underway – political, academic, military & business elites are being called out for past failures and questions of legitimacy has seeped into most areas of society, patriarchy, expertise, economic systems etc. The legitimacy of the European Experiment and it's current operational structure is no exception. On the path ahead its ability to 'manage the narrative' in times of turbulence and more importantly the implementation of policies that benefits its constituents and ensures that Europe makes the right steps to deal with an increasingly turbulent global reality effectively will be telling.

Replacement (A rules based path to change): Both at national and EU level you see plenty of evidence of this (Some would argue too much) with Europe's recent elections expressing a continuous push beyond the incumbents of the de-facto 'two party system' and the diversity of opinions being expressed more and more broadly. Over the last two election cycles in Germany the % of the share of the vote of the two traditional ruling parties went from 67.2% to 53.4% in France it went from 55.5% to 26.4%. This is recipe both for gridlock and for a more representative democratic reality, a multi-party system demands compromise and leads to continuous replacements and avoids any of the extremes having too much power at any given time. And it is a safety valve that give the populace an outlet to express their frustrations short of all-out conflict and revolution. High levels of inertia at both national and EU level could of course lead to a larger & broader frustration that could drive individual nations and/or parts of the populations to seek other frameworks.

STUDIES IN
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—SECRET—

TRIGGERS TO WATCH:

Elite division: As discussed prior to this, it is already taking place to some degree at the party political levels and while much is being made of the conflicting policies and associated heated rhetoric between some national governments as well as between national governments and the EU apparatus, in reality it is more akin to Taleb's observation on the "stability of small jumps" – beyond the shrill rhetorical noise, inherent limitations ensures a relative equilibrium of policy and economic ideas. A significant split between business and political elites would be a real point of departure from the status quo and something to watch out for as a trigger for real splintering.

Policy deadlock: As discussed this is the norm for better and for worse. The real risks is if the operating by committee, with too many diverse voices, leads to an all out inability to plan and act effectively in the face of large external changes. There are a few of those around these days and how the EU and the individual nations navigate this will be telling & worth watching.

Legitimacy: Europe has a very free expression of opinion and if you are as free as your ability to criticize and change your 'rulers' it must be deemed to be a free society broadly with a relatively informed and aware populace. However in our interconnected and increasingly digital and online reality information warfare and other forms of manipulation has taken on another dimension and powers within and externally are and will continue to challenge the durability and legitimacy of the 'Experiment'. These tools can be a positive source for the exchange of ideas, communications and insights that can help give voices to more people and help mobilize society for change to the better. As we have seen more recently they can also be a vehicle and accelerant for the opposite. Europe will have to face these realities and find ways to show a united front – rhetorically and in reality - to these challenges.

And from NN Taleb's work:

Build in safety valves to direct & relieve pressures building up in the system? As discussed at length above, the European nations and the EU has plenty of these build in and they have stood up to the test so far.

Level of centralization of governance: While much is made of the EU's clique of manipulative bureaucrats & the traditional tropes of 'dark forces' behind the curtain, the broader European Experiment is relatively decentralized and as democracies the constant regular churn leads to renewal and circumvents the 'bad/mad' emperor syndrome of dictatorships and oligarchies.

Level of diversification of economy: The EU is a major global trading power with a very diverse collective economy and even at local levels most of its member states rely on a diverse range of industries within the services, manufacturing & resources (mainly agricultural) spheres. While global in scope and focus, it does rely – for better and for worse - on internal trade within the union which accounts for around 60% of total trade.

Level of debt & leverage: European nations have comparatively high levels of debt across the private, corporate and government sections. Some nations who struggle with creating sustainable economic growth are facing debt sustainability issues which flare up on occasion and the banking sector is 'tied to the mast' of this leaking vessel. So far the ECB and the healthier economic players have been able to keep it afloat with monetary games of circular reasoning and duct tape. In terms of triggers both to the downside and the upside (some form union wide solution being effectively implemented that could be a foundation for real economic growth) this is a space to watch.

History of surviving shocks: European history is all about shocks interspersed with short bursts of calm and tranquility & with rapid periods of real advances. It has been to the edge (a few times) and back again and over the last 70 odd years (with a lot of help, direct and indirect, from the cousins across the Atlantic) it has managed to stay relatively peaceful and to build a sturdy societal and economic reality.

**"TRIGGER
ANALYSIS
SHOULD
FOCUS ON
CONTEXTS
INSTEAD OF
SPECIFIC
EVENTS."**

**– J.E. Margolis, CIA
Studies in Intelligence
Series.**

SUMMA SUMMARUM..

Is the EU a perfect format? No, is it a comprehensive Geo-economic block loosely directed from a somewhat clunky yet democratic central framework of leadership by committee and with a comparatively strong national self determination amongst the union members? Yes. Is it resilient? Yes. Is it a model society of muscular 'Anti-fragile' strength and with a vision for the next 100 years? No, but neither is anywhere else really. Is it a 'monochrome super-state'? No – and it never will be, the aim should be a giant Switzerland, a flexible yet cohesive place of plurality but with common goals were interests align & were global challenges & opportunities demand a collective approach.

It is home to over half-a-billion relatively well-educated people, many with the means and ability to go live elsewhere, which some of them do but the vast majority does not. While there are plenty of differences & challenges - 24 official languages, east/west/north/south/old/young divides and some very real and daunting challenges, internal and external, on the path ahead - the cohesiveness appears stronger than the shrill protestations of the naysayers.

Serious observers may want to move beyond the sloganeering and the doom and gloom glasses and look at the real trends and triggers that will determine the outcomes on this ancient continent in the years and decades ahead. Investors should also shake off the lazy 'takes' and dig a little deeper, they might just find some real gems amongst all the negativity.

The European Experiment has been ongoing for millennia, from the more inclusive Hanseatic League to the more repressive & confrontational attempts to unify the continent under a religious banner and/or that of a single nation. The last 60-70 years has been some of the most productive for the inhabitants and businesses of the continent and as such the 'Experiment' is not going away any time soon. It will be noisy and it will never be a smooth running machine but that would appear to be a crucial part of what makes it resilient.

**“THAT WHICH DOES
NOT KILL US MAKES US
STRONGER.” – F. Nietzsche**

**“As an
architect
you design
for the
present,
with an
awareness
of the past,
for a
future
which is
essentially
unknown.”
– N. Foster**

THE VIEW FROM AFRICA & THE MIDDLE EAST...

8.7832° S, 34.5085° E
29.2985° N, 42.5510° E

IN THE SPOTLIGHT: BEAR SIGHTINGS IN AFRICA...

Since the *Ursus arctos crowtherii* AKA the Atlas Bear last roamed North Africa 150 years ago it has been sparse in bear sightings on the African continent, with only an intermittently increase when the Cold War provided the required climate. That has begun to change. The '*Ursus Ruthenia Wagnerus*' has been spotted with increasing frequency around the place in the last couple of years. In some locations it has settled down for the long haul others it has swept through for some opportunistic scavenging, leaving only destruction and its droppings behind. It is time to follow its footsteps in an attempt to assess the scope & implications of its mission.

Luckily I know just the guy with an extensive network in both camps (Russia & Africa) and who is not afraid to get into the mix of things, let's call him "**Agent A**" in order to preserve his ability to move discreetly around the region. In the following pages we will try to map out Russia's renewed focus on the Middle East & Africa and try to unearth its motivations and role going forward. "**Agent A**" acted as a sounding board for this segment, providing granular insights into the dynamics at play - for that I thank him.

While China's move into Africa has been well documented, Russia's maneuvers has been kept largely in the shadows beyond the focus on its role in Syria and increasing weight upon the policy of the OPEC it is not clear that there is a coordinated mission as such, which is of course just the way the Russian leadership group likes it.

It is our opinion that Russia's role in China's BRI project is one of the most important components yet the one that is least discussed and understood. It is as if a lot of signals are being deployed to focus attention on anything but this area of this vast project. Our guest analyst, Velina, will discuss the linkages and strategic visions of these two so-called 'revisionist powers' AKA the 'Dragon Bear' in her segment so here we will look more at Russia's role within the loose operational framework of the two as well as getting more granular with Russian (direct & indirect) operations across the MENA & Sub-Saharan regions.

The Great Game is afoot...

Offence is the best defense...

As seems to be a common thread in Russia's strategic moves over the long arch of history, there seems to have been a defensive measure as a result of a real and/or perceived threat behind its most recent international expansion. While Russia had been busy securing funding for expansions of its energy output and the means of exportation it had largely neglected the geostrategic sphere of establishing levers for controlling the price of these products – the key pillars of the Russian economy – And by around 2015 the Russian leadership felt certain that the US, with its rising shale industry and its vassal state, Saudi Arabia, were deliberately lowering oil market prices to both protect their consumer based economy and to control its foes, namely Russia & Iran. Oil prices was seen as a subtle tool to nudge these upstarts in the right directions by the US and dictate their actions through the creation of inherent barriers to their ability to expand economically and militarily. Furthermore if push came to shove these levers could be used to seed internal conflict by limiting the leaderships ability to provide for their citizens and as such they would increasingly lose their legitimacy.

At the end of 2015 Russia had to cut its public spending by 10% due to the growing pressure from the pincer movement of international sanctions and low energy prices for an economy that relies on \$100 oil. The actions following this seem to indicate that Russia A) Moved closer to China, becoming its prime procurer of raw materials and 'bare knuckle street fighter' & B) Determined to push back against the US & cease the initiative in the Middle East in order to control the oil price lever.

This push for a higher degree of self-determination (Russian view) or to be a global spoiler & opportunist (Western view) was quickly expressed with an aggressive move into the Syrian morass. Considering Russia's past ill-fated adventures when progressing south – be it the Caucasus or Afghanistan – this was a bold move. This could be considered the only time since the end of the Cold War, a country had dared to project military force far away from its borders without the approval of the US.

While Russia's ongoing relationship with Syria's leadership had provided them with a naval base in Tartus on the Med since Soviet times (An arrangement that was extended and expanded in 2017) Syria had not been considered important for Russian national interests. In response to US and Western indecision and lack of commitment to the cause, Russia seized the opportunity and have established a foot hold for the long term in the region. A region which is undergoing dramatic change as the 'lines in the sand' drawn up by Messrs Sykes & Picot after WWI are being swept away across the region aptly called the Middle East – a place where the interests of the East and West meets. While it did not give them direct control of an oil-price lever it gave them a powerful seat at the table where decisions with wide ranging effects would be taken.

The Syrian conflict was a key catalyst for the regional refugee crisis that was affecting the European Union & Syria was an important strategic area for both Iran and Turkey – two of the dominant powers in the broader region. For its new found 'best friend' China it was also a potentially important area for its BRI project. Potential oil and gas pipelines surely added another motivational factor. Getting involved in Syria – not really to solve any of the crisis playing out – but to be the final arbiter and important decision maker on all these issues with minimal financial or military risk was too great an asymmetric bet for Russia not to get involved. Only history will tell if it turned out a winning one for Russia, but so far it's looking productive from their perspective. So much so that it appears to have become a form of a loose template for further moves across the MENA and Sub-Saharan regions.

Libya is a comparatively good example but with significant oil to be controlled as an added bonus, which is playing out right now. As the 'Western' parties are bickering or looking the other way Russia has made real inroads in the place. Besides control of the significant Libyan 'Oil lever' Libya is another key cog in the European immigration crisis dynamics and as more and more of North Africa and the Saheel is falling into a state of chaos, the refugee crisis will only continue and NATO/EU will be forced to dedicate more of its budgets towards its Southern flank defense (and not the Russian sphere) as the inescapable reality that the European southern border does not start on the balmy sandy beaches of the European Med but somewhere deep in the Sahara Desert. **Historically the Mediterranean has always been a conduit for the movement of people, ideas and goods, not a barrier.**

**“IF YOU
LIVE
AMONG
WOLVES
YOU
HAVE TO
HOWL
LIKE A
WOLF.” –
Russian
Proverb**

Roaming with *Ursus Ruthenia* Wagnerus...

Beyond these two key developments Russia has been steadily expanding its military influence across Africa, setting off alarms in Western intelligence circles with increasing arms sales, security agreements and training programs for unstable countries or autocratic leaders. In the Central African Republic, where a Russian has been installed as the president's national security adviser, the government is selling mining rights for gold and diamonds at a fraction of their worth to hire trainers and buy arms from Moscow.

The Wagner Group - a private military force founded by a former Russian intelligence officer and linked to an associate of President Putin - announced in a statement last year that 175 instructors - believed by Western analysts to be employed by the Wagner Group - have trained more than 1,000 Central African Republic troops.

Russia is seeking more strategic bases for its troops, including at Libyan ports on the Mediterranean Sea and at naval logistics centers in Eritrea and Sudan on the Red Sea, according to an analysis by the Institute for the Study of War. Last year, Russia signed agreements on military cooperation with Guinea, Burkina Faso, Burundi and Madagascar. Separately, Mali's government has sought help from Moscow to combat terrorism, despite the thousands of French troops and UN peacekeepers who are stationed in the country.

Sudan's president al-Bashir, brought in Russian mercenaries in January to help shore up his rule against nationwide protests. And last spring, five sub-Saharan African countries - Mali, Niger, Chad, Burkina Faso and Mauritania - appealed to Moscow to help their overtaxed militaries and security services combat the Islamic State and Al Qaeda.

Beyond the murky deals for the various private military groups, Africa has become big business for Russia. Thirteen percent of Russia's total arms exports in 2017 were sent to Africa, according to the Stockholm International Peace Research Institute. Though nearly 80% of all Russian military sales across the continent are to Algeria, a longtime customer.

Tunisia, an ally of the US, also has close intelligence, counterterrorism and energy ties to Russia. And Burkina Faso took delivery last year of Russian-made military transport helicopters and air-launched weapons. Egypt, a staunch US ally, is also becoming a solid customer of Russian weaponry. Egypt signed a deal in late 2018 for \$2 billion worth of Russian SU-35 fighter jets, the Moscow-based newspaper Kommersant reported in March. And in the ultimate play for a US controlled player, Putin has been working to develop a close relationship with Saudi Arabia's leadership through the OPEC/Russia collaborations. It has also been a vocal supporter of Iran, just as the US has turned up the heat on it with its noisy abandonment of the JCPOA.

Russia is also seeking new economic markets and energy resources, in some cases rekindling relationships with countries that were in place during the Soviet era. Russia has major oil and gas interests in Algeria, Angola, Egypt, Libya, Senegal, South Africa, Uganda and Nigeria and recently Russian firms went back into Zimbabwe to develop new diamond mining operations.

“Russia has bolstered its influence with increased military cooperation including donations of arms, with which it has gained access to markets and mineral extraction rights. With minimal investment, Russia leverages private military contractors, such as the Wagner Group, and in return receives political and economic influence beneficial to them.” - US General Waldhauser, the head of the Pentagon's Africa Command.



**“Tactics mean
doing what you
can with what
you have.”** – S. Alinsky

The way of the Chess player in a hurry...

Rounding off with a look at the China/Russia division of labor factor, we start with a trip to Verona, Italy, where in 2017 Rosneft Chief Executive Officer Igor Sechin delivered a powerful presentation based on a report titled: **“Toward Ideals of Eurasian integration.”** According to this report the crucial division is not between Europe and Asia, but between regions of energy consumption and regions of energy production. The map (See the Addendum on the next page for more details) shows a cohesive Eurasian block – Mackinder’s Heartland – divided into 3 different blocks; On one side; Europe inc. Turkey – an energy consumer & on the other side Asia-Pacific also an energy consumer with Russia & the Arctics, Caspian & Middle East as one continuous zone of ‘Energy production’ down the middle.

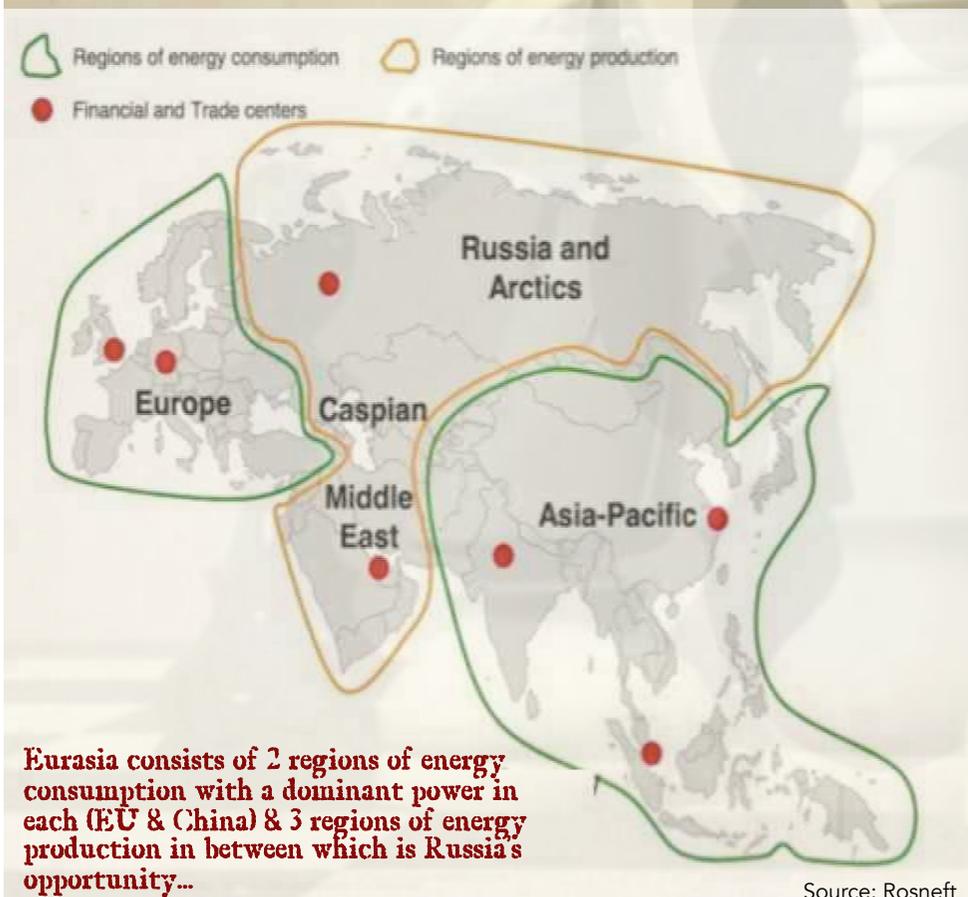
The report goes on to discuss how the “geography of Greater Eurasia provides opportunities to create a unified economic landscape” and it states; **“Greater Eurasia is a huge economic and energy space that has all the prerequisites for cooperation and economic integration. Eurasian gravity is stronger than any external influences. The movement towards a united Eurasia is organic and natural. In the energy sector of greater Eurasia mutual investments, the exchange of assets and technologies have already reached a large scale, despite such factors as sanctions pressure.”**

From a geostrategic perspective the presentation and ‘Sechin’s Map’ shows 3 powerful zones – two of which already has a dominant leader; The EU & China, while the ‘gooey bit’ in the middle, rich in minerals, is up for grabs with Russia, Iran/Saudi Arabia the key regional players. This appears to be not just Rosneft’s opportunity but more importantly Russia’s claim to a seat at the big table as the premier purveyor of minerals.

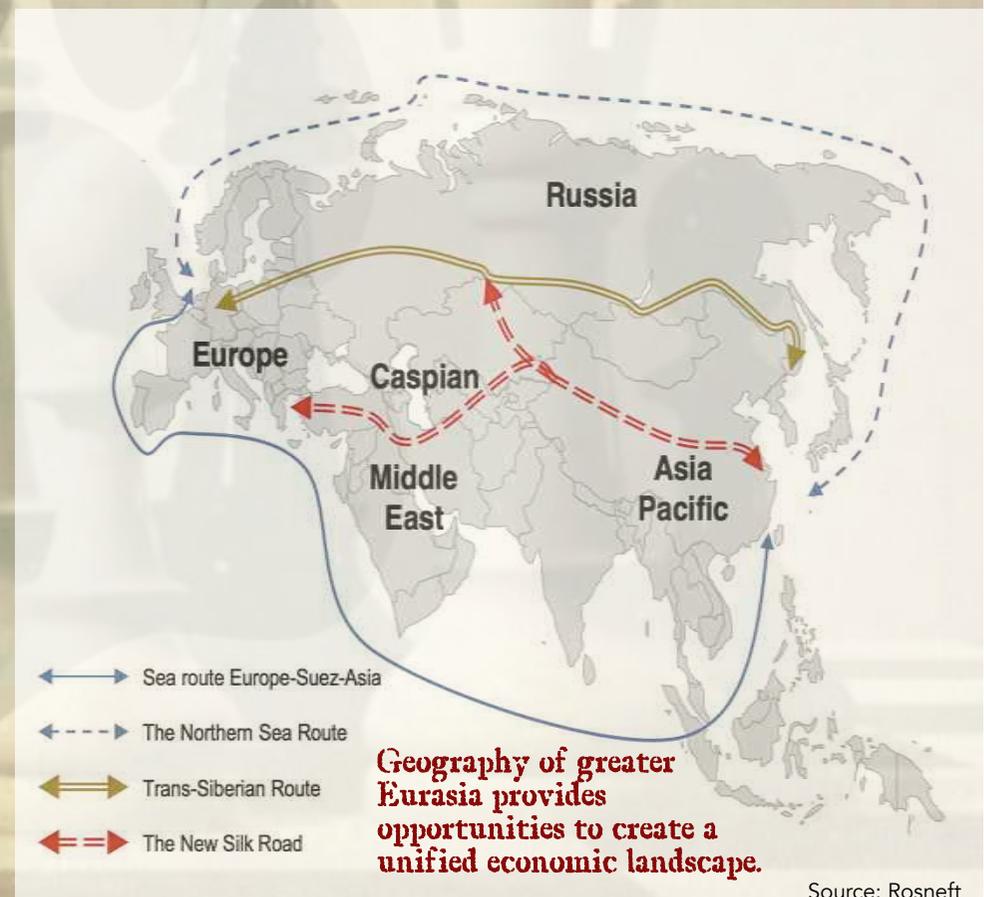
The more granular, opportunistic, brawling approach along with the grand strategic vision provides an interesting lens with which to look at Russia’s African adventures. **The way of the Chess player in a hurry.**

“EURASIAN GRAVITY IS STRONGER THAN ANY EXTERNAL INFLUENCES. THE MOVEMENT TOWARDS UNITED EURASIA IS ORGANIC & NATURAL.” – I. SECHIN

SECHIN'S MAP...



THE EURASIAN HEARTLAND...



IN THE SPOTLIGHT: ETHIOPIA – THE QUIET LION STARTING TO MAKE SOME NOISE:

If you like me used to watch TV in the 'Western world' in the 1980s you will most likely associate Ethiopia with famine and civil war, images imprinted in the mind by harrowing visuals from awareness campaigns by charitable organizations & events such as the 'Live Aid' concerts. Contrast that with the past decade, when Ethiopia has averaged annual economic growth rates of just above 10%. The dynamics underpinning this stellar achievement has been so dramatic that Ethiopia's progress has been dubbed an economic miracle, and the nation has been compared to the success of the so-called 'Asian Tigers' and given the moniker; 'African Lion.'

The latest IMF forecast estimates that Ethiopia was the fastest-growing economy in sub-Saharan Africa in 2018 with 8.5% growth for the year. Ethiopia is not just growing in terms of top-line economic data points, but has already met or is coming close to meeting some of its key Millennium Development Goals, including universal primary education and reductions in infant mortality. **The country's poverty rate has fallen from 67.1% in 1995 to 26.7% in 2015.** Unemployment rates, though still high, have been coming down. And the number of Ethiopian millionaires has increased faster than in any other African country. The nation has targeted a goal of reaching so-called middle-income country status by 2025 and it appears within reach if some internal and external hurdles can be overcome.

In terms of geography, Ethiopia is based in the complicated Horn of Africa, it holds the somewhat dubious title of being the most populous landlocked country in the world & this rugged & contrasting terrain – split in two by the aptly named 'Great Rift Valley' - is the home to the 2nd most populous nation on the African continent with a population of 109 million people and heavily youthful skewed demographics. The highest population density is found in the highlands of the north and middle areas of the country, particularly around the centrally located capital city of Addis Ababa while the far east and southeast are sparsely populated.

Archaeological finds dates back more than 3 million years and it's a place of ancient culture. Unique among African countries, the ancient Ethiopian monarchy maintained its freedom from colonial rule with the exception of a short-lived Italian occupation from 1936-41. In the 1970s and 1980s, Ethiopia experienced several civil conflicts and communist purges under the rule of the Derg, who deposed Emperor Haile Selassie who had ruled since 1930 and established a socialist state. Torn by bloody coups, uprisings, wide-scale drought, and massive refugee problems, the regime was finally toppled in 1991 by a coalition of rebel forces, the Ethiopian People's Revolutionary Democratic Front. A constitution was adopted in 1994, and Ethiopia's first multiparty elections were held in 1995.

A border war with Eritrea in the late 1990s ended with a peace treaty in December 2000 though the issue has simmered along with some flare-ups. In the south towards neighboring Somalia, the former British administrative line has little meaning as a political separation to rival clans within Ethiopia's Ogaden and southern Somalia's Oromo region. Ethiopian forces invaded southern Somalia and routed Islamist courts from Mogadishu in January 2007. Since then "Somaliland" secessionists has provided port facilities in Berbera and trade ties to landlocked Ethiopia. The border region with Sudan has also seen civil unrest. In August 2012, longtime leader Prime Minister Zenawi died in office and was replaced by his Deputy Prime Minister Hailemariam, marking the first peaceful transition of power in decades. Following a wave of popular dissent and anti-government protest that began in 2015, he resigned in February 2018 and Abiy Ahmed Ali took office in April 2018 as Ethiopia's first ethnic Oromo prime minister. In June 2018, Abiy announced Ethiopia would accept the border ruling of 2000, prompting rapprochement between Ethiopia and Eritrea. This was marked with a peace agreement in July 2018 and a reopening of the border in September 2018.

It will take more efforts to navigate the dynamics of a troubled neighborhood, with some conflicts crossing into Ethiopia via ethnic and religious ties. So far Abiy has shown some deft touches and have moved towards peace with all the neighbors and calmed internal forces of disruption with an inclusive approach that has been hailed by all sides and international observers. **This newfound calm has been a key part of the foundation for the continued economic growth, internal social stability & advancements in institutional capacities that together has harnessed the positive potential of the nation and has delivered some real change for its people.**

“Great investors conceptualize problems differently than other investors. These investors don't succeed by accessing better information, they succeed by using the information differently than others.”

– M.J. Mauboussin

Thinking big while walking a tightrope...

Ethiopia's rise has been largely driven by an increase in industrial activity, including investments in infrastructure and manufacturing. Amongst them has been a light rail system, the 1st of its kind in the region and if you follow the Blue Nile for 500 km north from Addis Ababa you'll find Ethiopia's standout infrastructure project. The **Grand Renaissance Dam** which will be the largest dam on the African continent upon completion.

When complete, the dam will generate approx. 6000 megawatts of electricity for both domestic use and export. The dam also puts management of the flow of the Blue Nile in Ethiopia's hands which has the potential to spark a power shift in the region. For Egypt, the Nile is, literally, a lifeline. The vast majority of the nation's 97 million people live along its banks and it has been its 'breadbasket' for millennia and currently the river provides Egypt with around ¾ of its water. We discussed similar dynamics, in our segment 'The MENA Water Issue' seen through the lens of Iraq' in the 2018 Q3 ATWI8P report, between Turkey and Iraq. Based on those findings it will take even more deft diplomacy from Abiy to avoid a deteriorating relationship with Egypt & Sudan. However if it can be managed it will be a real game changer for Ethiopia for the long term.

The positive dynamics has already spurred foreign investments, poor in capital & with very limited local capital markets much of the investment in Ethiopia has come from overseas. According to the IMF, foreign direct investment growth was 27.6% between 2016-17, with investments going into new industrial parks and privatization of state-owned businesses. China has become not only Ethiopia's biggest foreign investor but also its largest trading partner in the process. Ethiopia has also encouraged foreign investment in its manufacturing industry, hoping to compete with India and China, especially in the textile industry, with its plentiful of cheap labor.

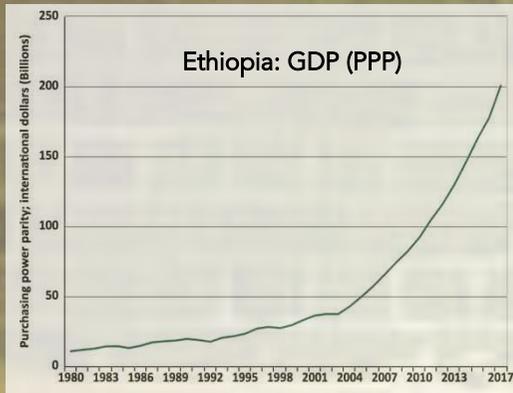
Triggers to watch (positive & negative) going forward are further opening of the economy inc. telecoms & banking/financial services inc. potentially launching a stock exchange, how the government handles urban developments, Abiy's continued ability to sooth regional issues as well as manage internal ethnic dynamics, the balancing act with China over debt sustainability and influence, continuing to secure sustainable flows of FDI & controlling government debt and budget deficits, the completion of the final stages of the dam project & the related debt dynamics, the ability to continue to expand productivity of the crucial agricultural sector & the expected elections next year.

**“TRAVELING
IS LEARNING.”**
- ETHIOPIAN PROVERB

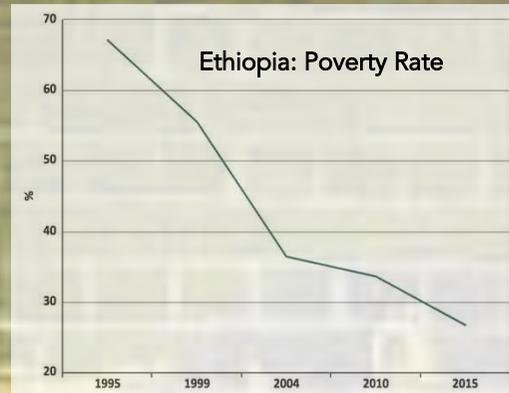
**“MAN CANNOT DISCOVER
NEW OCEANS UNLESS HE
HAS THE COURAGE TO LOSE
SIGHT OF THE SHORE.”** - A. Gide

VISUAL ADDENDUM TO PAGE 5: MENA & SUB-SAHARAN AFRICA: ETHIOPIA:

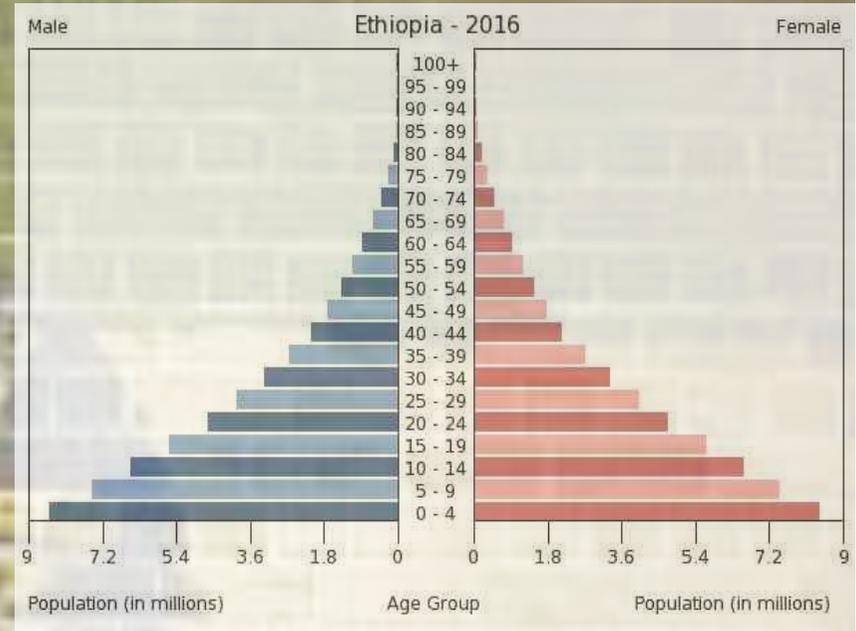
ROARING AFRICAN LION...



ATTACKING POVERTY...



THE DEMOGRAPHIC DIVIDEND MUST BE REALIZED...

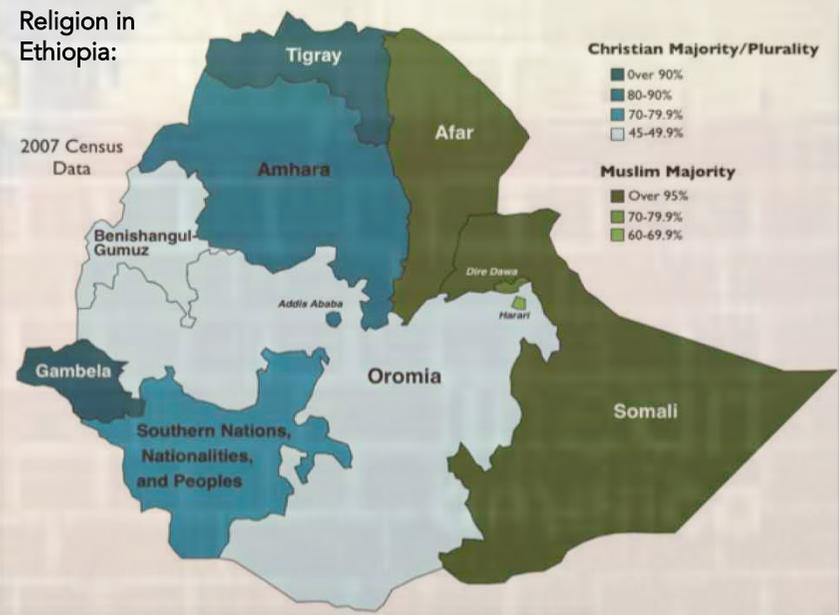


LEADER OF THE PACK: Africa's fastest-growing economies... (Sub-Saharan Africa: 2018 % to GDP Growth)

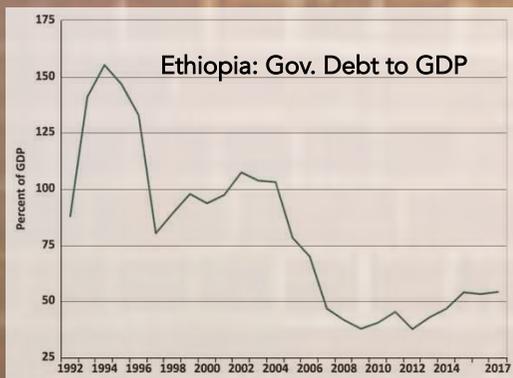


KEEPING THE PEACE...

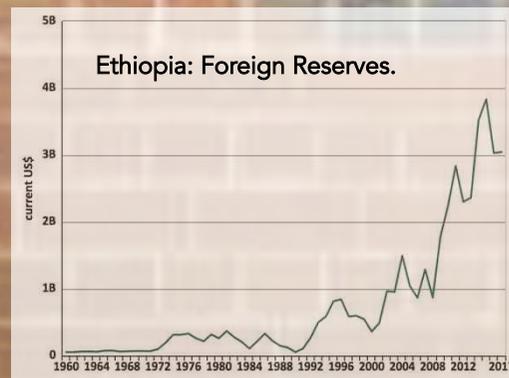
Religion in Ethiopia:



SOMETHING TO WATCH...



DON'T EAT THE SEED CORN...



SOAR WITH VELINA TCHAKAROVA HIGH ABOVE THE EURASIAN HEARTLAND FOR A BIRDS-EYE VIEW OF THE GLOBAL LANDSCAPE OF A DAWNING GEOPOLITICAL ORDER. BE WARNED THERE MAY BE MYTHICAL BEASTS & HEAVY DOSES OF REALPOLITIK HANDED OUT ALONG THE WAY.

On a less dramatic note please understand that the views and opinions expressed in this piece are those of the author and do not necessarily reflect the official policy or position of her institute AIES.

The following overview is an attempt to outline the three most systemic developments for 2019 as well as to elaborate on possible implications for global affairs, mostly by offering a bird's-eye view on the geopolitical forest while deliberately ignoring the trees.

This overview is built on three premises: 1) Realpolitik (no eternal friends and enemies, solely eternal interests) is the main driver of interactions between competitors and allies in international relations; 2) nature abhors vacuums and thus each geopolitical vacuum is immediately being filled by competitors; 3) all processes are cyclical with respectively a phase of rise and fall. Against this background, it is to be expected that the Global System will be facing a general process of decline due to a global economic slowdown, stagnating trade and deteriorating globalization, but also because of worsening political and socio-economic indicators in general. At the top of the iceberg, I identify three systemic issues with the greatest potential for disruptive impact and unintended consequences:

- A falling eagle versus a rising dragon – A war of a thousand battles.
- It's Helsinki 2.0 order, stupid!
- The Dragonbear is here to stay.

It's the framework which changes with each new development and not just the picture within the frame...

IT WILL GET MUCH WORSE BEFORE IT GETS BETTER...

The declining eagle versus the rising dragon: A war of a thousand battles...

Currently, the Global System is approaching a new bipolar moment as there are only two imaginable poles – the USA and China. The former has unilaterally been shaping the global order for the last fifteen years and still counts as the only state actor with global power projection capabilities to shape international supply chains and secure trade routes, which are still overwhelmingly maritime. Given the impressive economic and trade growth trajectories of the latter, there are indeed certain expectations about its possible rise on the global arena, however it remains unknown where exactly this journey leads to. Indeed, there are first steps towards a comprehensive geo-strategy by China through its ambitious Belt and Road Initiative stretching to all continents. Even though the Silk Roads have been known since ancient times, **it should be stressed that China is slowly but surely becoming a European power, and with a European shift towards Asia, this process is unleashing tectonic structural movements in the global order.**

Moreover, a second layer of the Global System consists of regional actors and free riders with limited power projection capabilities that strongly propagate multilateralism as the most desired framework for international relations as they seek to capitalize on the already established global order without significantly contributing to it. Among the most prominent examples are Russia (with global nuclear power projection and significant defence capabilities, however possessing a limited economic and trade profile), India, Japan, Canada, the big EU member states such as UK, France and Germany et al, just to name a few. Looking back to the scale of the Global System, the most powerful militaries in 2019 belong again to the main competitors USA, Russia and China. Considering the various dynamic constellations at the regional level all over the globe, the main free riders are already engaged either with the USA or China to a great extent. In this regard, the new realities reflect old equilibrium in terms of geopolitics as well as an emerging systemic bipolarity of the new global order, which is still widely being overlooked, whereas the key foreign policy agenda is increasingly shaped by the choice between these two players.

Logically, further large investments are expected in key sectors allowing the rapid growth of at least regionally dominant centres, in which defence, space technologies, artificial intelligence and cyber security will be the most advanced because each significant breakthrough in these areas might bring about effects of higher order that are desired and required in terms of global competitiveness. Moreover, a differentiation between economic and trade indicators, on the one side, and security and defence, on the other side, has meanwhile become irrelevant due to the unprecedented interconnectedness of the man-made systems of the globalized economy, finance, monetary affairs (currencies), trade and energy through the constant interactions between their components. This explains why the US-China issue isn't just a trade war but a comprehensive systemic rivalry encompassing all key elements of the above-mentioned globalized networks. Thus, the big question in this regard is: Will it be a full-fledged systemic rivalry between two antagonized competitors, or will they somehow manage to establish a peaceful co-existence of two parallel systems along technological progress and breakthroughs amid the Fourth Industrial Revolution and the assured mutual destruction of deterring nuclear weapons?

The answer to this question requires a closer look at the current situation. The whole saga surrounding the ongoing US-China talks is quite telling – constructive talks follow another set of constructive talks each month and the next session of productive meetings takes place immediately after the previous ones with constantly rescheduled timelines. China's Commerce Minister described the negotiations with Washington as "very difficult and very hard." He also stressed that there are "significant differences between the two countries' systems, culture and development stages."

Ultimately, what is being described as a trade dispute appears to become a full-fledged non-military war of a thousand battles with an open ending as the competition between the two countries has a systemic nature. It encompasses namely all significant fields of activity from trade and economy to diplomacy and international/regional organisations to currencies and finance. Moreover, it contains an escalation potential in the future due to the competition in sensitive areas such as 5G networks, space, cyber and defence capabilities. In this context, the North Atlantic Treaty Organisation (NATO) shifted its attention from Russia, which had predominantly preoccupied its agenda for the last decades, to the potential security challenges and threats from China – state owned communication networks, possible expansion towards the Arctic and South China Sea, military build-up and advancements in the field of sensitive defence technologies.

Against this background, there are two significant developments resulting from the current polarization of the Global System – the Helsinki 2.0 launched by the USA and Russia in 2018 (at the level of Trump-Putin bilateral talks) and the Dragonbear (the unprecedented bilateral axis of convenience between China and Russia (at the level of Putin-Xi Jinping bilateral talks).

It's the Helsinki 2.0 order, stupid!

The well-known Helsinki global order, which was established on the 10 principles agreed upon between the West and the Soviet Union in the Final Act of 1975, is becoming obsolete now. Back in 1975, the West and the Soviet Union bloc met in Helsinki to negotiate and sign a final act with ten principles that have been guiding their relations during and after the Cold War until now, among which the principle of sovereign equality, the refraining from the threat or use of force, the inviolability of frontiers, the territorial integrity of states, and the non-intervention in internal affairs were the most prominent. Indeed, these principles were constantly affected by the actions of single state actors or organisations over the last decades, and yet they built a solid foundation for their behaviour in a bipolar and later on unipolar global order. Even though, the Helsinki Accords are not binding, they have been accepted as common 'rules of the game', whereby both systemic rivals were eager to abide by them as they built the ground for reducing tensions during the Cold War and promoted cooperation between competitors by demanding compliance with obligations under international law.

The beginning of Helsinki 2.0 was symbolically marked by the first official bilateral summit between the US President Trump and Russian President Putin in July 2018 in Helsinki, Finland, whereas no agreed statement was published, nor any practical agreement between the two counterparts was reached. Trump and Putin met five times altogether and each time there was a lack of transparency on what was exactly discussed or agreed on between them. It created the impression that negotiations, agreements and talks took place behind closed doors in a secretive way without significant information being made public. Furthermore, these bilateral meetings took place in the shadow of Russian collusion accusations and under the toughest US sanctions ever placed on the country and its individuals, whereas Russian oligarchs were also directly affected this time.

In light of the deteriorating bilateral relations between the two most significant nuclear powers, the erosion of the Helsinki global order is obvious due to the new realities in global affairs. The message is that key international agreements could be re-negotiated at any time or even cancelled under President Trump's decision. The most prominent case is in the field of an arms control regime. As former Prime Minister Manmohan Singh pointed out, the old arms control agreements are already being consigned to history. Many countries are meanwhile modernising their nuclear arsenals with tactical or low yield weapons, which increases the likelihood of their use. The two dominant nuclear powers – the USA and Russia no longer act in line with the Helsinki Accords and do not share the common interest in abiding by these rules.

Furthermore, Helsinki 2.0 points clearly to the trend of bilateralization of global affairs, as there is no longer a sole guarantor of the global order and its international rules and norms. In this context, Trump has been preoccupied with setting his own foreign policy agenda, moving away from international law obligations or alliance commitments. The US withdrawal from key deals or agreements sealed in fact the emergence of the Helsinki 2.0 global order – e.g. the Iran Deal, the Transpacific Partnership, the Transatlantic Trade and Investment Partnership, the Paris Agreement, Intermediate-Range Nuclear Forces Treaty, and is likely to be followed by a withdrawal from the New Start with Russia, which might unleash a new (nuclear) arms race. Trump's attitude towards organisations such as the World Trade Organization (WTO), the European Union (EU) and even NATO contributes to the further erosion of the settled rules and principles of global affairs due to the increasing lack of trust and commitment towards such institutional bodies.

To sum it up, Helsinki 2.0 reflects strong national agendas, realpolitik, the decline of international and regional organisations and their norms, whereas other countries seek to copy Trump's bilateralization of international relations (e.g. Israel, Brazil etc.). Thus, **it is to be expected that the whole "rules of the game" as established during the Cold War and the unipolar moment of US hegemony will be re-reshuffled with unimagined consequences amid Global System transformation.** Even though the main free riders and even a rising China still stress the importance of multilateral frameworks and established regional and international organisations, the emerging systemic rivalry between the USA and China as well as the deteriorating relations between the USA and Russia already reflect a growing great powers competition and the flux of global affairs, in which realpolitik behaviour and ad hoc alignments would increasingly occur consequently.

The Dragonbear is here to stay...

The third systemic development in global affairs that deserves special attention is the Dragonbear as the alliance or axis of convenience between China and Russia that has been predominantly overlooked or considered being unrealistic in the last decade. The expert community remains divided on this issue, whereas a majority is still convinced that the relationship is only of a temporary character due to its inherent conflict of interests and thus it expects that the cooperation between Moscow and Beijing would remain limited in scope and time. A much smaller group claims that the Dragonbear would continue to challenge the West as an unprecedented alliance aimed at creating parallel to the US-led institutions and partnerships in all significant spheres of global affairs. So far, it seems that the Dragonbear's geopolitical task is achieving complementarity through coordination of objectives and actions at the highest political level based on the principle of *'Not always with each other, but never against each other'*. Nonetheless, there are certain developments in the regions of overlapping geopolitical and geo-economic interests such as Central Asia, the Middle East, Africa and Latin America, which point to possible tensions in the future (e.g. Chinese loans and investments in Russian spheres of influence in Central Asia or former Soviet space, and now the so called Chinese 16+1 initiative with countries in Central and Eastern Europe).

From the US perspective, facing an alliance of such scale as the Dragonbear along with the competition over new partners and allies is significant for its future positioning in the global order. Indeed, various strategic documents published in 2019 have already identified the challenge of great power competition and eventually concluded that the USA would be dealing with the Dragonbear amid Global System transformation (e.g. Worldwide Threat Assessment of the US Intelligence Community, The Assessment and Recommendations of the National Defence Strategy Commission, National Security Strategy of the United States of America etc.). Furthermore, there is a risk that key allies of the US are still not on the same page regarding their view of the Dragonbear, particularly in Europe due to their own geopolitical calculations and interests, but also mostly due to their free riding position in the current Global System, which allows balancing between great powers (e.g. UK/Germany on the Huawei 5G Network; Italy and Portugal on the Belt and Road Initiative; the CEE countries on the 16+1 Initiative; Germany on Russia's Nord Stream 2; Italy, Greece on the EU sanctions against Russia following the annexation of Crimea etc.). Looking closer at the realities at the system level, it is rather chimeric to expect another significant player being capable of shaping the global order in the near future, thus the combined efforts of the two disruptive actors China and Russia to create alternative systems as opposed to US-led structures and processes along globalised economy, finance, monetary affairs, energy and trade are very much worth keeping an eye on this great disruption potential.

So long as the Dragonbear shares the common interest in opposing the US in every possible field, the systemic coordination of actions will continue despite emerging bottom-up tensions in areas of intersection of national interests. The main common denominator of the Dragonbear isn't just the goal of opposing the USA, but also establishing and consolidating a Eurasian land connectivity as a reaction to the American maritime dominance in the Indo-Pacific realm and thus making sure that there is a certain independence from maritime chains of supply in case of future blockades. This is very much oriented against US and European interests as Moscow and Beijing share a common objective of excluding third actors' involvement in Eurasia. Thus, a highest-ranking (top-down) coordination between President Putin and his closest circle, on the one side, and President Xi Jinping and his closest supporters, on the other side, makes sure that the Dragonbear gets consolidated despite existent bottom-up tensions on the ground (e.g. in Kazakhstan there are already fears of an overwhelming Chinese presence in all spheres through loans, investments and business activities, whereas the political elite is still very much influenced by Russia). One of the most obvious examples is that both countries still struggle to diversify their economic cooperation portfolio by identifying potential areas and directly arranging deals at the top level, however neither the trade volume nor the economic ties have extensively been expanded despite these efforts.



THE
ENEMY OF
MY
ENEMY IS
MY
FRIEND...

A dragon and a bear walks along the Silk Road...

Potential frictions between Russia and China lie in the geographic prioritization and the overlapping geopolitical interests. Russia is a regional power possessing nuclear weapons with global reach and with vertical expansion of geopolitical and geo-economic interests from the Arctic and the Baltics through the Eurasian landmass and its near abroad in Eastern Europe to the Caspian, Black and Mediterranean Sea as well as to the Balkans and the MENA region. However, there is a well-established Russian fear of Chinese penetration particularly in Central Asia and the Far East as well as other traditional spheres of influence such as the Balkans, Eastern Europe and the rest of the former Soviet space.

Furthermore, Africa and to some extent Latin America may become a playground of conflictual tactics (e.g. Venezuela, Sudan etc.). Moreover, their interests in the energy sector do not overlap since Russia is one of the major oil suppliers while China tops the list of the countries with greatest oil imports. A sort of new energy interdependence as the one between Russia and Europe could emerge in the short and mid-term as Russia is increasingly taking the role of supplying China with oil and natural gas through various pipelines and thus diversifying its energy portfolio away from Europe.

Also, new connectivity is being explored and expanded such as in the Arctic, Central Asia and beyond to balance the US-dominated global supply chains. However, the current Chinese grand projects constitute a horizontal expansion from China to Europe and Africa through a network of various connectivity and infrastructure tools (transport routes, pipelines, trade roads, loans programs etc.) and are meanwhile institutionally backed by a set of China-led organisations such as the Asian Infrastructure Investment Bank, the Eurasian Investment Bank, the Shanghai Cooperation Organization etc.

From Beijing's perspective, the worst-case scenario would be a situation in which Russia starts adapting to the rise of China by balancing through a potential ad hoc partnership with the USA just like China did in the 1970s during the Cold War. Obviously, Moscow would not tolerate an emergence of Pax Sinica in continental Eurasia and the neighbouring areas that have been Russian strongholds for centuries.

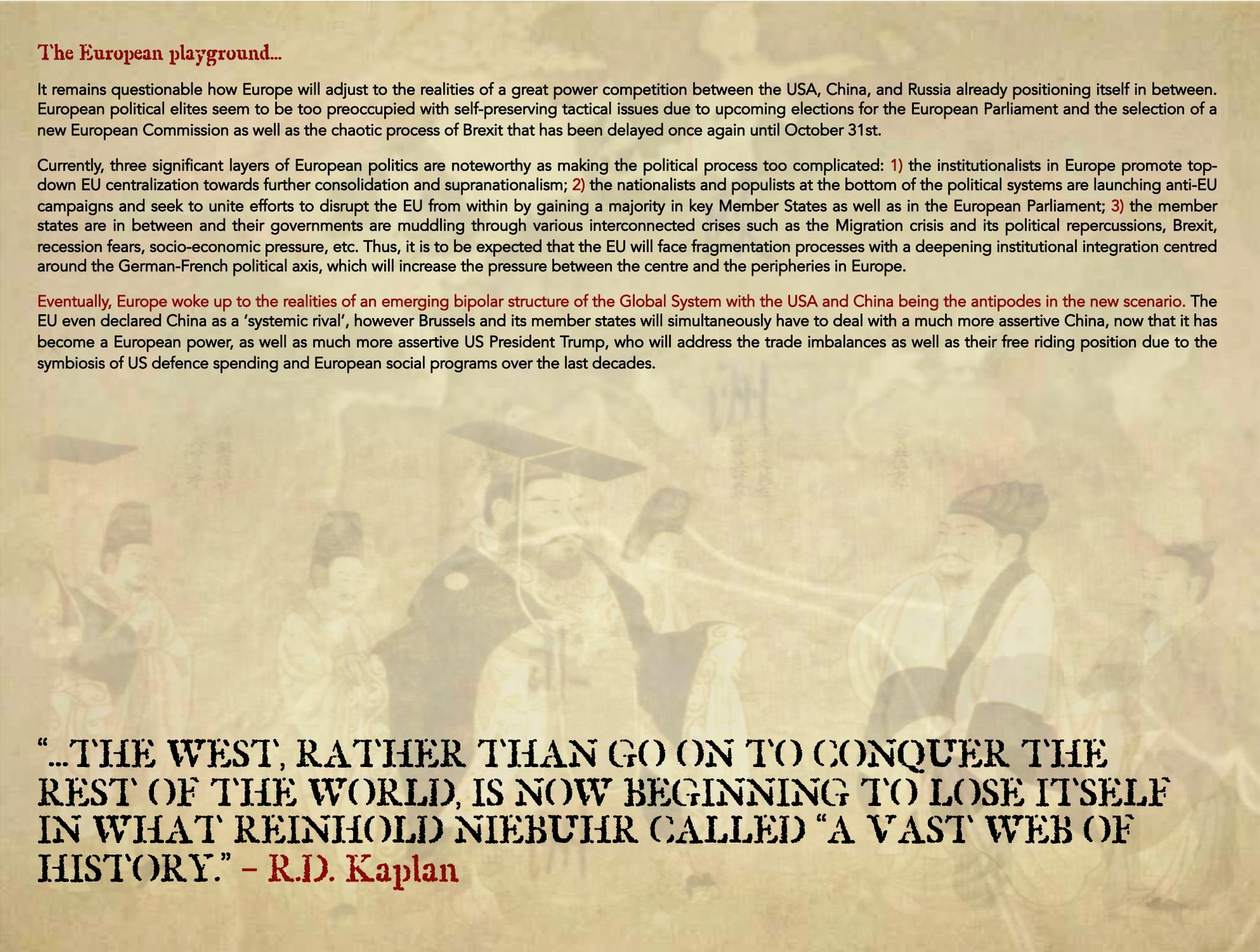
POTENTIAL
FOR
CONFLICT...

The European playground...

It remains questionable how Europe will adjust to the realities of a great power competition between the USA, China, and Russia already positioning itself in between. European political elites seem to be too preoccupied with self-preserving tactical issues due to upcoming elections for the European Parliament and the selection of a new European Commission as well as the chaotic process of Brexit that has been delayed once again until October 31st.

Currently, three significant layers of European politics are noteworthy as making the political process too complicated: 1) the institutionalists in Europe promote top-down EU centralization towards further consolidation and supranationalism; 2) the nationalists and populists at the bottom of the political systems are launching anti-EU campaigns and seek to unite efforts to disrupt the EU from within by gaining a majority in key Member States as well as in the European Parliament; 3) the member states are in between and their governments are muddling through various interconnected crises such as the Migration crisis and its political repercussions, Brexit, recession fears, socio-economic pressure, etc. Thus, it is to be expected that the EU will face fragmentation processes with a deepening institutional integration centred around the German-French political axis, which will increase the pressure between the centre and the peripheries in Europe.

Eventually, Europe woke up to the realities of an emerging bipolar structure of the Global System with the USA and China being the antipodes in the new scenario. The EU even declared China as a 'systemic rival', however Brussels and its member states will simultaneously have to deal with a much more assertive China, now that it has become a European power, as well as much more assertive US President Trump, who will address the trade imbalances as well as their free riding position due to the symbiosis of US defence spending and European social programs over the last decades.



“...THE WEST, RATHER THAN GO ON TO CONQUER THE REST OF THE WORLD, IS NOW BEGINNING TO LOSE ITSELF IN WHAT REINHOLD NIEBUHR CALLED “A VAST WEB OF HISTORY.” – R.D. Kaplan

Conclusions...

The global power competition is clearly an outcome of the emerging Global System transformation causing major reshuffles of the globalized networks and structures of finance and monetary systems, the global trade and economy as well as energy, agriculture, water and food systems amid the Fourth Industrial Revolution. Against this background, the process of polarization and partition is imminent and will be further deepened by the emerging systemic rivalry between China and US, while all significant regional players and free riders will have to take an 'either/or' decision and position themselves in between at some point.

The worst possible outcome would be a systemic competition between a falling eagle and a rising dragon that spirals out of control and leads to fundamental Global System change (systemic financial crash much worse than the Great Financial Crisis in 2007, a disruption of global supply chains, regional and peripheral military tensions and proxy wars etc.). The best-case scenario would be a sort of global coexistence of US-led and China-led blocs of alliances, partnerships and connectivity along regional networks of trade, finance, currencies, economy, telecommunications, payment systems, parallel institutions and organizations, just to name a few.

To conclude, the three systemic developments I have outlined will determine which player will succeed in being more capable of shaping the global order for their own benefit in the future.

TREAD
CAREFULLY
INTO THE
UNKNOWN...

REFLECTIONS ON THE JOURNEY AS WE PREPARE TO REACH THE SUMMIT...

Geopolitical cycles are slow-moving. Revolutions happen fast but dawn slowly. It appears that we have entered the dawn of a new era, international relations are in flux, diverse trends – technological, social and economic – are tearing at the fabric of individual societies & the overall framework of the collective global order of the last 70+ years. While the outcome is uncertain, it is clear that the status quo cannot hold. The Italian philosopher Antonio Gramsci wrote; **“The crisis consists of precisely the fact that the old is dying and the new cannot be born; in this interregnum a great variety of morbid symptoms appear.”** This could be considered an apt description of the world order today.

It takes time to build a geopolitical order, the many moving parts have to fall into place, players jostling for positions of power will have to work through a process of reestablishing comparative positions of power across different domains, establishing the required complex institutions & frameworks to underpin the new reality is a lengthy trial-and-error endeavor done by the cumbersome format of a committee of diverse players with conflicting objectives and interests - the art of the compromise is an uncertain field. Shared interests, norms and values need to develop and become accepted. Humans and nations prefer certainty and the familiar so the incumbent power structures will naturally put up firm resistance to change and it will find support from a public fearful of the unknown. Change is most often a process and not an event. Changes in the geopolitical order are generally decades in the making, it could be argued that our current predicament was born out of the global financial crisis in 2008 and as such we are a decade into such a shift and as to our findings in this report we are starting to see clear and undeniable signs of such a process of erosion around the world today.

If you consider the trajectories of all the major current geopolitical dynamics today, the one thing that is clear is the fact that they are all in flux. Be it the strength of political institutions in the US & Europe, the transatlantic relationship, US-China relations, the state of the EU & NATO, the Middle East balance of power, regional power politics in Asia – all are going through change and the path ahead for all of them is more unclear than they have been since perhaps WWII.

As the Great Power competition intensifies, with the US reacting like a startled horse to its sudden awakening to China & Russia's decade long attrition by a 1000 cuts strategy, all nations – large and small - are forced to reassess their world views and come to the realization that we are back to the power dynamics of the times of Lord Palmerston who summed it all up so eloquently with his observation;

“Nations have no permanent friends or allies, they only have permanent interests. We have no eternal allies, and we have no perpetual enemies. Our interests are eternal and perpetual, and these interests it is our duty to follow.”

Realpolitik is back in vogue and nations are now left to adjust to this rather inconvenient reality as are investors. Geopolitical risks will spill over into the QE4ever Prozac-like bliss of financial markets and global businesses will face a treacherous sea ahead, where clawing for neutral ground will become more and more fraught. A fragmentation of global markets, supply lines, communications technology and the rules based system that has underpinned 7 decades of economic growth & relative low social volatility is under way.

Political systems are incurring polarizing trends due to too many campaigns based on sloganeering over actual ideas, too many partisan fights by incumbents with short time horizons blinded by zero-sum thinking, too little focus on shared values and on finding common ground, too much talking and not enough listening. This along with a 24/7 dumbed down celebrity culture, geared to make already short attention spans shorter, has made the general populace increasingly cynical, shortsighted, confused and left feeling insecure about their role in society. Martin Gurri wrote; **“Uncertainty is an acid, corrosive to authority. Once the monopoly on information is lost so too is our trust.”** Once the trust is gone so is the foundation for the constructive dialogue required to find solutions to problems and to right the wrongs.

So-called populism is on the rise – it is inherent in the 'Western' form of democracy, it finds its sustenance in the chasms between such societies promises and the impossibility of their broad and equal application. A more honest dialogue is needed, and for the 'Western' model to be refreshed and appeal both to its own populations and those of the rising powers, it must find its way back to being the land where merit has opportunity to blossom. Merit of ideas and people.

The vast web of history is slowly but surely engulfing our shared reality, it is crucial that we heed its lessons and realize that while our current systems are in need of evolution, the fever of revolution that is setting in may not be all that it's cracked up to be.

“The origins of hot wars lie in cold wars, and the origins of cold wars are found in the anarchic ordering of the international arena...Theorists explain what historians know: War is normal.

- K.N. Waltz

SOURCES & INSPIRATION...

In the words of Sir Isaac Newton: **"If I have seen further it is by standing on the shoulders of Giants."** On this page we humbly give thanks to those great individuals, source materials, books that provided us with the insights shared in this report.

SOME WRITTEN FOOD FOR THOUGHT FROM OUR Q4 READING LIST:

Munich Security Report 2019 - **MSC.**

The Global Risks Report 2019 - **WEF.**

Towards a stronger international role for the Euro - **European Commission.**

The Return of Marco Polo's World - **R.D. Kaplan.**

Towards ideals of Eurasian integration - **I.I. Sechin.**

Russia is a rogue, not a peer; China is a peer, not a rogue. - **RAND Perspective Series.**

Ethiopia is Africa's fastest-growing economy. - **WEF.**

Is Ethiopian PM Abiy's reform drive running out of steam? - **DW.**

US & China got into a trade war and Mexico won - **Bloomberg.**

Computational Propaganda - **Renee DiResta.**

Present at the creation: Disaggregated Globalization. - **K. Maxwell**

Russia to China: Together we can rule the world. - **B. Maçães.**

The moment the Transatlantic charade ended. - **T. Wright.**

United States Vs. China: A Tech War. - **Chase Taylor.**

We the people: The battle to define populism. - **S. Rae.**

Data mining adds evidence that war is baked into the structure of Society. - **MIT**

The black swan of Cairo. - **NN Taleb & M. Blyth**

SOMETHING TO LISTEN TO THAT WILL MAKE YOU THINK:

A potpourri of varied thinkers on the questions surrounding the potential confrontation scenarios for the US & China:

<https://www.bbc.co.uk/sounds/play/m0003jtp>

Great panel discussion on China's Rise:

<https://www.cia.gov/news-information/blog/2019/csis-michael-collins.html>

A last thought...

**"INQUIRY
IS
FATAL
TO
CERTAINTY."**

- Will Durant

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ON THE SIDE OF THE ABLEST NAVIGATORS.**

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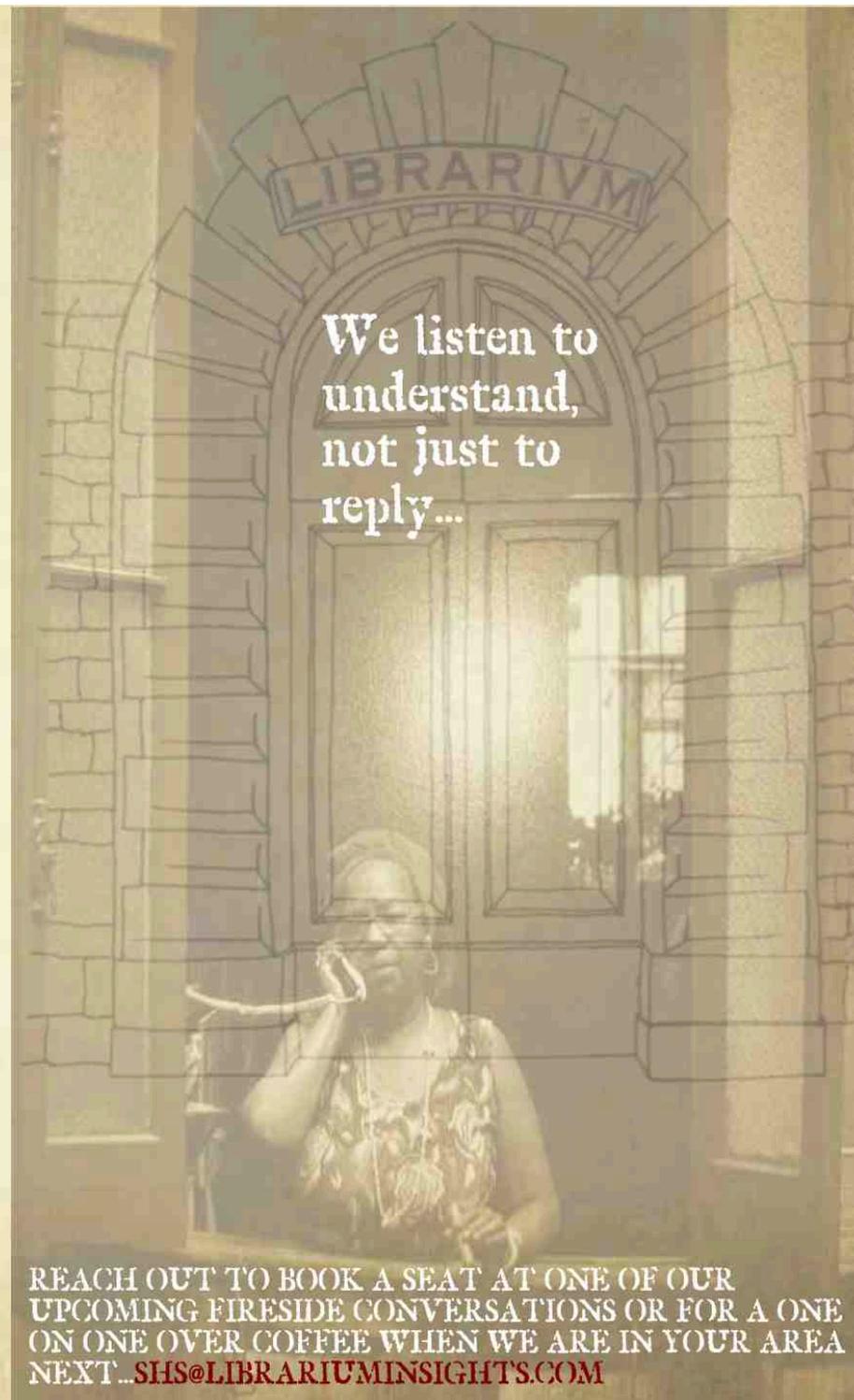
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