

Weekly Commentary 2 – Jan 2023

Investing in a Multipolar World

Last week, in our first Weekly Commentary of the year, our analysis focused on the so-called consensus views of analysts who should know in which direction currencies, equities and bonds would be headed.

And we also made the point that in many cases, consensus views can be wrong. And it is important, in any investment, to plan for contingencies in case things go wrong. In 2022, most investors in the world were caught when consensus views went unpredictably wrong, and heavy losses were incurred. Our Weekly Commentary No 1 presented some views on how the markets may turn out differently from what has been forecasted by the vast majority of experts on how financial events and outcomes will turn out this year. I hope that helps.

In truth, the easiest way to understand investing today is that the world is entering into a brave new world. A multipolar world. In that multipolar world, rules are changing in extensive and profound ways. These rules will dictate how humans and hence markets will behave in the foreseeable future. And during the transition between the current unipolar world and the raw nascent multipolar world, the change will not just glide along effortlessly. There will be misunderstandings, mistakes, maladjustments and misdemeanours, and these will contribute to upheavals and turbulence. To assume that the world will move seamlessly between the two political structures in which the 8 billion people on this planet have lived and will live, without any disruption would be silly. Especially since in the new order, the basic stance is confrontation. How can we not expect disruption?

In the second Weekly Commentary this year, I will try to outline what the changes in the world order are likely to be. I will not be able to get all of it right, but it will be better having a game plan to transit from one to the other, than not at all.

The unipolar world that we are talking about is the American Empire that has been running the world since the end of WW2. Since that time, the US has had the most money, the best technology, a good economic system that brings out the best in its resources, a culture that is invigorating (and I don't mean smoking weed), and a political system that seems to engender change for the better. All that is good, except when it was thought by the Americans that since the world was made in their image, they deserve to rule the world. They became convinced that the country was the shining city on the hill, illuminating the way forward for the rest of humanity.

About fifteen percent of that world buy into that point of view. These are the countries that share a common history with the United States. They are the countries from which the US population emigrated, and there is a natural cultural link. The group to which all these

countries belong has become known as the “collective west” and they claim to have “values” to which all of them are supposed to subscribe to and support. That is all fine and good.

The problem arises when they want the other 85% of the planet’s people to also adopt the same values. And rules.

And that has been how the unipolar world became the “rules-based system” of the international order since, arguably, the end of the Cold War. It is an economic and political system based on liberal capitalism, with the United States setting the standards and framework for how the rest of the world should behave, and conduct business which the global hegemon will tolerate. And if there are dissenters, the collective west would exercise overwhelming military power to enforce its rules.

It was all dandy when people of the same cultural background agree to conform to the same rules of conduct and organize themselves accordingly as a far-flung American empire. If all these countries in the 15% of the world’s population want to belong together bound by language, race, religion and “values”, why not? It only becomes problematic when this group of the 15% want the other 85% on the planet to become like them. And adhere to the rules they didn’t make or have a say on.

In the last ten years, the seeds of the multipolar system have been sown. From about 1990, after the Soviet Union broke up and the successor state, Russia, took over its historical role in the region from the Baltic to the Kamchatka Peninsula, the country went through a long period of economic stagnation, even as they were desperately trying to become part of the western club that beckoned, at the “end of history”, to save the country from the mistakes of the Soviet era. But the countries of the west were fundamentally scared of Russia, even during the period when they were weak and non-threatening during the depths of their problems after the Soviet empire broke up. The west did not want to accept Russia as a member of the same European club, and instead, they only saw orcs where former communists were trying to become good capitalists.

They had probably seen how the Soviets had displayed qualities of great strength when they came back from defeat after the Nazi invasion of WW2 and its ability to challenge their world with a nuclear armed empire and a formidable land army during Warsaw Pact days. Or maybe it was the vast resources and land area which Russia still has, which indisputably make them the largest country in the world even as the collective west derisively snubbed it as being only a gas station pretending to be an economy.

The attitude was to continue to contain Russia rather than to accept Russian overtures to become peaceful neighbours on the same continent. And the way to contain Russia was to not only reject Putin’s offer to become part of NATO but to bring an armed NATO to the doorsteps of Russia, posing an existential threat to it. The last straw for the Russians was

when the west conspired to induct Ukraine into the western alliance to hem the country in. EU leaders at the highest levels, including a highly respected Merkel, lied to Putin after the Maidan Accords to prepare Ukraine to take on Russia. It was this kind of subterfuge that has led to the complete breakdown of trust between the two blocs.

In 2014, when the Ukrainian democracy chose a pro-Russia leader, the west went about organizing a colour revolution to replace that with a pro-western government, and allowing the new government to pursue a centuries-old internecine strife that split that country between Catholic, Ukrainian speaking Slavs who want to be in the west, and the rest which are Orthodox, Russian speaking Slavs that are closer to Russia. The west spent the next 8 years equipping this pro-NATO Ukraine centered out of Kyiv to contain, weaken and if possible split up Russia into smaller states they could get comfortable with and possibly work out self-serving deals to use the vast resources of Russia in the global capitalist empire of the west.

Well, the Russians, after having been rejected by the Americans on their overture to play on the same team, would not be bullied in a conflict by Ukrainians which they would regard as kid brothers. A war, and the beginning of a new multipolar system, was in the making.

The start of the conflict led most analysts in the world to continue to expect that perhaps up to 60-70 percent of the world's countries would be on the US' side. But lo and behold, that did not happen. The countries with 85% of the world's population were not interested to sanction Russia, and after ten months, you can hear the leaders of these countries are not just uncritical of Russia's invasion (an obvious legal wrong), but also empathetic of the existential threat to Moscow posed by the western coalition. Most of the Global South have been victims of white colonialism before.

And then there is China.

After the CCP first established sovereignty over the mainland, it took just 35 years - one generation - for it to become the second largest economy in the world, and if we use the more appropriate purchasing power parity standard, the largest. And it is inevitable that as they emerged from poverty, get an education that is unmatched anywhere in the world, especially in STEM subjects, they will come to understand that the imposition of the rules-based system is in the interest of the west, not China's. And it is also inevitable China will gravitate away from the global system in which the US wants to be global hegemon. As they say in the country, one mountain cannot have two tigers.

The Chinese have been diplomatically careful throughout the Ukraine conflict. Had China backed Russia like the EU supported America, that would have been a deterioration of international politics into WW3 or at least two rival blocs: Europeans and Americans against

Russians and Chinese, with Ukraine as the first battleground of a 21st century East-West confrontation.

That did not happen. While China is undoubtedly in the Russian camp, it has carefully stayed on the sidelines without any western country being able to find fault with their diplomacy. And you can be sure the west was trying very hard to do just that. China has even managed to remain friends with the Ukraine government in Kyiv. This is diplomatic skill of the highest order. It has stayed brotherly close with Moscow, but it cannot be perceived that it is supporting the war either, while it keeps open its channels to the EU and the US and, as noted above, even Ukraine. With such diplomatic **expertise not demonstrated in the west over the last two years, China has steered a path right in the middle**, as the name Middle Kingdom requires.

The creation of the geopolitical circumstances which led to Russia's invasion of Ukraine is a thirty-year re-shaping of a East-West relationship, even as the war on terror was going on. The conflict on everyone's minds through the last four American presidents was the war against terrorists, and the old Cold War against Russia which suddenly became a hot war caught everyone by surprise. And in the multipolar world the war spawned, it is not all black and white, like in the days of the old bipolar world, even to either side. There are several powers, some of which cooperate more with each other than with others, but in the end each power pursues its own course towards each of the other powers in the light of its own interests. The collective west may be one pole, but Russia and China are not the other pole in a simple bipolar world. In particular, China tries to be friends with both sides, especially Europe and that makes it a third pole. Hell, some EU countries even buy loads of stuff from Russia even as they talk shit while wearing NATO hats.

That is good news because a simple bipolarity would be detrimental to the interests of the world. Two blocs that decouple all relations from each other would be an economic disaster. We won't be able to solve the climate crisis, and the whole world would be consumed with just US-China rivalry. Now this rivalry is defused by the ability of China to still relate to the European part of the collective west. It is a complicated three-party contest.

And if you have forgotten, there was a period in Chinese history called the Three Kingdoms era, which produced a very profound set of diplomatic and military principles useful to Chinese thinkers to this day. The Chinese will thrive in this environment.

Needless to say, bipolarity can re-emerge from the current line-up. An escalation of tensions between the US and China might trigger that. Should China be forced into a military conflict over Taiwan against the US, that would undoubtedly be a game-changer. I don't think that would happen, as I have written in previous editions of this blog, and we can discuss this again later as circumstances change.

In any case, the current multipolarity is very complex to navigate. If the Ukraine war ends in a military victory for the Russians, as it seems destined to, especially after the recent U turns to Ukrainian military fortunes on the Donbass front, the EU and the US will maintain their sanctions against Russia, for years if necessary. Basically, the world will see a “mini cold war” between, on the one hand, the EU and NATO countries and their closest partners (such as Australia, Japan, New Zealand, and South Korea) and, on the other hand, Russia. But “the West” will maintain relations with China (fraught though they may be) even as China continues its partnership with Russia.

The sanctions war has shown up as the greatest failure of American and western diplomacy since WW2. Firstly, they have backfired. Putin recently rubbed it in when he said in a speech that the country was completed unhurt by western machinations. Worse still, the sanctions have hurt the EU, sometimes, at the hands of best buddy, America.

Secondly, not only has China refrained from supporting the sanctions, India, nor the vast majority of states in Africa, Asia, and Latin America, representing 85% of humanity has backed away from that anti-Russian position. If interpreted generously, it can be said that the non-participation of many countries in the sanctions can be understood to be that they see the war as another instance of great powers doing what great powers do, and do not feel inclined to pronounce on it either way. But if we are to be truthful about it, many countries are simply also thinking this is a good time to demonstrate to the global hegemon, the United States, that they cannot be counted on to just jump on the bandwagon just because they say so. Other than the countries that are protected by the American nuclear umbrella such as Japan and S Korea, nobody wants to be American military allies if they can help it.

It would be a egregious mistake to regard multipolarity as a faceoff between democracy and autocracy. As a matter of fact, the attempt to define it as such by the Americans in 2022 led to an embarrassment for the Biden administration. Two summits organized as “democracy gatherings” ended in the Americans being shown the cold shoulder. The division of the world into democracies vs autocracies, of us vs them, is a false narrative because many autocracies are best friends with the west and vice versa. Therefore, I believe that the EU and the US would in future resist the temptation of depicting international politics as a confrontation between democrats and autocrats.

The reality is that most countries in the world have a mixture of democratic and autocratic norms. And it is widely recognized that autocratic systems have in many ways, become more successful than the purely democratic systems, which is a phenomenon the Americans fear and are trying to reverse. In fact, most countries want to work with China, the ultimate autocrats, and for China to support them. The world is not driven by values, but by states pursuing their interests.

In that context, being against Russia is not enough to convince states to side with the EU and the US, let alone being against China. Other states, especially those that enjoy close

partnership with Russia and/or China, want to know: what can the EU and the US offer them? What are they for?

For the collective west, the overall project to keep the world together with a single core set of rules, to which all states subscribe, is not working. The west needs a stable political and financial-economic framework to pursue their interests. The Americans also don't want the Chinese to succeed diplomatically and economically in Central Asia, Africa and especially South America, but that ship has already sailed. It's going to be pretty hard to reverse, as all the countries with 85% of the world's humanity can see for themselves that the Chinese governance model works well and in recent years, better than the western one.

The narrative in the unipolar world is that you are either "with us or against us". But that refrain is increasingly recognized as being out of synch with what is happening in the world. Most countries don't want to be restricted to a western definition of the world order and they want to make choices for themselves.

Keeping all states wed to the system will mean compromise, but that is preferable by far to major powers leaving the system and undermining it from the outside. Compromise with other powers only makes sense, of course, if they abide by the rules of the system, both old and new. Which is a challenge, notably with regards to China.

The way China looks at the problem of the multipolarity in the world is simple. It is epitomized in its Belt and Road Initiative, the BRI, that has been in place for a dozen years. That program says that everyone is a friend, and friends can sign up for the benefits of the BRI whatever the domestic political and economic structure of the partner is, and China does care, or want to change the ways things are done in the partner country. No "either with us or against us" bullshit. That's their idea of multipolarity – economic cooperation without involvement in domestic politics. On that basis, three quarters of the countries in the world have signed up to the Chinese vision. If we consider that all western countries are orbiting around the Americans' pole, then all the BRI countries are in China's corner in the multipolar world. And why not? Chinese multipolarity is non-intrusive, unlike American carpet-bagging.

To compete with China in this multipolar world, the west is instituting their own BRI equivalents. For the EU to prove to the world that it has something to offer, **the Global Gateway, its answer to China's Belt and Road Initiative, is of vital importance.** That is what the EU is supposed to bring: substantial investment in infrastructure (in digital, climate and energy, transport, health, and education and research). But in the context of the war against Russia, the funding of such an initiative lacks resources.

On its side, the US has its own **Build Back Better Framework** but that in the end focuses on domestic rather than international investment. It is an export initiative, and people see through that. So the reception to that has been appropriately cold.

Whoever occupies the White House, rivalry with China will remain the US' number one strategic priority, rather than pursue the kind of multilateral system that the Chinese prefer. A lot depends on the future direction that China itself will take, of course. Its geoeconomic strategy thrives under the stability that the BRI provides. But strident nationalism in Africa, Central Asia and elsewhere may pose problems.

In other words, one key facet of the formation of the multipolar world is that the lead countries try to attract adherents by infrastructure programs. At this time, the BRI is way ahead, and the collective west is trying to catch up. It will actually be a tall order, because budgetary processes in the west are constrained by military expenditures and domestic social programs.

Predicting, or even launching war, is easy enough. Building peace through economic cooperation is much more difficult but there will be political strings tied to these programs which will define the new multipolar world.

Back to the conflicts that have defined the new global order. The war in Ukraine has two narratives. There is the western narrative and there is the Russian one. If you choose to believe the western narrative, the war is being won by Ukraine and the collective west, and Russia is losing. The narrative is that the Russians were beaten back from Kyiv, Kherson and Kharkiv. They are running out of everything – missiles, tanks, planes and even ammunition. Soldiers for sure. This description of the state of the Russian war effort has been going on since March 2022. And it is said that the Russians have incurred heavy manpower losses. Yet, the Russians are still there, against the combined weight of arms of the entire west. Finally, in the western narrative, the Ukrainians are on the way to recapture all the lost territories in four oblasts in the east, and these will soon be liberated from the Russian Federation. And eventually so will the Crimea.

On the Russian side, the narrative is that their army made tactical withdrawals from Kyiv, Kharkov and Kherson, and Ukraine only took back what the Russian army gave up without military defeats. They claimed that their mission is not to occupy territory but to demilitarise Ukraine. Most independent analysts agree on that score. The Russian story is more believable and that the Ukrainians have suffered frightful losses. As the EU president, Ursula von der Leyen said in an indiscreet moment, the Ukrainians have suffered losses of more than 100,000 KIA.

What is the real story? It is of course an evolving story, and it is true that the Russians now occupy less territory than at the height of their special military operation. If you follow the fine print of the two narratives on both sides, it is obvious that the Ukrainians have not really moved the needle in chasing the Russians out of the country. Ten months into the war, and the Russians have been occupying the contested regions in the Donbass, and the regions around the Azov Sea. Crimea? The Russians have been there for 8 years. It is also known that the battlefronts in these regions are now heavily fortified, and it would be very difficult

to dislodge the Russians. Most recently, the Russians are continuing their advance and have taken the town of Soledar, which was resolutely defended by the Ukrainian army.

To assess the situation objectively, we just have to look at a map. A picture speaks better than a thousand words. And here is one:

Areas of Russian military control in Ukraine



The map is from the BBC which is hardly empathetic with Russia. And it is about a month old.

Looking at it objectively, and asking tough questions, it is clear that the Ukrainians, on their own have not been able to hold back the Russians. The map of eastern Ukraine looks the same in May/June 2022 and nothing has essentially moved in either direction. The best way to describe it is that Ukraine lost that part of their country permanently after a short war. And since then, the Ukrainians have been sucked into a war of attrition set up by the Russians to systematically pound the Ukrainian army to smithereens by artillery and eliminate the spearhead of the western military threat. This interpretation seems closest to what we can see.

But this outcome is unacceptable to the collective west, and so they threw their weight behind Ukraine and short of sending combat troops into the frontlines, they supplied weapons to Kyiv so that they can continue fighting. As a matter of fact, the Ukrainians were stopped from signing a peace deal by Boris Johnson in June, and for the war to continue. Now the war is not actually one between Russia and Ukraine anymore; it is between Russian and the entire collective west. Or described in the language of geopolitics, the war in Ukraine is a proxy war.

That has been costly for the Ukrainians. Yes, they did take back some of their lost territory in Kharkiv in the north and a little bit less in Kherson in the south, but other than that they have been stuck in a rut. They could not dislodge the Russians and they are also suffering a horrific destruction of their urban infrastructure from Russian missile attacks. One third of their population are now refugees, ending all possibility of an economic revival for at least half a generation. The country has been systematically destroyed.

Now, the latest news from the front that the Russian army is gaining ground tells us that there is no peace coming up in that theatre anytime soon. That makes the bipolar contest between the west and the Russians one with very long legs...

The Wall Street Journal published this last week:

“If time works to Moscow’s advantage, it’s in the west’s interest to dramatically increase support for Ukraine in coming months, abandoning the excessive caution that characterized weapons deliveries until now, says retired Air Marshal Edward Stringer, former head of operations at the British Defense Staff.

“By continuing to drip-feed just enough for Ukraine not to lose, what the West is doing is just prolonging the war,” Air Marshall Stringer says. “Whatever we realize it or not, Russia has thrown a gauntlet to the West. And, even though our own troops aren’t fighting there, we are thoroughly invested in this conflict, and we have to provide the materiel to win it.”

“Ukraine’s own once-significant defense industry has been decimated by Russian airstrikes in the 11 months of war, and the country is now almost wholly reliant on Western-provided weapons and ammunition to survive. While Russia’s economy, roughly the size of Spain’s, it a minnow compared with the combined might of the US and its NATO allies, Western defense procurement and manufacturing - unlike Russia’s – is largely continuing to follow peacetime procedures and schedules.

“The West, in general, naturally overshadows Russia in economic potential and defense-industrial capacity, and that should make you believe that, in a protracted war, Ukraine with

Western support stands a much better chance of winning the conflict,” says Michael Kofman, director of Russia studies at the Center for Naval Analyses, a think tank that advises the US military. “But that is not a predetermined outcome. Potential is just that. It takes a great deal of will, and wars are fundamentally a contest of wills.”

“Before last fall’s mobilization, Russia= which began the invasion using most full-time contract troops – suffered from manpower shortages in Ukraine while relying on an overwhelming advantage in artillery firepower. Now that Russia has mobilized 300,000 reservists, it has solved its manpower problem just as it’s starting to run low on ammunition and materiel.

“The calculus on ammunition and weaponry is more complicated. Ukraine uses up Western-supplied 155 mm artillery shells at roughly twice the rate that they are being manufactured by the US and allies, military analysts say. At this rate of fire, Kyiv could draw down US and European reserves to critical levels at some point this summer or fall.

“By then, Russia – with its single-minded focus on the war – may be able to expand its own ammunition production to keep pace with the tempo of the fighting. The US and allies are also investing in new ammunition production lines, but these are unlikely to make a major difference until next year, creating a potentially dangerous gap between Ukraine’s and Russia’s firepower in the second half of 2023.

“We should not underestimate Russia. They are mobilizing more troops, they are working hard to acquire more equipment, more ammunition, and they have shown willingness to actually suffer but to continue the war,” NATO Secretary-General Jens Stoltenberg says.

What does the above description of the multipolar world mean for investing?

All in all, I think that investing in this contorted new environment to be fraught with risks. The first point I would like to highlight is that there is a war involving two blocs out of the three in the multipolar world. A lot can go wrong, even if we rule out the prospect of a nuclear war. If it were just a Russo-Ukraine internecine war between two Slavic nations, the impact on the world would be small. But the west, in their incomprehensible hatred or fear of Russia, has used that fracture to expand it into a much wider conflict between the entire west and Russia. It is now a war that will have consequences for everyone on the planet.

In a peaceful unipolar world, the big thing to look forward to (which is what investment is about) was the global supply chain being created and extended to all corners of a world rendered flat through international goodwill and collaboration. As long as we get behind

investments which would be driven forward by that growth of the global supply chain, it would make sense.

Now, the conditions for the continued growth of the global supply chain have been up-ended. The multipolar world requires the major countries to break up the supply chain that is rooted in the countries in the other two power blocs, entirely for fear of supply disruptions and for security reasons. It also upends trade theory, and the benefits of comparative advantage can no longer be utilized for the advancement of the global economy.

This must, therefore, bring about a slowdown of the driver of the seamless integrated economy that will enhance corporate profits or even global presence of corporations. A post cold war peace dividend is being reversed. The tenets of the WTO are now history.

In this environment, there can be the following conclusions:

- 1) The long bull market in equities is over. One should not expect that the bull market of the last twenty years that we have seen to continue unabated. There is now less room for corporate earnings to grow and without those, stock prices cannot go up as rapidly. Even as the global stock markets recover from high interest rates imposed by the western central banks to fight inflation, they are unlikely to resume the highs they managed to achieve just a year ago. It is even possible that as global MNCs lose their ability to produce cheaply and earn high profits, equity value will not behave like they did in the last twenty years when the WTO was in expansionary mode. Risk premiums will need to be built in.
- 2) The amazing effectiveness of the global supply chain to control inflation will now be limited. For a good twenty years, the ability of the west to control price rises has been due to its ability to import cheap and good products from the developing countries to which the manufacturing can be outsourced. No longer. As the global supply chain gets truncated, the inherent high wages of the advanced economies will reassert themselves. Inflation will start from a higher base. It may not be an average of 10-15% annual inflation, but the old base of core inflation being at 2 % is likely to be wishful thinking. Western currency bonds will not make sense. All bonds will not make sense, in a high inflation environment.
- 3) Oil and commodity prices will be more volatile than before the world was divided into a multipolar system. Each country will try to hoard its own supplies of energy and other critical resources so that they will have either a military or commercial advantage or both. Those who don't have these resources will be subject to higher price volatility than before.

- 4) The unipolar world was marked by the financial dominance of the United States. It also meant that the dollar has been king. Needless to say, the Russians and the Chinese are no longer willing to accept this state of affairs, and are trying hard to diversify away from the dollar dominated world. This will take some time, but eventually it will happen. How long this will take is anybody's guess because for the moment, there is no alternative to the dollar in trade transactions. The Euro does not look like it will be the replacement reserve currency because in the multipolar world, it has lost a major economic advantage – cheap Russian energy which cannot be replaced. The Euro will suffer from higher rates of inflation than the US dollar and the Continent's component countries will suffer from slower growth. The Chinese RMB will obviously become more important in international transactions although this will be carefully managed by the Chinese government which obviously does not want to price themselves out of global markets in its trade. We expect the Yuan to appreciate but there will be limits to its appreciation in any given time period. Currency volatility will be a given.

- 5) And as US equities will become more difficult to invest in, Chinese stocks will become more attractive as the multipolar world will drive Chinese companies to expand market share and take on global western MNCs. I would not be surprised if very soon, as Chinese technology continues to improve, we will all be buying computers and smartphones with Chinese chips inside and EVs that are better than Tesla cars.

- 6) As the BRIC countries de-dollarize, they will seek gold as a reserve for the new emerging reserve currencies. Gold may creep upwards.

All in all, investing in the multipolar world will be much more difficult than in the days when all we had to do is to hold US dollars and buy American equities, these being the principal beneficiaries of the global supply chain just rolling forward in a flat world without disruption. Now that the disruption has occurred and seems permanent at this time, all our investing notions will have to change.

Happy investing!

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Un-Influencer in a World full of Hubris