Multipolarity And Globalization: Incompatible Pairing

Presentation to:
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A Word On Methodology

For (geo)political analysis to be investment-relevant, it has to...

1. Examine policymaker CONSTRAINTS, not their PREFERENCES
2. Maintain risk-neutrality
3. Reveal endogenous (geo)political assumptions, not fixate on exogenous ‘tail risks,’ or as Mark Twain said:

“It ain’t what you don’t know that gets you into trouble. It’s what you know for sure that just ain’t so.”
Forecasts For 2015

• Keystone theme: Multipolarity continues

  • East Asia: Tensions temporarily subside
  • Middle East: Iran-Saudi proxy war in Iraq
  • Russia: Cold War Lite subsides and simmers

• EM: Bloodbath

• DM: U.S. political risks overstated, in Europe understated (but not existential)
Hegemonic Stability Has Underpinned Globalization

GLOBAL

-EXPORTS* (AS A PERCENTAGE OF GLOBAL GDP) (LS)
-POPULATION LIVING IN CAPITALISM**
  (AS A PERCENTAGE OF GLOBAL TOTAL POPULATION) (RS)

Pax Americana

* BASED ON IMF DATA, SHOWN SMOOTHED.
** PERCENTAGE OF GLOBAL POPULATION LIVING IN COUNTRIES WITH FRASER INSTITUTE ECONOMIC FREEDOM INDEX EQUAL TO OR GREATER THAN FIVE.
BASED ON FRASER INSTITUTE AND WORLD BANK DATA.
Hegemonic Stability Evolving Into Multipolarity

GEOPOLITICAL POWER INDEX*
U.S. RELATIVE TO RUSSIA AND CHINA

* THE GEOPOLITICAL POWER INDEX MEASURES A COUNTRY’S POWER BASED ON A WEIGHTED AGGREGATION OF ITS ECONOMIC, MILITARY, POLITICAL, TECHNOLOGICAL, AND GEOGRAPHICAL ENDOWMENTS.
SOURCE: BCA CALCULATIONS.

U.S. ROLE IN WORLD AFFAIRS:
ACTIVE ROLE
STAY OUT

RESPONDENTS WERE ASKED THE QUESTION, “DO YOU THINK IT WILL BE BEST FOR THE FUTURE OF THE COUNTRY IF WE TAKE AN ACTIVE PART IN WORLD AFFAIRS OR IF WE STAY OUT OF WORLD AFFAIRS?”
Multipolarity Is Messy And Dangerous

The National Capability Index measures the material capability of countries in the form of iron and steel production, military expenditures and personnel, primary energy consumption, and total and urban population.

Source: Correlates of War Database by Singer, Bremer, and Stuckey.

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Multipolarity Will Erode Globalization

TRADE GLOBALIZATION*

Hegemonic Instability

Pax Americana

Pax Britannica

* TRADE GLOBALIZATION IS MEASURED BY IMPORTS AS PERCENTAGE OF GDP FOR 148 COUNTRIES WEIGHTED BY POPULATION.

Investment Conclusions

• (Geo)political risks will increase in frequency – search for safe-haven assets continues
• Competition for commodities between competing regional powers will intensify
• EM needs access to foreign capital inflows and foreign markets for sustained growth
  • DECADE THEME: DM over EM
• Global savings glut will be assuaged
  • Inflation may not be dead
East Asia Tensions Are On A Secular Rise

GEOPOLITICAL POWER INDEX

- CHINA
- U.S.

33% increase in two decades

MILITARY EXPENDITURE*

- CHINA
- JAPAN

* SHOWN IN CONSTANT 2011 U.S. DOLLARS.

NOTE: THE GEOPOLITICAL POWER INDEX MEASURES A COUNTRY'S POWER BASED ON A WEIGHTED AGGREGATION OF ITS ECONOMIC, MILITARY, POLITICAL, TECHNOLOGICAL, AND GEOGRAPHICAL ENDOWMENTS.

SOURCE: BCA CALCULATIONS.

SOURCE: STOCKHOLM INTERNATIONAL PEACE RESEARCH INSTITUTE.

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China: Armed And Friendless

CHINESE DEFENSE SPENDING BY DECADE

<table>
<thead>
<tr>
<th>Decade</th>
<th>% Of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970s</td>
<td>4.5</td>
</tr>
<tr>
<td>1980s</td>
<td>3.5</td>
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<tr>
<td>1990s</td>
<td>2.5</td>
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<tr>
<td>2000s</td>
<td>2.0</td>
</tr>
<tr>
<td>2010s</td>
<td>1.5</td>
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</tbody>
</table>

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WHICH COUNTRY IS THE GREATEST ALLY?

- U.S.
- CHINA

<table>
<thead>
<tr>
<th>Country</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>PHILIPPINES</td>
<td>80</td>
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<tr>
<td>SOUTH KOREA</td>
<td>70</td>
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<tr>
<td>JAPAN</td>
<td>60</td>
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<td>THAILAND</td>
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<td>INDONESIA</td>
<td>20</td>
</tr>
<tr>
<td>MALAYSIA</td>
<td>10</td>
</tr>
</tbody>
</table>

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History Is Not Reassuring

Europe in the 19th century...

Rhymes with Asia in the 21st century

* IN 1990 INTERNATIONAL GEARY-KHAMIS DOLLAR; SOURCE: ANGUS MADDISON, REBASED TO 1870=100.

* AT PURCHASING POWER PARITY, IN REAL TERMS; SOURCE: IMF; REBASED TO 1995=100.
Middle East: Second Derivative Of Multipolarity
CIVILIAN DEATHS IN IRAQ 2008-2014

Higher than during the anti-U.S. insurgency

CONTRIBUTION TO EXPECTED OIL SUPPLY INCREASE (2012-2020)

SOURCE: WORLD ENERGY OUTLOOK 2013, INTERNATIONAL ENERGY AGENCY.
Oil Price Collapse: Is There A Clear Demand Driver?

GLOBAL INDUSTRIAL PRODUCTION

Is today like 85/86?

Less clear demand catalyst

WTI OIL PRICES

If today’s price collapse is like 1985/86...

...then prices should have bottomed already

* OIL PEAK IN NOVEMBER 22, 1985 IS REBASED TO THE JUNE 20, 2014 PEAK LEVEL.
Russia-West Tensions Will Simmer, Not Blow Up

NATURAL GAS IMPORTS AND EXPORTS (2012)

- EU IMPORTS FROM RUSSIA AS PERCENTAGE OF EU CONSUMPTION
- RUSSIAN EXPORTS TO EU AS PERCENTAGE OF TOTAL RUSSIAN EXPORTS

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SOURCE: BRITISH PETROLEUM.

RUSSIAN OIL EXPORTS* AS A PERCENTAGE OF TOTAL OIL EXPORTS (2013)

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* SOURCE: UNCTAD.
Why Not Buy Russia On De-Escalation?

RUSSIA: 12-MONTH FORWARD P/E RATIO*

RUSSIA: COMPARATIVE VALUATION INDICATOR* (LS)
CORPORATE GOVERNANCE INDICATOR** (RS)

* SOURCE: THOMSON/IBES.
** SHOWN ADVANCED; SOURCE: WORLD BANK.
EM: Bloodbath – Structural Reforms Are Needed

**Emerging Markets**: Productivity**

Structural rise in productivity

Structural decline in productivity

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**Emerging Markets**:

BCA Governance Indicator** (LS)

GDP Per Capita*** (RS)

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* MARKET CAP-WEIGHTED AGGREGATE OF 21 EM ECONOMIES.
** SOURCE: THE CONFERENCE BOARD, TOTAL ECONOMY DATABASE
*** WEIGHTED BY POPULATION.
Growth Is Not Correlated With Equity Returns

No correlation!

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SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION) AND IMF WORLD ECONOMIC OUTLOOK.
* NOTE: DATAPoints REPRESENT CHINA, BRAZIL, INDIA, RUSSIA, SOUTH AFRICA, SOUTH KOREA, TAIWAN, MALAYSIA, CHILE, MEXICO, AND SINGAPORE DURING FOUR SEPARATE TIME PERIODS.
Gauging Risk Of Social Unrest

* INEQUALITY IS MEASURED BY GPD PER CAPITA AS A MULTIPLE OF MEDIAN WEALTH. SOURCE: IMF WEO OCTOBER 2014 AND CREDIT SUISSE GLOBAL WEALTH DATA BOOK.

** INDICATOR IS AN EQUALLY-WEIGHTED AVERAGE OF THE FOLLOWING MEASURES: GOVERNMENT EFFECTIVENESS, VOICE AND ACCOUNTABILITY, RULE OF LAW, AND CONTROL OF CORRUPTION. SOURCE: WORLD BANK AND BCA RESEARCH.
...But The Economy Is Actually Worse Off Than In 2011

EURO AREA: REAL GDP

EURO AREA: UNEMPLOYMENT RATE
European Risks Appear To Be Under Control…

PERCENT OF VOTING INTENTIONS:
- Spanish* Centrist Parties
- Podemos (Spain)
- Italian** Centrist Parties
- 5S Movement (Italy)

* Includes the People's Party, Socialist Worker's Party, and the Union, Progress and Democracy.
** Includes the parties in the Centrodestra Coalition and the Centrosinistra Coalition.

All series are aggregated from various polling data.

Percent of respondents in favor of the euro:
- Greece
- Spain
- France
- Italy
- Germany
- Euro Area Average

Source: EU Commission.

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Europe: Populist Appeal Has Plateaued

EURO AREA*: NON-CENTRIST PARTIES IN PARLIAMENT

Support rises…

…and then peaks

Great Recession

* INCLUDES AUSTRIA, BELGIUM, FINLAND, FRANCE, GERMANY, GREECE, ITALY, THE NETHERLANDS, PORTUGAL, AND SPAIN.
U.S.: Polarization In Context

SOURCE: POOLE, ROSENTHAL, ET AL. (2014) AND BCA CALCULATIONS.