

Wermuth Asset Management GmbH

Mainzer Landstr. 47
60329 Frankfurt am Main
Tel.: +49 – 69 -95 92 54 78
Fax: +49 – 69 - 95 92 54 79



Golikovsky per., 15
Moscow 119017
Tel: + 7 495 10 10 772
Fax: + 7 495 10 10 774

Monday, 4th June, 2007

US missile shield: commentary

President Vladimir Putin's assertion that missiles could once again be pointed at Europe if the USA proceeds with its plan to locate a missile defence shield in Poland and the Czech Republic is merely the latest in escalating rhetoric between the USA and Russia. These comments, while not entirely unpredictable, will nevertheless be alarming at face value to many. However, they need to be put into context.

In an election period, the Kremlin has more to gain out of crisis than out of co-operation

First of all, it should be borne in mind that Putin has a history of blunt undiplomatic talking which is alien, and even shocking, to those more used to the more diplomatic political discourse found in Western countries. This blunt style of speaking plays extremely well to the Russian public (most notoriously Putin spoke of hunting down Chechen terrorists "and kill them in the s**thouse", shortly before launching the second Chechen war in 1999, a popular move at the time). At a time when Russia will soon be facing parliamentary and presidential elections (December 2007 and March 2008 respectively), this audience is likely to be uppermost in Putin's mind. The creation of an atmosphere of crisis and of encirclement by enemies is one of the oldest tools utilized by governments (not just in Russia...) seeking legitimacy/popularity/re-election. Thus, the Kremlin has more to gain by opposing the missile shield in any form than by seeking co-operation: this is most likely the reason why it flatly declined Washington's offer to make any missile shield system transparent to Russian inspection. Any compromise offered by the USA at the upcoming G8 summit in Heiligendamm near Rostock, Germany, is likely similarly to be rejected. (One possible "compromise" would be to offer to cancel the shield in the Czech Republic, where the proposal is highly unpopular, while keeping the shield in Poland, where the proposal is extremely popular.)

At the same time, Russia has a history of making hard statements prior to major international summits. Again, the real audience for such posturing is the Russian public. It is advantageous for the Kremlin to be seen to play tough with foreign statesmen in order to project internally the image of Russia as an equal with other world powers, and to contrast this with the Russia of just ten years ago, which would go cap-in-hand to world summits, and meekly do the bidding of Western governments. In PR terms, it is easier for the Russian government than for its western counterparts to manage any concessions actually made at these summits, given the largely pliant nature of much of the media in Russia.

From the USA's point of view, it is likely that many in Washington are aware that this is the game being played by Russia, and therefore they are unlikely to be overly concerned by this latest statement. Perversely, they may even take comfort from the fact that Russia recently successfully test-fired a new missile: in the event of actual aggression from Iran (or any other rogue state) Russia would be far more likely to take the side of Europe and the USA. It is also true that to re-aim missiles at Western targets is no simple matter, requiring a huge change in infrastructure and hardware, and a re-writing of the national defence strategy, and Western capitals will be aware of this.

Recent Ahmadinejad comments

America's insistence that the missile shield is aimed not at Russia but against potential future aggression from Iran and other rogue states also makes it difficult for the USA to back down. The fight against terrorism is still an extremely political issue in the USA, even as the war in Iraq has become to be increasingly unpopular. The remarks over the weekend by President Ahmadinejad of Iran that the world would soon "witness the destruction" of Israel will only harden the determination of America to take a hard line against Iran, and to be seen to do so. This will be the case whoever occupies the White House: America is sworn to defend Israel at almost any cost, and both the Republicans and the Democrats will actively court the pro-Israel votes in the lead-up to the US presidential elections in 2008. Russian concerns over a missile defence shield will barely register by comparison.

So on both the American and the Russian sides this issue is likely to become one that is dictated far more by internal political considerations than by actual events. Russia will benefit from appearing to be in conflict with its Western partners (on this and on many other issues), while in America policy over the shield will arise from matters unrelated to Russia. This will continue until the electoral cycles in both countries are over in 2008, upon which normal and genuine co-operation will resume between Russia and the West. Publicly, at least, there will be no solution on this issue before then, providing plenty of scope for sensationalist headlines such as those witnessed on the front page of today's Financial Times ("[Putin threatens to target missiles at Europe](#)"). From the point of view of professional investors, this offers the possibility that, as the markets react negatively to apparent sabre-rattling, attractive valuations will open up in stocks that are fundamentally sound.

Yours sincerely,

Christopher Peters
Political Analyst and Investor Relations Officer
Christopher.Peters@wermutham.com