

Tim Ash says of Russia-U.S. relations - "lots of wishful thinking"

Opinion

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"I think they are clearing the ground for more aggressive future actions against Russia, and this could still include sanctioning Russian government debt."

LONDON, Apr 12, 2018 – Tim Ash of Bluebay Asset Management offered the following comments on U.S.-Russia and related issues at 11:25 today: I think we are all guilty sometimes of wishful thinking. The market I think that there will be a rapid ramp off/de-escalation around Western - Russia relations. Related to Russia perhaps one of the more interesting developments over the past 24H, excepting Trump's missile man tweets, were the comments made by US Treasury secretary, Steve Mnuchin, where when asked if he still stood behind the conclusions of the US Treasury report to Congress in January in response to in my case that my 17-year-old son will wake up at 7 am every day and get on with his exam revision, doing 9 hours revision a day on his own volition. the Congressional CAASTA bill which supposedly had advised against sanctioning Russian government debt, he affirmed in the positive. As per the Bloomberg report, when asked whether he stood by the January report, he said: "I do", but then went on to state that "I'm not going to comment on what we're doing going forward and what we're not going to do going forward, you shouldn't interpret anything into it". Some are likely to seize on this as affirming the "soft" UST position and that Russian sovereign debt is somehow going to be ring-fenced from future US sanctions actions. Indeed, Russian assets have had a bid today, I think as a direct result of these comments from Mnuchin. But in my view this is an incorrect read - more like wishful thinking. First, the UST report from January is classified, so it is not that easy anyway to draw too many conclusions. Second, the way Mnuchin answered was quite diplomatic. Sure he is going to stand by the report, as written at a particular point of time, but he did not say that this is still the US Treasury view or USG policy and will remain the case. My take is that US policy is evolving and the reality now is that with the April 6 action the Rubicon has been crossed, and Russian assets are no longer grandfathered from future sanctions actions. Now I would accept that sanctioning Russian government debt is still not the UST's favoured action – if we are at 6-7/10 now in terms of sanctions severity, this would be 8-9/10. And I think the UST report will likely have said, that we don't favour it at this stage (January), but would not want to rule it out – we want to keep all options on the table. But in taking out grandfathering of corporates with the April 6 action, I think they are clearing the ground for more aggressive future actions against Russia, and this could still include sanctioning Russian government debt. But this is still a few sanctions iterations in the future – and will still require further deterioration in the geopolitical setting. I think it is useful to think through the US Treasury mind-set on why it might not be opportune to sanction Russian government debt – at least as per the January report, and at that point in time. Therein I think the main factors were/are not to cause broader contagion to other markets, but also not to unduly hurt invested US institutional investors. But I think the UST actions on April 6 were a clear message to US institutional investors to reduce exposure to Russia – no other interpretation to the range of oligarchs sanctioned plus the removal of grandfathering on already issued corporate securities. But as US institutional investors consequently reduce Russia risk/exposure, then the bar for going after Russian

government debt reduces. I am not saying the USG wants to do this – it wants relations with Russia to improve – but it is clearing the deck, creating more options for itself on the sanctions front against Russia going forward and assuming the worst in terms of the likely future course of relations with Russia. I would also add in a similar vein that the UST will have been noting that their actions on Russia on April 6 caused little global contagion, aside from a modest uptick in aluminium prices. This would suggest that similar sanctions actions can be asymmetric – the US can hit and hurt Russia without much backdraft. A read from this is again that the bar for further and more aggressive sanction actions from the UST to Russia is reducing. As a result of the above I would be cautious in reading too much from Mnuchin’s comments, and in fact there were just a statement of the obvious – of course he is still going to stand by the conclusions of a report issued by his own department to Congress back in January. In conclusion, for me Mnuchin’s comments yesterday do not change much the game-changing nature of the April 6 UST sanctions designation. But the questions that investors need to ask when thinking of investing in Russia are: First, what is likely to be the direction of travel in US/Western – Russian relations? Second, if you are investing in any asset owned by a Russian oligarch, how well do you know that oligarch, and what is the risk of that oligarch being included in future US sanctions designations? On the first of these, as a 40-year plus Russia “expert” I find it almost impossible to call – and I have seen no clear cut view from all the Russia experts that I know and trust. But, one can only really judge by the facts which are that since 2013 (perhaps even 2008 and the Russian invasion of Georgia) there has been a continued trend deterioration in relations with Russia, and continued (wishful thinking) hopes of de-escalation over this period have proven to be totally wrong. Prudence would surely suggest we need to assume the existing trend continues, so have to assume yet more Western sanctions on Russia. I would add that US-Russia relations are now at a 40-year low, not this bad since the Russian invasion of Afghanistan in the late 70s. Indeed, I think the US Congressional CAATSA bill kind of says what it is on the tin – the Countering US “ADVERSARIES” Through Sanctions bill. And adversaries therein from the US perspective are Iran, North Korea, Russia, Cuba, et al thus far. I think investors have been warned. Ignore such signals at your peril. On the latter point, after the April 6 designations, no one can be sure. I don’t think there is any analyst in the industry that can give surety on this point.

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