

Note to the reader:  
This Investment Commentary was written  
on October 1, 2001, before the US attack on  
Afghanistan

## It's not a nightmare

### 1. The perfect crime

"This is the greatest work of art in the whole world." This is how Karlheinz Stockhausen, a 73-year old German composer, described the series of attacks of September 11, 2001. He had to apologize immediately for his tasteless slip of the tongue and deny that it was "meant this way." He did not want to side with the terrorists. For him, the fascination lied in the "leap away from security, from the obvious, from life," and this occasionally happened in the arts, too.

The composer's faux pas could be dismissed as one of many irrelevant remarks by experts of all sorts that had to be endured in recent weeks. At most, one might reflect on the state of today's art world, which no longer sees its calling in buildup and enjoyment but only in destruction and depression. Thinking a bit further, one might wonder whether it will be these qualities of Western civilization which will henceforth help us to convince the world at large of the advantages of freedom, rule of law and security.

For one thing, the fascination for the perfect crime applies to the external functioning of the attacks. The entire action could be prepared under complete cover. The perpetrators relied on traditional means of communication, such as couriers, apparently avoiding high-technology devices, such as mobile phones and the Internet, which are eagerly monitored by intelligence services. The timing of the actions was perfect. They waited for a typical clear Indian Summer day, selected the punctually departing morning flights, awaited

adequate CNN coverage for the second attack on the World Trade Center, arranged for the timely creation of a second front with the crash on the Pentagon in order to heighten the confusion and (justified) fear of further fronts. The flight routes were selected in such a way as to enable the aviation authorities theoretically to observe the abnormal goings on in the sky and possibly intervene. The entire planning was perfectly designed to reveal the inability of the USA to protect itself against such threats.

By choosing the simplest tools – carpet cutters, not some 007 revolver hidden in a ball-point pen or camera – the whole project was made crisis resistant. As a matter of fact, it can not be ruled out to this day whether or not a fifth, sixth and seventh airplane with the same aim or as a backup in the event of failure of the first four planes had been under way. The preparation of the attacks must have gone back several years. Keeping all of this a secret borders on the impossible. In a nutshell – the enemy is extremely competent.

### 2. Perfect psychology

While the external action alone bespeaks breathtaking perfection, the psychological dimensions demonstrate profound knowledge of religious history, considerable psychological know-how and utter contempt for human beings. The selection of the objects was just one thing. Truly, with the World Trade Center, the epitome of a global economy and the Babylon of the financial markets was smashed, with the Pentagon the symbol of military power, and if the assassins in the fourth airplane had not failed – the passengers' resistance, incidentally, was something the otherwise so perfect planners had not counted on – they had not expected such bravery from such (in their view) decadent people – the White House or the Capitol, symbols of

the world's largest functioning democracy, would have been hit.

The other aspect is embedding the attacks in a virtually perfect context of religious history and psychology. The selection of suicidal people as a weapons platform, which is difficult to combat through normal police and military channels because the people are ready to die, must also be viewed against the backdrop of the history of Judaism, Christianity and Islam. The *human sacrifice*, i.e. the person prepared to die for his god, constitutes a religious tradition. Difficult for us to comprehend, the story of Abraham, who was to sacrifice his son Isaac after having sent his other son Ismael into the desert and probable death, is at the beginning of Israel's history and its belief of being a chosen people. The Muslims, of course, derive their origin from Ismael, who miraculously escaped death by thirst after all. The line leads from the spared Isaac by way of the dolorous history of the Old Testament to Christianity's founder, who delivered himself intentionally to his executioners.

In this context, an American commentator said: "The terrorists certainly can't be called cowards." And this is precisely where the psychological feat of the architects of the attacks is rooted: There is a danger that it might turn from a despicable crime into *religious martyrdom*, particularly since the anonymity of the perpetrators could be maintained. To date, nobody has taken credit for masterminding the attacks. As a result, they are perceived as a stroke of lightning out of a clear sky, an "Act of God," atonement for everything the ruthless Americans, the free West and the nasty globalizers have done to the world.

Put in another way, the demoniacal achievement lies in the creation of a memento for all those who feel uncomfortable in the face of the undeniably assertive display of American power and those who abhor the wave of globalization of world trade and international financial flows.

### 3. The idolatry of the "reasonable ones"

It would be wrong to believe that this type of psychological embedding has no effect on our ever so enlightened Western world. The European reactions to the attacks speak volumes, in our opinion. To be sure, under the

pressure of events, solidarity with the USA was professed quickly, in fact very quickly, along with the preparedness to participate in an international campaign against terrorism. In the same breath, though, hope was also expressed widely that the Americans should proceed in a "reasonable" manner, spare innocent people and by no means engage in a confrontation of cultures. Have any European heads of government, with the notable exception of Britain's Tony Blair, expressed their hope for a complete success of the action against the terrorists? Effectiveness, that is *impact on the target*, and not fear of collateral damage, should be the aim that is expected of authorities responsible for the security of their citizens.

The talk shows featuring all kinds of experts are having their heyday. No evening passes without well informed as well as not so well informed sources providing background on Islamic terrorism, the failure of American Middle East policy and American arrogance in general. There is no round without a pronouncement of our share of guilt in the whole situation. There is certainly no objection to exploring the causes or unequivocally pointing out where mistakes were made and continue to be made. Still, one gains the impression that the terrorist attacks on New York and Washington have already turned into a transcendent memorial where penance is done and prayers for reasonableness are said.

What is actually deemed as reasonableness partially defies description. Some want to resolve the Israel/Palestine conflict. Good luck! But is there enough time for it? Others would like to eliminate the North/South gap. For others, "fair trade" is not only an issue but also a universal recipe for avoiding terror. There is an apparent inability to differentiate between *long-term desirable strategy* and *short-term necessary action*. From Germany, there was a proposal for a "round table" (which proves itself so well there...), at which all parties should congregate. One implores peace, joy and apple pie, until the pie is infested with Anthrax and Sarin.

Europe, of course, has a tradition of ignoring unpleasant, painful and potentially dangerous necessities. Less than a century ago, terrorists seized power on this enlightened Continent. Their success also had a social and political background, their evolution also reflected

economic and political frustrations, and the world in those days also bore the imprint of a wide range of injustices. Europe at the time recited the prayer of reasonableness until it was too late and disaster descended upon the Continent. It cost the lives of millions of people.

#### 4. Clear and present danger

The recognition that the attacks of September 11 were perfectly organized in operational as well as psychological respects has two consequences, in our opinion. One of these is positive, the other negative. With regard to the former, it may be argued that precisely *because* of the perfect success of the attacks, it is highly unlikely that the terrorists will hit a second or third time in the immediate future. Even perpetrators of terrorist attacks are subject to incentive structures. Those who believe that they act in the name of a higher power do not wish to imperil their success by a second try. The "ticket to heaven" might become uncertain as a result of ensuing failures or halfway successes. This is because on the one hand, a world alerted by the first attacks is quite capable of mobilizing its defenses and foiling or at least impeding the next attacks. On the other hand, there are hardly any further such rewarding and symbolic targets.

But this touches on the second, negative aspect. It would be absurd and dangerous to assume that the troubles are over for the medium and longer term with the September 11 attacks. The evidence that the ominous Osama Bin Ladin is behind the attacks is strengthening. There is a methodology in the past actions that is quite probably attributable to Bin Ladin. The first attack (1998) was aimed at the American embassy in Nairobi and took place on land. The second one hit the American navy vessel USS Cole in October 2000 and was planned and carried out at sea; the next action occurred on September 11 from the air. A logical continuation would be either a drastic increase in the number of victims by using chemical or biological weapons, or a complete paralysis of Western infrastructures by nuclear weapons. In both cases, America would not necessarily constitute the sole conceivable target. On the contrary: For a nuclear-magnetic pulse (NEMP) causing the most extensive breakdown of all electronic devices and switches by means of exploding an atomic

weapon with point of explosion at a height of a few dozen kilometers, Europe would serve as a most tempting object, as it is much more densely populated than the United States.

The Bin Ladin organization undoubtedly has both the means and the planning capabilities for the three above-mentioned attacks as well as future and even more drastic actions. Interestingly, this organization does not consist of a hierarchically led army of devoted and blindly obedient acolytes. Instead, Bin Ladin controls a cluster-like network with cells in all countries with open societies relying on the essentially good conduct and relatively harmless nature of their citizens. Hidden like latent metastases in outwardly healthy bodies, then, these cells lead an unobtrusive existence in order to be activated at some point in time and, for example, empty a Perrier bottle containing Sarin, a poison gas, into the air conditioning facility of a large building. The effect of such an act could exceed that of New York by a multiple.

Such a globally operating organization with a highly modern structure, of course, remains largely unassailable, partly because it can hardly be found and the destruction of one cell does not impair the other cells or the organization as a whole. The Bin Ladin organization has much in common with the buildup principle of the Internet. Crisis resistance is one of its outstanding characteristics. Who cooperates with whom, i.e. whether or not further notorious sources of trouble in this world, such as Iraq or Libya, have extended their tentacles into the Bin Ladin network and vice versa, is difficult to identify but cannot be ruled out. There is no doubt, however, that Bin Ladin has a great influence on the terrorist opposition in Egypt.

There are studies that closely analyze the few original thoughts expressed by Bin Ladin at sermons and interviews. They arrive at the conclusion that his determination to enforce a (fixed) political idea has totalitarian characteristics. America must be driven out by Islamic terrorists. This seemingly straightforward objective inherent in power politics is backed up by a historical episode from the time before (!) Mohammed. It tells about the expulsion of the Abessinians from the Arabian Peninsula by the Mekkans, who were then believers in the god of Abraham(!). Bin Ladin does not care about the actual chronology but simply

twists it into a war between Christians and Muslims in order to stake a claim for an Arabian territory utterly devoid of Christians. Parallels with extreme forms of Zionism are readily discernible.

It will be Bin Ladin's historical achievement to convert the actually introvert and quite tolerant Islam into an extrovert, aggressive theology. In contrast with the also highly fundamentalist forms of Islamism, *Djihadism* seeks to carry the conflict abroad and destroy foreign property and ultimately dreams of an Islamist world state of god. In other words, it represents one of many attempts at turning the world of Islam into a big and proud Caliphate.

Bin Ladin's recruiting base is the Arabian Peninsula, where he comes from, particularly among the Arab Afghanistan fighters. However, for demanding assignments, such as the September assassination, well educated young people from prosperous families in other Islamic countries are sought. The network of mosques so confusing for Westerners, and the possibility to incorporate a great variety of political contents in the Friday prayer in languages hopelessly alien to us, offer excellent multiplication opportunities for an organization such as Bin Ladin's. With respect to logistics and know-how, his threads and those of the Afghan Taliban regime, with which he is tied up, converge at the Pakistani intelligence service. The latter is closely linked with the American CIA but is emotionally leaning towards Ben Ladin's ideas. Pakistani officers and members of the intelligence service are part of the Taliban army.

##### **5. "Reasonable" reaction - out of the question**

An analysis of this fundamental point of departure shows that it is highly unlikely that America will be able to limit its response to a micro-surgical operation embodying the "reasonableness" advocated by European allies. The political objectives of Bin Ladin and his followers are no longer aimed only at the American military presence on the Arabian Peninsula but at any and all American (including Western European) spheres of influence. Western individualism and Western values (e.g. with regard to women) are incompatible with the ideas of the Jihadists. They perceive Western thinking, especially the free handling of money and everything

that can be done with it, as a threat to their totalitarian regime, and correctly so. Moreover, every totalitarian regime thrives on a conflict with an external opponent. Accordingly, America and the entire Western world can not pin any hope on a "peaceful" solution of this issue.

If the obviously highly exposed civilized world wants to protect itself against the danger of continually worsening terrorist attacks, there is no way around a military operation against Afghanistan, Bin Ladin's principal area of influence. According to Russian intelligence, 55 training camps are operating there. The country's fierce hatred toward a military opponent was experienced by the British in the early part and the Russians in the latter part of the twentieth century. But this does not alter the fact that treatment at the root, i.e. conducting ground operations, will have a sustained impact.

Thus, our forecast points in the following direction: In the coming years, the United States will have to conduct a combined campaign, using all available means, including covert operations, against Bin Ladin as well as the satellites of the Bin Ladin network. Territorially, the operation will initially concentrate on Afghanistan, but a widening in the direction of Pakistan, Sudan, Iraq and other countries is quite conceivable. Success will depend largely on the extent to which America will manage concurrently to resolve other and strategically important issues in a credible manner. This undoubtedly includes an attempt to end the conflict involving Israel and Palestine. In view of the irresponsibly heavy dependence of the USA on easy crude oil imports and reflecting the need to control safe starting bases, this policy is unlikely to turn out very Arab friendly.

##### **6. Far reaching global political implications**

The United States, which had just begun to shift its political focus inward, has been compelled by the September 11 events to pursue a decidedly global and intensive foreign policy. In an amazingly short time, the switches were turned and lively diplomatic activity was initiated. It is entirely clear that the newly sought international loyalty will not be attained without compromise and substantial reciprocity. Some astonishing events have already taken place. To wit, Britain and Spain

were among the first countries to offer the Americans their close cooperation. Why the rush? Because both nations have been plagued by continuous terrorist problems, the UK in Northern Ireland and Spain in the Basque province. At least as far as the Irish terror is concerned, there is evidence that significant support is flowing from the USA. Britain and Spain will try to link "their" problems with those of the USA. This makes sense, since in the long run, there can only be a zero-tolerance strategy vis-à-vis terrorism, and any differentiation between "good" and "bad" terror must be dispensed with. Terror as a tool of foreign policy, unfortunately not entirely unknown in the USA either, can turn against the original sponsor and should be abandoned.

Another trend is already emerging. Certain countries, whose existence used to be acknowledged only marginally and reluctantly in view of their political regimes, are now becoming valued allies. These are mainly Afghanistan's northern neighbor republics. Russia and its President Putin have also experienced a distinct upgrading. On the one hand, Russia can contribute valuable Afghanistan know-how. In addition, it will be possible for him to dispose of "his" Chechen conflict under the heading of combating terror and still remain acceptable.

All of this signifies a return to "realpolitik" and a shift away from lofty moral aims for a globally oriented policy. The appropriate institutions, such as the UN and NATO, will be used and serve as a front, but under the pressure of events, the rules of power politics will prevail. It would be wrong to assume that the hastily forged coalition against terrorism will endure permanently. The conflict will entail enormous tension, starting with the already burgeoning streams of refugees and the initial victims, to the serious impairment of special interests, such as those of France in Iran and China's along its Southwestern border.

## 7. Security versus freedom

Terror of any kind, particularly the perfection of terror by the Bin Ladin organization, is the antithesis of the free community of responsible, decent people. The Red Brigade in Italy and the RAF in Germany had also shamelessly exploited the institutions that fought

them. Bin Ladin's sleeper cells pose extremely difficult problems for security services and intelligence organizations. How on earth should they be uncovered if there is no evidence whatsoever of any ties with international terror? Equally helpless are such initial proposals as US Attorney General Ashcroft's idea of punishing the ownership of more than USD 10,000 in cash if it can be linked with terrorist intentions. We can not possibly imagine how the application of this penalty will work out in practice.

We believe that the significance of financing terrorism is substantially overrated. How much did the September assassinations actually cost? A couple of thousand dollars, no more, for knives and airline tickets. The Bin Ladin organization is *extremely* cost efficient. The members of the cells are integrated in the normal work process. The Taliban in Afghanistan needs money. Until a few years ago, the Americans supplied it with arms.

In the process of the worldwide investigation directed against the planners of the September attacks, a lot of *jumping on the bandwagon* is taking place by forces that have long sought to put an end to the *private sphere in finance*. Thus, Mr. Welteke, President of Germany's Bundesbank, recently said that it would be hard for him to understand that investigations relating to tax evasion, the drug trade or combating terrorism ended up with a reference to the banking secrecy. This is an incredible statement if one thinks it through. Citing three completely different types of violations in one breath reveals what the Bundesbank President is thinking of the appropriateness of government interference. In a manner of speaking, he is throwing some of his German fellow citizens, the presumably about 25% not totally honest minimal delinquents, into the same pot together with the highly criminal terrorists. The purpose of the fight against maintaining the private sphere apparently justifies any and all means. A similar barrage is emanating from CNN, attacking all offshore centers in general and the banking secrecy in particular. A campaign appears to be set in motion that is reminiscent of previous attempts out of New York to bring pressure to bear with the aim of forcing the Swiss financial center to its knees. In this case, the object is indeed completely unsuited. The *Swiss banking secrecy does not exist* for crimes of any kind, especially terrorism!

The problems as such, however, are rather serious and far reaching. The objective of the fight against terrorism is to preserve our free society. Since modern terrorism is apparently moving around quite skillfully in this free society and is abusing it for its purposes, the introduction of measures designed to tighten controls is unavoidable. Tracking financial transactions is believed to be useful. One tightens the security at the entrances of public buildings, subjects flight passengers to all sorts of video screening, monitors telephone conversations without any legal controls and screens the Internet traffic. As long as – but only as long as – this activity actually concentrates on combating terrorism, good luck! However, if other aims are included, such as fighting the use of drugs or tax evasion, the allegedly protected freedom is actually abused. The Orwellian control regime would be the ultimate consequence of the September attacks.

Even if such a development is acceptable – and Mr. Welteke and CNN are by no means alone in their viewpoint – the broadly based gathering of any possibly useful information would have to be denied, because with regard to the objective, the identification and elimination of terrorist cells tends to be more hindered than supported. In the science of information, there is the basic law of the negative interrelation between the quantity of information and its relevance. The more information is available, the less relevant it is. Thus, the way things are handled at present, there is a danger that the FBI, CIA and the Bundesnachrichtendienst, etc., will accumulate immense mountains of data which cannot be handled by all of the computers in this world and any and all analytical methodologies. As a result of these efforts, no terrorist cells but a few much less dangerous drug pushers and a lot of harmless tax delinquents will be caught. The free society, however, will have suffered damage.

#### **8. Recession – how severe?**

In our Investment Commentary No. 210 of late August, we sought to describe the status of the world economy at the time. Following the September attacks, the only change in that picture relates to one of the few then existing (slim) silver linings, namely *lively* consumer spending and construction activity in the USA. There is no doubt that the events

of September 11 will have consequences for the further course of the US and world economies. This reflects not only the real loss of a wide range of infrastructures during more than a week, but also the shocks caused by the attacks.

Paced by the American economy, the world economy has sustained a real shock, which has a *five-fold impact*. First, transaction costs have risen considerably. As a result of September 11, drastically beefed up security controls are needed, flying has become more expensive and arduous, merchandise declarations must be prepared much more accurately (from certain areas of the world, in fact, shipments of goods are simply turned down); in brief, the exchange of goods and services has become more expensive. This adversely affects either corporate margins, or – if prices can be raised – the income situation of the consumers. In both cases, the economy has suffered a real loss.

The second consequence relates to higher investment in security equipment, such as video monitoring devices, facilities for controlling people and luggage, screening software and the like. This may lead to the first meaningful boost for the technology sector, notably in the United States, because of its size and since all such facilities nowadays are equipped with an extremely sizable amount of technology. Nevertheless, the positive effects of such a real impulse should not be overestimated, as regardless of all factual necessity, investments in security do not boost productivity.

The third consequence concerns the sector which in recent years has contributed to GDP growth to a continually diminishing degree. It is *government spending*. Coping with the damage of September 11 alone has opened up large new budget items, and not only in the USA but also in Europe. If an extensive military action is added to this in the months ahead, the one-time push will turn into a presumably rather enduring one with all its negative effects. In any event, juicy tax reductions are moving into the distant future. On the contrary, the capital markets will be tapped anew as a result of the necessary new debt incurred by the United States. The steep interest rate curve as well as the dollar and the European currencies already seem to be discounting such a development.

The impact on *consumer behavior* is the fourth consequence. The advent of new risks heightens the propensity to save, because "...one never knows what's ahead." The question, in fact, is only how long the resulting slump in consumer spending will last. We believe that much depends on the further developments in the realms of security and politics. The question of the likelihood of further imminent attacks was discussed earlier in this report and ranked as a low probability. Consumer sentiment, however, will also be determined by the success or failure of the American counter-measures. We project an extended and risky exercise with a major impact. We do not expect this to generate any positive impulses for consumer sentiment. The more crucial issue, however, will be whether a deterioration in the income and asset situation might develop at some point in time and for what reasons. Aside from the above-mentioned shock engendered by higher transaction costs, we could visualize such a development only in the event of a drastic tightening on the fiscal level if higher taxes should succeed today's generosity.

The fifth consequence of the attacks is the historically probably uniquely generous *money supply* with which the major central banks flooded the financial system. There is no doubt that this support, notably during the one-week system breakdown, was necessary and reasonable. It would be wrong to believe, though, that this flood of money would not wreak collateral damage, too. The grimace of renewed inflation is at least peeking around the corner.

### **9. Investing is a nightmare**

The current situation of the world and the world economy is not a nightmare. Instead, it constitutes harsh reality, as the (supposed?) security has turned into an actual and dangerous threat. We have discussed the planning capability and the means available to the terrorists. We also talked about the grave risks inherent in an American operation "at the root." It would be irresponsible to harbor any illusions in this regard. New and dramatic changes in the situation might occur at any time and suddenly, and the consequences might surpass even those of September 11. The likelihood of such an imminently dangerous scenario is deemed as relatively minor.

On a best-case basis in the short as well as the long term, the terrorist problem has a relatively lean, "smart" but efficient and sustained solution, assuming also the removal of the other long festering boils from the face of the earth. The likelihood that this will be accomplished with ease, however, is also regarded as slim.

The central problem for the investor and his adviser lies in the fact that one must actually be prepared for everything. Between actual war and a quick solution of the problem, there are numerous *other scenarios* that one should also reasonably anticipate. There is no optimal solution for all contingencies. Yet, we believe that a few *principles* are worth bearing in mind.

If the situation should actually take a turn to the worst case scenario, this would mean that aside from one's own life, if it can be saved, property rights have a chance to survive. Property rights mainly represent residential real estate and shares in financially sound companies. Mere claims of ownership, which include so-called secure bonds, at least historically have turned out to be relatively unsafe instruments. The same applies to currencies, which often had to be devalued as a result of wars.

Under the best-case scenario we have projected, a high level of investment in all sectors of the economy is recommended. All investors are familiar with the heavy stock price losses incurred in the past 1.5 years and can imagine the recovery potential that a rapid transition to normalcy would produce.

The nightmare is actually in between, comprising an amalgam of real uncertainties precipitated by the reality of mostly exaggerated fluctuations in the financial markets. In the wake of all the losses that have already been sustained, how can an additional one or two bad years be digested? In these intermediate cases, it is not so much a question of the right strategy but one of endurance.

There is an other principle that should be taken very seriously and adhered to increasingly in these very unusual and dangerous times: *Diversification* among world regions and sectors is absolutely *compelling*. It is imperative to make investments in different legal systems, and - depending on the scenario - different endangered or favored regions

of the world. There is no longer any “safe haven” on this globe. This particularly applies to the pension funds responsible of our retirement income. An overly strong “home bias,” i.e. an exaggerated imbalance in favor of domestic markets, could prove to be illusory security. Strategic work, therefore, is particularly important at present.

A concluding remark: After 1.5 years of sliding stock prices, and in the wake of the bloody events of the last month, it is easy to be a pessimist. Doubts in humanity and its future are more than understandable. Interestingly, though, humanity has managed to survive somehow. Time and again, positive developments have been achieved, often just when the night seemed darkest. The regenerative strengths of human beings continue to be wondrous and will ultimately prove those who pulled the strings of the September 11 attack wrong.

KH, October 1, 2001