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The rules have changed - Part II
Investing for the next war

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"Everybody has a plan until they get punched in the mouth." Mike Tyson

A year ago, I wrote 'The rules have changed - so must investing'. What I tried to do with that paper was to share a simple idea: the world we grew up in as professionals was ending. Twelve months on, the signals are even clearer. So I am writing this sequel with a short preamble about the fate of France in 1940. Skip it if you are not interested.

France, 1940

The generals in the French high command had a plan. It was called the Maginot Line: a chain of forts and tunnels along the French-German border. The Line was inspired by WW1, when defence had a huge advantage over offence. Recent innovations in machine guns and heavy artillery made offensives almost suicidal. Every attack ended in massive casualties and barely any advance. The lesson seemed clear: dig in and let the enemy break themselves on barbed wire and concrete. So France built the Line. State of the art, for a war that had already ended.

Then came May 1940. The Germans did not attack the Line. They went around it. Panzers poured through the Ardennes, air power softened the defences, radios coordinated tanks and aircraft in real time. Six weeks later, France had fallen. The Line had not failed. It had simply been made irrelevant by a change in the frame of reference.

Battle of Verdun, 1916

Fort on the Maginot Line, 1940

Why this preamble? Because it is a textbook example of strategic failure. The French high command did not realise the frame of reference had changed. And that, unfortunately, is a risk we are running today in the real estate industry. The frame of reference is changing radically and so we cannot invest the way we did over the last 30 years.

The world we grew up in - and the one arriving

Most of us built our careers between 1990 and 2022. It was a remarkable period for the international financial services industry, with extraordinary tailwinds:

Economically, globalisation was the default. Goods and capital moved across borders with few restrictions, at least relative to the past.

Politically, liberal democracy was the norm. Free press, separation of powers, rule of law. Governments were almost always held by moderate parties.

Geopolitically, the United States was a benign hegemon, constrained by international law and international institutions.

Monetarily, the dollar was dominant. Interest rates were low. Inflation was kept under control by (allegedly) independent central banks. The Euro, despite some hiccups, gave Europe a stable framework for trade.

Some of these features had been present since 1945. Even through the high inflation of the 1970s, the dollar remained the reference currency; the US Navy policed the seas and western governments were still held by the moderate centre. Most investors never had to think about any of this. They were treated as givens. That was the point. But that world (like any other period of stability in history) also created the seeds for its own demise. Whilst this requires a thesis on its own, here are some hints.

The first seed is inequality. Liberal economics reduces redistribution in favour of 'wealth creators'. And consequently, inequality grew steadily from the 1980s.

The second seed is the rise of China. China joined the WTO in 2001 displacing traditional industry jobs in the West - think of textiles in Italy. China is now the world's second largest economy, a tech giant, but its economic might is not matched by political influence - that is always an issue.

The third is low rates and low inflation (partly caused by China's rise) pushed up house prices and financial assets, deepening inequality further.

And, fourth, fifth and sixth, I haven't even mentioned how **social media** has **polarised the information ecosystem**, or what it has done to **Gen Z**. And of course, I am not even mentioning **AI**.

All of the above created social discontent, a rise of angry educated young people without the proper access to (non-inherited) wealth and the rise of populism. These seeds are exactly what is leading us to the new world order.

The new world

Politically, the extremes are rising. Not just in the United States. Populist parties now lead the polls, or come close to it, and not just in the USA.

Geopolitically, alliances are fraying. The US commitment to defend its Western allies is in doubt as never before.

Economically, we are moving from globalisation to state capitalism. Tariffs. Rent controls. Mandates forcing domestic capital to invest at home. The state is taking back economic power, and the policy uncertainty index is at extreme levels - even in Europe.

Monetarily, the dollar's dominance is no longer automatic. Gold has more than doubled since January 2023. Many countries appear to be buying gold because they fear the dollar can be weaponised against them.

Socially, information tribes have hardened on social media. Young people say the system is not working for them, and angry young unemployed men - yes, men in particular - are a dangerous social force that populists know how to mobilise.

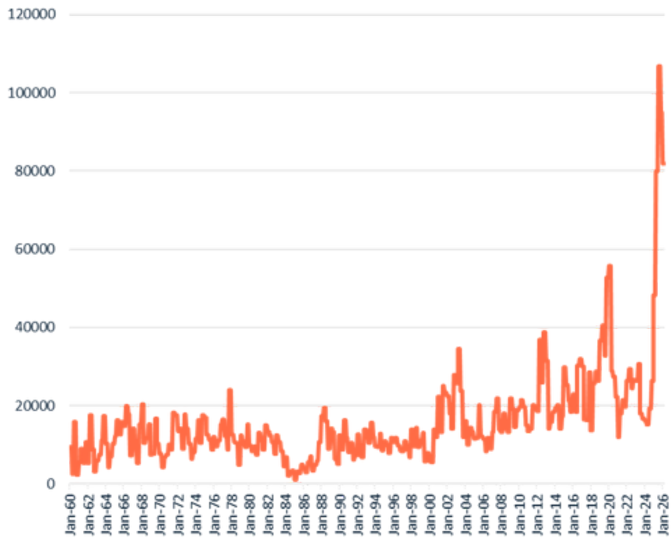
Technologically, AI threatens to compound all of it in ways we cannot yet imagine.

My intention is not to scare you. It is to note that the pillars we thought were immovable are indeed moving. This has happened before - during the interwar period (20s and 30s), and in the 1970s and early 80s - and it is happening again. We just need to be aware of it and act accordingly.

When every pillar moves at once

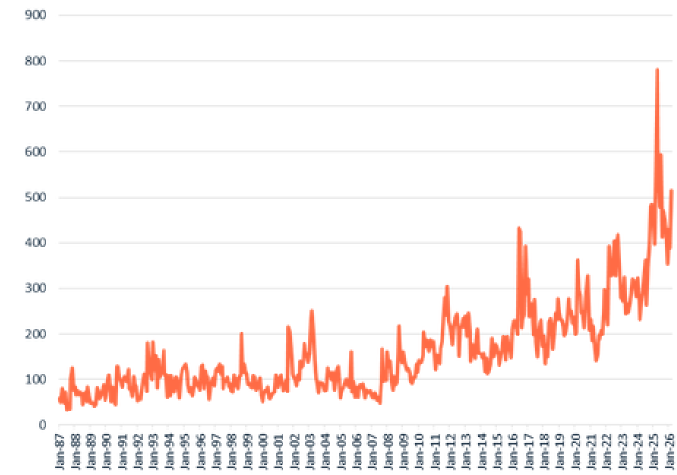
I have said above above that the old world rested on pillars no investment committee bothered to discuss in the last 30 years (The dollar as reserve currency, Freedom of the seas, rule of law, low inflation etc). In a stable system, deep-conviction investing is hard, but it is doable. The logic is straightforward. One variable shifts and you follow it through. Shortage of housing? Buy residential.

Global policy uncertainty [1]



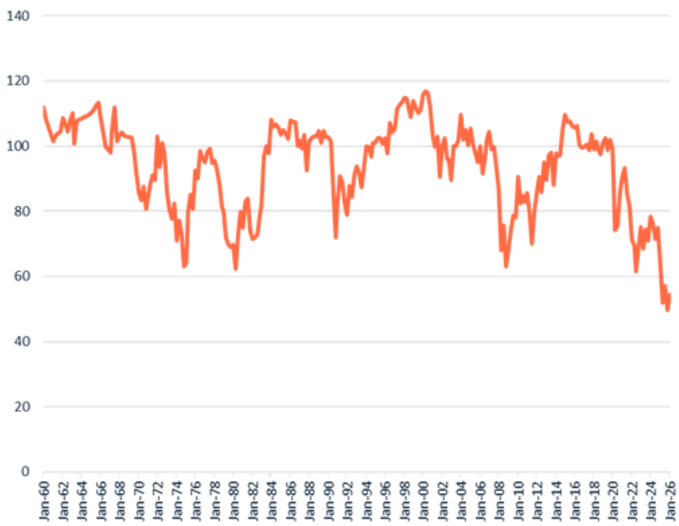
Source: Macrobond

European policy uncertainty [2]



Source: Macrobond

Young feeling most pessimistic since 1960 [3]



Source: Macrobond

1 World Economic Policy Uncertainty, World Uncertainty Index (WUI, Uncertainty (GDP Weighted Average) Index

2 Europe, Economic Policy Uncertainty, Economic Policy Uncertainty Indices, News Based Index, Index

3 United States, Consumer Surveys, University of Michigan, Consumer Sentiment, Summary Indices, The Index of Consumer Sentiment within age subgroups, Age 18- 34, Index

Rise of e-commerce? Buy last-mile logistics. Ageing population? Buy senior housing. Decarbonisation? Buy prime green offices and avoid capex risk. Each conclusion follows cleanly from a single shift, because everything else stays constant - ceteris paribus, as economists say (sorry, I am being pedantic).

Now everything is moving at once

Each pillar is significant on its own. Working out the combined consequences of a new technology, state capitalism, broken alliances, and a disaffected young population - all at the same time - is genuinely beyond me.

Take housing. Yes, there is a shortage, but:

- What if populist governments respond with rent controls? It has already happened in Barcelona, Berlin and New York.
- What if deglobalisation pushes up construction costs for years to come? It is happening right now everywhere.
- What if AI hollows out the young white-collar workers who underpin urban rents? We don't know, but it could happen.
- What if the monetary regime shifts and refinancing costs settle at a level that breaks existing business plans? Happened in 2022-23.
- What if populists ban institutional investors from owning single-family homes? Happened in the USA.
- What if foreign students are restricted from public universities? Being talked about and seems to be happening in the US and the UK.

Each is plausible alone. Combined, the range of outcomes widens dramatically. The logic of "if A changes, then X" no longer holds when A, B, C, D, E, F and G are all changing at once. What happens to X? I certainly cannot predict it, let alone have deep conviction about it.

This is the problem with old-style thinking it needs a stable frame of reference. You can have conviction about one moving piece when everything else is fixed. You cannot have conviction about one moving piece when everything is moving.

Here is my "deep conviction". The world is changing but it is not going to end. We just need to prepare for the change.

Back to the classics

What to do about this knowledge? Clearly, I don't have a formula for situations like this. But here are a few principles I find useful.

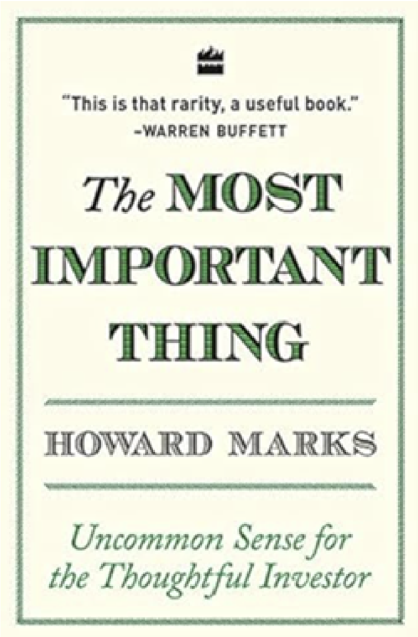
- Approach every investment with humility (no 'deep conviction')
- Make sure the price reflects the risk. This is true in every sector, and risks today are higher than they have been
- Even in periods of instability - the 1930s, the 1970s - some investors made money
- Read the classic texts of value investing
- "Risk off" is not the answer, particularly when cap rates approach the risk-free rate. But doing nothing isn't the answer either. Doing nothing is itself an active decision

And more specifically, here is how Howard Marks, Seth Klarman and Benjamin Graham think and how Sam Zell applied this thinking back in the 70s.

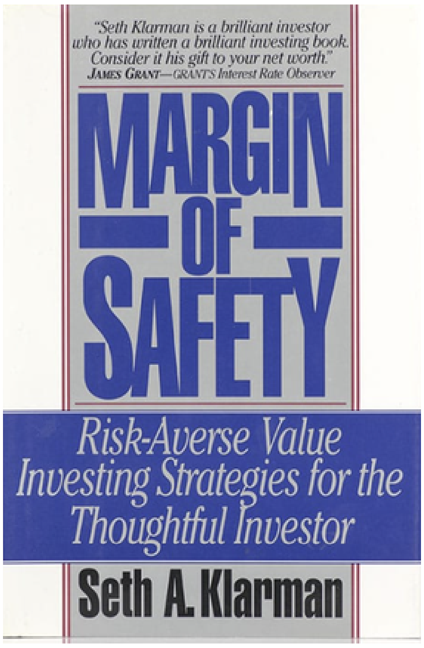
Howard Marks - 'Nobody Knows'

Howard Marks wrote two memos with similar titles - 'Nobody Knows' in 2008, after the Lehman bankruptcy, and 'Nobody Knows (Yet Again)' in

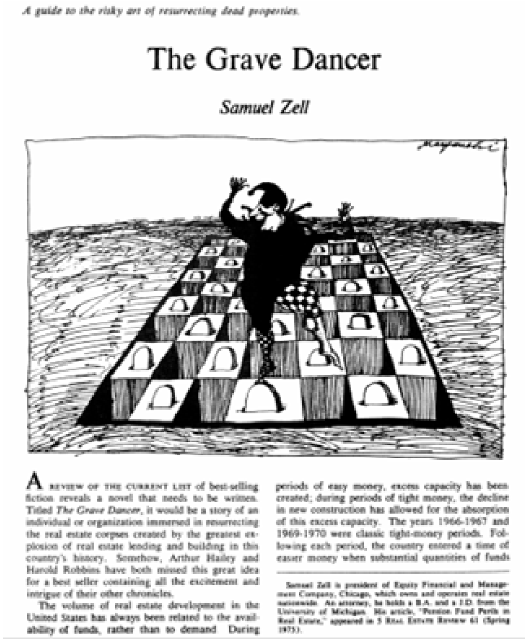
Howard Marks



Seth Klarman



Sam Zell



2025, after the so- called "Liberation Day". In both, he approaches investing with humility, admitting he cannot forecast the future. But here is what he does know: "we can't confidently predict the end of the world", and so he does not reach his "conclusions with confidence, nor act without trepidation". Howard Marks does not do deep-conviction investing.

What he is really saying is that he sees others are fearful, and he is too, but he can prepare. Tons of scenario testing. Reasoning out what is most logical. The bet he is making is that the system will change, but it will not collapse.

Seth Klarman - A margin of safety

Seth Klarman talks about margin of safety, and about risk analysis. He says something really close to my heart:

"Value investing is a risk-[based] approach; attention is paid as much to what can go wrong (risk) as to what can go right (return)."

And:

"A margin of safety is necessary because valuation is an imprecise art, the future is unpredictable, and investors are human and do make mistakes."

This applies directly to our world. Look at the price. Analyse what can go wrong. Bet that the system does not collapse.

Sam Zell - In the Midwest

Look at the legendary real estate investor Sam Zell. In the 1970s, he bought distressed apartment buildings and commercial properties across the Midwest and Sun Belt - some of them unfinished - from over-leveraged syndicators, when everyone else was fearful.

Zell did not go "risk off" at all. Unfinished? Mid west? 1970s great inflation? Wow! But his process was simple. Replacement cost was X. He could buy at 0.3 to 0.5X. Even if rents stayed flat, he would make money on the spread (and inflation was high at the time). The properties were in second-tier locations, but the margin of safety was huge. His bet was as follows: rents should at worst stay flat, and I have bought far below replacement cost. A lot has to go wrong for me to lose money. And he didn't.

The new mindset

The shift from the last war to the next is not a sector rotation, or a country rotation, or a move into operating assets. It is a change in philosophy. From deep conviction to humility. From themes to risk analysis. From narrative to stress testing. From price-takers to price discipline. Real estate in 2026 rhymes with 1932, 1973 and 2009. The convictions of the last cycle - scarcity guarantees rents, prime is safe, megatrends are destiny - are already in the price. The opportunity, as in every regime change, belongs to investors who buy resilience at the right price. Look at what Sam Zell did in the Midwest. As Darwin put it: survival belongs not to the strongest, nor to the most intelligent, but to those most responsive to change.