

GROUPE  
ERIC STURDZA

GEOPOLITICAL REPORT  
2026

# CONTENT

## 2026 GEOPOLITICAL REPORT

<b>1. Executive Summary</b>	<b>3</b>
<b>2. 2025 Recap</b>	<b>4</b>
Confirmations in a year of strategic drift	
<b>3. United States</b>	<b>6</b>
Transactional power, global ramifications	
<b>4. Asia and China</b>	<b>14</b>
Managed rivalries and strategic consolidation	
<b>5. Eastern Europe and Russia</b>	<b>22</b>
Continued stalemates and grey-zone conflict	
<b>6. Middle East</b>	<b>28</b>
Managed volatility	

**Sent to press  
on 23/01/2026**

### Contact

#### **Groupe Eric Strudza**

invest@banque-es.ch

info@coges.com

info@ericsturdza.com

www.banque-es.ch

www.corraterie-gestion.com

www.ericsturdza.com

#### **Herminius**

info@herminius.com

www.herminius.com

# EXECUTIVE SUMMARY

The geopolitical landscape in 2026 will remain structurally unstable, shaped by **United States** political volatility, enduring regional conflicts, and the continued failure of diplomacy to deliver lasting political settlements.

In **Europe**, the conflict in Ukraine is unlikely to be resolved. Rather than a decisive military outcome, the war is expected to persist through expanded grey-zone operations and sustained pressure along contested fronts. As a result, European governments will face rising defence requirements, accelerating rearmament efforts while navigating growing fiscal and political constraints.

Across **Asia**, strategic competition will remain intense but controlled. China is expected to focus inward, prioritising economic stabilisation and technological upgrading. While tensions around Taiwan will persist, Beijing is likely to defer any major escalation, favouring long-term positioning over short-term confrontation.

In the **Middle East**, geopolitical tensions will remain contained but fragile. Conflicts are unlikely to escalate into broader regional war, yet ceasefires will remain precarious. Ongoing threats to maritime security, combined with selective engagement by both the United States and China, will continue to weigh on regional stability.

Taken together, these dynamics point to a global environment defined by persistent geopolitical friction rather than resolution, reinforcing the **need for caution, resilience and strategic flexibility in 2026**.

# 2025 RECAP

## CONFIRMATIONS IN A YEAR OF STRATEGIC DRIFT

**The geopolitical developments of 2025 broadly validated the central assumptions outlined in last year's report. While the year did not deliver major geopolitical breakthroughs, it confirmed a pattern of strategic drift, selective escalation and constrained policymaking across regions.**

### UNITED STATES

In the United States, the forecast of a domestically focused and transactional Trump presidency proved largely accurate. The administration prioritised internal political objectives, weakened key federal institutions, expanded the use of executive power, and pursued an aggressive tariff and immigration agenda. In foreign policy, Trump's appetite for asserting US power in the Americas grew significantly in 2025, and the Caribbean became a key focus towards the end of the year. US strikes on Venezuela in January challenged the notion of the US as a paragon of the rules-based international order, drives an ever wider fissure between the US and other NATO countries. Attempts to rehabilitate relations with Russia failed to translate into meaningful breakthroughs, constrained by European resistance, congressional pressure and Moscow's own rigidity. Relations with NATO and the EU were volatile but contained, with allies increasing defence spending while the US reduced direct support to Ukraine. Towards China, tariff escalation exceeded expectations, although the broader strategic posture shifted from containment to extracting economic advantage.

### ASIA & CHINA

China maintained a firm stance on its strategic red lines. Beijing resisted US pressure through targeted economic and technological countermeasures, while continuing to prepare for long-term strategic competition. Contrary to expectations, however, the security relationship proved less confrontational, largely reflecting US restraint rather than Chinese de-escalation. As anticipated, China refrained from military action against Taiwan and avoided direct conflict in the South China Sea, even as regional anxieties intensified. Japan's economic vulnerability to US policy materialised sharply following the imposition of tariffs, triggering economic strain and political change, though the bilateral relationship was subsequently recalibrated.

## EASTERN EUROPE AND RUSSIA

The war in Ukraine remained unresolved, confirming expectations of a prolonged conflict rather than a negotiated settlement. Russia showed no willingness to engage in direct talks with Kyiv, and its demands remained incompatible with Ukrainian red lines. European support for Ukraine strengthened as US commitment weakened, with the strategic objective shifting from outright victory to ensuring Kyiv enters any future negotiations from a position of relative strength. Importantly, fears of conflict spillover into NATO territory did not materialise.

## MIDDLE EAST

The Middle East followed a similarly familiar pattern of containment without resolution. The conflict environment remained volatile but largely bounded. The Houthis did not significantly escalate their engagement with Israel, although Israeli strikes weakened their operational capacity. Israel acted decisively against Iran's nuclear infrastructure, exceeding expectations when US forces followed up with direct strikes – a development not anticipated in last year's outlook. Iran's retaliatory response was more assertive than forecast, highlighting the region's continued propensity for miscalculation. Elsewhere, the Israel–Lebanon ceasefire largely held, albeit imperfectly. Meanwhile, the relative influence of the US, Russia and China in the region continued to erode, underscoring the limits of external power absent sustained political and military commitment. Overall, 2025 reinforced a central conclusion: geopolitical risk did not stem from sudden rupture, but from persistent instability, weakened diplomatic leverage and the absence of credible pathways to resolution. This environment favours caution over conviction and underscores the growing importance of strategic resilience over tactical optimism.

# UNITED STATES

## TRANSACTIONAL POWER WITH GLOBAL CONSEQUENCES

**In 2026, US policy will be shaped less by institutional consensus than by President Trump's political position, personal priorities, and use of executive authority. Domestic policymaking will remain highly centralised, while foreign policy will continue to be characterised by transactional decision-making, uneven coordination across institutions, and a preference for high-visibility outcomes over durable strategic alignment. Strategic priorities will be asserted selectively, subordinating traditional US strategic interests to deal-making and personal leverage. This dynamic creates heightened risk for allies – particularly in Europe – but also accelerates structural adjustments, notably in defence and strategic autonomy. While the 2026 mid-term elections will be pivotal domestically, foreign policy volatility will persist regardless of their outcome.**

### TRUMP'S PRIORITIES IN 2026: POWER CONSOLIDATION FIRST

Trump's overriding priority in 2026 will be the consolidation of his political position ahead of the mid-term elections. Preventing Democratic control of the House of Representatives is central to protecting both his personal interests and his ability to continue bypassing legislative and administrative constraints. Policy priorities will reflect Trump's self-image and domestic political narrative rather than a coherent strategic framework. "Peace", tariffs, immigration enforcement, stock market performance and industrial reshoring will dominate his agenda, not as integrated policy objectives but as instruments of political projection.

Trump increasingly appears to view himself as one of three global strongmen who will set the global agenda – alongside Vladimir Putin and Xi Jinping. Each have their own region of exclusive interest: the Americas for Trump, Eastern Europe and Eurasia for Putin, and Asia for Xi. Trump will therefore aim to meet, and do deals with, the other two members of the triumvirate in ways that align with his priorities.

### WHO REALLY CONTROLS UNITED STATES POLICY?

Trump's approach to policymaking involves short periods of intense but inconsistent presidential engagement on issues of personal and political interest to him. Much of his administration's agenda will therefore be driven by officials who believe they are reflecting Trump's shifting impulses, or who pursue objectives of their own. This dynamic will produce a policy mix focused on tightening immigration controls, constraining electoral participation, weakening the administrative state, advancing transactional trade arrangements, asserting US dominance across the Americas, exerting pressure on the European Union, seeking to normalise relations with Russia, and promoting a "Made in America" agenda aimed at reshoring manufacturing and securing critical supply chains.

While Trump dominates domestic policy through agenda-setting, media saturation and direct pressure on institutions, foreign policy remains fragmented. Competing actors pursue divergent agendas under the assumption they are aligned with presidential intent, until Trump becomes engaged. In theory, those closest to Trump (like his business partner Steve Witkoff, son-in-law Jared Kushner, and Vice-President J.D. Vance) will always have control over foreign policy; in practice, when Trump has become engaged on an issue, he has often chosen the approaches adopted by more expert officials not part of the inner circle (such as Secretary of State Marco Rubio).

It is understood by those engaged in US foreign policy that President Trump's approach is transactional and unilateralist, and that traditional principles underpinning foreign and security policymaking are often subordinate to the administration's objectives. In practice, Trump oscillates between reliance on trusted insiders and deference to more experienced officials when personally engaged. This produces sharp reversals, policy incoherence and a consistent preference for publicised "deals" over institutionalised outcomes. As a result, US foreign and domestic policy often reflects personal instinct rather than strategic assessment – and may diverge from objective reality.

The direction of US domestic policy is largely controlled by Trump personally. He sets the agenda and news cycle through constant engagement with legislators and through his wide use of social media. The bulk of this domestic policy reflects Trump's impulses and interests, even if he may distance himself from policies that fail.

## EUROPE: VOLATILITY AS RISK – AND OPPORTUNITY

Trump's volatility presents Europe with a strategic choice. If Europe assumes that Trump's favour can be relied on, and thus must be sought, his volatility is a danger. If Europe assumes that Trump's favour cannot be relied on, and plans and acts accordingly, it is an opportunity.

The opportunity emerges from recognising that US and European strategic interests have now diverged more sharply than at any point in recent decades. Prior to Trump's re-election, Europe and the US differed on policy but broadly shared core strategic objectives. That is no longer the case. Efforts to curry favour.

***"Treating Trump's favour as a nice-to-have enables European states to coalesce more firmly around shared priorities and push back against Trump's agenda for Europe."***

This approach may also limit Trump's room for manoeuvre by strengthening domestic US opposition to his objectives, encouraging him to shift focus elsewhere.

For outsiders, it may be difficult to tell the difference between European states currying Trump's favour and European states treating that favour as a nice-to-have. European states must maintain workable relations with Trump to restrain his most disruptive instincts, but this need not come at the expense of defending their core interests. An excellent example has been the way in which Europe has managed Trump's attempts to end the Russia-Ukraine war. Through a combination of calibrated diplomacy and increased defence burden-sharing, European states have protected Kyiv from a ceasefire or settlement on Russia's terms. To outsiders, this has looked like pandering to Trump. In reality, it has been effective diplomacy that has protected core European interests.

## DEFENCE: A STRUCTURAL OPPORTUNITY

***“The most significant opportunity for European states arises in the defence sector. In less than a year, Trump has weakened – perhaps fatally – European trust in the US as a security guarantor and in US defence firms as reliable suppliers.”***

A particular opportunity for European states arises in the defence arena. In less than a year, Trump has weakened – perhaps fatally – European states' trust in the US as an ally, and their trust in US defence firms as providers of materiel. While US firms may believe there is still an opportunity to repair this relationship, from the EU's perspective, particularly in the defence sector, the relationship with the US is likely perceived to be broken or close to breaking point. Short- to medium-term discretionary defence spending is likely to shift away from US providers towards European ones, though not exclusively. Longer-term defence planning will reflect a structural reduction in reliance on the United States. This represents a major opportunity for Europe's defence-industrial base and for deeper intra-European defence integration.

## THE 2026 MID TERM ELECTIONS: CONSTRAINTS ON US POLICY

The 2026 US mid-term elections are likely to shape the trajectory of US domestic governance but will have more limited direct impact on foreign policy. If Republicans retain control of the House of Representatives, the US risks institutionalising a transactional, quasi-autarkic and oligarchic economic model in which traditional boundaries between state authority and private interests continue to erode. If Democrats regain control of the House, they will use the remaining tools of the administrative state to investigate the administration, pursue impeachments, and weaken or block key elements of Trump's domestic agenda – including immigration enforcement, tariffs, and efforts to undermine the rule of law.

US foreign policy, however, is unlikely to shift significantly because of the mid-terms. This reflects both the constitutional dominance of the presidency and the Senate in foreign affairs, and the low probability of a Democratic Senate majority. More importantly, any meaningful constraints on Trump's foreign policy are likely to emerge before the elections. Trump faces pressure to deliver visible 'wins', particularly on trade, which may push him towards pragmatic deals with the EU or China that contradict his rhetoric. At the same time, his broader foreign policy vision – centred on spheres of influence, accommodation with Russia and China, and a weakened Europe – runs counter to the prevailing US national security consensus, which continues to view both Moscow and Beijing as core threats.

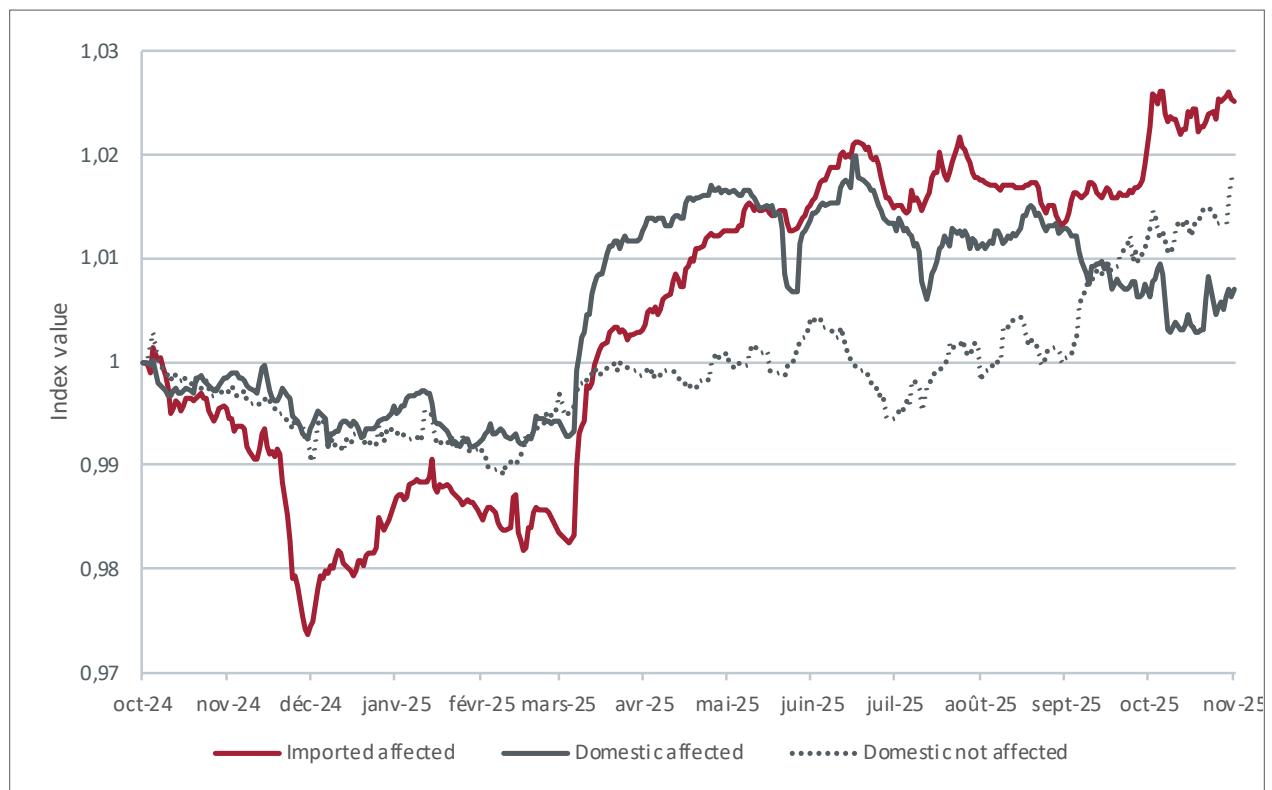
His grip over the Republican Party is weakening and is likely to erode further as his domestic agenda and political track record increasingly endanger Republican mid-term re-election prospects, even in traditionally safe Republican seats.

***“The limits of Trump's foreign policy ambitions are therefore defined by his personal hold over the Republican Party.”***

At present it is impossible to predict what will happen in the mid-terms. Several reputable polling firms place Trump's approval ratings at historically low levels for this stage of a US presidency, and the unpopular economic impact of his core policies on the cost of living points towards potential Democratic victory in 2026. This would see a continuous struggle by the Democrat-held house to reassert the separation of powers and assert the primacy of Congress, assisted by a fracturing MAGA movement. However, the economy may yet rebound, and the Supreme Court may save Trump from the most ruinous of his policies, namely that on tariffs (it is currently reviewing whether he has the legal power to impose them). Attempts at gerrymandering and other mechanisms to ensure that the playing field is not level may well lead to the Republicans retaining control of both the House of Representatives and the Senate in 2026. In that case, we would expect to see continuing political fragmentation as a diminishingly cohesive MAGA group would challenge electoral legitimacy.

Regardless of the outcome of the mid-terms, a handful of Trump's policies will persist, including beyond his current term. The identification of national champions, particularly in technology and heavy industry, and their protection through regulatory and trade policy are now structural features of the US economic strategy. They are likely to persist after Trump's current term, even if tariffs themselves are eventually discredited by the time the US elects a new president.

#### G1: TARIFFS TRIGGER IMMEDIATE PRICE INCREASES IN AFFECTED GOODS



Source: Cavallo, Llamas, Vasquez (2025) 'Tracking the Short-Run Price Impact of U.S. Tariffs'

Trump will continue to impose tariffs for as long as he is able. They are central to his political identity, and retreat would be perceived by him as a personal defeat. The Supreme Court may rule against their legality in the first quarter, potentially giving the administration's economic team and concerned Republican lawmakers leverage to push for reversal. More plausibly, sustained pressure from deteriorating cost-of-living metrics could force a partial retreat by late 2026. The most likely outcome, however, is that Trump maintains the policy in defiance of advice, prioritising political self-preservation over economic considerations.

In the longer term, a return to a functioning bipartisan consensus in US politics remains possible, but only once Trump has left the political stage and his agenda has been discredited. If Democrats regain control of the House of Representatives in 2026, such a consensus could begin to re-emerge by the end of the next presidential cycle, in the early 2030s. If not, it is unlikely to materialise before the mid- to late-2030s.

## WHERE DO UNITED STATES STRATEGIC INTERESTS LIE?

US strategic interests and Trump's personal strategic priorities diverge sharply. Trump's geographic focus is overwhelmingly on the Americas, which he appears to view as the only region of intrinsic strategic value. His ambition to dominate the hemisphere and consolidate US primacy across North America is genuine, though he will prioritise precise military strikes over starting all-out war.

The justifications for this interest will vary and will largely consist of buzz-words that animate sections of the US national security policymaking space (such as immigration, rare earths, drug trafficking, control of the Arctic or freedom of navigation). Some of these justifications may reflect genuine feeling at the time they are advanced. However, they will not be the reason why the administration is establishing or expanding US control or influence in the region.

Trump's personal strategic interests lie in areas where US power can be leveraged to align with these interests. These are the Persian Gulf; Saudi Arabia; Russia; China; Lebanon; and (possibly, in 2026-7) Indonesia. In all of these cases US strategic interest is likely to serve as a public justification for US engagement that in fact advances the agenda of whatever state has co-opted Trump's personal interests. On occasion this engagement will indeed serve US interests, but that is not the prime reason for the engagement. The administration's attempts to reframe relations with Russia and China should be seen in this light; removing the military-confrontational aspect of bilateral ties allows businessmen to come to business arrangements.

Traditional US strategic interests remain distinct. Russia and China represent systemic threats as nuclear powers seeking to weaken or overturn the US-led international order. Europe, Canada, Japan and South Korea serve as buffer zones against direct threats to the continental US, provide strategic leverage for US interests and underpin the rules-based international system (or RBIS) that has contained nuclear-power rivalry since 1945.

Which of these competing conceptions ultimately shapes US strategy will depend on the 2028 presidential election. A Republican victory would see Trump's worldview prevail, including the conflation of oligarchic business interests with those of the US state. A Democratic victory would restore traditional strategic priorities, but in a far more hostile environment: confidence in the rules-based international system will have been deeply, and potentially irreversibly, damaged.

Europe faces significant risks in the period up to the 2028 presidential election. It will have lost its US security guarantee – few European NATO members believe Trump would invoke the Article 5 mutual defence provision in its protection – and may well face a resurgent Russia. The EU as an institution is also likely to be a target for US pressure, in trade and political terms. However, it has the capacity to protect its interests strongly, particularly if Trump's personal leverage over the Republican Party continues to weaken.

## TRUMP SEEKS TO CONSOLIDATE CONTROL OVER THE AMERICAS

The seizure of President Maduro of Venezuela and the confusion that has since surrounded the US's intentions in Venezuela are further proof that President Trump places his impulse to act for his interests over prioritising policy rationale.

***"In this case, the impulse to seize Maduro was almost certainly driven by Trump's interest in establishing US hegemony over the Americas."***

If so, the seizure would seem to have implications for other states or territories in the hemisphere which have been the objects of Trump's threats. These would include Cuba, Greenland and Colombia. However, the US threat should be seen in the context of how Trump perceives the use of force overseas. He is opposed to war and the complications that it creates; he revels in acts of war that come with no real consequences and no likelihood of US casualties. This translates into stand-off missile strikes and special forces raids, not invasion or occupation; against entities which can offer little or no resistance; and without subsequent domestic political difficulties or engagement.

What does this mean for the territories Trump has threatened? Cuba is likely to face US pressure aimed at regime change, to include the halting of Havana's supply of Venezuelan oil, and perhaps a wider blockade; US armed action against Cuba seems much more problematic, given the regime's comparative strength and more limited penetration by US intelligence. Greenland will face US pressure whose limits will be determined by Copenhagen's responses; if Trump can create a legal justification for invasion, he will issue the order, if he thinks Danish or European weakness will make the move risk-free. The more likely scenario would see the US administration attempting to push Greenland towards accession to the US. Colombia is unlikely to see substantive US action beyond an intensification of attacks on narcotics networks, further tariffs, and probable support for a right-wing candidate in the presidential election run-off in June.

Trump's threats to Greenland have obviously given rise to questions about the viability of the NATO alliance and its Article 5 mutual security guarantee. Trump almost certainly sees the alliance in transactional terms; it can be called on when it suits the US to do so, and otherwise be ignored or even undermined. This would translate into the US helping to defend certain member states and refusing to help others. However, in reality, Trump might find it politically impossible to ignore an invocation of the Article 5 guarantee. The non-US political-military heart of the alliance – the UK, France, Germany, Poland, Sweden, Finland, the Baltic States, Italy and the Netherlands – would almost certainly still treat the guarantee as sacrosanct, even if the US did not. However, the obvious split between Trump and the rest of NATO clearly presents anyone with an interest in weakening the alliance (such as Russia and China) with political opportunities.

Trump's obvious flouting of established norms in seizing Maduro and threatening Greenland has also led to questions about whether these events create precedents for Russia and China to flout norms to their own advantage in their own neighbourhoods. But China and Russia are already willing to flout norms; the fact that Trump does so will not change that calculus. Instead, the importance of Trump's actions lies in another message they send; that he is committed to his notion of the world divided between three great powers, with each having exclusive rights within those regions. This will probably force them to rethink their engagement in the Americas. It may, however, encourage them to push harder in their own immediate areas, and in the one region – Africa – which Trump appears to feel is no-one's exclusive preserve.

## IMPLICATIONS FOR EUROPEAN AND WESTERN INVESTORS

The implications for European and Western investors will vary according to asset exposure and sectoral focus. That being said, significant and likely lasting damage has been done to the Europe–US relationship, and a return to its former depth and reliability should not be assumed. Nonetheless, over the next three years the United States is not comprehensively disengaging from Europe. Outside the defence domain – where restoring trust will require sustained effort and political change – transatlantic economic interdependence remains substantial.

Europe and the United States continue to be each other's largest markets, a reality explicitly acknowledged in the latest US National Security Strategy. In energy, Europe's rapid move away from Russian supply has increased its reliance on US exports, particularly LNG. While Europe will now seek to rebalance its energy mix – including the controlled reintroduction of limited Russian supplies beyond 2028 – this does not imply a political realignment with Moscow.

At the same time, the Trump administration and its associated commercial interests view the European Union not merely as a partner but as a political and regulatory constraint. As a result, trade policy and diplomatic pressure are likely to be used to weaken, or potentially undermine, the EU as a coherent actor. The consequence will be a further erosion of mutual trust and a growing, increasingly visible strategic distance across the Atlantic.

Paradoxically, this deterioration also creates opportunity. In several key sectors – most notably defence, energy infrastructure, and strategically sensitive industries – reduced reliance on the United States is likely to channel capital toward European providers. For European investors, the loss of transatlantic trust may therefore translate into structural advantages in sectors where autonomy, resilience, and regional capacity are becoming strategic priorities.

## KEY TAKEAWAYS

- **Domestic politics dominate macro outcomes.** Tariffs, immigration, reshoring and market signaling are used as political instruments. Policy reversals and abrupt announcements will continue to generate episodic market dislocations rather than sustained directional trends.
- **Transatlantic alignment can no longer be assumed.** Europe faces sustained political and regulatory pressure from the US, and reliance on US security guarantees and policy predictability represents a growing strategic and investment risk. This has caused US and European strategic interests to diverge sharply.
- **European defence is a structural investment theme.** Europe is reallocating investment towards sovereign defence, industrial capacity, and wider resilience, amid diminishing trust in the US as a security partner and supplier.
- **Decoupling creates European alpha.** As trust erodes, capital is increasingly channeled toward European defence, energy infrastructure and strategically autonomous industries, creating medium- to long-term opportunities for Europe-focused portfolios.
- **Mid-term elections change constraints, not direction.** The 2026 mid-terms may limit Trump's ability to execute domestic policy but are unlikely to materially stabilise US foreign policy or reduce geopolitical volatility.
- **Protectionism will likely out-last Trump.** Industrial policy, national champions and selective trade barriers are now embedded features of the US economic model, regardless of political succession.
- **Strategic geography matters for risk pricing.** US focus on hemispheric dominance is increasing geopolitical risk in the Americas. **Venezuela and the Caribbean will be a key hotspot** affecting energy flows, maritime security and regional stability.

# ASIA AND CHINA

## MANAGED RIVALRIES AND STRATEGIC CONSOLIDATION

**In 2026, Asia will be characterised by managed rivalry rather than escalation. India–Pakistan relations will remain tense but controlled, with neither side seeking decisive confrontation. China under Xi Jinping will prioritise economic consolidation and technological upgrading, adopting a pragmatic approach to the United States while maintaining calibrated pressure on Taiwan without resorting to force. Maritime tensions in the South and East China Seas will persist but remain contained, with trade disruption a greater risk than conflict. Japan faces acute strategic and economic challenges, as doubts over US security guarantees push Tokyo toward deeper regional defence cooperation while testing fiscal and market confidence.**

### HOW WILL INDIA PAKISTAN RELATIONS EVOLVE IN 2026?

India and Pakistan are strategic rivals and mutual existential threats, regularly exchanging fire over disputed territory, and each is sensitive about the other conceivably gaining strategic advantage. This means that bilateral ties are constantly at a pitch where misread signals or acts of terrorism can spark conflict. However, both sides are now adept at containing those sudden flurries of violence, and choreographing them so that each side's pride has been salved by the time of a ceasefire, as the brief conflict in April and May 2025 showed. Neither state is interested in all-out war and both are now adept at avoiding it.

This will not change in 2026 – even if each state is worried about geopolitical moves being made by the other. India is worried that Pakistan's arms acquisitions from China will give it a technological advantage, and that Islamabad's currying favour in the Trump administration may further strengthen its hand. Pakistan is worried that India's engagement with the Taliban government in Afghanistan will result in Indian-backed destabilisation of Pakistan, and the loss of strategic depth. Yet these moves are within the bounds of business as usual. So far there is no indication that either side is about to secure the kind of coup that will shift the strategic balance decisively in its favour. And that means that relations in 2026 should be within the bounds of business as usual too.

## XI JINPING: REAL POWER GOALS AT HOME AND ABROAD

Xi Jinping's underlying domestic and international objectives – as distinct from formal policy signalling – remain broadly consistent with previous years, but the hierarchy and tempo of priorities in 2026 are likely to be more pragmatic than ideological.

At a strategic level, Xi's long-term ambition to bring about “the great rejuvenation of the Chinese nation” is unchanged. However, 2026 is likely to see less about grand repositioning of the international order and more about securing a stable and credible start to the 15th Five-Year Plan. The immediate focus is to place the economy on a sound and predictable trajectory, reduce systemic risk, and ensure that priority industries become genuinely more competitive technologically.

Domestically, the economy remains functional and growing, but growth is uneven and increasingly constrained. The traditional engines of property and manufacturing continue to underperform, while structural pressures such as rural-urban inequality, education gaps, and an ageing population persist. To a significant extent this slowdown is intentional rather than accidental: Xi has sought to suppress volatility in sectors whose excesses could threaten financial and social stability, while forcing a transition toward higher-value industries.

That transition, however, requires time, policy discipline, and external stability. In 2026, the leadership's overriding concern is not maximising short-term growth but ensuring that this rebalancing proceeds within predictable boundaries. External shocks – particularly renewed turbulence in US-China economic relations – therefore present risk to that process.

### ***Against this backdrop, Xi is likely to pursue a more transactional and stabilising approach to Washington.***

Securing a “reasonable deal” with the Trump administration that is narrow and economically focused would serve China's interests by insulating key trade and technology flows from further escalation. This won't be intended to signal strategic accommodation but rather risk management.

Industrial policy will remain central. Artificial intelligence and semiconductors are clear priorities, both as drivers of productivity and as symbols of technological autonomy (with an eye to superiority). Beijing will also continue to push domestic capability in these areas as a hedge against continued uncertainty in access to foreign technology.

2026 for Xi is therefore about consolidation rather than confrontation: stabilising the economy, anchoring the 15th Five-Year Plan, nudging industry up the value chain, and containing external risk away from the US so that longer-term ambitions remain achievable.

## TAIWAN IN 2026: ESCALATION RISK AND INVESTOR IMPACT

The probability of China launching a military operation to take Taiwan in 2026 is very low.

Beijing continues to examine whether shifts in US politics (as represented by Donald Trump's return to the White House) create new opportunities. Chinese officials are clearly testing the proposition that American disinterest in Taiwan's democratic credentials might move toward non-intervention. However, when assessed against structural features of US politics, alliance credibility, and escalation dynamics, this notion appears fragile. Chinese policymakers are aware of this, even if some are disappointed by it.

More fundamentally, Xi Jinping cannot afford a failed operation. A botched attempt to seize Taiwan would carry catastrophic consequences: domestic legitimacy damage, elite fragmentation, economic shock, and the effective collapse of China's long-term strategic trajectory. That constraint dominates decision-making. As a result, Xi is highly unlikely to accept undue risk or act on ambiguous signals.

From this perspective, attempting a Taiwan operation in 2026 would be reckless rather than opportunistic. It would come too early in the 15th Five-Year Plan, before the economy is stabilised, before priority technologies (notably AI and semiconductors) are sufficiently embedded, and before the PLA can be confident of success under contested conditions. The leadership's priorities likely remain patience, preparation, and keeping options open.

This is not to say officials will remain passive. Beijing will continue to:

- Apply political and psychological pressure on Taiwan;
- Deter formal moves toward independence;
- Signal consequences for large arms purchases;
- Conduct grey-zone activity across air, maritime, cyber, and information domains; and
- Cultivate a sense of long-term inevitability around unification.

These actions are not to be seen as preparation for war, but rather to shape the environment. While they carry a non-zero risk of miscalculation, China has strong incentives to control escalation. If force is ultimately used, it is far more likely to be when conditions are clearly favourable and on Beijing's timetable – i.e., not in 2026.

***For Western investors in 2026, the key takeaway is that headline geopolitical risk around Taiwan is likely to remain elevated, but actual kinetic risk remains low.***

Markets may periodically display significant price movements on military exercises, coercive signalling, or rhetorical escalation, but these episodes are more likely to generate volatility than structural shifts. Beijing's overriding priority remains economic stabilisation and technological upgrading; triggering a Taiwan crisis that would almost certainly provoke sanctions, capital flight, and supply-chain disruption would be self-defeating at this stage.

That said, investors should expect:

- Persistent geopolitical risk premia on China-exposed assets;
- Continued scrutiny of semiconductor, AI, and dual-use technology supply chains;
- Heightened sensitivity to US-China political signalling, even when substantive change is unlikely.

For Beijing in 2026, Taiwan remains a central objective – but one to be pursued cautiously, incrementally, and only when the risk of failure is minimal.

## CHINA-RUSSIA: PARTNERSHIP OR POWER PLAY?

Xi Jinping's view of Vladimir Putin is best understood as transactional and unsentimental rather than personal or emotional. Whatever private judgements Xi may hold about Putin's competence are ultimately secondary to the benefit enjoyed since 2022 by Beijing in continuing dialogue with Moscow.

A Russian “win” in Ukraine – defined loosely as Moscow securing most of what it wants – would clearly benefit Beijing. It would weaken Western credibility, reinforce the principle that force can revise borders, and accelerate the erosion of US and European authority in the international system. Equally, however, a prolonged war with no settlement also works for China. It continues to drain Western political attention and resources, locks Russia into deeper dependence on Beijing, and exacerbates divisions between the United States and its European allies.

***Xi Jinping's view of Vladimir Putin is best understood as transactional and unsentimental rather than personal or emotional.***

Trump's approach to Ukraine is viewed particularly favourably in Beijing. His apparent willingness to de-prioritise European security is seen as alienating the EU and undermining Allied cohesion. From China's perspective, this fragmentation of the Western bloc is a strategic gain regardless of how the war itself evolves.

Xi therefore needs Putin to be durable and not necessarily outstanding. In the near term, China's core objective is that Russia survives as a coherent state and strategic counterweight to the West, without collapsing into instability or becoming so weakened that it ceases to be useful. Beijing is content to profit economically from Russia's predicament through discounted energy purchases and expanded use of the Renminbi (and even preferential and opportunistic access to Russian markets) while avoiding overt responsibility for Moscow's war.

There is, however, no “ultimate goal” to China's friendship with Russia: China is not seeking to absorb or fragment the country economically. Nor is it inclined to intervene if Russia were to experience internal turmoil. The relationship is one of asymmetric alignment: Russia as a junior partner whose confrontation with the West consistently redounds to China's advantage.

In short, Xi does not need to like Putin. What matters is that Putin's choices (or victory or stalemate) continue to weaken Western cohesion and distract US leadership. They also reinforce a more permissive environment for China's longer-term ambitions around the world. With this in mind, Beijing currently sees little downside to its relationship.

## EAST ASIA TENSIONS: CONFLICT OR CONTAINED RIVALRY?

Tensions in the South China Sea are likely to remain persistent but contained in 2026. The underlying disputes – territorial claims, freedom of navigation operations, and China’s assertion of rights within the so-called Ten-Dash Line – remain unresolved, and there is little prospect of substantive compromise. Southeast Asian claimants will continue to resist Chinese encroachment, while the United States and its partners will maintain freedom-of-navigation operations that are shadowed and challenged (but not physically obstructed) by Chinese forces.

There is also little appetite among regional actors for escalation. Beijing is broadly comfortable with the current level of friction and sees no strategic need to intensify pressure in 2026. While China’s behaviour remains coercive at the margins – particularly toward weaker nations – it is not seeking to push the situation out of control.

***In the Absence of a triggering event, South China Sea tensions are likely to remain a managed irritant as opposed to a catalyst for conflict.***

Indeed, Beijing may have incentives to exercise additional restraint. Minimising the risk of an armed incident with the United States aligns with China’s broader objective of stabilising relations with Washington where possible, particularly while it focuses on domestic economic priorities and longer-term strategic questions elsewhere (as noted above).

Relations between China and Japan are likely to be particularly strained in 2026, driven not by military topics but by politics. Until there is a change in Japan’s political leadership, bilateral ties are expected to remain difficult. While the risk of military confrontation remains very low, the diplomatic space has narrowed and mistrust has risen markedly.

In response, Beijing is likely to pursue a selective charm offensive toward South Korea, and to a lesser extent ASEAN states. Improving – or at least stabilising – relations with Seoul allows China to offset tensions with Tokyo and complicate US-led alignment in northeast Asia. South Korea, for its part, will seek to balance economic exposure to China against security dependence on the United States, producing a cautious but pragmatic posture.

The likelihood of armed conflict between China, Japan, and South Korea in 2026 remains very low. None of the parties has an interest in precipitating a confrontation, and all are acutely aware of the economic and strategic costs of escalation. China’s approach can be thought of as assertive and calibrated, rather than reckless or confrontational.

The greater risk in 2026 lies not in military conflict but in trade disruption. US trade policy – particularly the use of tariffs as leverage – continues to generate second-order effects across northeast Asia. Measures aimed at China can spill over into Japan and South Korea through supply chains, retaliation, or efforts by Washington to rebalance leverage among allies and competitors alike.

For Beijing, however, there is little incentive to provoke economic disruption with Japan, South Korea, or Southeast Asia in 2026. China's preference is to maintain trade flows and to avoid unnecessary shocks while its own economy remains in transition.

In conclusion, 2026 is likely to see high diplomatic tension but low conflict risk across both the South and East China Seas. Beijing will continue to bully its neighbours to differing degrees, but it is broadly comfortable with the current equilibrium. Unless specific events trigger escalation, the region is more likely to experience managed friction and episodic trade volatility, not open conflict.

MAP 1: CHINA'S MARITIME CLAIM IN THE SOUTH CHINA SEA



Source: Herminius

## THE KEY CHALLENGES FOR JAPAN IN 2026

The key challenge for Japan in 2026 will be strategic. It will need to find ways to bind the Trump administration into upholding US security guarantees, while simultaneously preparing itself to defend its own interests with its own resources, and ensuring that any US-China rapprochement does not jettison Tokyo or wider regional security. It is unlikely to succeed in its ambitions in relation to the US, because Japan does not matter to Donald Trump. However, Japan may well have more success in strengthening regional defence relations with Australia, South Korea, India, and ASEAN states, and in increasing its defence capabilities through increased defence spending and the acquisition of advanced weapons systems.

The key challenges for Japan in 2026 will be to secure its own economic security interests in the face of the decline of the multilateral rules-based trading order, and to safeguard its national security interests by ensuring the US remains bound to its alliance with Japan, building links with other potential regional allies, and by increasing its own military capabilities to deter potential aggressors.

Japan would like to see US-China relations put onto a more stable and predictable footing. Japan has more to lose than to gain, in both economic and security terms, from any further worsening in US-China relations. Japanese companies have made vast investments in China, and any US-China conflict would undoubtedly affect Japan badly. Meanwhile, the possibility of a US-China rapprochement that sees the US cede its position in East Asia to China is remote. So Japanese interests are best served by a return to stability. However, regardless of the scenario, Japan has precious little influence over US-China relations.

What Japan can do is work to bind the Trump administration into upholding US security guarantees, while simultaneously building alliances with other Indo-Pacific powers, and preparing itself to defend its own interests with its own resources. Japan may have success in 2026 in strengthening regional defence relations with Australia, South Korea, India, and ASEAN states, and in increasing its defence capabilities through increased defence spending and the acquisition of advanced weapons systems.

The key domestic challenge will be managing the economy. Prime Minister Sanae Takaichi's economic strategy aims to enhance self-sufficiency and strategic autonomy with state-led investments in certain strategic sectors. Additionally, Takeichi is implementing selective tax cuts to try to reduce the impact of politically problematic inflation. This approach combines a looser fiscal policy to boost growth, while the Bank of Japan gradually increases interest rates to control inflation. The obvious risk is that the government's additional spending is another temporary fillip and fails to boost Japan's economic growth trajectory. With government debt levels already high, financial market concerns about the sustainability of Japan's fiscal position may lead to an even weaker Yen and higher interest rates. If Takeichi's approach fails to end stagflation – or worsens it – her tenure as prime minister is likely to be short.

## KEY TAKEAWAYS

- **China will consolidate rather than escalate.** Xi Jinping's agenda is pragmatic: he will seek to stabilise growth, secure industrial upgrading, and insulate the economy from external shocks. Ideology will yield to risk management under the 15th Five-Year Plan.
- **Low-level provocation trumps military escalation in Taiwan.** Beijing will sustain intimidation and grey-zone operations but avoid outright conflict. The risk to Western investors lies in volatility, not military escalation.
- **Broader maritime tensions will also persist but stay contained.** The South and East China Seas will remain arenas of managed friction. China will continue to avoid all-out conflict while defending its territorial claims.
- **Xi sees Russia as a strategic lever.** Xi's view of Putin is instrumental. Beijing wants a durable, dependent Russia that distracts the West and supplies discounted resources without creating instability.
- **Japan faces twin strategic and fiscal strains.** Tokyo must hedge against U.S. unreliability by deepening regional security ties, even as heavy stimulus spending tests market confidence and risks inflation.
- **Regional economics outweigh conflict risk.** Asia's 2026 landscape is one of competitive coexistence – marked by a high diplomatic temperature but low conflict risk. Trade disruptions pose the primary risk for investors.

# EASTERN EUROPE AND RUSSIA

## CONTINUED STALEMATES AND GREY-ZONE CONFLICT

**In 2026, the Russia-Ukraine conflict is unlikely to reach a definitive resolution, with both sides holding irreconcilable positions. A ceasefire is possible but fragile, contingent on Russian or Ukrainian crises prompting compromise. Hybrid and “grey-zone” Russian operations against Eastern European and NATO states are likely to escalate, heightening security concerns and investor uncertainty. Europe is militarily capable of self-defence, though political will and reliance on US support remain key. US policy under Trump is unpredictable, while Chinese economic assertiveness adds strategic pressure. Europe faces a complex environment requiring strengthened defence, economic resilience, and careful diplomacy.**

### UKRAINE CONFLICT: RESOLUTION OR STALEMATE?

There is not likely to be a definitive resolution to the Russia-Ukraine war in 2026. The most that can be hoped for is a ceasefire. But any ceasefire is unlikely to be long-lasting; Russia views Ukraine's defensive moves as military provocations, and may choose to resume full hostilities on those grounds. However, a ceasefire seems implausible in 2026, because Ukraine will not accept Russia's maximalist demands, and is still able to stop the Kremlin achieving them on the battlefield.

Ukraine seems willing to accept a ceasefire that freezes the current front line, if Kyiv receives solid security guarantees; there are no constraints on its force levels; and the final status of Russian-occupied Ukrainian territory is reserved for resolution in a final peace deal. Russia, on the other hand, still wants to control all of Ukraine, remove its government, be recognised as having sovereignty over four Ukrainian oblasts, and have a veto over Kyiv's future direction. A non-negotiable for Putin (and one of the primary reasons for the 2022 invasion) is blocking Ukraine from joining NATO; he sees the organisation as an inherent threat and is perennially anxious about its expansion towards Russia's borders. Agreements by Ukraine's allies to provide peacekeeping forces – while contributing to advancements towards peace – will also be interpreted by Russia as a hostile move.

These positions are not reconcilable. A ceasefire is therefore only likely if one or both belligerents is forced to compromise. At present this does not seem likely. Ukraine can keep fighting as long as it has European backing. And while Russia cannot win the war and is finding it economically dangerous to keep fighting it, the Kremlin has yet to appreciate the need to take what it can get. Only a crisis in one of the belligerents is likely to precipitate compromise. At present, it appears that this is more likely to occur in 2026 in Russia than in Ukraine.

***A ceasefire is therefore only likely if one or both belligerents is forced to compromise.***

The Trump administration and the Kremlin both appear to be convinced that the Ukrainian government is close to collapse and will have to accept their terms. This is not so. Zelensky cannot be voted out of office until three months after martial law ends (which in practical terms means the war ends). He is unlikely to be forced from office, despite a current corruption scandal, because his challengers want to be elected, and he retains sufficient popular support. Only accepting the kind of terms Russia is insisting on would push him out of office. Polling shows Ukrainians are ready to accept the kind of ceasefire terms outlined above, but they are not ready to accept Russia choosing who rules them, or who they choose to ally with, and will keep fighting to resist Russia's demands.

## PUTIN'S CORE OBJECTIVES AT HOME AND ABROAD

Putin's stated geopolitical objectives are very close to those outlined in his December 2021 ultimatum to NATO. He wants to restore Russian control over the former USSR, at least in Europe; see NATO forces from outside Eastern Europe withdraw from Eastern European member states; and reverse the accession of Finland and Sweden to NATO. He will probably settle for complete control of Ukraine and incorporation of much of its territory into the Russian Federation, if only as a result of a final settlement after a second (post-ceasefire) war.

Putin undoubtedly envisions a post-war geopolitical arrangement where NATO has collapsed or at a minimum lost its teeth; where Russia is elevated to recognised global power status, as a peer of the USA and China; and where it is free to pursue its own interests in Europe without external interference. However, Putin cannot achieve this by his own actions; he needs the Trump administration to deliver it for him. Unfortunately, he has comprehensively mishandled this relationship in 2025. It is unlikely he will do any better in 2026.

## NATO EXPOSURE: ESCALATION RISKS

There is no real prospect of the conflict expanding beyond Ukraine in 2026. This is because Russia's energies are focused on Ukraine, and initiating hostilities against an Eastern European or NATO member state would hugely complicate the Russian war effort.

***However, the past year has seen a clear escalation in Russian 'grey zone' activity against these states, to include sabotage. It is logical to assume this activity will continue to escalate in 2026,*** particularly in states deemed most hawkish in their support for Ukraine (such as the Baltic States, Finland, Poland, Germany, Denmark, Sweden, Norway, the Netherlands, and the UK). This activity may escalate to include deniable assassinations, lethal sabotage, and abductions. It is unlikely to involve overt acts of war.

This "grey zone" or hybrid warfare activity will undoubtedly increase concern that war is imminent in NATO or EU member states. It will include components that are aimed at fanning that concern, and undermining resolve to resist Russian ambitions (such as information and cyber operations). Whether it has a significant effect on markets or business will depend to a considerable extent on how European states handle the threat. Resolve will reassure markets and investors. Concessions and division between allies will weaken confidence. For the moment the former seems more likely than the latter.

However, the Trump administration has the capacity to foster division and undermine collective confidence. Its National Security Strategy had as an objective the fostering of “patriotic” organisations – i.e., far right ones – in Europe. Should it actively pursue this objective with a competence and coherence that has so far eluded it in its foreign policymaking, division and waning market and business confidence in Europe would undoubtedly follow.

## CAN EUROPE DEFEND ITSELF?

Yes. If Russia were to initiate open conventional hostilities against Europe, it would probably be defeated – even now, before Europe has operationalised the rearmament first set in train after the Russian invasion of Ukraine. (Which is why Russia places such great weight on using ‘grey zone’ or hybrid warfare tactics against NATO and EU member states.) It might be argued that Europe would not have the political will to fight; but the reality is that when a democracy is attacked, popular will coalesces around the need to defend itself, which is then transformed into the political will to act. While some European NATO members might be reluctant to respond to an invocation of the Article 5 mutual defence obligation, the militarily most capable undoubtedly would. And while the absence of US support and its force enablers (assumed by the question) would make the war much harder and more costly for Europe, it would probably not change the end result. Russia has been brought to a standstill by a state a quarter its size; denied air superiority by a tiny, obsolete air force; and hidden its navy in harbour, away from a state without a fleet. For all of the agonising about the weakness of Europe’s defences, it is more militarily capable than Ukraine – even now.

At present there is a live question about whether there is sufficient political will in European states to bolster defence capabilities to the extent required in the absence of US security guarantees or support.

***It is worth noting that defence spending among EU member states has nearly doubled since the Russian invasion of Ukraine, and is due to increase further.***

The possibility of having to replace US force multipliers – and thus allow Europe to fight alone while maximising its capabilities – will cause a major reallocation of resources and a significant shift in procurement. But Europe could defend itself against Russia now. To that extent, the question about sufficient political will to fill the US-sized capability gap becomes moot.

Europe has declared ambitious defence spending plans to reinforce its security in the wake of a reduced US security presence. NATO’s renewed baseline is collective deterrence, anchored in the commitment for allies to spend at least 2% of GDP on defence, with a growing number of European states moving beyond that threshold. Forward deployments along the eastern flank, enhanced rapid-reaction capacities, and pre-positioned equipment are designed to demonstrate credible readiness. The US will continue to underpin NATO militarily, but Europe is under mounting pressure to assume greater responsibility for its own security, both because of U.S. strategic focus on the Indo-Pacific and political uncertainty in Washington.

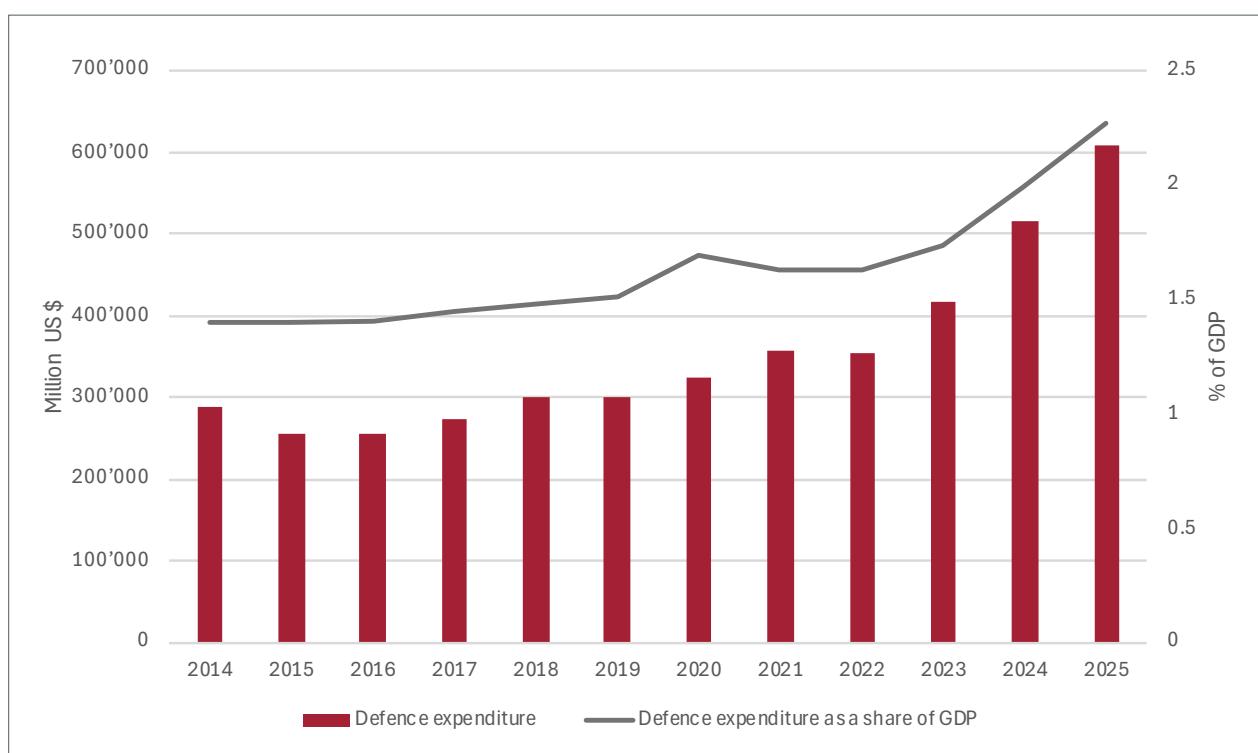
Within the European Union, defence integration will deepen gradually through increased joint procurement, industrial coordination, and support for Ukraine. The challenge will be aligning diverse national priorities, managing budgetary constraints, and ensuring interoperability.

By 2026, the direction of travel will be clear, with Europe transitioning from a peace-dividend era to a more sustained defence posture, balancing deterrence with resilience, and reinforcing NATO as the core framework of European security.

***Europe's defence industry in 2026 will take on a more strategic role in national policies, and will be increasingly essential to sustaining long-term security.***

In 2026, the European defence industry is expected to become larger and more coordinated, but still ultimately remain fragmented. Russia's war in Ukraine has accelerated production cycles, driven major increases in defence spending, and revived munitions manufacturing after decades of underinvestment. Governments are pushing industry to scale up capacity, reduce delivery times, and secure supply chains – particularly for ammunition, air defence, drones, and advanced missiles. EU initiatives will encourage joint procurement and standardisation, aiming to strengthen Europe's own industrial base and reduce reliance on U.S. capabilities. However, differing national priorities, competition among major defence firms, and budgetary pressures will limit full integration. Overall, Europe's defence industry in 2026 will be more strategic, more central to national policy, and increasingly essential to sustaining long-term security.

## G2: DEFENCE EXPENDITURE OF NATO COUNTRIES 2014-2025 EXCL. US



Source: NATO [<https://www.nato.int/content/dam/nato/websvc/documents/finance/def-exp-2025-en.pdf>]

## EUROPE'S DECISION MAKING CENTRES

Europe does not have geopolitical consensus, as such, because it encompasses too many states, with too varied a set of political and geopolitical arrangements, to permit the degree of unity implied by the term. It does, however, generate geopolitical critical mass – a group of states and/or institutions sharing a common view on an issue, or desiring a common outcome, and pulling other states and/or institutions with them, until together they form a collective that drives policy.

## US AND CHINA: EXTERNAL PRESSURES ON EUROPE

The impact of US policy in 2026 will be uncertainty. It is not clear what US policy is, or will be over the short to medium term. Trump's tariffs could stop altogether, or intensify; they could also be reduced as the result of an agreement, and then increased again if he chooses to break that deal. Similarly, Trump's threats about EU acceptance of US standards are also subject to his whims. In theory there is certainty to be found in Trump's desire to break up the European Union. But this is not the policy of his administration as a whole, nor the Republican Party, nor the Democratic Party, nor is it a real concern for American voters; any moves he might make might well be swiftly reversed by another administration, or even his own.

This uncertainty will prove challenging for export-orientated states and sectors in 2026. It will also increase political pressure for protection of state or regional economic champions. This will further complicate debates within EU policymaking; the organisation has always found that reconciling protection of sectors or companies with the requirements of a single market has been the most difficult and emotionally intense political debate.

Uncertainty will also be the impact of Chinese policy – albeit to a lesser extent. China's tariff policy is shaped to some extent by Trump's tariffs; European uncertainty about Trump's policies translates into uncertainty about Beijing's.

However, Chinese policy – unlike that of the US – has a clear direction of travel, and a clear core (and inflexible) driving impulse, that will apply for at least the next five years. China aims to dominate new technologies while maintaining access to global markets for old ones. While it is broadly opposed to tariffs per se, it will use other tools to limit access to its markets and compel access to others'. China will push back hard against attempts to limit its access to Europe's electric vehicle, green energy production, and consumer goods markets, to name a few. It will also probably apply export controls – even if only through restrictions on supply – on critical minerals. The difficulty Europe faces is that Xi's regime does not understand democracies in general, or the EU in particular, and is prone to escalate disagreements into disputes that then frustrate the objective sought.

## KEY TAKEAWAYS

- **A definitive solution to the conflict in Ukraine is unlikely in 2026**, with the parties in the conflict unable to establish trust-building measures. Ukraine's ability to continue the fight is dependent on continued European backing.
- **Putin seeks to restore Russian control over the former USSR**, and to continue to oppose NATO's presence in eastern Europe. However, Russia's military will not be capable of sustaining any expanded conflict in Europe beyond 'grey zone' tactics.
- **Defence spending among EU member states has nearly doubled** since the Russian invasion of Ukraine and is set to increase further as Europe transitions from a peace-dividend era to a more sustained defence posture.
- **Uncertainty over trade terms with the US will push European states towards protectionism.** However, China can be expected to push back hard against European protectionism on new technologies.

# MIDDLE EAST

## MANAGED VOLATILITY AND ENDURING INSTABILITY

**In 2026, the Middle East will remain a region of managed volatility with persistent flashpoints in Gaza, Lebanon, and the Red Sea. Gaza's ceasefire is fragile, Lebanon faces ongoing Hezbollah-Israel tensions, and Houthi threats to Red Sea shipping create limited but tangible oil market risks. Iran will focus on rebuilding capabilities rather than projecting power, while Israel's strategic dependence on distant allies leaves it exposed. US engagement under the Trump administration is likely to remain selective and personal, with Russia and China pursuing limited regional influence. Nuclear proliferation remains unlikely, though regional hedging could intensify in response to uncertainty.**

### MIDDLE EAST FLASHPOINTS AND OIL MARKET RISK

The potential flashpoints to watch in 2026 are Gaza; Lebanon; and the Red Sea.

It is probable that the Gaza ceasefire will break down during 2026. The first phase has been almost entirely implemented. However, the second phase is unlikely to move forward. No state will provide troops for the international stabilisation force supposed to provide security in Gaza in phase 2 if Hamas is not disarmed first, while the interim political administration outlined for phase 2 can only take over if it is backed by a stabilisation force. Hamas is refusing to disarm, and any Israeli attempt to force it to do so would reignite the conflict. A protracted failure to move into phase 2 would also probably cause hostilities to resume.

The second potential flashpoint is Lebanon. Neither Israel nor Lebanon wants the Israel-Hezbollah war to resume. However, Israel's systematic breaking of the ceasefire deal is justifying Hezbollah's rearmament, and simultaneously making it politically harder for the Lebanese government to disarm the organisation. The most likely outcome for 2026 is that the situation will continue as it is at present, with the Lebanese government making honest attempts to disarm Hezbollah but having limited success, and Israel continuing to violate the ceasefire. However, there is a small but real possibility that hostilities will reignite.

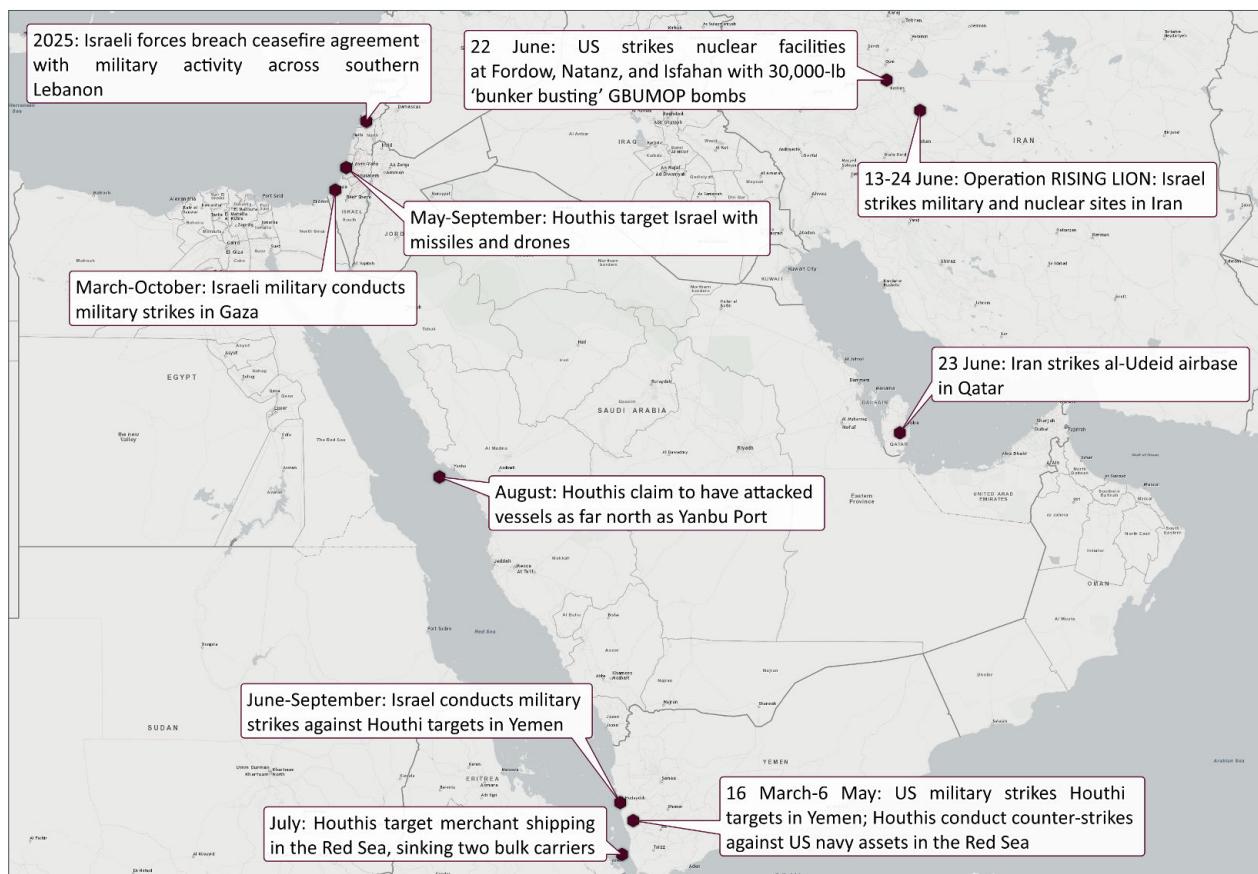
The third potential flashpoint is the Red Sea. If hostilities were to resume in Gaza, the Houthi movement would probably respond by targeting international shipping in the Red Sea and Gulf of Aden which it deems to have links to Israel.

The first two flashpoints are unlikely to have any real effect on oil prices. The third, however, has potential to cause a spike, particularly if the campaign is protracted. However prices are currently fairly low and there is little generalised concern about security of supply. It is therefore likely that the market concern created by threats to Saudi oil exports would be limited. This would change, however, if the campaign were protracted, and coincided with a marked reduction in Russian exports as a result of Ukrainian action against the 'shadow fleet'.

Iran is currently in a rebuilding phase. It is unlikely to initiate hostilities in 2026 and the damage caused to its nuclear programme, air defence system and ballistic missile arsenal by the ‘12-day war’ of April and May means that Israel is unlikely to resume its attacks. Instead, Tehran is trying to rebuild its air defences and ballistic missile stocks and reestablish the capabilities of its regional proxies – even if it currently has little it can offer these groups. There is always a small risk that Iranian actions against specific ships in the Persian Gulf can escalate into wider confrontation. However, the regime is now weakened on both the international and domestic stage, making it more vulnerable to internal rebellion or opposition protests.

For the Iranian regime to lose control of the country, there are four potential triggers. First, if the unity of the security forces – namely the IRGC, and the regular military – is broken, the regime would struggle to maintain control over government institutions, opening it up to powerful challengers. Second, the state-backed banking system is increasingly parlous (the rial has roughly tripled against the dollar in the last year) – but props up a banking system highly leveraged on real estate. The regime would struggle to react to a mass collapse of banks and prevent a chain-reaction. Third, should Baloch and Kurdish groups take up arms against the regime, the regime would struggle to suppress them. Fourth, the regime is highly vulnerable to the bazaar system, through which a large proportion of essential goods are traded. Merchants already joined protests in December by striking, thus creating a strangle on essential goods, and triggering wider protests in January. Should these four issues occur in Iran, it would be very hard for the current regime to maintain its control over the country.

#### MAP 2: SECURITY EVENTS IN THE MIDDLE EAST IN 2025



Source: Herminius

## WHAT NEXT FOR ISRAEL?

Much depends on what happens to the Gaza ceasefire deal. If it collapses, then Trump will be forced once again to make a choice between Israel's interests and his own (i.e., the deal with his name on it, plus his commitments to Gulf states), and Israel will lose. If it holds, or if it fails and Hamas is to blame, then Israel may begin to rebuild its international ties..

***It is difficult to see Israel rehabilitating itself in its region or in Europe with Binyamin Netanyahu still in office. Even if he were to disappear from the scene in 2026, rehabilitation will be difficult.***

The difficulty Israel faces, whoever rules it, is that it depends on democracies thousands of miles away to buffer it against its neighbourhood. (Even Israel's much-vaunted defences have only been made possible by flows of money, technology, and diplomatic and political top cover from these states.) It seems to have lost popular opinion in those states and is reluctant to acknowledge why. It is particularly dependent on the US, not just for direct support, but for applying pressure on the neighbourhood to work alongside Israel rather than against it; and now it has a US president who it has alienated, and who wants to disengage from the Middle East. Finally, it has made it impossible for regional states that want full engagement with Israel to have any real dealings with it. The scene thus appears to be set for a cycle of Palestinian action, Israeli reaction, international pressure on Israel, Israeli grievance and refusal to change course, and then further Palestinian action. Israel seems set for greater violence and international isolation over the medium to long term. What next for Iran: could it rebuild its regional power base in 2026?

## IRAN: REGIONAL COMEBACK OR CONTAINMENT?

Iran will not rebuild its regional power base in 2026, because the local political contexts have changed. Hamas is profoundly weakened militarily and politically, and has much less room to engage with Iran, partly because regional states are genuinely keen to prevent it regaining its former capabilities; it will also struggle to rebuild its influence in Syria following the regime change. Hezbollah is a shell of its former self and is still a hugely unpopular political actor in Lebanon; while Lebanese government efforts to disarm it may not succeed, there is little doubt that it is under significant political and social pressure. It is also because Iran has little to offer. Tehran's first priority is rebuilding its own defences, and it has neither the funds nor the capability to resume major shipments of ordnance to its proxies.

It is also because the Iranian state is itself in considerable flux. It is not clear who will succeed Supreme Leader Ali Khamenei, who is 86 and in uncertain health. Hawks within the regime have been weakened by the humiliations of 2024 and 2025; doves have been weakened by Iran's desperate economy (which they get blamed for whether in power or not). The '12-day war' forced the regime to review its strategy for the nuclear programme, which has yet to come to a clear conclusion. This will be a year for Iran to rebuild its capabilities and try to solve its strategic quandaries.

## US, RUSSIA AND CHINA: COMPETING AGENDAS

The US' National Security Strategy was clear that the Trump administration wants to disengage from the Middle East. To some extent this clashes with the interests of the Trump family and its associated networks, which have a strong regional focus. (The Trumps have established close personal ties with the Saudi and Qatari royal families.)

***However it seems likely that even if the US does not start to disengage from the region in 2026, other states will believe that this is Washington's intent, and will seek to take advantage of it.***

These states are unlikely to be Russia or China. Russia has little bandwidth for political or economic engagement that is not intimately linked to the war against Ukraine. This means its regional engagement is likely to be focused on Iran, where its links have been growing since 2022. China has a theoretical interest in the region – as a source of recruits to support its desire for a multi-polar world order – and has used the UAE as a strategic lever for its Belt and Road initiatives. This engagement will continue to intensify – but would have done so whether the US disengaged or not. The problem China faces in capitalising on its economic ties is that it is not trusted as a political or security partner, a legacy of its much-touted strategic agreement with Iran. This means that the most likely beneficiaries of any US disengagement will be states such as Turkey, particularly in the security domain; the extension of Pakistan's nuclear guarantee to Saudi Arabia illustrates what lack of confidence in US guarantees can lead to.

Inasmuch as the US does have areas of interest in the Middle East in 2026, it is likely to focus on those areas where the Trumps have established personal links (Saudi Arabia and Qatar) or where the links already existed (Lebanon). In theory the US should have a strong interest in the success of the Gaza deal. However, it was structured to minimise US involvement, and its failure to address the key obstacles to peace, or allocate resources to overcoming them, indicates it was a deal for the sake of a deal. It is therefore entirely possible that Trump's personal commitment to it is limited, and that a breakdown would cause him to walk away from the whole effort, claiming he had done what he could.

## NUCLEAR PROLIFERATION RISKS IN 2026

Iran is rebuilding its nuclear programme – and there is no clear outcome of what this will look like and no other state is in a position to effectively buy a nuclear capability, as Saudi Arabia did with the extension of Pakistan's nuclear umbrella to the kingdom in 2025.

However, loss of confidence in US security guarantees, coupled with any US disengagement from the region, will undoubtedly cause several Middle Eastern states to explore the acquisition of a nuclear capability. This is necessarily a long-term project that may not result in the acquisition of civil-use nuclear reactors, let alone a weapons programme. Furthermore, almost all states that will consider the idea will drop it as being too expensive or diplomatically isolating. Nevertheless, it will be on the table.

When analysing the implications of nuclear proliferation it is important to understand the constraints that apply on the use of nuclear weapons. It is politically extremely difficult for a state with these weapons to use them against a state that does not have them; in effect, the existence of the nuclear state has to be threatened by conventional forces before deployment can be justified. Use against another nuclear-armed state obviously creates the possibility of a nuclear exchange, forcing all concerned to think exceptionally carefully about escalation. This means that there is (for instance) no likelihood of Saudi Arabia getting Pakistan to use nuclear weapons against a state attacking the kingdom, unless its existence were threatened. Nor, if Saudi Arabia had its own nuclear weapons, would it be able to use them against a less-than-existential threat. There is thus no likelihood that (for instance) Houthi attacks on key Saudi facilities would be met with a nuclear response, now or in the medium to long term.

## KEY TAKEAWAYS

- **The Gaza ceasefire will become increasingly fragile.** The likely failure of phase two of the ceasefire increases the possibility of renewed fighting and prolonged humanitarian distress.
- **Israel's security model looks brittle.** The country's heavy reliance on distant democratic sponsors will clash with fraying public support and a disengaging US, leading to greater diplomatic and military isolation over time.
- **Iran's focus will be primarily domestic.** Tehran will focus on rebuilding its damaged military and nuclear capabilities while weakened proxies and succession uncertainty will limit its ability to project power abroad.
- **The Red Sea is a conditional, not systemic, oil risk.** Houthi threats to shipping will create limited, episodic price spikes rather than structural supply shocks, unless a prolonged campaign overlaps with a sharp fall in Russian exports.
- **Great-power presence is shallow and selective.** US involvement in the region is increasingly personal and Gulf-focused, while Russia and China lack the will or trust to replace Washington, leaving space for regional hedging and opportunism.

# ABOUT THE AUTHORS



GROUPÉ  
ERIC STURDZA

**As a family business, our expertise relies on the forty years' banking experience of Eric Sturdza, founder of the Eric Sturdza Group, of which we are part. The latter is represented by three entities:**

## **Banque Eric Sturdza**

Private Banking, offering tailored solutions for HNWI clients, and investment services such as discretionary portfolio management, advisory, as well as lombard lending and asset structuring.

## **Corraterie Gestion (COGES)**

Wealth management and Family Office, including a wealth planning offering.

## **Eric Sturdza Asset Management**

Asset management boutique offering high-conviction strategies of actively managed investment products or segregated mandates.

Our clients directly benefit from this, thanks to a large network of prestigious fund managers and experts and to our ability to address their needs with a pragmatic and multi-dimensional approach.



# **HERMINIUS**

**Herminius is an intelligence & advisory firm. We help some of the world's leading decision makers – spanning the wealth and asset management industries, multinational companies, and private equity – to create value, reduce risk and make better decisions.**

Our clients draw on Herminius to help them address an exceptionally wide range of challenges, ranging from geopolitical and public policy developments – we have been the geopolitical and maritime risk advisors to the Lloyd's Market Association's Joint War Committee since 2005 – to M&A, talent assessment, commercial litigation support, asset identification and recovery and project finance (including acting as a principal advisor to the Core Lender Group of a \$35bn LNG project).

The heart of our business is our global network that provides our clients with detailed insight on a discreet, independent basis, and which we combine with the judgement and advice of an in-house team who have worked on acutely sensitive issues across sectors and all around the world.



GROUPÉ  
ERIC STURDZA



## **Legal information**

This document intends to provide information and opinions on different matters. It is intended only for this purpose. This document does not constitute an advice, an offer nor a solicitation by Group Eric Sturdza or any of its affiliates, or on behalf of Group Eric Sturdza or any of its affiliates, to buy or sell any financial instrument or to subscribe to any financial instrument. This document does not contain any recommendation personal or generic and does not take into account the investment objectives, financial situation or needs, or knowledge and experience of any persons. This document does not contain any offer or any solicitation to purchase or subscribe to any financial services or to participate in any financial strategy in any jurisdiction. It does not constitute an advertisement or an investment recommendation or a research or strategy recommendation. Moreover, it is provided for informational and illustrative purposes only and does not contain financial analysis. This document mentions and presents benchmarks which may only be used for comparison. The information provided must not be relied on and must not be the only source to make a decision about financial investments. It is also not a legal or tax advice, or any recommendation about any kind of financial services and is not intended to constitute any kind of basis on which to make a decision on a financial investment. Group Eric Sturdza or any of its affiliates is not responsible and may not be held responsible for any loss arising from decision taken on the basis of the information provided in this document or for any liabilities arising from such decision. Although all due diligence has been performed to ensure that this information is accurate at the time of its publication, no guarantee is given regarding its accuracy, exhaustiveness or reliability. The information provided may change, even immediately after publication and there is no obligation to provide an up to date information at any time. Furthermore, the information provided in this document do not intend to provide all the legal and necessary information on financial instruments or on issuers. Other publications from Group Eric Sturdza or any of its affiliates may in the past or in the future reach different conclusions from the information contained in this document. Furthermore, the present document and the information provided do not in any way engage the responsibility of Group Eric Sturdza or any of its affiliates or its employees.

## **Information on risks**

Investments are subject to a variety of risks. Before taking any decision of investment or entering in any transaction, any investor should request detailed information on the risks associated with the decision of investment and with the financial investment. Some type of products are in general bearing higher risks than others but general rules cannot be relied on. It is remembered that past performance is not a reliable indication of future results and that historical returns and past performance as well as financial market scenarios are not reliable indicator of future performance, significant losses remaining always possible. The value of any investment depends also on the fact that the base currency of the portfolio is different from the currency of the investment subject to the foreign exchange rates. The exchange rates may fluctuate and adversely affect the value of the investment when it is realized and converted in the base currency of the portfolio.

## **Distribution information**

This document is not directed towards specified jurisdictions or toward specific person or entity resident in a specific jurisdiction and doesn't constitute any act of distribution, in jurisdiction where such publication or such distribution is contrary to the applicable law or regulation or would be contrary to any mandatory license requirement. This document is provided for the sole use of its recipient and must not be transferred to a third person or reproduced.

