



# MAXIMUM DANGER

We are confronted once again with the terrible specter that is war. At this very moment, Ukrainian freedom fighters are defending attacks from Russian forces across a vast front and apparently holding their own. As so often happens with war, what was supposed to happen—i.e. a lightning quick Russian victory—didn't happen at all.

This has to be the most dangerous moment in world history in a long, long time. There hasn't been uncertainty like this on the geopolitical stage since the fall of the Soviet Union in the late 1980's. Yeah, the Global War on Terror was dangerous but not like this. With Ukraine, there's just so much that could go wrong from here. One little mistake or misunderstanding and boom, we could all be at war.

Over the past few weeks, I've racked my brain trying to figure out what Putin is after with this move but it just doesn't make a lot of sense. Part of me thinks maybe it's true that he's just crazy. The only thing I can think that makes any sense is that Putin has determined for whatever

reason—presumably so that he can remain in power for life—that he is better off with a world that looks more like the bi-polar Cold War world. Because that's exactly what he's going to get.

The game theory on this is not that complicated. First of all, Putin had to know, from decades of Cold War precedent, that it was highly unlikely that the US and EU would respond militarily. We are all still very afraid of nuclear holocaust and rightly so. At the same time, he had to know that the US and the EU wouldn't just roll over. There's just no way to game theory this rationally and think the US in particular wouldn't respond somehow. Even the most casual study of history reveals that America is not a nation to be trifled with and makes for a most dangerous adversary.

Look, if Putin didn't expect sanctions, then God help us all. For that would mean he's not prepared to deal with the consequences of bi-polar economic isolation. And make no mistake about it, these sanctions are serious. The West

has unleashed the largest, coordinated economic attack against a country since WWII. Time will tell, but it could be damaging enough to the Russian economy to escalate into full-blown armed conflict. I'm guessing that Putin as thought this all through though. Maybe he underestimated the extent of the sanctions but I have to believe he knew they were coming.

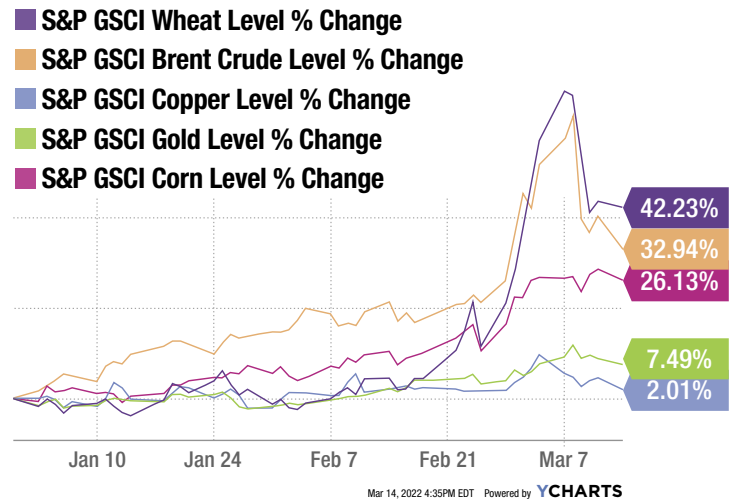
Now, I'm not sure exactly why Putin would think a Cold War world was better for him and the Russian people but I can kind of see a path. At the very least, if you want to be dictator for life, it's better to be closed off completely to pesky little things like democracy and freedom, especially from culturally related neighbors. Economically, I think the argument has something to do with the global coordinated move against hydrocarbon fuel and energy. If you are Russia, a low-carbon world doesn't look all that good. What would they have to trade if they cannot trade oil and gas? From the Russian perspective, the case for geopolitical inclusion certainly looks less compelling going forward.

Who knows? Maybe one day we'll find out what Putin is really after. For now, all we can do is theorize and look to the market for some clues. In some sense, the market response has been pretty predictable. Stocks are down. Volatility is up. Gold, oil, wheat and other commodities are ripping higher. The dollar is surging.

With crypto, something interesting has happened. In the early days of the conflict, crypto sold off with the rest of the market and basically looked like it was correlating with tech stocks. But then, as the sanctions came out and banks started closing, reports came in from both Russia and Ukraine that crypto was the only thing working. Immediately, crypto started trading higher and now has established a new, less correlated pattern. This moment of crisis appears to have proven one of the most important theoretical value propositions for the whole crypto movement!

To me, the market seems to be signaling that the go-forward world is going to look like a lot like the Cold War era. This is what got me thinking about the whole Putin motivation question in the first place. It's back to that Jungian idea of looking at the results of an action to infer the intent. Right now, it seems like we're going through the first phase of the transition: a dramatic, global reordering of supply chains

and trading patterns. This is why commodities are going through the roof:



There's going to be a lot of pain in this restructuring and a very damaging bout of inflation, probably enough to throw the world into a recession, but it's not necessarily all that bad for risk assets. The Cold War era was generally good for equities, at least outside of the Soviet Union.

I'm not really a believer in conspiracy theories but something struck me the other day that has me thinking and shaking my head. Regular readers will remember this but going into 2022 we talked a lot about how Central Banks were in an impossible situation. They had to somehow engineer a policy solution that would reduce the post-COVID inflationary pulse without destroying asset markets and the economy. Now they have this incredible out. They can just blame everything on the Russian invasion.

Anyway, I suspect the Fed won't even have to raise rates now. What I think is likely to happen is this: The market will continue to wobble. Inflation will rage. Consumer sentiment will fall and fall. And then, eventually, we'll have a recession and the inflationary pressure in the system will subside. If the market falls far enough, the Fed will cut rates back to zero, reintroduce QE and we'll be back to where we were in April of 2020.

If I'm right about all this, buying the dips is probably the move. That being said, this is a time for caution so tread carefully. □