

One Year and Counting: Assessing the Ongoing Market Impact of the Ukraine War

Speaker Key:

DP	David Pett
KM	Kevin McCreadie
GV	Greg Valliere
Gen. AL	Lt. General (ret'd) the Honourable Andrew Leslie

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00:00:06	DP	"Balloongate" has stolen the headlines this month, but the Ukraine war may still pose the biggest geopolitical risk to investors. In this episode of Inside Perspectives, Kevin McCreadie, AGF, CEO, and Chief Investment Officer, welcomes back Greg Valliere AGF's Chief US Policy Strategist, and special guest, General Andrew Leslie, to discuss the implications of a war that continues to rage with no end in sight. I'm your host, David Pett, let's get into it.
00:00:42		Welcome back, guys, good to see you again. Since the last time the four of us were together, you three have become rock stars of the investment community in Toronto. You guys are on the road doing these gigs. I hear you were at one last night. What was it like?
	KM	Ageing rockstars are back in vogue, David. We've been doing a lot of knowledge based sessions with advisors, which are great [?], really.
00:01:08		And the topics we're going to discuss today are prevalent and top of mind for everybody. So, we probably had a three hour dinner last night, where we discussed this in a more intimate setting, 40 people. But it was good dialogue, good conversation. Obviously, there's a lot of interest in these topics right now. Geopolitics is coming back to the fore, versus a year of dealing with the macroenvironment of central bank tightening and things of that nature, and now we're focused on the other things, maybe.

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	GV	There's so much uncertainty. People really want to get our view, because things aren't clear right now.
00:01:37	DP	Are you getting lots of autograph requests and things like that, or no? Do you get food? I think it was at a pretty nice, swanky steakhouse last night. Do you get a meal with this?
	KM	Yes, we get or we get to eat for our supper, sing for our supper, I should say.
	DP	There you go. So, you talked for what, a couple of hours, and then there are questions?
	KM	It's pretty interactive. It's a good format.
	DP	I'll have to check the tour dates, and maybe I'll catch the next one, when it happens. We are approaching the one year anniversary of the Ukraine war.
00:02:05		From my perspective, and from what I've read, I feel like things have maybe escalated a little bit, since the start of the year. There seems to be a bit more resolve from the standpoint of Ukraine's allies, Germany, Canada, the US, pitching in with tanks, in particular. General, what's your feel for where we're at in the war right now?
	Gen. AL	Well, as is often true in warfare, a lot can change in a month. So, a month ago, we were speaking about, essentially, a period of bloody, grinding stability, where you had relatively equal forces that were slowly trying to recoup their strength, both in people and equipment.
00:02:39		They had to get set for spring offences both ways, Ukraine into occupied territory in Russia, and try and block them and gain more. Well, things are actually not going well right now for the Ukraine. The bravery of their soldiers is unquestionable, as is their brilliance in doing so much with so few. But Russia has reverted to, essentially, World War One, World War Two tactics of human wave assaults, unsupported by heavy equipment, except for their own artillery fire, trying to swarm, and essentially, clamber over the

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		corpses of those who've been killed in front of them to get at the Ukraine soldiers.
00:03:13		The kill ratios are probably five, six, seven to one in the favour of the Ukraine. So, the Ukraine is literally killing hundreds of Russians every day, but they're not stopping. And where they're coming from, remember about three to four months ago, Putin announced that there would be a mobilisation of approximately 300,000, quote, new soldiers, most of whom were old or very young. And now they're starting to show up in the front lines. But instead of giving them time to train and prepare, Putin is coldly, ruthlessly using them, essentially, to soak up bullets, to expose the Ukrainian defenders in their prepared positions to the other forces that are watching, the Wagner mercenaries, or the more trained soldiers with more advanced weaponry, to pinpoint the Ukrainians and then target them.
00:03:55		And the Ukraine can't afford the blood loss that Russia can. Russia and Putin don't care about their soldiers. The President of the Ukraine cares deeply. And of course, if you look at the relative populations, this grind is now favouring Russia, and they're building up large concentrations of more of these poorly trained troops, and if they're going to do something, it will probably be within the next two weeks, so they have time to do some sort of offensive action, before the spring rains occur. So, it's building to a bit of a crescendo, which could be very dangerous for the Ukraine.
00:04:26	KM	So, General, one of the things, when we look at those ratios of casualties, and you're now looking at probably five different fronts on that Eastern flank, if you will, how long can Ukraine support this with manpower? They're a much smaller country, and you've lost a lot of folks who have left the country at the onset of the war. How long can this go on, before it gets into a place where it really becomes Ukraine losing the war?
00:04:52	Gen. AL	I would argue that right now, the Ukraine is the best combat experienced army in the world. So, they have done brilliant work. But even the best troops in the world, facing huge numbers of poorly trained enemies, can be overwhelmed. I'm not saying the Ukraine is at a position yet to be overwhelmed. As the months grind on, the Ukraine has got to augment its combat power with new equipment, which better protect their troops, ergo, the push

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		for tanks. Tanks provide a variety of things, firepower, protection, and mobility.
00:05:24		And all three of those things are in great demand. The first amongst them is protection, and you can do a lot with a whole bunch of tanks, much more so than you can with a whole bunch of dismounted infantry in the conditions that currently exist in the Ukraine. The big question is will the tanks get there in time? And what happens if they don't?
	GP	With this scenario of carnage that you describe, what about morale? Could morale start to erode, not just in the Ukraine, or not just in Russia, but in the West? Could morale begin to waver even in the US, in terms of funding aid to Ukraine, if the prospect is for this war to just continue on, and on, and on?
00:06:01	Gen. AL	Well, it's an excellent question to ask, because the results, my answer is a bit puzzling. The Russian troops that have really bad morale, they keep attacking. Now, there's evidence to show that right behind the lead Russian conscripts, there are professional soldiers with machine guns, who will shoot them, if they try to turn around and back off. But the Russians keep coming. Conversely, the Ukraine, who is facing savage conditions, and doing brilliantly, their morale is sky high, and they're performing in an exemplary fashion.
00:06:31		And you can see the cheerful enthusiasm with which they're dealing with what's going on. But underlying all of that is an air of exhaustion. Because those poor folks have been fighting the professionals amongst them since 2014. And the vast majority, they've been fighting really hard, nonstop since last February, so they're getting tired. The soldiers are getting tired, their equipment is tired, it needs replacement, and of course, the Russians know this, and they're willing to bleed them, even though they're paying much more in blood.
00:07:01	KM	So, we're in World War One trench warfare right now, sort of. We're about to move toward World War Two tank kind of warfare. Does this escalate to a place where what was armoured personnel carriers that became a request for tanks, that now is a request for F16 fighters? When does this dynamic start to change into a more

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		dangerous way? Because all of a sudden, that stuff made in the west starts to look like a western war against Russia.
00:07:28	Gen. AL	It does, and it's a very good analogy, which I have not heard used before of World War One, moving to World War Two, moving to contemporary warfare, and then who knows what else? The tank barrier has now been breached. If you recall, way back when, actually it was in late February of last year, Putin said okay, but not tanks and not fighters from the west into the Ukraine. Because they were trying to sort of establish some ground rules to prevent the trigger use of nuclear chemical weapons. Well, I think the West has had it in terms of the savagery of the Russian forces, ergo tanks.
00:08:02		And there's also a realisation that if they don't send tanks now, then they could arrive too late because of Russia's recent mobilisation efforts. And there's probably, deep down at the thinking levels of the strategic analysts in Washington, those who favour supporting the Ukraine, they better get as much stuff out the door and into Ukrainian hands, before there's a presidential election in the United States, because we're not quite sure which side is going to win.
00:08:28	GV	And I would just point out that Republicans, not all of them, but a minority of Republicans, which is enough to move legislation, are becoming dissatisfied with the amount of spending, not just on Ukraine, but on defence in general. And I think that there's a possibility that while we'll still give aid to Ukraine, it will be aid going up at a slower pace.
	KM	And then you fast forward, if we go back to what the General said, if this is a two year grind and you have a change in the White House, the west is aware [?], it's not just the White House, but Joe Biden is, essentially, the one making decisions, it feels like, for NATO.
00:09:03		It seems, over this past year, a European leader has not emerged to take the lead. If anything, it comes back to what Washington wants to do first, which in cajoling, gets others to do it. Whether it be armoured personnel carriers, now tanks, and maybe planes, but there seems to be lacking a true European leader in this fight. And if you lose Biden out of it and replace by a Republican, who may not have the same feelings for this, we may be getting to an

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		end game in the next two years that, after all of this, would be pretty hard for people.
00:09:33	GV	Speaking of endgame, if we could get into the head of Vladimir Putin. Zelenskyy seems to be pretty transparent. We know where he is, but is Putin so delusional that he doesn't realise what a debacle this has been for his country, with young man leaving Moscow and St Petersburg for Helsinki or wherever, fleeing the country? With his economy in bad shape, with, I've heard, as you have, over 100,000 casualties. What does Putin think? What is his end game?
00:10:01	Gen. AL	He has made a series of really bad, stupid decisions over the course of his career, but none more so than in the last little while. This is existential for Putin and his inner team of oligarchs, i.e., if they don't win, then there's probably a couple of tough, young successors who are eyeing their jobs, going hmm, I think it's time to arrange an accident for our beloved President Putin, and out of the window he goes. That's, perhaps, wishful thinking. In the short term, Putin has no intention of stopping.
00:10:28		The impact, though, of should it devolve down further and we get a Republican President, I'm not saying any of the potential candidates would think this way, but if the support to the Ukraine starts to waver, think of the impact on international stability, respect for peace and security, and also, the fact that this would encourage Russia to try it elsewhere. Don't forget, they've invaded about 15, 16 nations since 1944, so this is not a foreign concept to the Russian army.
	DP	We've talked, obviously, a lot about how the war is progressing. I want to get into the market implications of that.
00:11:01		But I did have a question. I wanted to go back to Kevin, you talked about the US leading the charge. But it strikes me that Germany has manned up, for lack of a better term, with respect to the tanks. Does that make an impact in terms of where this heads? The fact that Germany seems to be in on this?
	Gen. AL	An excellent point, because in the past, Germany was one of the most recalcitrant of nations, in terms of providing combat support. Canada as well. So, now that Germany has stepped up to the

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		plate and promised not only a bunch of Leopard 2s, but also, approximately 200 Leopard 1s, which is still a tank that's better than a T71, the Russian equivalent.
00:11:35		That is enormously heartening, and will probably set a fairly good example for some of the other holdbacks within NATO. It's also encouraging to see Germany getting more and more focused on the seriousness of what this means, not only to them in terms of their contributions to NATO, but their stability in their markets. Because, of course, as Kevin has pointed out many times in previous podcasts, Germany is like the engine room of the European economy.
00:12:03		And they need a bunch of stuff, which comes from all over Europe and the rest of the world. And if things don't go well with international peace and security, Germany has the highest price to pay.
	KM	You have to go back and remember, Olaf Shultz, if you go back to the [?] 80s, the current leader of Germany, he was on the bandwagon of demilitarising Europe and NATO, because he feared this conflict of building NATO to challenge Russia would end up this way. And so, this is a hard philosophical ground for a country that had vowed, after World War Two, never to rearm themselves again.
00:12:34		And now you see what a border looks like, Ukrainian driven, but German tanks, it probably feels a little bit too much for these guys, philosophically. But I do think there are differences between western Europe, which is a little bit removed from the front, to those in the eastern European countries, who think of themselves as potentially next in line, or closest to the battle. They want Washington in the middle of this [overtalking].
	DP	Countries like Poland?
	KM	Yes. They want Washington in the middle. They do not want Washington to leave.
00:13:01	DP	Let's maybe talk about the market implications of this. It's been a bit of a roller coaster for markets over the last year, with respect to how the Ukraine war has impacted them, an on and off, if you will.

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	KM	Sadly, as we talked about a year ago, beginning days of it, people didn't take this seriously and didn't pay much attention, and actually rallied when the Russians finally invaded, because they thought it would be over quick. The fact that the Ukrainians actually showed some real fighting spirit, that's when the market started to have some problems. And then it went into the back, and you get to May, it's no longer on the front page.
00:13:30		Things that markets got concerned with were when you had the grain embargo, and all of a sudden, you saw wheat prices skyrocket. When natural gas pipelines were cut off, whether it be sabotage on the Nord Stream pipelines, whatever, those have implications for the economy, that's when the markets will take notice. If you look at it, in its simplest phase, a year later, and we talked about sanctions, sanctions are not a sprint, they're a marathon. And if you think about it, Russia, a year later, has not suffered that poorly.
00:14:00		And so, the question is how much more will it take in a timeframe of a marathon before they start to suffer? If you look at just GDP in Russia, it's only down 4%. You take the case of the Ukraine, which is basically the area they've lost here, their industrial and agricultural heartland, their GDP is down 30%. So, if you think about even Russian oil, year-over-year, with all the sanctions and everything else, and now the price caps, which we can talk about, Russian oil is up in volume 2%. They've been able to sell it to the Chinese, the Turks, the Indians.
00:14:31		So, one would argue that economically, there's been massive pain here, and this is part of the reason why I think the Ukrainians can't just stop here. They have to get back what they've lost, if they have hope for an economic future, because it will be a massive rebuild. From a markets perspective, what they will care about will be the next escalation in this. If there are fighter planes that are given, if the Russians come back and now really say that this is NATO fighting them, that's what markets will care about. If the price caps on oil have not worked, as we've talked about, today it's a \$60 price cap, oil is trading the world markets mid-70.
00:15:03		That oil is going to India, it's getting refined, and coming right back to Europe. And so, we've tried a lot, but this is going to take time.

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		So, the markets are, like, put them over here. The things that will disrupt energy supply, as we get into the summer and refilling those storage tanks will probably cause nat gas to pop up again. And probably, if this escalates and the Russians cut off those grain exports, all of that has more economic implication. But I'd say the big one is the escalation of things.
	DP	Is that a tool still for Russia? Can they still use economic warfare? That's still a tool, is it?
00:15:35	KM	I think, from the west's standpoint, it's more of a tool. Thinking about cutting them off from resupply of parts and semiconductors. And so, that as they deplete things over time, they will have shortages of things, but they are trading with, again, China and India, and other places. So, this has not worked as effectively.
	GV	Speaking of weapons that Russia might use, what about these drones, General, with Iran? There's been a deal recently, where the Iranians are going to produce. Are they shoddy or are they of high quality? Can they be shot down?
00:16:04	Gen. AL	They're not breathtakingly new technology, but there are lots of them. They're cheaply made, and Iran takes a certain particular delight in exporting them to other countries in Europe to kill citizens. Iran, of course, is more than a failed state, it's a very dangerous state, in terms of its ruthlessness towards not only their own people, but everyone around them. And it's alarming, actually, it's quite disturbing that they're building a drone factory inside Russia.
00:16:31		It just makes you wonder what else Iran is receiving from Russia, in terms of payment, which could be downright destabilising, in terms of his implication for nation states that we're friendly with who are in the Middle East. But it's nothing new and nothing the Russians could not have done themselves. But quite frankly, it's faster, better, and cheaper to get Iranian technology and Iranian labourers inside Russia, building them.
	KM	Can I switch gears to another actor in this that we talked about a year ago, which was surprising to all of us?

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00:17:01		That India was not vocal in any way aligned with the west here. A year later, if anything, they have shown themselves to be closer to Russia on some of this.
	Gen. AL	I think India, strategically, has played it very carefully, and very India centric. And by the way, that's not a criticism. They have managed, in my opinion, to adequately balance the desires of the west for India to punish Russia, in the sense of supporting, or not negating, activities in a variety of UN and international organisations, which criticise Russia.
00:17:37		They are buying Russian oil, but Russia is certainly not making a terrible amount of money on that, though they are making some. And India's reselling that, as Greg has mentioned, to friends of ours in Europe and elsewhere. They are essentially neutral, but they are the world's third largest power. So, the good news is they haven't fallen on either side of the equation. What do I mean by that? Well, if they'd fallen in line with the US, that could tilt the balance of power, such that Russia and China would be pushed even more closely together.
00:18:09		And by the way, let's not forget that Russia and China have had fractious relations with India for a couple of thousand years. So, they're not natural allies, even though they have been a couple of times in the past. So, the good news is that India has not tipped heavily towards the US, which could have triggered something in Russia and China even more unpleasant than the war in Ukraine, and nor have they gone all in with Russia and China. So, hats off to them.
00:18:38	DP	That Russia China relationship, there have been periods over the last year where China has rebuked Russia a little bit, in terms of their stance. I'm just curious to know, they're together on this a little bit, though, still, right?
	Gen. AL	They are but I believe that China is willing to fight to the last Russian, which is a really uncomfortable spot for Russia to be in. Because if things go really badly, I think China would be ruthless in cutting Russia off at the knees, and saying you're on your own now, boys.

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00:19:10		So, yes, they're not allies, per se, but they're certainly strong and supportive in public pronouncements of eternal, lasting love and fraternity, and all the rest of that nonsense. This is geopolitics, and China's a tough player.
	DP	I would almost venture to guess that Xi is probably regretting his man hug and bromance of Putin at the Olympics last year right now a little bit. Things didn't go as planned. We've got a little bit more time, maybe I'll just go around the table. We've talked at length about Ukraine war, we've talked a little bit about China.
00:19:38		Is there anything out there in the geopolitical landscape that has you worried, or perhaps a little bit more enthusiastic, in terms of how it may impact markets over the next year?
	GV	Well, we've mentioned all the bad actors, except a bad one in North Korea. That's always going to be an irritant, I would assume, but probably nothing overt. In listening to the General last night and today, I come away with a conclusion, sadly, that this may drag on for quite some time, before it's resolved.
00:20:09	Gen. AL	The fog of war is thick in Europe right now. We're not quite sure what's going to happen, and that uncertainty is going to cause strategic unknowns and it's going to have, almost certainly, an impact on markets eventually. What duration and intensity, that's Kevin's, and he's very good at explaining that. As a strategist, looking at the key players, Putin will eventually leave, the sooner the better, probably through fatal applications.
00:20:34		His successor may be equally, or frighteningly enough, even better, in terms of organising violence in the Ukraine. So, don't bet on that being a solution. There are two other countries that I would recommend, or maybe three, that we watch. What happens in Germany, will they lose the current enthusiasm for supporting the Ukraine, as the economy gets further hit by market instabilities, and spare parts issues, and lack of productivity, and all that?
00:21:02		What will happen amongst the staunch support, or what will happen to the staunch support, that the United Kingdom, under Boris Johnson, gave to the Ukraine, if there's a sudden shuffle in government's, or even a change in government? And of course, the United Kingdom's economy, which is probably worthy of some

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		discussion, doesn't do as well as was originally planned? And what happens in France, as they face another series of presidential elections? Marine Le Pen is still out there, and she's tried two or three times.
00:21:30		She's certainly not my cup of tea, but she's essentially pro-Russian, and her numbers keep inching up. So, those are things to think of.
	KM	I think there's a weariness that's not just in the Ukraine, whether it be each of these governments, looking at what their COVID spend did to their fiscal budgets and the deficits that are being run in every one of these countries. And the longer this goes on, the wherewithal to finance this, whether it be in the US, and the fight that's coming over budget and defence spending, it's going to play out in Europe as well.
00:21:58		So, in some ways, there's a couple of end games that start to emerge, I think, or start to become apparent, as we move into this next phase, whether we call it the third phase, is that if probably, there's not a lot of progress made, I think it just gets harder for the west, and people start to look for off ramps. In some ways, Europe has got somewhat lucky with a very, very warm winter, so the fear of the freezing citizens of France and the UK hasn't occurred. We've also, surprisingly, been able to be very expedient about building liquid natural gas terminals faster than many people have thought.
00:22:32		So, the good news is, we start to move away from this dependency on Russia from an economic driver, maybe because of energy dependency, but it replaces it with this weariness to support it, if it goes to where the General started, this is a two year slog. I just can't see how the west, NATO, and NATO, in the beginning, had really coalesced, but nobody's stepped up and done their spending. And I think there's a lack of ability to continue to fight this from an economic battle.
00:23:01		For the markets, they will react, as the General said, when this escalates, when somebody gets desperate and does something. When a NATO made plane, tank, etc., fires into Russia, that escalates this, that will be a market negative. And I think that if

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		commodity prices are triggered, because of an event that causes disruptions in those, again, markets will take notice.
	GV	And I think the American electorate will take notice. And just to reinforce what Kevin said about a weariness, there's a weariness in Washington.
00:23:33		And a lot of American voters are saying we have to spend billions and billions more, we have our own problems here, in the US, that we need to address. So, I do think that this the support in the US and elsewhere is not indefinite.
	DP	Yes. And couple that with what the general said about Germany, it sounds like that's maybe a common thread for some of these countries in the west that are having to contemplate what to do next, in terms of the Ukraine war. Kevin, let me end it on one question.
00:24:00		With all of this geopolitical uncertainty that we're facing, and there seems to be more and more of it, how do investors manage through it? what's the secret sauce, from your perspective?
	KM	For us, it's taking a more cautious approach this year. The front and centre topic we've been talking about, away from geopolitics, is a different phase of what [?] central banks do. The aggressive tightening and surprise hikes that we saw last year are over. Now it's just this end game. Where are we going to be? When do we end? And it's coming pretty close. Canada has stopped for now. The US, probably somewhere late spring, early summer will pause, maybe a little later for Europe.
00:24:33		So, that part of it will now be a look back and wait and see what damage have we done? But you still, I think, have to be a little cautious here. Markets have extreme volatility priced into them right now, and part of it is economic. We're discounting the geopolitical, but I've seen, in my career, the geopolitical can create very, very tense reaction functions to the market. So, for us, I'd say be cautious. We're sitting on a little bit more cash than we normally would be. We have some hedges in our portfolio. We have inflation hedges in our portfolio.

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00:25:01		We have things that if things go a little bit sideways there, that will give us some lift. But I think you have to play through the fact that we are going to be in a very choppy period, certainly for the next six to nine months.
	DP	Let's end it there, guys. As always, fantastic stuff. True rock stars with me today. We'll see you next time. For a full transcript of today's episode, visit agf.com/podcast , and don't forget to subscribe to hear more from us at Apple Podcast, Spotify, Google Play Music, Stitcher, Podcast Attic, and Pocket Casts.
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