February 2022

Last Tuesday the S&P 500 closed in Correction territory, down 10.3% from its January 3rd all time high. Following the Russian invasion of Ukraine on Thursday, the tech heavy NASDAQ initially fell 3.5% into Bear territory, down over 20% from its all time high, but rallied to close up 3.3%, a historic swing, when the sanctions Biden announced against Russia were far less severe than threatened, or anticipated. From today's The Morning:

A surprising start

The initial days of the Ukrainian invasion have not gone well for Russia.

The Russian military has taken no major cities, and video from Ukraine has shown scorched Russian vehicles and dead soldiers. Contrary to what President Vladimir Putin and his aides apparently expected — and what many Westerners feared — Ukraine’s government did not fall within a matter of days.

But military experts caution against confusing a war’s initial days with its likely result. Russia has now begun to use even more brutal tactics, including a bombardment of a residential area in Kharkiv, Ukraine’s second-largest city, home to universities and long considered a center of national culture. ...

“We’re only in the opening days of this, and Putin has a lot of cards to play,” Douglas Lute, a former U.S. ambassador to NATO, told The Times. “It’s too early to be triumphalist, and there are a lot of Russian capabilities not employed yet.”

The Russian military has an established strategy for taking over hostile cities, one it has used in both Syria and Chechnya. The strategy revolves around firing missiles and bombs into residential neighborhoods, both to destroy infrastructure and to terrify civilians into fleeing, before advancing into the city on the ground, as my colleague Steven Erlanger explains.

Many analysts predict that Putin will take a similar approach in Ukraine, killing thousands of civilians to avoid a humiliating quagmire. “A big fear among U.S. military officials is that Russia, having suffered initial setbacks, will unleash a huge bombardment of missiles and airstrikes on not only Kyiv, but other cities where there’s serious resistance,” my colleague Eric Schmitt said. ...

Ukrainian troops and civilians continue to resist the invasion. “It’s amazing how citizens have fought back,” said Valerie Hopkins, a Times correspondent now in Kyiv. They have thrown Molotov cocktails, engaged Russian troops in street fights and even tried to repel Russian tanks with their bodies. ...

Ukrainians’ efforts to defend their country are having an effect. Russia has not yet won control of the airspace over Ukraine, and the Ukrainian military has been surprisingly successful at downing Russian planes and helicopters. “But American analysts have always said air defenses were one of Ukraine’s main vulnerabilities,” Eric added, “so we’ll see how long they can keep it up.”

The U.S. and its allies are also trying to help Ukraine — albeit without sending troops. Western European countries are sending ammunition, missiles and other equipment, while Turkey has sent drones that seem to have played a role in destroying Russian convoys. The U.S., E.U. and Britain — after initially imposing relatively cautious sanctions against Russia ... — have also become more aggressive in the last few days.

The ruble's rout

At the heart of those sanctions are measures to isolate Russian banks, including the country's central bank, effectively strangling the Russian economy by denying it cash.

Switzerland yesterday said it was departing from its usual policy of neutrality and freezing Russian assets in its banks, which many oligarchs use. The Biden administration, similarly, said that it was freezing the Russian central bank's assets in the U.S. "The move on the central bank is absolutely shocking in its sweeping wording," Adam Tooze, the director of the European Institute at Columbia University, told The Times. ...

There are early signs that the sanctions are having some of their intended effects. The ruble has lost about 20 percent of its value versus the euro since Sunday. Russian stocks have plummeted, too. (Except for pre-pandemic India, we have repeatedly advised against Emerging Markets investments, and Russia in particular.)

A declining currency reduces the buying power of Russian consumers and businesses, by making all foreign goods more expensive. The falling currency and stock prices also seem to be causing anxiety among many Russians. In some cities, customers have lined up at A.T.M.s, fearful that cash will run out. ...

Russia "got a bloody nose in the early days of the war," said Michael Kofman, a military expert at CNA, a think tank near Washington. "However, we are only at the beginning of this war, and much of the euphoric optimism about the way the first 96 hours have gone belies the situation on the ground and the reality that the worst may yet be to come."

From this morning's Signal:

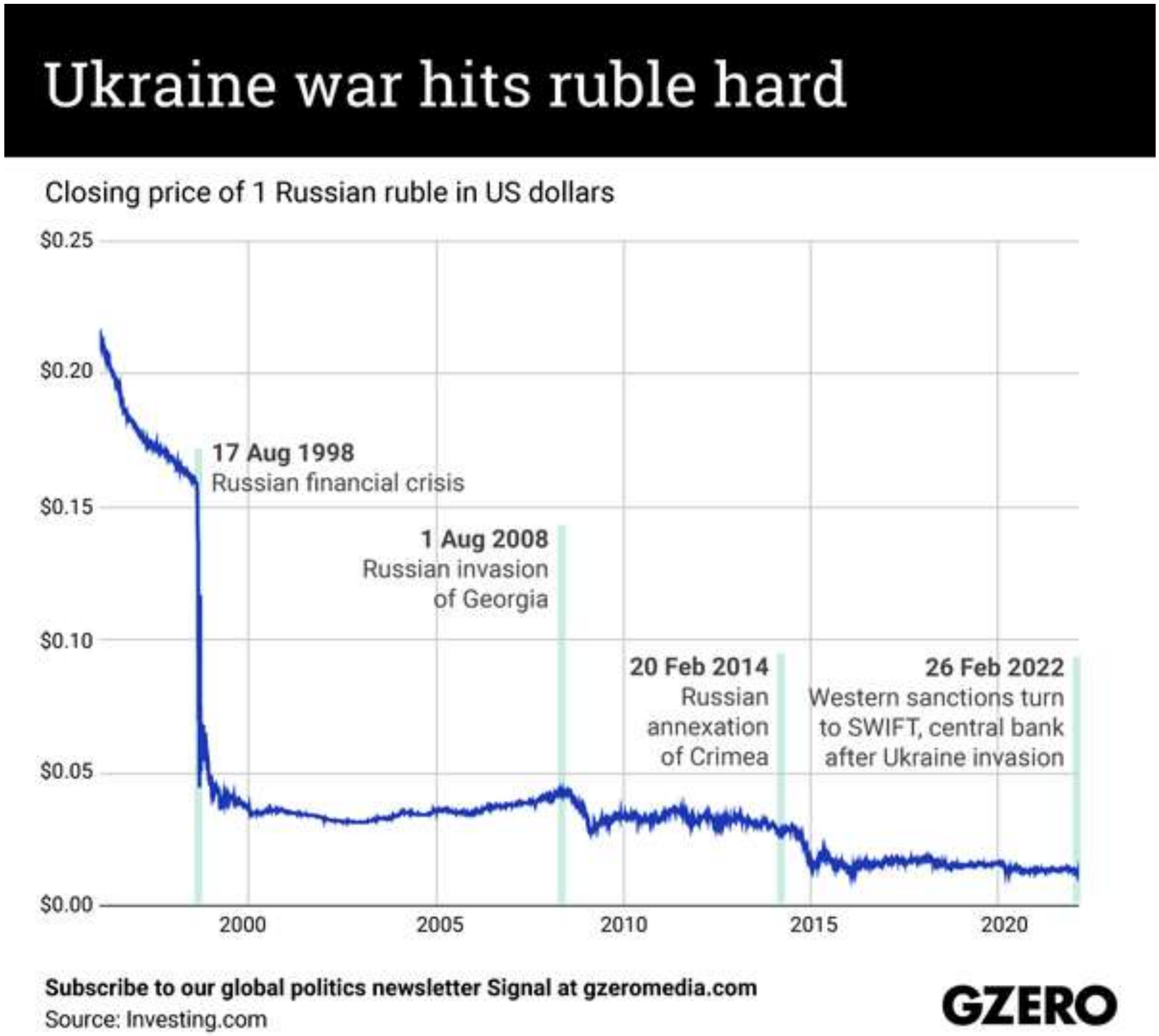
Russian and Ukrainian representatives met for "talks" in Belarus on Monday, but they left little hope for a swift resolution to the crisis. They also made only vague plans to continue negotiations soon.

Simultaneously, Russia ramped up its assault, shelling residential areas in Kharkiv, Ukraine's second-largest city ... and intensifying the air and ground attack on Kyiv. While Russian troops have faced tough pushback from Ukrainians, a nearly 40-mile-long convoy of Russian arms is reportedly en route to the capital, which the Pentagon now says Moscow is close to encircling. British intelligence also warned that Russia is upping its use of artillery around several cities, which could increase civilian casualties.

In Russia, people are already feeling the burn of international pariah status. The ruble crashed as much as 30% against the dollar on Monday, and Russia's stock market remained closed as the West imposed sanctions against the Russian Central Bank and other big lenders. Several cities in Russia saw mass bank runs as people feared losing access to their savings.

The dreaded refugee crisis, meanwhile, is fast becoming a reality. Half a million Ukrainians have already fled, with most going to neighboring Poland, as well as Hungary, Romania, Slovakia, and Moldova. These countries have rolled out the red carpet for Ukrainians ....

Russian President Vladimir Putin, for his part, appears increasingly agitated by how things are going in Ukraine, and some analysts warn that he appears to be recalibrating his military strategy, meaning things could soon get worse.



Russia’s currency nosedived on Monday, losing as much as 30% of its value against the US dollar after fresh allied sanctions targeted Russia’s central bank and key lenders. The ruble has suffered double-digit losses in a single day only twice before. Once during the 1998 Russian financial crisis, and again in late 2014 as a result of collapsing oil prices and Western sanctions over Russia’s annexation of Crimea. Here’s a look at how the ruble has fared over the past quarter-century.

Ian Bremmer's 10 min. Quick Take: https://www.gzeromedia.com/quick-take/the-us-is-at-war-with-russia-4-scenarios-from-here?utm_source=Eurasia+Group+Signal&utm_campaign=581151b333-EMAIL_CAMPAIGN_2022_03_01_12_07&utm_medium=email&utm_term=0_e605619869-581151b333-170115209

A banner headline again from today's WSJ:

Assault Intensifies as Talks End

BY YAROSLAV TROFIMOV

KYIV, Ukraine—Talks between Russia and Ukraine on a potential cease-fire ended with no deal as Moscow intensified its assault ....

The talks, on the fifth day of Russia's invasion of Ukraine, convened after Russian forces have struggled in most of the country, failing to take any major city amid fierce resistance, particularly around Kyiv. ...

Russia, facing battlefield difficulties and under mounting economic sanctions, appears to be preparing a possible escalation of its war. In an indication that Moscow might be shifting to a more destructive approach, two residential neighborhoods in Kharkiv, Ukraine's second-largest city, came under heavy shelling, likely by multiple rocket launchers. ...

After intelligence briefings Monday night, U.S. senators said Russia's focus is to encircle Kyiv, and the U.S. and its allies will be racing against the clock to get humanitarian aid and weapons into the country. ...

Russia's financial system has started to feel the impact of Western sanctions imposed over the weekend. The ruble nosedived and Russia's central bank raised its key interest rate to 20% to try to prevent an outflow of deposits from Russian banks as sanctions curb their access to international markets.

The U.S. and the European Union said over the weekend they would hinder Russia's central bank from using its foreign reserves and exclude a number of Russian banks from the international Swift payments network, among other measures. The EU also closed its airspace to all Russian planes. ...

On the front lines along the city's northern and western edges, soldiers were buoyed by recent victories. "The famed Russian special forces came here, and ran away so fast that they left us three vehicles as trophies," a Ukrainian trooper said as he readied to leave on a mission with a squad armed with sniper rifles.

In a sign that Russia doesn't have control of the skies, convoys carrying Ukrainian reinforcements rumbled in broad daylight through the city, including several long-range artillery pieces followed by truckloads of shells.

"On the fifth day of the full-scale Russian war against the people of Ukraine, we're standing firm," Mr. Zelensky said. "Every crime that the occupiers commit against us brings us closer and closer to each other. Russia never imagined that it would face such solidarity." ...

In recent days, Russian forces have cut off the main direct highway leading to the western city of Lviv from Kyiv, and on Monday continued to pour troops into that area, inching closer to the Ukrainian capital's remaining lifeline, the highway leading south to Odessa. Connections between Kyiv and Lviv have remained open via a detour and by train.

On Monday, Ukraine's railways operated additional evacuation trains from Kyiv free of charge, on top of the previously scheduled connections to Lviv and other western Ukrainian cities. A large proportion of Kyiv's population, which stood at three million people before the war began, has fled the city in the past five days. ...

Over 520,000 people have fled to neighboring countries and up to four million refugees could follow in coming weeks, the United Nations High Commissioner for Refugees said on Monday. ...

Russian troops have made considerable progress in southern Ukraine as they advanced from the Crimean Peninsula toward Kherson, Mykolaiv and Mariupol. Another offensive, stalled by Russia's failure to capture Kharkiv, pushed to link up with these troops from the north, aiming to encircle some of Ukraine's most capable forces that are deployed in Donbas. ...

The insistence that Putin must be irrational conflates rational with moral. He has clearly miscalculated, but that shouldn't excuse the West's failure to stand up to him. From the NYT:

Why Is Putin at War Again? Because He Keeps Winning.

Feb. 25, 2022

By Chris Miller

Mr. Miller is an assistant professor of international history at the Fletcher School at Tufts University and a co-director of the school's Russia and Eurasia program. He has written extensively about Russia and is the author of "Putinomics."

There is no world leader today with a better track record when it comes to using military power than President Vladimir V. Putin of Russia. Whether against Georgia in 2008, Ukraine in 2014 or in Syria since 2015, the Russian military has repeatedly converted battlefield successes into political victories. Russia's rearmament over the past decade and a half has been unmatched by a comparable increase in Western capabilities. So it is no surprise why Russia feels emboldened to use its military power while the West stands by.

Russia's past three wars are textbook examples of how to use military force in limited ways to achieve political goals. The invasion of Georgia in 2008 lasted five days but forced that country into humiliating political concessions. In Ukraine in 2014, regular Russian military units were deployed at scale for a few weeks, but this proved enough to force Kyiv to sign a painful peace deal. When Russia intervened in Syria in 2015, some Western analysts predicted a disaster along the lines of the Soviet invasion of Afghanistan, which began in 1979 and ended, after a decade of quagmire, in retreat. Instead, Syria's civil war served as a testing ground for Russia's most advanced weaponry.

For the past decade, Americans have come to believe that Russia's strength lies in hybrid tactics — cyberwarfare, misinformation campaigns, covert operations — and its ability to meddle in other countries' domestic politics. Yet as we have searched for Russian phantoms behind every misinformed Facebook post, Russia has replaced the poorly equipped army it inherited from the Soviet Union with a modern fighting force, featuring everything from new missiles to advanced electronic warfare systems. Today the threat to Europe's security is not hybrid warfare but hard power, visible in the cruise missiles that have struck across Ukraine.

"We are 50 percent-plus of global G.D.P.," Jake Sullivan, President Biden's national security adviser, argued recently, contrasting this to Russia's unimpressive 3 percent share of the world's economic output. However, economies don't fight wars; militaries do. America's economic power was tested when Mr. Biden threatened tough sanctions if Russia were to invade Ukraine; Mr. Putin did so anyway, betting that hard power would carry the day.

There's still no doubt that America's military has better trained troops and more capable systems in aggregate. However, what matters is not theoretical military matchups but the ability to use force for specific aims. Russia has developed precisely the capabilities needed to rebuild its influence in Eastern Europe. The United States, meanwhile, has watched its room for maneuver in the region steadily shrink, hemmed in by Russian antiaircraft systems and cyber- and electronic warfare threats.

Letting the military balance in Europe shift in Russia's favor was a choice. The United States has itself partly to blame. Even after Russia's first attacks on Ukraine in 2014, America's reinforcements on the continent were only enough to slow the rate of improvement in Russia's position. The Biden administration has presided over military spending cuts, after inflation is considered. America's roughly $700 billion defense budget may look impressive, but Russia has the advantage of paying less for troops' salaries and for domestically produced equipment. Adjusting for these differences, Russia's defense budget has grown far more rapidly than America's over the past two decades. European allies have even more to answer for: Germany and other European countries must wake up from the fantasy that peace is their birthright. They used to have serious fighting power. It is time to rebuild it.

It may be that, in trying to swallow all of Ukraine, Mr. Putin has finally overstepped. A long occupation of Ukraine would stretch Russia's capabilities, especially because its military advantages will be less significant if the conflict shifts into Ukraine's populous cities. However, we should not simply assume that Ukraine will become Mr. Putin's Afghanistan or his Iraq because other leaders have made their own errors. Mr. Putin could simply choose to destroy Ukraine and leave the West to pick up the pieces. Such a dismembered, dysfunctional Ukraine could well suit his interests. Russia's recent wars have been carefully calculated and limited in cost. There's no guarantee that this conflict won't be, too.

The U.S. strategy of making public intelligence about Russia's military buildup around Ukraine was clever, but Mr. Putin has called our bluff. It was once popular to mock the Russian president for his 19th-century worldview, but his use of military power to bolster Russia's influence has worked in the 21st century. The West's assumption that the arc of history naturally bends in its direction is looking naïve. So, too, is the decision to let our military advantage slip. Soft power and economic influence are fine capabilities to have, but they cannot stop Russian armor as it rolls toward Kyiv.

Ukrainian resistance, and massive demonstrations throughout the West appears to have given our leaders time to find their backbones. From Feb. 25th's Signal:

Biden SWIFTly avoids "nuclear" economic sanctions option. US President Joe Biden on Thursday announced fresh sanctions on Russia just hours after Vladimir Putin invaded Ukraine. Biden says the sanctions — which build on Tuesday's first wave by targeting more Russian banks and cutting Moscow off from the US financial system — will severely cripple Russia's economy. But the US president held back on booting Russia from the SWIFT global financial payments system, likely because some European nations need it to keep buying Russian natural gas. (Not the UK, whose PM Boris Johnson notably favored Russia's exclusion from SWIFT.) Meanwhile, some EU members are reportedly asking for exemptions to the sanctions: Italy wants to keep selling fashion items to wealthy Russians, and Belgium to continue sourcing Russian diamonds.

From the WP:

How Putin has fortified Russia against the West's sanctions

By Sebastian Mallaby

February 24, 2022

Now that Vladimir Putin is invading Ukraine, the West faces a test of a comfortable idea: that it can exercise power while making minimal sacrifices.

Three things have encouraged this appealing delusion. The West won the Cold War without having to fight the Soviet Union directly; the carnage was confined to proxy wars in poorer countries. The West has managed non-military challenges with relatively little sacrifice; the flu pandemic that began in 1918 killed 1 in every 150 U.S. citizens, many of them of prime age, whereas the coronavirus pandemic has killed around 1 in 500. On the flip side, where the West has accepted sacrifice, the payoff has been dismal. See: Iraq and Afghanistan.

Now, facing the Ukraine invasion, the United States and its allies are up against a dictator who imposes sacrifice on his people in the name of an antiquated, territorial vision of greatness. The West preemptively ruled out the option of matching force with force, arguing that Ukraine is not a member of NATO — never mind the fact that the security of NATO members bordering Ukraine will be undermined if Russia's invasion is successful. Instead, the West has bet on the idea that it can fight Russia with sanctions. But sanctions are not free. They, too, demand sacrifice.

Since the Ukraine crisis in 2014, Putin has shown a gritty understanding of this truth, while the West has done the opposite. As Matthew C. Klein observes in the Overshoot newsletter, Russia has used the past eight years to reduce its vulnerability to sanctions. The Russian people have accepted a drop in living standards, cutting their consumption of imports by more than a quarter. Russian businesses have paid off overseas creditors, reducing their foreign debt by one-third. The Russian state has tightened its belt, allowing it to build up its reserves of gold and foreign currency.

By embracing these sacrifices, Russia has fortified itself against the West's economic weapons. The central bank has a $630 billion rainy-day fund. Even if sanctions blocked 100 percent of Russian exports for an entire year, the country could continue to import at its current pace and have foreign-exchange reserves left over. President Biden's initial response to Putin's incursions was to bar U.S. investors from buying Russian bonds. But Russia has no need to borrow from Americans.

Meanwhile, how did the West prepare for today's crisis? Rather than reducing their exposure to Russian energy supplies, Europeans blithely *increased* it. In 2013, the European Union imported about 135 billion cubic meters of Russian natural gas; by 2019, the last year before the coronavirus pandemic distorted the numbers, it imported 166 billion cubic meters — a jump of almost a quarter. Russian coal exports to Europe have soared. Despite Europe's vaunted investments in wind and solar power, Russia's share of the E.U. energy market climbed from 16.5 percent to 18.5 percent in the years after the 2014 crisis.

This puts Europe's recent actions into their proper perspective. Amid great fanfare, Germany has (finally) frozen the certification process for the completed but not yet operational Nord Stream 2 pipeline, which was intended to double natural gas deliveries from Russia. This is the action of an alcoholic who, having already deepened his dependency, pledges not to supplement the regular evening delivery of whiskey with an additional one at lunchtime. Given its current import needs, Russia can survive just fine without the Nord Stream 2 project.

The United States and its allies have followed up with other sanctions. They have targeted Russian parliamentarians and Putin friends, but the dictator will probably shrug at this. They have hobbled most of Russia's banks, but Russian companies that want to do business in the West will find alternative financial partners. They have banned exports of certain tech products to Russia. This will hit home, but the effects will materialize slowly.

The sanction that would really count would be the suspension of Russia from the SWIFT system, through which banks exchange messages about payments. This would greatly complicate trade between the West and Russia, generating enough havoc to cause Putin genuine problems. Russia’s central bank might be bulging with reserves. But this money won’t be of much use if it cannot be used to buy imports.

For excellent and obvious reasons, the foreign minister of Ukraine and the three Baltic states have called upon the West to boot Russia from the SWIFT system. This weapon has been used before, against Iran in 2012 and again in 2018. But expelling Russia from SWIFT would cause an energy crisis in Europe, so Germany and its neighbors are opposed. For the moment, at least, they regard the sacrifice as unacceptable.

Of course, the West’s softness — its refusal to accept sacrifice — explains why Putin felt emboldened to invade Ukraine in the first place. Now, the West has to choose whether to ratify his calculation.

Sebastian Mallaby is the Paul A. Volcker senior fellow for international economics at the Council on Foreign Relations and a contributing columnist for The Washington Post. He is the author, most recently, of "The Power Law: Venture Capital and the Making of the New Future,” published in February 2022.

The consensus is that Biden has played a weak hand well. Plenty of blame, including Afghanistan, for the weak hand. From the front page of Saturday's WSJ:

How Western Allies Misjudged Putin

*By **Michael R. Gordon** in Washington, **Stephen Fidler** in London and **Alan Cullison** in Kyiv, Ukraine*

Western powers and their allies have lined up to oppose Russian President Vladimir Putin’s invasion of Ukraine. They can’t say he didn’t warn them.

Fifteen years ago, the former KGB officer railed against U.S. domination of global affairs and assailed the post-Cold War security order as a threat to his country. In the years that followed, he grabbed portions of Georgia, annexed Crimea and sent troops into Ukraine’s Donbas region.

Mr. Putin sent repeated signals that he intended to widen Russia’s sphere of influence and cast the North Atlantic Treaty Organization’s eastward expansion as an existential threat to Moscow’s security. He made plain he viewed Ukraine as part of Russia.

Yet until recently few Western leaders imagined Mr. Putin would go through with a full-scale invasion, having miscalculated his determination to use force—on a scale that recalls the Soviet invasion of Czechoslovakia in 1968—to restore Russian control over the nations on its periphery. ...

“It was strategic narcissism and an associated failure to consider the emotion, ideology, and aspiration that drives Putin and the Siloviki around him,” said H.R. McMaster, the retired three-star Army general who served as former U.S. President Donald Trump’s national security adviser, referring to the small circle of hard-line advisers around the Russian president.

Open disdain

Mr. Putin's all-out assault on Ukraine has put the West on its back foot, where it is now struggling to find ways to deter the Kremlin's aggression and to influence a Russian leader who has openly expressed disdain for the West and called into doubt its willingness to take decisive action.

The costs of the West's failure to deter Russia are now being borne by Ukraine, which for 14 years has existed in a strategic purgatory: marked for potential membership in the North Atlantic Treaty Organization but never admitted into the alliance and the security guarantees that it provided.

Longer term, the invasion has ruptured the already chilly relations between the Western alliance and Moscow.

When Mr. Putin's forces invaded Georgia in 2008 after it was promised eventual NATO membership, and recognized two breakaway areas, the West reacted by temporarily suspending dialogue, before returning to business as usual. Sanctions imposed after Russia's annexation of Crimea in 2014 also didn't bite.

In recent months, senior U.S. officials have laid out Mr. Putin's invasion plans. The misreading of Mr. Putin, however, cuts across multiple U.S. administrations.

Former President George W. Bush said he had looked into Mr. Putin's eyes and found him trustworthy. Former President Barack Obama dismissed Mr. Putin's Russia as a "regional power" threatening its neighbors out of weakness. Former President Donald Trump saw the U.S.'s European allies, and their reluctance to assume more of the burden for defense, as a bigger problem than putting the Kremlin on notice. President Biden sought to build a "stable, predictable" relationship with Mr. Putin with a summit meeting in June.

The attack exposes complacency in Europe, which allowed its military to shrink and did little to reduce its energy dependency on Russia, despite Moscow's increasingly aggressive behavior, which included cyberattacks on Western targets. Even as the West imposes sanctions on Russia, it is sending hundreds of millions of dollars daily to pay for Russian gas.

Western leaders took comfort in the limited nature of Mr. Putin's earlier military interventions. Those were considered deniable, smaller-scale operations that sought to mask the extent of Russia's role. Russian actions also included hacks on the Democratic National Committee in 2016 and cyber attacks on its neighbors. The U.S. and its allies neither marshaled the military and economic leverage to forestall his invasion of Ukraine nor presented a major diplomatic concession, such as halting NATO expansion.

"The West did not underestimate Russia's military capabilities. It watched the determined military modernization program since the Georgian war in 2008, and saw some of its fruits in the militarily successful intervention in Syria in 2015," said William Courtney, the former U.S. ambassador to Georgia and Kazakhstan during the Clinton administration. "But the West may (?) have underestimated the Kremlin's willingness to use force in Europe, and against a people which Putin claims are one with Russians."

Mr. Putin's early cooperation with the West morphed into animosity over his two decades in power. The Russia he inherited had a broken bureaucracy and an economy the size of Belgium. Now he oversees a government and military fueled by years of high energy prices.

When Mr. Putin became president in 1999, he cut a very different figure from his predecessor, Boris Yelstin. Mr. Yeltsin had a jovial, backslapping relationship in public with former President Bill Clinton. Mr. Putin was a closed book.

By the time Mr. Putin came to power—via the KGB and local politics in his native Saint Petersburg—Russia was inside the Group of Eight and was being consulted by NATO although staying outside the alliance.

International scene

In his early exchanges with Western leaders and new on the international scene, Mr. Putin appeared respectful.

Mr. Bush attempted to build a personal relationship with him. In their first meeting at a summit in Slovenia in June 2001, Mr. Bush said: "I looked the man in the eye and found him very straightforward and trustworthy… I was able to get a sense of his soul. He's a man who's deeply committed to his country and the best interests of his country."

After the Sept. 11 attacks, Mr. Putin was the first foreign leader to call Mr. Bush to offer condolences and cooperation in fighting terrorism.

He offered intelligence and logistical support to the U.S. as it invaded Afghanistan, over the heads of some in Russia's military establishment. Michael McFaul, who would later become an adviser to the Obama administration at the time praised the relationship as "another chance to really end the Cold War."

Thomas Graham, the senior National Security Council official for Russia affairs in the Bush administration, said that the U.S.-led invasion of Iraq was the first of several events that Mr. Putin would have objected to if Russia carried more sway.

"Putin didn't believe in these things but didn't see much point in opposing them because the West was going to do them anyway," Mr. Graham said. "He told people that he was not going to oppose them publicly because it would just make him look bad."

Mr. Putin's suspicions toward the West became more pronounced with the so-called colored revolutions beginning in 2004 that toppled leaders of former Soviet states, and later with the Arab Spring.

NATO had meanwhile continued its expansion to Eastern European countries that had been in the Soviet-aligned Warsaw Pact in 1999 and then in 2004, when the alliance was also enlarged to cover the three Baltic states that had been part of the Soviet Union. The U.S. and its allies saw enlargement as a way to encourage reform in the newly emerging democracies. NATO's new members were looking to sit under the U.S. security umbrella should Russia threaten to absorb them again.

Railed against NATO

Mr. Putin's anger over enlargement became clear in a speech he made at the annual Munich Security Conference in 2007, where he surprised his audience as he railed against the unipolar world dominated by the U.S. There he laid out his grievances against NATO expansion, leveling allegations of broken promises from the West that NATO wouldn't shift eastward and depicting enlargement as a threat to Russia.

Enlargement "represents a serious provocation that reduces the level of mutual trust. And we have the right to ask: Against whom is this expansion intended?" he said.

Tensions ratcheted up further a year later. Mr. Putin was invited to a NATO summit in Bucharest, where leaders were discussing a route into the alliance for Georgia and Ukraine. While Mr. Bush wanted the countries to be admitted in short order, France and Germany opposed the move.

In the end, a compromise allowed Georgia and Ukraine to eventually be admitted but with no date set.

The outcome turned out to be the worst of both worlds for the two countries. Hard-liners in Moscow had identified them as potential future adversaries—but ones that weren't yet protected by the alliance's security guarantees. "They got the hot breath of Russia on their necks while they didn't get NATO membership," said Jamie Shea, a senior NATO official at the time.

While in Bucharest, in a meeting with Mr. Bush, Mr. Putin told him that Ukraine wasn't a real country, according to Western officials.

In August that year, Mr. Putin invaded Georgia, routing a U.S.-trained Georgian military. Western experts say that Russia learned from the military mishaps in that incursion and subsequently upgraded its equipment and shifted toward a professional, rather than a conscript, army.

Slighted by U.S.

When Mr. Obama visited Russia in 2009, he met Mr. Putin at his dacha. There, according to a memoir by the U.S. president, he received an "animated and seemingly endless monologue" on the slights Mr. Putin felt the U.S. had made, including expanding NATO and invading Iraq.

After Russian forces seized Crimea from Ukraine in 2014, Mr. Obama dismissed the development as the actions of a "regional power that is threatening some of its immediate neighbors, not out of strength but out of weakness." The following year, after Russian forces intervened in Syria on President Bashar al-Assad's behalf, U.S. officials played down the significance, saying it might even lead to a Russian quagmire.

Successive U.S. presidents sought to keep the possibility for cooperation amid the differences. Mr. Shea, the former NATO official, said in retrospect that the West should have acted earlier and more firmly.

"We should have imposed in my opinion the sanctions on Russia that we are imposing today either in 2008 or 2014, because then Putin might have got the message that the West would react vigorously and might have been deterred," Mr. Shea said.

Ukrainian President Volodymyr Zelensky, days before Russia launched war on his country, likened the West's posture toward Russia to the mistakes of appeasement in the 20th century. He criticized Western nations for not imposing sanctions earlier. "What are you waiting for?" he said. "We don't need sanctions after the bombardment begins."

So what are the investment implications? From this morning's Global Investment Strategy Special Alert:

A New Cold War

False Dawn

In the lead-up to the invasion, Vladimir Putin assumed that Ukrainian forces would fold just as quickly as US-backed Afghan forces did last summer. He also presumed that the rest of the world would reluctantly accept Russia's takeover of Ukraine. Both assumptions appear to have been proven wrong.

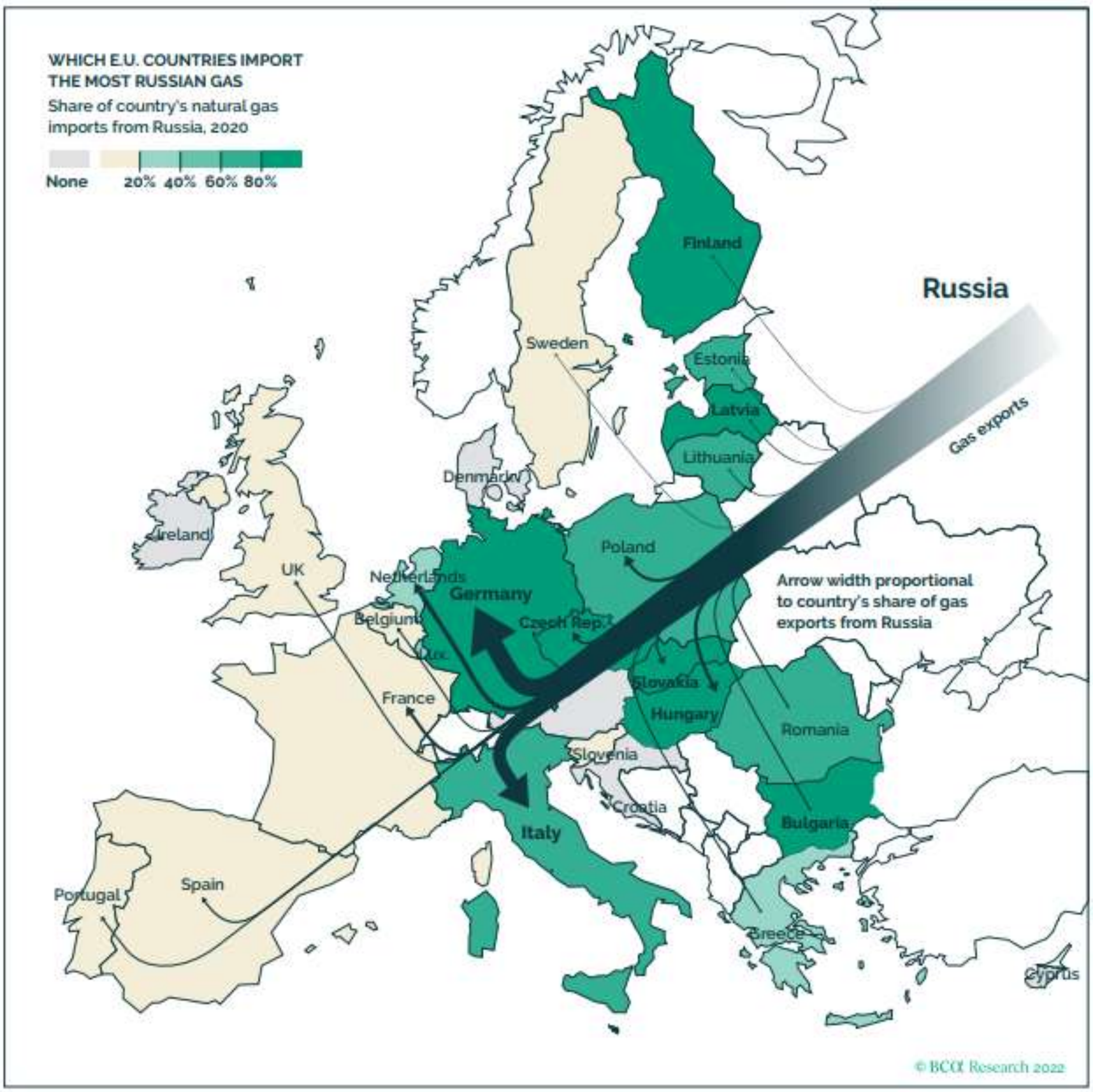
Even if Putin succeeds in installing a puppet government in Kyiv, a protracted insurgency is sure to follow. In the initial days of the invasion, Russian troops generally tried to avoid harming civilians, partly in the hope that Ukrainians would see the Russian military as liberators. Now that this hope has been dashed, a more brutal offensive could unfold. This would trigger even more sanctions, leading to a wider gulf between Russia and the West.

It is highly doubtful that sanctions will dissuade Putin from trying to subdue Ukraine. Putin made a name for himself by staging a successful invasion of Chechnya in 1999, just three years after the Yeltsin government had suffered a major defeat there. To withdraw from Ukraine now, without having fomented a regime change in Kyiv, would be a humiliating outcome for him.

In this light, BCA's geopolitical team, led by Matt Gertken, has argued that ongoing peace talks taking place on the border of Ukraine and Belarus are unlikely to amount to much. The situation will get worse before it gets

CHART 1

Central and Eastern Europe Would Suffer The Most From A Russian Energy Blockade



SOURCE: JOSH HOLDER, KARL RUSSELL, AND STANLEY REED, "HOW A UKRAINE CONFLICT COULD RESHAPE EUROPE'S RELIANCE ON RUSSIA," *THE NEW YORK TIMES*, FEBRUARY 15, 2022.

better.

Market Implications

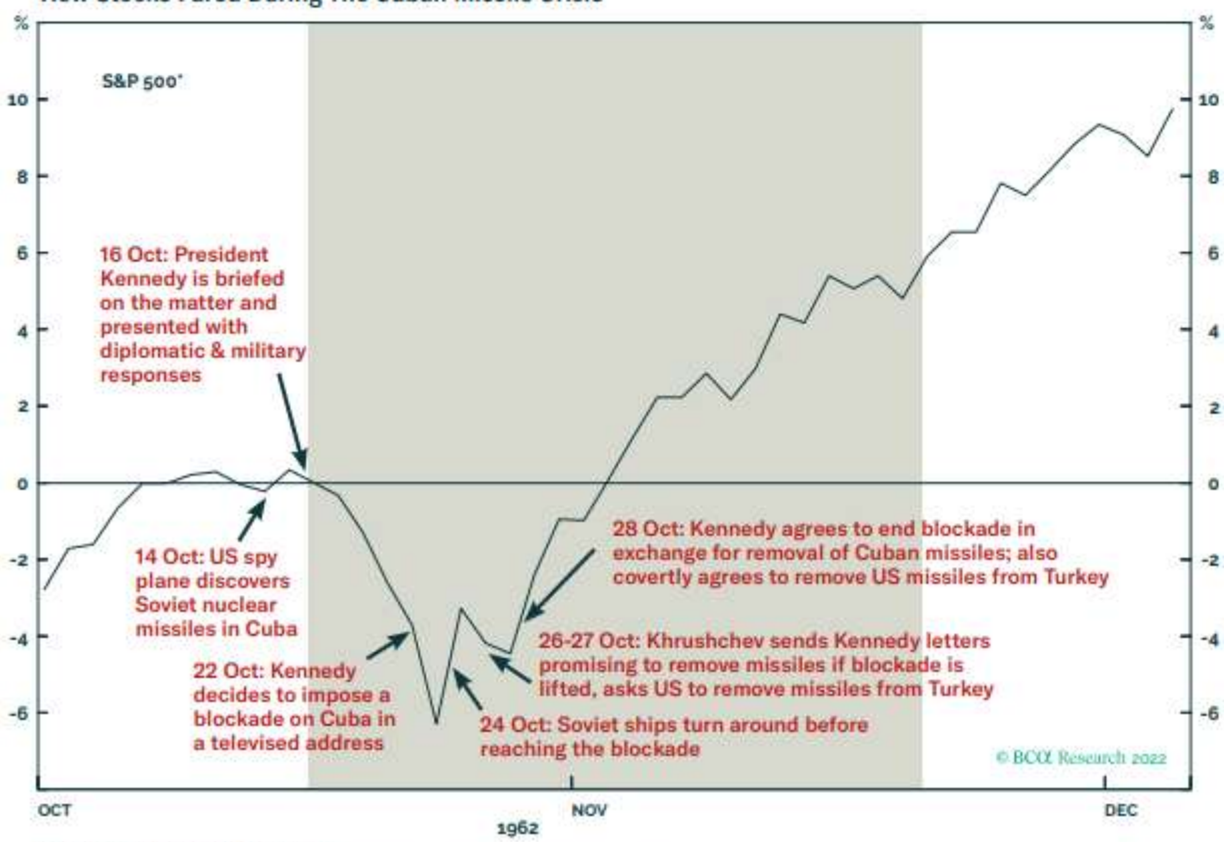
It always feels a bit crass writing about finance during times like this, but as investment strategists, it is our job to do so. With that in mind, we would make the following observations:

• Global equities are likely to suffer another leg down in the near term as hopes of an imminent peace deal fizzle. Consequently, we are downgrading our view on global stocks from overweight to neutral on a 3-month horizon. Nimble investors with a low risk tolerance should consider going underweight equities.

• We are shifting our stance on US stocks from underweight to neutral on a 3-month horizon. Europe could face significant pressures from near-term disruptions to Russian gas supplies. It does not make much sense for Russia to export gas if it is effectively barred from accessing the proceeds of its sales. Central and Eastern Europe will be particularly hard hit (**Chart 1**).

• For now, we are maintaining an overweight to stocks on a 12-month horizon. While it will take a month or two, both sides will ultimately forge an understanding whereby Russia and the West continue to publicly bad-mouth each other while still pursuing mutually beneficial arrangements. Remember that during the Cold War, the Soviet Union continued to sell oil to the West. Even the Cuban Missile Crisis had only a fleeting impact on equities (**Chart 2**).

CHART 2
How Stocks Fared During The Cuban Missile Crisis



* REBASED TO OCTOBER 16, 1962 = 0%.
NOTE: SHADING REPRESENTS THE START OF THE CRISIS UNTIL THE END OF THE NAVAL BLOCKADE ON CUBA.

Assuming that any reduction in Russian energy exports is temporary, oil prices will eventually recede. BCA's commodities team, led by Bob Ryan, expects Brent to settle to $85/bbl by the end of 2022 (down from the current spot price of $101/bbl and slightly below the forward price of $87/bbl). Like oil, gold prices have upside in the near term but should edge lower once the dust settles.

• Global growth should remain solidly above trend in 2022 as pandemic-related headwinds fade and fiscal policy turns more expansionary. Even before the Ukraine invasion, the structural primary budget deficit in Europe was set to swing from a small surplus to a deficit. The emerging new world order will lead to sizable additional military spending, as well as increased outlays towards achieving energy independence (new LNG terminals, more investment in renewables, and perhaps even some steps towards restarting nuclear power programs).

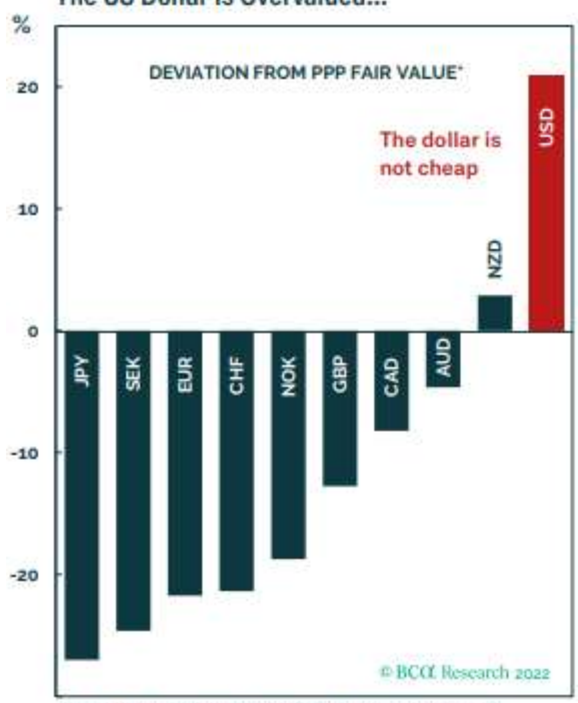
• China will also step up credit easing and fiscal stimulus. This will not only benefit the Chinese economy, but it will also provide some much-needed support to European exporters. ...

• Central banks will temper their plans to raise rates in the near term. Investors and speculators are net short duration at the moment, which could amplify any downward move in bond yields. However, over a multi-year horizon, recent events will lead to both higher inflation and interest rates. Larger budget deficits will sap global savings. The retreat from globalization will also put upward pressure on wages and prices.

• As defensive currencies, the US dollar and the Japanese yen will strengthen in the near term as the conflict in Ukraine escalates.

• Looking beyond the next few months, the dollar will weaken. On a purchasing power parity basis, the dollar is amongst the most expensive currencies (**Chart 7**). For example, relative to the euro, the dollar is 22% overvalued. The US trade deficit has doubled since the start of the pandemic, even as equity inflows have dipped. Speculators are long the greenback, which raises the risk of an eventual reversal in dollar sentiment.

CHART 7
The US Dollar Is Overvalued...



* OUR FOREIGN EXCHANGE STRATEGY PPP MODEL IS BASED ON RELATIVE PRICE RATIOS AGGREGATED USING FIVE GROUPS IN THE CPI BASKET WITH CUSTOM WEIGHTS. PLEASE REFER TO THE FOREIGN EXCHANGE STRATEGY AUGUST 23, 2019 SPECIAL REPORT TITLED 'A FRESH LOOK AT PURCHASING POWER PARITY' FOR FURTHER DETAILS.

• The freezing of Russia's foreign exchange reserves will encourage China to diversify away from US dollars towards hard assets such as land and infrastructure in economies where they are less likely to be seized. It will also encourage the Chinese authorities to bolster domestic demand and permit a further modest appreciation of the RMB since these two steps will reduce the current account surpluses that make foreign exchange accumulation necessary. ...

In summary, the near-term outlook for risk assets has deteriorated. We are downgrading global equities from overweight to neutral on a tactical 3-month horizon. We continue to expect stocks to outperform bonds on a 12-month horizon as the global economic recovery gains momentum. On an even longer 2-to-5-year horizon, equities are likely to struggle as interest rates rise more than expected. ...

Follow-ups

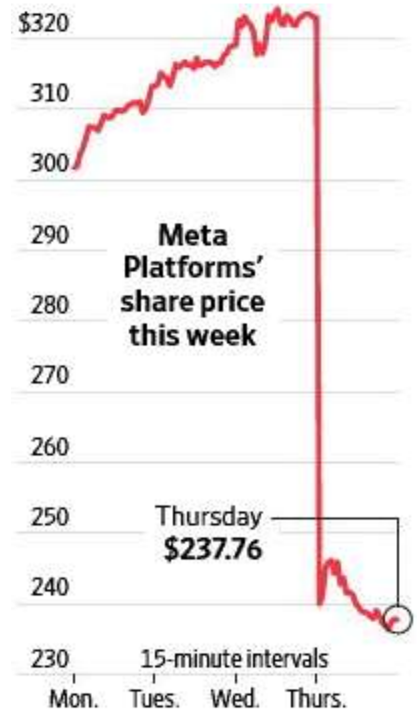
From the front page of February 4th's WSJ:

Meta's Plunge Rattles Lofty Tech Shares

Stocks 'priced way beyond perfection' face scrutiny; Facebook parent has record fall

BY KAREN LANGLEY

Facebook's parent company shed more than $230 billion in market value Thursday, a one-day loss that is the biggest ever for a U.S. company and increases pressure on a stock market long powered by technology shares. Meta Platforms (formerly known as Facebook) gave a disappointing financial forecast, helping the major indexes snap a four-session winning streak. The tech-heavy Nasdaq Composite index dropped 3.7%, its worst day since September 2020, while the S& P 500 fell 2.4%.



Source: FactSet

PayPal Holdings and Spotify Technology also spooked investors in recent days, when the payments giant lowered its 2022 profit outlook and the streaming company elected not to provide annual guidance. Both companies suffered sharp drops in their stock prices.

The setbacks reflect the increased scrutiny companies are under as ... the Federal Reserve is preparing to raise interest rates for the first time since 2018. Rising rates tend to reduce the multiples that investors are willing to pay for a share of company profits, a trend that stands to mean pain for stocks that are trading at lofty valuations. That has put heightened pressure on the companies to show their financial results justify their price tags. In recent days, several have fallen short, raising concerns among investors that further declines in major indexes could lie ahead. ...

The Facebook parent company surprised investors with a deeper-than-expected decline in profit and a downbeat outlook. The company said it expects revenue growth to slow and shared that it lost about one million daily users globally. Shares declined 26%, their worst daily performance since they started trading in 2012.

The company's challenges include a new ad-privacy policy from Apple that Meta expects to cost it more than $10 billion in lost sales for 2022. The requirement that apps ask users whether they want to be tracked limited the ability to gather data used to target digital ads, driving advertisers to change their spending.

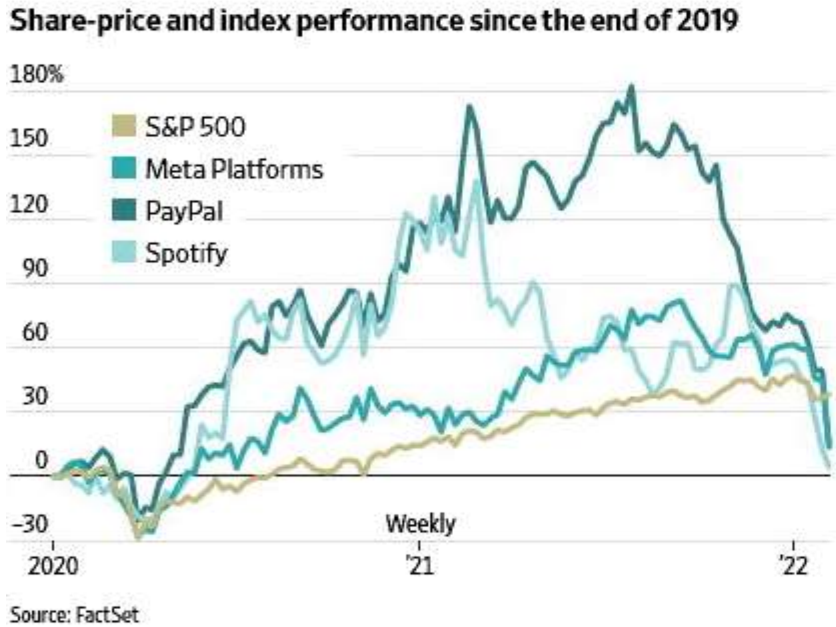
Meta's $232 billion drop in market value exceeds the record that Apple set in September 2020 when the iPhone maker lost about $182 billion in a single day, according to Dow Jones Market Data. ...

Earnings season had been overshadowed until recent days as investors fretted over the Fed's plans to raise rates. They sold stocks across sectors, helping to send the S& P 500 down 5.3% in January, its worst monthly performance since the March 2020 slump.

Results out of the tech segment haven't been all bad. Google parent Alphabet reported robust sales growth and unveiled plans for a stock split this week, helping the company add more than $135 billion in market value

Wednesday. And Amazon.com said after Thursday's closing bell that profits nearly doubled in the holiday period, helping send its shares up about 15% in late trading.

Shares of Snap Inc. and Pinterest also got a big bump after hours. Snap posted its first quarterly profit, and Pinterest said it expects first-quarter revenue to grow sharply. All three stocks had declined in the regular session ahead of the reports.



Meta, PayPal and Spotify entered 2022 at rich valuations. While the S& P 500 ended December trading at 21.5 times its projected earnings over the next 12 months, Meta was trading at 23.6 times, PayPal at 36 times and Spotify at 543.9 times, according to FactSet. Spotify isn't an index constituent. By Thursday, Meta's multiple had pulled back to 18 times forward earnings, while PayPal traded at 25.6 times. Spotify, meanwhile, traded at 666.2 times, after analysts cut their earnings forecasts. ...

PayPal lowered its profit outlook for 2022 and abandoned a target it set last year of roughly doubling its active user base. Executives said business this year will be pressured by forces including inflation, supply-chain problems, the Omicron variant and the runoff in government stimulus. Shares slumped 25% Wednesday in their worst selloff on record and continued sliding Thursday.

And Spotify, which is embroiled in a controversy over Joe Rogan's podcast, said it added users but declined to give annual guidance, pulling shares down 17% on Thursday.

Broadly, the corporate earnings season has surpassed expectations. With results in from about half the constituents of the S& P 500, analysts estimate that profits from index constituents rose 29% in the holiday quarter from a year earlier, according to FactSet. That is up from forecasts for 21% growth at the end of September.

Positions

The last individual stock we bought for clients was BCOR on 12/20 @ 16.39. It closed yesterday @ 19.90. There still hasn't been an IVE System Pick since, despite the current Correction. We continue to hold off on deploying the cash that has accumulated in, and been added to, accounts in equity funds for clients that invest in Funds only.

BIMBX - We have added a secondary objective of Capital Preservation for 2 existing clients, adding this OEF with a Risk Ratio relative to the S&P 500 of 0.2 for 1 of them on 2/7 @ 10.30. Morningstar's chart compares its performance since inception to BILPX, a BlackRock Event Driven OEF with a Risk Ratio of 0.4, that we are currently using for another client to reduce volatility:

BlackRock Systematic Multi-Strat Instl BIMBX ★★★★ Bronze

NAV / 1-Day Return	Total Assets	Adj. Expense Ratio	Expense Ratio	Fee Level	Longest Manager Tenure
10.30 / ↓0.29 %	8.5 Bil	0.980%	0.980%	Low	6.73 years
Category	**Alt Style Correlation / Relative Volatility**	**Min. Initial Investment**	**Status**	**TTM Yield**	**Turnover**
Multistrategy	High / Low	2,000,000	Open	1.73%	503%

A well-balanced multistrategy that aims to provide downside protection.

Summary | by Bobby Blue Jul 15, 2021

A well-structured, experienced team oversees BlackRock Systematic Multi-Strategy, designing a resilient portfolio that has excelled in varied market environments. Its three cheapest share classes retain their Morningstar Analyst Rating of Bronze, with the most expensive share class rated Neutral.

Lead manager Tom Parker leans on more than 40 years' worth of industry experience, with the last decade spent managing BlackRock's largest hedge fund, Fixed Income Global Alpha (FIGA). It shares many elements with this offering, with the strong long-term record being generated by the same 63-person investment team. Recent churn, including the loss of the group's head of macro investing in both 2018 and 2020, introduces some uncertainty, but the strategy remains in proven and experienced hands.

The core of this strategy is a long-only, multisector fixed-income sleeve, with an allocation of roughly 50% of the strategy's risk budget. This systematic strategy aims to provide credit exposure with less downside risk than pure high yield. It has been successful at that objective owing to cautious credit selection; its worst monthly loss of 5.3% is nearly half the Bloomberg Barclays US High Yield Index's worst loss of 11.5% over the fund's lifetime. Complementing that sleeve are two offsetting sleeves; a market-neutral equity component that skews toward companies with solid balance sheets that should perform well in credit sell-offs, and a global macro strategy that seeks to benefit from periods of interest-rate volatility. Each of these sleeves use strategies that are adopted from FIGA but with a lower use of leverage. This has led to lower portfolio volatility but has also damped returns from those strategies, particularly in the macro sleeve.

The team constructed these strategies to perform well during credit sell-offs (when the fixed-income sleeve will lag), which leads to a well-balanced return stream across different market environments. Its 4.9% annualized return from its June 2015 inception through June 2021 is in the top decile of category peers, and its 0.97 Sharpe ratio is best in the category.

Process Above Average

The managers here combine three complementary portfolios to create a multistrategy fund that can withstand varying market environments. Its design, which leads to balanced returns from each sleeve, drives an Above Average Process rating.

The core of this strategy is a long-only, multisector fixed-income sleeve that receives a 50% risk allocation. A top-down, economic regime-focused model drives sector allocations, and then a bottom-up credit selection model picks individual credit. The remaining 50% of the portfolio's risk budget is split between an equity market-neutral strategy and a global macro sleeve. Each complement the fixed-income sleeve; the equity sleeve takes a credit lens to find companies with strong balance sheets that should perform well in periods that the fixed-income lags, and the macro sleeve benefits during volatility.

Both the macro and the equity market-neutral sleeve borrow elements from BlackRock Fixed-Income Global Alpha, a hedge fund that Parker and team have managed since 2004. Strategies like the team's stock-selection model can easily be run in each vehicle, but others--like those employed in the macro sleeve--have been harder to port over because of leverage constraints in the mutual fund, which has led to only middling returns. A bolstered macro sleeve with strategies adapted to the mutual fund format would improve this already strong option.

The allocations to the three substrategies remains consistent over time, but the substrategies themselves are quite active. The fixed-income sleeve allocates to investment-grade and high-yield corporate debt, securitized credit, dividend equities, and U.S. Treasuries. Depending on the team's read of the macro environment--which it breaks into five different regimes that broadly define investor's risk appetite--allocations move between more-aggressive high-yield securities and more-conservative mortgage-backed securities and investment-grade bonds. A 10% allocation to high-yield debt in March 2020 was near its historical low point and reflected the team's cautious view then, but it had been drifting lower since September 2019. This allocation has gotten as high as 27% in August 2018, when the team saw strong demand for risky assets.

The market-neutral equity sleeve invests in firms with strong balance sheets and sells short those with poor credit fundamentals, creating a portfolio that the team expects will perform well in credit drawdowns while limiting sector and factor bets. The macro sleeve takes relative-value positions in global interest rates and market indexes, which are often slight arbitrage opportunities. The diminutive nature of these trades means leverage is often needed to drive meaningful returns during periods of low volatility, which the team is reluctant to use here because of its perception of the market's risk appetite.

People Above Average

Lead manager Tom Parker has extensive experience developing systematic fixed-income and alternative strategies and receives ample support from over 60 investment professionals. This drives an Above Average People rating.

Parker has led this strategy since its 2015 inception, though he has held leadership roles on the systematic fixed-income team for over a decade. Comanagers Scott Radell and Jeff Rosenberg work with him to manage the expansive team, which includes 63 investment professionals. They are spread across six distinct teams that research and construct the underlying strategies, like macro, credit, and relative value. Those teams in turn are led by a sector head, who drives the team's research and implementation agenda. The team structure is well-designed, with each lead possessing over a decade's worth of experience at BlackRock, enabling consistency.

This experience can be coveted by rivals; in 2018, six team members including deputy CIO Ben Brodsky left to join a London-based hedge fund startup. More recently, Matt Potts--formerly the head of the group's macro strategies--left in 2020. Given its large size, churn is to be expected, but the 17 additions and five departures over the past year stood out. Most of the new hires are experienced and will bolster the team's research agenda, but how they integrate into the sprawling team bears watching.

Parent Above Average Jun 4, 2020

BlackRock's advantages outweigh its disadvantages; it earns an Above Average Parent rating.

BlackRock is a $6.4 trillion money manager with unparalleled scale and influence. It's a market-leading and standard-setting passive investor with iShares. It has a deep and talented fixed-income team. Its Aladdin software is a vital risk analysis and portfolio management tool for the industry. BlackRock Financial Markets Advisory has secured the trust and mandates of many governments, including the Federal Reserve's pandemic-inspired debt-buying program. BlackRock also has designs on alternative, factor, and private-equity investing and has pledged to double its ESG ETFs and incorporate ESG in all its strategies. Fees also have improved.

Its ascent has had setbacks, though. Multiple attempts to revamp its active equity lineup have yet to produce the revival fixed income achieved. The firm has launched some gimmicky strategies. In 2019 and 2020, it fired two executives and a closed-end fund manager for violating company code of conduct policies, showing how difficult it can be to foster and enforce an ethical culture at such a behemoth. While it preaches ESG's virtue, it has often sided with management in ESG proxy votes.

BlackRock is not the best at everything it does, but it realizes the best way to serve its public shareholders is to fulfill its fiduciary duty.

Performance

An emphasis on downside protection has led to strong risk-adjusted results. Since its June 2015 inception through June 2021, the fund's institutional share class has returned an annualized 4.9% with volatility of just 4.0%, leading to the category's best Sharpe ratio of 0.97 over that period. Much of this strength can be attributed to excellent performance in equity and credit drawdowns; it has posted positive returns in two of the four S&P 500 drawdowns of more than 10% since its inception. It did experience an 8.73% loss from Feb. 20 through March 25, 2020, though it had regained all these losses by the end of April. Its conservative approach means it may lag in strong equity markets; it has captured just 21% of the S&P 500's upside since its inception, though its drawdown performance more than compensates.

All three substrategies have contributed to performance at different times, leading to a smooth return stream. The equity sleeve has delivered positive performance in 11 of the 19 periods that the fixed-income sleeve has sold off, including its best month of 2.26% in March 2020. The macro sleeve performed well in that volatile month, too--returning 0.52%--also its best month. While encouraging to see that sleeve hold up well in volatile markets, its performance outside of these periods hasn't been noteworthy. It has averaged just a 0.01% monthly return since inception, owing to its limited use of leverage.

Price

It's critical to evaluate expenses, as they come directly out of returns. The share class on this report levies a fee that ranks in its Morningstar category's cheapest quintile. Based on our assessment of the fund's People, Process and Parent pillars in the context of these fees, we think this share class will be able to deliver positive alpha relative to the category benchmark index, explaining its Morningstar Analyst Rating of Bronze.

SREZX for **SFREX** - We sold the underperforming 2-star rated SFREX for 4 clients on 2/4 @ 11.58, replacing it with SREZX (Refinitiv Lipper Fund Awards for 2021's #1 Global Real Estate Fund out of 148 for the 3-year period ended 11/30/2020) on 2/7 for 3 of them @ 14.56. SREZX's Morningstar chart since inception compares their performance:

PGIM Select Real Estate Z SREZX ★★★★★

NAV / 1-Day Return	Total Assets	Adj. Expense Ratio	Expense Ratio	Fee Level	Longest Manager Tenure
14.56 / ↓0.14 %	355.4 Mil	1.040%	1.040%	Above Average	7.52 years
Category	**Investment Style**	**Min. Initial Investment**	**Status**	**TTM Yield**	**Turnover**
Global Real Estate	Mid Blend	0	Open	1.65%	165%