



The Perch Pod Episode 53

Understanding the Ukrainian Front

With Sim Tack

Jacob Shapiro:

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Jacob Shapiro:

Hello, listeners. Welcome to another episode of the Perch Pod. As usual, I'm your host. I'm Jacob Shapiro. I'm also the founder and chief strategist of Perch Perspectives, which is a human-centric business and political consulting firm. Joining me on the podcast today is Luke Gromen who is the founder and president of Forest for the Trees. Luke is a well known writer, entrepreneur. His research and his perspective on macro is particularly good and that's why I was so happy to have a chance to speak to him today.

Jacob Shapiro:

Today, we're recording this Friday, February the 25th. Russia invaded Ukraine... Was it yesterday or two days before? I don't know. Space-time doesn't really work in my head right now. You should know that this will release in about a week, so portions of the Russia conversation here might feel a little bit dated. But because this conversation was so focused on really broader and more fundamental structural things, I thought it was okay to wait to put it out on our normal cadence. Thank you so much, Luke, for agreeing to come on even though it's been an incredibly busy couple of days.

Jacob Shapiro:

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crack open a bottle of wine because it has been a week. Take care of each other and I'll see you out there. Cheers.

Jacob Shapiro:

All right. Luke, there's absolutely nothing going on in the world for us to talk about today. I don't know how we're going to fill this podcast. Thanks for coming on the show.

Luke Gromen:

Thanks for having me on, Jacob. Yeah, unfortunately, there is a lot going on like you said.

Jacob Shapiro:

Yeah. It's depressing. What can you say? I try to maintain my sense of irony and sense of humor because that's the only way I've been able to stay sane in this business for over a decade. I try and take it as it comes. How about the first question I'll throw at you? We're recording on Friday, February 25th. It's 3:20 PM Central here in the United States. Maybe the first question I'll throw at you is, how do we disaggregate what's happening in the markets that is Russia, Ukraine related and then just what was already happening before all the Russia, Ukraine stuff popped off?

Jacob Shapiro:

Because I feel like a lot of people are making assumptions that what they're seeing in the market is related to Russia, Ukraine. I'm sure there was a knee-jerk panic reaction, but I'm not sure how much effect that's actually going to have going forward here and going into the Fed hiking. Help us pull those two things apart if you can.

Luke Gromen:

It's a great question. It's something I've been wrestling with in a few markets. I've been wrestling with it in the treasury market watching yields rising. I've been wrestling with it in the gold market where you have seen obviously gold rising and gold acting in a way that is very different. One of the big things in macro to watch for is when correlations break down, right? One of the biggest correlations of the last several years or so at least, and really long-term correlation, has been gold and US real rates, right?

Luke Gromen:

After inflation rate of interest on treasuries, that correlation between US real rates and gold has broken down in a major way to the point where... A good metric or chart that we've used has been global negative-yielding debt. I believe this is nominal, so I'm mixing it a little bit. Global negative-yielding debt went from call it \$14 trillion to \$4 trillion in the span of a month. That would've implied a price of gold falling three, four, \$500.

Luke Gromen:



Instead, gold went up a hundred bucks. That issue, I'm watching, is okay. In the context of what we're watching was that all Russia, Ukraine premium was that gold calling bullshit on the Fed, which up until a couple days ago was really what I thought most of it was. So there's been a few key markets I've been watching for. And there's an interplay to this. To me, the biggest thing that nobody is talking about macro pre-Ukraine situation, post-Ukraine going kinetic has been the US fiscal situation.

Luke Gromen:

Simply, there's virtually nobody looking at the US fiscal situation, the US balance of payments, which never mattered for the last 50 years, 40 years certainly, but they matter now. As we're seeing this evolving multi-lateral system, as we're seeing global central banks not buying enough treasuries relative to our issuance, all this, it's hard to disaggregate... We're still in the fog of war literally.

Luke Gromen:

What we're watching in financial markets that is... Was the stock market up 700 points today and up yesterday because there's a flight of global capital to the US or is it because the Ukraine situation is going to push off the rate hike? Or is it because the fiscal situation is going to go critical as a result of this and the Fed's going to actually have to renew QE or expand QE? There's a lot that right now as we sit here today that... It's still very difficult to disaggregate what's what.

Jacob Shapiro:

Yeah, there's a lot to unpack there. So why don't I start with you talking about how gold was calling bullshit on the Fed. Obviously, if we'd had this podcast even 36 hours ago, Thursday morning, when gold was up like two and a half percent or flirting on 3% right after the news Russia went in, we might be thinking very differently and I think you've seen that ping pong in financial media in general. But do you think that gold is calling bullshit on the Fed? Do you think that the Fed is going to have to be more dovish than people are expecting? Because that sentiment seems to be oscillating all over the place just based on the new cycle every day at this point.

Luke Gromen:

I think it still is. I agree it's still oscillating. I think if you zone out a little bit, it's helpful, more helpful, to really get a little bit more context. So if you look at, for example, the chart of... Excuse me, gold over the long-dated treasury bond, so if you chart GLD over TLT, because long-dated treasury bond is the biggest primary reserve asset competitor of gold, an interesting pattern emerges, which is, since March of 2020, gold has outperformed the long-dated treasury by 55%.

Luke Gromen:

Since early 2016, gold has outperformed the long-dated treasury bond by 75%. Now, in theory, these two things should be moving right along together. There was an interview that Charles Gave gave about three or four years ago where he made the point that if you're watching what China and the US are doing, gold is really a key pivot. If you watch what China's doing, it's using and bringing gold back into



the system as some sort of neutral reserve asset. Russia bringing gold back into it as a neutral reserve asset very clearly.

Luke Gromen:

If the price of gold is rising, then China and Russia are winning, are gaining influence, and if the price of gold is falling, the US is. I think it's hard to disaggregate the noise and the short-run about what Gold's telling us, especially because it's such a weird market, a manipulated market, it's got massive amounts of paper. It's such a political market, partly because of what we were just saying. But when you take a step back and you look and you say, "Wow!" After falling, after the GLD over TLT fell from 2011 through 2015, 2016, it has been a steady up into the right chart where GLD is gaining versus TLT.

Luke Gromen:

In particular, it's been very pronounced after the COVID crisis, which I think is really interesting then in terms of making it much more relevant to this discussion of, is it calling bullshit or is it not? The fact that it's up 55% against the long bond in two years, I think it is calling bullshit a bit. I think it's starting to say, "Hey, there's a problem here. There's an inflation problem. They're not going to be able to raise rates as much as they think to fight inflation." And I think that's right. I think ultimately when you look at the fiscal situation, I think the Fed's much more cornered than most people realize.

Jacob Shapiro:

We'll zero in on that because I think you're right that people have forgotten about that. So talk about why you think the Fed has backed itself into a corner, probably of its own making you would probably say. But what is the corner and how much room do they have to tighten, if any at all, or are they just going to realize immediately that they made a mistake if they try and tighten too fast?

Luke Gromen:

It's a mistake of their making, but it's really they are cleaning up the messes of the people in Washington, of the politicians, or of the people that are explicitly politicians. I've always said the Fed are politicians too, but they're unelected. It's a multi-prong problem. We've made, for the last 20 to 50 years, a series of very poor policy choices, whether you talk about economic policy choices, trade policy choices, geopolitical policy choices, all of which or a number of which have led to...

Luke Gromen:

Look, if we borrow a bunch of money and spend it on the Eisenhower highway system, great. If we borrow a bunch of money and spend it on education or taking care of our old people or taking care of our veterans, great. When you spend \$6 trillion over 20 years going into the Middle East to secure-

Jacob Shapiro:

Nothing.



Luke Gromen:

... China's oil for it in Iraq, that is not a good use of money. In the short-run, these poor policy choices, because we're the United States, because we've been a unipolar power for 30 years, because it's the dollar, in the short-run, these mistakes, these major errors have no cost. But the longer you go on and the more you keep compounding them with financial policy errors, right? Instead of letting people take pain in '08, you paper over it, instead of letting people take pain in the financial markets in 2020...

Luke Gromen:

Arguably, by 2020, it was a special situation and it was too late to be able to let people take pain. But '98, they should have taken pain, '94, they should have taken pain, '87, they should have taken pain. They never did. You had 70 million baby boomers born between '46 and '64. Stood to reason that 70 years later, they were going to turn 70. The actuaries would've told you that, any sixth grader with a calculator would've told you that. There was never the political courage to reform entitlements in a necessary way all that time.

Luke Gromen:

It got to a point now where it's too late. Then the trade policy with China, trade policy with NAFTA. So you've done this unique combination of bad foreign policy, where we borrowed a bunch of money unproductively, lack of political courage to reform some decent programs in terms of the entitlements in a useful way, a bad financial policy of bailing out bad investments over and over, and then bad trade policy where we basically off-shored our industrial base and increasingly financialized our economy so that the key driver to consumption became rising asset prices.

Luke Gromen:

So all of this feeds on itself. I think it's important to highlight in terms of background context because it leads us to the point where we are. Where we are now with US debt-to-GDP at 122%, with US deficits... The Fed has never tightened rates with debt-to-GDP that high. We're uncharted territory. US deficits as a percentage of GDP came out of this year at about 12%. We've never tightened rates with it more than two or 3% of GDP. Again, uncharted territory.

Luke Gromen:

Since 3Q '14, foreign central banks have only bought in total \$88 billion in treasuries while issuance of treasuries in that time... The US total debt has gone up 11 trillion. So foreign central banks have bought about 9% of our treasury debt in aggregate over the last eight years. By way of comparison, the prior 12 years, they bought about 55% of it. Instead, they've bought about a quarter trillion of physical gold, these central banks, since 2014, which again ties into the point before.

Luke Gromen:

Then the last point is, is because of all of the aforementioned, the United States is entering a tightening cycle with US... What I call true interest expense, which is treasury spending, which is interest, and then



some of the stimulus stuff that's helping inflate GDP plus the entitlement pay-as-you-goes. I mean, right now, we're paying about \$2.7 trillion per year just for health and human services and for social security. Tax receipts are about four trillion, but they are very inflated by the inflation and the booming economy.

Luke Gromen:

We grew nominal GDP almost 12% last year. Right now, just the true interest expense is about 100% of tax receipts. And tax receipts are highly sensitive to asset prices rising and continuing to rise ad infinitum based on the policy decisions, and particularly in trade, that we made over the last 30, 40 years. So you've got this doom loop they've put themselves in where they need asset prices to rise to generate the tax receipts, to cover the promises they've made to the baby boomers, but they want to take the froth out of the asset markets because it's starting to spur inflation.

Luke Gromen:

That is this fiscal problem that is not appreciated. And again, it all ties back to foreigners aren't buying enough of our treasuries, foreign central banks, foreigners. And we're issuing all this debt because, again, we didn't have the political courage to reform some of this stuff. We made some bad policy choices in terms of foreign policy. So it's now all here and it's now all gotten so big. It's sort of, unfortunately, like a cancer patient, right? Where you catch it in stage one, stage two, early. There's a lot of treatment options. Your chances of surviving are very good.

Luke Gromen:

The longer you wait and the worse it gets before you show up at the doctor, your chances of survival and your treatment options shrink. Unfortunately, that's what we have done. Again, it's not our politicians' fault. It's a human thing. It's an elected government, you're going to have these things. Any government's going to have these things. That's why we have these long cycles, these long debt cycles where way we have them. What I'm saying is, we're in this part of a long debt cycle and there's some things happening that it's been a long time since they've happened.

Jacob Shapiro:

Yeah. Is there any silver lining? Is there any way to sweep it under the rug? Is the patient terminal? Is it stage four? Is it stage three? Can zap it with some radiation and maybe knock it back in the stage 1.5? Or are we really just in this doom loop and it's just going to continue to spiral until you get some kind of political revolution? I mean, that happens in the US. It's usually not violent in the US. It happens with the progressive revolution with Teddy Roosevelt-

Luke Gromen:

Sure.

Jacob Shapiro:

... or the New Deal.



Luke Gromen:

Sure.

Jacob Shapiro:

Or Reagan, I think, qualifies as that sort of revolution. Things just have to get that bad and then one party has to get swept in and make those changes that you're talking about or do we have some room here? Can we buy some time before the crisis hits us in the face?

Luke Gromen:

We've been trying to buy time. I always like to say that it's not a Democratic or Republican thing. Compound interest is undefeated all time against their empires and governments. It never sleeps, it never stops growing. Really, I won't say it's terminal. I mean, it's not going to kill us. But what it does do, it is so far along. I do think it's stage four in this metaphor. What your choice really is then, it's really devalue or default/restructure.

Luke Gromen:

It's either, listen, the defense budget's 800 billion, it's 20% of tax receipts, it's got to go to 400 billion. Well, timing on that ain't real great, right? I mean, that's not a good look normally. It's a hard thing to do normally. But you're not going to show up now with what's going on and say, "We're going to cut the defense budget in half." Okay, so that's off the table. Entitlements. You're spending 2.7 trillion a year on just health and human services and social security.

Luke Gromen:

You're spending \$210 billion a year alone in veterans' affairs. Now, I'm not recommending we cut that. We don't do enough for those guys. With that said, that 210 billion when we went into Iraq was the size of the entire federal government deficit just to show you how that in the long-run bad policy choices have very severe costs. So can we politically cut entitlements?

Jacob Shapiro:

No.

Luke Gromen:

Probably not.

Jacob Shapiro:

No way.

Luke Gromen:



Not in the time scale we need, which is like by June. Or we need to cut treasury spending, and rates are zero, right? Quite frankly, we're actually going to make that worse by raising rates. Just by way of comparison, when the Fed last raised rates, this true interest expense number that I measure was about 65% of tax receipts. And it went up by 17%. So it went from 65% to 82% by 2018 just on the two and a quarter percent rate increase because you saw a softening in...

Luke Gromen:

Very interesting, when you financialize the economy, your tax receipts are very sensitive to the interest rates. So tax receipts fell or weakened sequentially and interest expense rose, and so you went from 65 to 82. Well, we're starting this one at like 100, so we're actually going the wrong way in interest. As they tighten rates, can they? Yes. I think they'll do one, maybe two. I think we're going to continue to see the volatility we've been seeing.

Luke Gromen:

But ultimately, I don't think they're going to be able to go for very long before they're faced with a choice, which is, do you want to miss coupon payments and treasuries? No. Do you want to skip payments on entitlements to the boomers? No. Three, do you want to cut defense spending by 100 or 200 billion in the middle of these stuff with Russia and China? No. Okay, option four is, hey, Fed, you pick up the phone, you call Powell and you say, "Money printer goes brrr," and he pays for it. And the release fails the dollar and the release fails inflation.

Luke Gromen:

I think that is the big surprise this year, is... And it's the thing that nobody's talking about virtually, which is the Fed is going to have to cut rates, print money into an inflation spike because of the fiscal situation. This is something emerging markets see all the time. It's a balance of payments, currency issue. It's stuff the Israelis saw in the late '70s and early '80s and I think that's just where we're going.

Jacob Shapiro:

That's not a very heartening thought. It occurs to me you're not using the language that a Marxist would. But when you listen to how China describes the United States and how it's reached late-stage capitalism, this is some of what their argument is, that the United States has become so bloated that China really doesn't have to do anything. It just has to worry about its own house and eventually materialism will take its toll with the United States and China just has to be strong enough when that happens.

Jacob Shapiro:

I wonder, did you see on CNN when the air raid sirens were going off in Kiev and they cut to a really unfortunate commercial where it was Applebee's and like chicken wings and something like that-

Luke Gromen:

Oh, no. Really?

Jacob Shapiro:

... in the middle of the air raid sirens? That also made me think late-stage capitalism. But where do you put China on the map here because they seem to be loosening right now already? They actually tightened and took some pain, dare I say, earlier on. So where do you think they slot in here? Does this make you more bullish about China from a macro perspective or their problem is serious enough to scare you away from that?

Luke Gromen:

I think they are in better shape. It's always hard just given some of the structural issues there. But it's been interesting. And this is, I think, a warning sign that's being largely ignored still by most on Wall Street in the context of what we just discussed, which is, China's been loosening and the Fed's been tightening and the Yuan's been rising against the dollar. When I talked earlier about when major correlations and macro break you have to pay attention, that's a huge one.

Luke Gromen:

That is a violation of rule number one in how the dollar has traded. For everyone's career that's probably 70 and under on Wall Street, FX trades on relative rates. And if the Fed's tightening and the PBOC's loosening, the yuan's going down against the dollar. The exact opposite thing is happening now. People say, "Well, how can that happen?" How can that happen is that there's a second component to relative FX rates that's always been there, which is balance of payments.

Luke Gromen:

It's relative FX rates and it's balance of payments, right? When you're Turkey and you're a twin-deficit nation and your currency starts falling, what do you do? You raise rates to defend the currency. And if you don't raise rates enough in Turkey, the lira still falls, right? So-

Jacob Shapiro:

They're cutting rates.

Luke Gromen:

They're cutting rates and then it really falls, right? The US is a twin-deficit nation that's never mattered like it mattered for Argentina or Turkey or the handful of other twin-deficit nations around the world because we have the reserve currency. Yet here we are in 2022 with this pile of problems we just discussed that I think are in stage four and the Fed is raising and the PBOC is loosening and the dollar's fallen against the yuan.

Luke Gromen:



You probably put an asterisk next to it because the yuan is not freely floating and all the things that people would say. And I think those are valid. I think those are valid. But still, I think there is a major signpost there of where we are on this, how acute this issue is, and how the dollar is likely to trade if/when the Fed is forced by compounding interest and those four choices we laid out earlier that Powell has to basically print the difference, how it's going to trade.

Luke Gromen:

So when I think of it that way, then yeah, I think China's probably a good place to have some incremental capital. A friend of mine pointed out a series of charts to me this week that boggled my mind, which was, if you look it on a two-year basis, a three-year basis, and a 10-year basis, Chinese government bonds have outperformed US treasuries. I was stunned by that, stunned by that. I feel like I'm in pretty good touch with all these stuff going on and you look at it, you go, "Wow!" And nobody's noticed that.

Luke Gromen:

When you're seeing this evolution towards multicurrency... I've centered it on the energy markets. We've very clearly seen a move where the marginal oil barrel, marginal BTU of gas is trading in Euro or in Yuan, no longer solely dollars. When you start moving commodities to multicurrency, you're going to start having currencies trade more on balance of payments and less on relative interest rates. I think that has started to happen. I think the mechanism of that is that basically everybody prints money for commodities and then everybody prints money for deficits.

Luke Gromen:

For us, we've got the biggest deficits because of the virtue of how the system has worked for 50 years, right? The system worked as we run all these deficits and you guys make all this stuff and we buy all this stuff from you and the deficits are a defining fact or function of the system. The system's evolving and now those are needing to be financed by our Fed because the foreigners aren't anymore. So I'm broadly interested in assets outside the US. I think China will do well. You can make a case some things in Europe. Again, this is all setting all the war stuff aside, which is a very big set aside.

Luke Gromen:

I probably would've said a lot more aggressively yes 36 hours ago. Europe, I think, just basically, ex-US, starts to get interesting as we get closer and closer to this moment where the Fed's going to have to, I think, grow their balance sheet into an inflation spike because of the US fiscal situation.

Jacob Shapiro:

Yeah. I was bullish Latin America even before the war. It seems to me that Latin America, again, has a lot of the characteristics of markets that can deal with this because they're far away from the mayhem, they have options for energy that are not Russia, a lot of them are exporting commodities which seem to be going up in price. Do you think that's right or am I missing something?



Luke Gromen:

No, I think that's right. That's a great point. I saw a chart the other day that... It's paradoxical. But it ties back to this break in correlation. Our whole careers, the developed markets have had positive real rates and the emerging markets have generally had negative real rates. It's the exact opposite. Brazil has very high positive real rates. A number of these Latin American countries have positive real rates, they have benefit from commodity prices, and positive balance of payment. So it's like all check, check, check. So yeah, that makes a lot of sense to me.

Jacob Shapiro:

Well, let's lean into the war a little bit. I'm actually delighted and surprised that we made it 26 minutes without having to talk about the war. A lot's going to probably change in the couple days that it takes to edit this and get it up. But why don't I ask you first. Did you see the war coming? I didn't. I was 70% no invasion, so I'm eating my humble pie here constantly and switching my views. But A, did you see the war coming, and B, where do you think it goes from here and what are the specific things in the markets you're looking at as a result?

Luke Gromen:

No, I'm in the same boat as you. I didn't think he would go. I thought that he had enough leverage and enough dissuasion that he was making his point. It's why I was surprised by it. With that said, when I started putting together, on Wednesday, a report I was working on where I looked at... And this isn't a blessing of it, but just simply looking at it. I'm going to try to be as sensitive to the real humanitarian disaster that's begun and is likely to continue.

Luke Gromen:

From a pure strategic standpoint, when you look at, I think, realities in what is happening in peak cheap oil and commodities, and that's to say if you take Russia's oil out of the mix... Let me back up. It's been harder and harder to find more oil for cheaper price. It's basically stopped happening. The incremental oil barrel is getting more and more expensive. That's peak cheap oil. That's a reality.

Luke Gromen:

When you then also lay around the US fiscal reality and the Western sovereign reality more broadly, what I think and I think part of the reason he has been as aggressive as he has surprisingly in hindsight is that with peak cheap oil being a reality and with the US fiscal situation being as precarious as it is, with the EU fiscal situation as precarious as it is, the debt situation more broadly there I guess, if you take Russian oil out of the mix of global supplies, oil's going to two, three, \$400 a barrel, whatever the price is.

Luke Gromen:

Those are all wild-ass guesses, but it's going high enough that it will without a doubt put the global economy into a very severe recession. And a very severe recession with what I just described before



with US true interest expense already at around 100% of tax receipts, your tax receipts are going to collapse with GDP. When that happens, again, you're going right back to, okay, you're cutting treasuries. So he's got this unique period of time where the only thing we can really hit that's really going to hurt them is oil and gas and commodities.

Luke Gromen:

And we can't take that away. There's not a darn thing we can do, because if we do that, we're immediately going to put the US treasury market at risk, we're going to put the US stock market at risk, the US debt market. You're going to see global markets and global economies collapse. I think he understands that. So it's an application of leverage that I can see why he is doing it.

Jacob Shapiro:

It's awfully shortsighted though, don't you think? I've been reflecting more and more about what the Chinese did with rare earth elements in Japan in 2010, which was they really had a stranglehold over Japan because Japan was so dependent on importing those rare earths from China. I forget exactly what Japan did that the Chinese off.

Jacob Shapiro:

But they pissed the Chinese off and the Chinese said, "All right, we're taking our rare earths and we're going home. You can't have them." It was very painful for Japan for a couple years, but in the last decade, they've gone to 90% dependence on China to 58. And they'll probably be below 50 in a couple years. The rare earths market, it's coming back and you've got other countries that want to refine and mine and things like that. So it seems like it's a short-term benefit.

Jacob Shapiro:

Sure, oil prices are high now, Russia has all the leverage in the world, but you just ensured that the Europeans are now going to probably double their spending on renewables and hydrogen and LNG and anything else they can get their hands on so that they don't have to deal with this in five years time so that if Putin comes knocking for something else, they can say, "No, here are your sanctions. We'll go right at you." So I have trouble with getting into Putin's mind because it feels so shortsighted in that sense, but maybe I underestimated the extent to which Ukraine is that important to him.

Luke Gromen:

Yeah. I did for sure. With that said, I was re-reading the other day his speech from February 2007 in Munich where... This isn't exactly a new demand. He's been saying, "Look, you promised us you weren't going one inch east of Germany in '89 and you've gone hundreds of miles east and we don't like it. You didn't like it when we put in Cuba and, and, and..." His complaints, whether valid or not, have certainly been on the tape for 15 years as it relates to that.

Luke Gromen:



And that's a part of the reason I was surprised why they actually got as aggressive as they did. In terms of shortsighted, for me, I think we may look back at what just happened as a real watershed event where it's not just about trying to get a short-term outcome. I think there are a number of things that have come into place on one hand. And I think there's probably some other factors that are forcing factors for them and for China that they may need to act faster than they might have otherwise or would've otherwise liked to.

Luke Gromen:

Because again, they're winning. They're just playing along, like you said, about China just letting the thing, compounding interest, do what it's going to do. I think we just saw the beginning of a major re-rating or a major relative re-rating of global power. And I think we're watching it in real time. When you watch our inability to really sanction Russia at all, and in fact, go out of our way... Today, I don't know if you saw Daleep Singh's press conference. We are specifically avoiding the energy... They're almost scared to sanction energy.

Luke Gromen:

And I think there might be something much broader happening here. I thought it was very fascinating, much broader goal here tying back to, I think, what the real goal is there, which is, they've got to move to a neutral reserve asset before the US dollar starts really tanking, right? They want to move away from the dollar. So when you saw today, other headline came across on Bloomberg, that the Chinese banks were actually cutting dollar funding for Russian commodities, and you go, "Holy cow! That's a really big deal." Then you read the article and they go, "They're still lending in yuan."

Jacob Shapiro:

In yuan. Yeah, exactly.

Luke Gromen:

Look at that. I put it to a guy who's been high-level veteran, global energy trader, 30 plus years experience, tied in with some... very high-level with global energy players. And I said it to him, he goes, "Make no mistake. When they say some clients can get lent in yuan, everyone that wants to do the deal in yuan will get done in yuan." To me, it feels a little bit like there's this broader recognition of, "Hey, we got them. Let's push this dollar issue."

Luke Gromen:

I mean, you go back to Obama in 2015 saying we can't do these Iranian sanctions because it puts the US dollars reserve status at risk. Three days later, Kerry said the same thing. Jack Lowe talked about it a few days after that. So when I get three senior cabinet members talking about the risk to dollar reserve status in a 10-day period in 2015, I don't think they were sitting around at the White House bar talking about that. I think there was a talking points memo within the context of the Iran negotiation that was saying, "Listen, if we do this, this is what the other parties have threatened with, what they will do."



Luke Gromen:

And when I bring that forward to today to we promise we're not going to touch energy like we're seeing out of the US, out of the Europeans, when we're seeing China going, "Hey, we're not going to do dollar, but you can move it all to yuan," it just feels a little bit like the goal here is not, "Hey..." The immediate goal, yeah, "Get off my border. I don't want you in NATO. I don't want any of you on my border in NATO. Do you understand me? And I sure as heck don't want nukes on my border."

Luke Gromen:

But I think that is just a forcing function of a much bigger move where it's like, "Okay, this is where it's going to happen. This is where it's going to happen." And you're seeing this machinery, this de-dollarization machinery, this move to, "Hey, we've got the oil leverage, we've got the debt leverage. Let's go." As long as those two stick together, Russia and China, setting aside some very real logistical issues as it relates to moving energy demand from West to East which can create a lag, I don't know how much better their leverage is ever going to get to do this, particularly now that the US has woken up post-Trump to what's happening here.

Jacob Shapiro:

Yeah, I guess so, but it's... I don't know. What I've been joking about the last couple days is congratulations to Mr. Putin. He's turned Russia from a great European power into China's gas station, which is... It goes to your point about the yuan. I mean, China's going to charge a premium for importing now all of this Russian weed and importing all of this Russian energy with... The pipelines actually aren't set up to work for and you're going to have to build through mountains and terribly horrible territory for building infrastructure.

Jacob Shapiro:

Yeah, I think Russia's actually put itself in a fairly difficult situation towards the end of the decade. But there's no doubt here that in the next couple years, they're going to be firmly in control. We talked about oil and you already mentioned Iran. Does Iran nuclear deal, which seems to be imminent now here on February 25th, give... I've been more worried about natural gas and coal rather than oil because I think Iran's coming back on the market and Libya, knock on wood, seems to be holding steady for now. Do you see it the same way? Is natural gas and coal also more scary for you or are you more focused on the oil and what could happen on the upper side of that?

Luke Gromen:

I've been more focused on the oil side. I'm not as well versed on the natural gas, other than the big numbers for natural gas where Germany's whatever, 60% of their gas, 55, coming from there and the Nord Stream 2 thing getting cut off, et cetera, is not helping them. Yeah. I've been much more focused on the oil side.

Jacob Shapiro:



Yeah. Well, let's shift gears a little bit. We talked about gold and oil and commodities, all sorts of things. Maybe we should pat ourselves on the back for not talking about crypto until 37 minutes in as well. I mean, we don't have a lot of history with Bitcoin, but it seems to me that Bitcoin has also been doing weird things in the context of everything that's going on. I'm personally more interested in the Ethernets and ADAs of the world. But tell me where you're at with Bitcoin, crypto, and how that story plays in here.

Jacob Shapiro:

I also, by the way, think it's super interesting that... I think with all the Ukraine, Russia stuff going on, everybody's missed that Russia looks like it's banning cryptocurrency or doesn't want anyone to hold Bitcoin going forward. The Central Bank of Russia was talking about that last month and they've got laws circulating their way through this month. So concerns there from Russia about their monetary policy and currency. I just threw a bunch at you, stream of consciousness. Where do you think Bitcoin goes into this picture that you're painting for us?

Luke Gromen:

Yeah, I think ultimately Bitcoin goes a lot higher simply because, again, the reserve currency of the world has a fiscal problem that it's going to have to resolve by balance sheet expansion in my view. It's interesting. To me, Bitcoin is not a bubble. I think it's the last functioning smoke alarm really. It's the last free market standing, right? Bonds aren't a free market. Gold's not a free market. Equities really aren't a free market. Around the world, they're all interfered with to some extent by global central banks and governments.

Luke Gromen:

I think Bitcoin is maybe a little, but not... It's a relatively pure market. And it's interesting, right? It's volatile as hell and it's been a very good leading indicator of excess liquidity and liquidity withdrawal. So when we were at 70,000 down to whatever, it dropped pretty quickly in November and into December, it's like, "Oh, here comes volatility for the market and here for the broader markets." Sure enough, two weeks later, it all showed up. So I think it's a broader liquidity measure. It's an early warning, I think.

Luke Gromen:

I saw the Russia crack down on it, I saw them maybe try to reverse a little bit headlines, but I don't know. It's weird, right? The Americans almost have like a love-hate relationship with it. It's like, "Hey, we hate Bitcoin," as any politician tends to, but then it's like, "Hey, people are sending Bitcoin to Ukraine. Is it good? Is it bad?" It depends on who it's going to, right? Well, then you can use it to move more currency. Well, that's okay. In this case, it's not good in this case. I think it's going a lot higher.

Luke Gromen:

I think ultimately the fiscal situation of the West was so precarious going into this that basically if anything went wrong, you're going to need the Fed to get back into growing its balance sheet again. And something's gone horribly wrong. Supply chains were supposed to get better. They weren't getting



better to start with, forget about it. I saw late today the Germans talking about maybe kicking Russia out of SWIFT, who knows. So if anything goes wrong, the options are really default, restructuring, or as the meme says, "Money printer go brrr."

Luke Gromen:

I think policy makers would really like to let some of the froth out. I think objectively they have, right? I mean, the fact that Bitcoin's at 39,000 and not 69,000, some of the froth is gone. But it's all fun and games letting froth out until the treasury markets starts to get threatened. And the treasury markets, tying back to our initial point, the deepest, most liquid market in the world. There was an article last week that liquidity's not really good, again, kind of like what we saw in March of 2020.

Luke Gromen:

So I talked around a bit on that. I ultimately just look at Bitcoin as a neutral reserve asset, as a last functioning smoke alarm of what's happening, as a good liquid to the indicator, and I use it as such.

Jacob Shapiro:

Am I right in taking from what you say that you don't see a scenario in which we start looking at Bitcoin as an actual currency because it doesn't function as a currency right now except maybe in a couple places in the world? But right now, it's a store of value, digital gold, whatever else. Is that where it remains or is there a scenario in your mind where things get so bad that people besides Klay Thompson and these other athletes are going to ask to be paid in Bitcoin going forward?

Luke Gromen:

To me, it's just a neutral reserve asset, right? I mean, it's buying digital real estate instead of saving your wealth in your house. It's digital gold, it's a digital neutral reserve asset. I don't think it ever becomes a currency. Functionally, why would you ever want to pay for anything in Bitcoin? Setting aside all of the technical back office, all of the mechanical issues with it, why would you ever pay in an appreciating or in a finite asset when you can pay in a depreciating fiat currency?

Luke Gromen:

And that's ultimately why the government hates it or dislikes it and a lot of policy makers certainly. Because look, through paper gold, they can control the release valve of the system of gold. But there's no unallocated London Bitcoin market like there is for gold. So it's painting a truer picture of what they're doing when they're loosening and when they're tightening. So, no, I don't see it as being a currency, not for any relevant investible timeframe. But it's a digital reserve asset in my view.

Jacob Shapiro:

All right. Last leg here before I let you go. We've had a lot of doom and gloom, there's a war about, everybody's afraid about inflation, let's try and be optimistic for a second. We mentioned a little bit Latin America, maybe emerging markets. But is there anywhere that you're optimistic, anywhere that



you're bullish, anywhere that you would tell folks to look in context of some of the risks that you've painted here on the horizon for us?

Luke Gromen:

I really like commodities. I really like ag, electric vehicles, electric vehicle-related metals, copper. There's sort of a peak cheap energy story there. There's an energy transition story there. And I think a really underappreciated inflation story, secularly, we frequently hear that, demographics, when you get a lot of old people, it's bad for growth, to oversimplify. I think largely that's true. But I think there's a nuance here, particularly in America.

Luke Gromen:

I'm not as well versed on how these schemes are set up overseas, so they might be there too. But I know in America, the baby boomers have call it \$35 trillion in wealth. \$35 trillion in wealth in assets estimated, they have spent the last two years inside their houses watching network news scaring the shit out of them that they're going to die way sooner than they thought. You've seen it in real estate, you see it in restaurants, you see it in a lot of different hints.

Luke Gromen:

The boomers have 35 trillion in wealth. The boomers are long money, they're long assets, and they're short time. So you go to a tradesman, it's like they almost don't care what the price is. "Hey, this is going to cost you 50% more when I quote you." "Don't care, do it, start tomorrow." You talk to architects, "Don't care, start tomorrow. When can you start?" So I think it turns the whole lots of old people's deflationary right on its head.

Luke Gromen:

The United States ran all these policies, we ran all these deficits, and part of the way we sterilized these deficits from showing up as CPI inflation that would've freaked out the bond market because we spent the last 40 years catering to the bond market like it's a spoiled child, we sterilize this stuff in the asset markets, right? So we didn't have CPI inflation so that the bond market would... We could borrow cheaply to do dumb things in the Middle East. But what did in doing this is we had this incredible asset price inflation.

Luke Gromen:

And the asset price inflation is critically important to fund the tax receipts, so the Fed's going to help keep that number up. People say, "Well, the Fed is not handing money to the people. They're just keeping asset prices up." Well, you got 30... What is it? 70 million boomers, 60 million boomers that have \$35 trillion and are short time and are now worried they might not live as long as they thought they were and they've got the Fed basically like giving them a printing press. It's like, "Hey, we want to go buy a house."

Luke Gromen:



"Okay. Buy a house." "Okay. Now we need..." "Brrr. Okay, run it back up to where it was." So it's this sterilization of inflation throughout most of the boomer's life that took place through the asset markets is now coming out into the CPI markets as they get old. "Hey, I already have three houses. What do I do? I've got all this money, I've got a required minimum distribution, what do I buy?" "Hey, Sonny, here's a \$100,000. I'm going to buy, put down on this house for you and your wife and my grandson because I love you." That's what any of us would do.

Luke Gromen:

But I think there's this really interesting dynamic of, look, it's probably really good for the housing market in the US. I think we're seeing signs of that, right? There's probably an opportunity there where housing has gotten killed because of rates, just on a typical trade, that maybe housing doesn't react to rates the way it has as a result of this, that there's better consumer spending growth than people think. I think it's more inflationary than people think. I think it's good for commodities and where there's this secular story away from this balance of payments issue that's looming in the corner.

Jacob Shapiro:

Yeah. I'm always in the lookout for arguments that falsify ideas about demography because I find the fact that everybody says... Everybody talks about demographics like it's really simple, that, "Oh, if you have the nice curve, everything is great. But if you're olding, everything is going to be terrible." Well, actually, if your growth is shrinking less fast than maybe your population is shrinking, could actually be a net benefit. One of my favorite examples of this is that Germany's demographics in the early 1930s were terrible.

Jacob Shapiro:

They were absolutely awful. It was because of World War I and because they were getting older and they had just industrialized. Within five to eight years, they almost took over all of Europe and they had this massive war machine, this massive economy. It was completely screwed up and it was terrible for everybody. But if you had been there in 1933 with your, "Oh, the demographic situation is not good in Germany, they're going to collapse," you would've gotten it completely wrong.

Jacob Shapiro:

So I actually really like what you're doing there with that idea because you're saying that the combination of the pandemic and this asset appreciation maybe is making demographics not as relevant maybe, especially for Americans as a result of the boomer generation. Am I taking it too far or-

Luke Gromen:

No, I think it's right. I mean, you've basically taken inflation that should have happened from 1985 through 2005 or 2010 in the CPI world and actually have just moved it, transposed it. You built an asset inflation bubble to sterilize what would've been a CPI inflation bubble and now it's going to come out of the asset bubble into their asset inflation bucket, I should say, into the CPI inflation bucket as people want to spend on stuff before they die.



Jacob Shapiro:

Well, and it's even crazier to think about because you mentioned about offshoring industrial policy, which also means that generation got to pay much less for the goods that they were buying before. So they were saving more in the first place. Now that we're in a globalization recession and everybody wants to nearshore and reshore and they just assume that the prices of consumer products aren't going to go up, that everything's going to be fine, but they're not.

Jacob Shapiro:

If you have to rebuild supply chains and pay people more and find all of these redundancies and there's not going to be one country like China that does everything... So not only have they been in that environment, but they were also in an environment where iPhones only cost a couple hundred bucks. If you actually manufacture an iPhone start to finish in the United States, I don't know how much it would be, \$10,000?

Luke Gromen:

And it's still a deal. That's the crazy thing, right? It would still be an incredible deal, right? I mean, would you pay 10,000 for your phone? I would pay 10,000 for my phone in a second. There's songs on my phone I would pay a \$1,000 dollars for.

Jacob Shapiro:

I would pay \$10,000 for someone to throw my phone into a fiery inferno and I never have to see it again. But I got to make a little more boomer money before I can get rid of my phone. That's not going to happen quickly. Luke, before I let you go, what haven't I asked you that you think I should have or what am I missing or what's an important thing that I didn't hit you on? If we hit everything, that's fine too. But I always like to close with asking people if I missed anything or if there's anything on top of your mind that you want to close out with.

Luke Gromen:

No, I think you've really hit... To your credit, you did a great job, I think, really digging in on... What I think is the biggest issue is this US fiscal situation. I'm told in the '60s and '70s, every major Wall Street bank had at least one US balance of payments analyst. That became a useless job by the '80s because US deficits didn't matter. That's the way the system worked, deficits didn't matter. You always fight the last war. Generals fight the last war, investors fight the last war.

Luke Gromen:

We're looking for the last crisis. So going into the '08 crisis, there were like three people on the planet who understood the repo market, even knew it existed. I'm told by guys that were in looking at... really in the financials, it's like, "Oh, the banks are all fine. If you X out the bilateral repo book, then they're really under-levered." Well, of course, X the bilateral repo book, the bilateral is where all the problems



were. Now, fast forward to today, there's a lot more people... And that's not saying anything derogatory toward them.

Luke Gromen:

There's a lot more people who know what the repo market is, they've heard of it. There was a repo rate spike, there was a crisis. But nobody's talking about balance of payments. If you look at markets through a balance of payments lens, through the US balance of payments lens, it's been very, very useful. When the Fed's tightening... Or isn't loosening enough... Forget about tightening. If the Fed's not loosening enough, it's dollar up, emerging markets down. It's tighter financial conditions, it's more volatility, and vice versa.

Luke Gromen:

I think by the end of this cycle in the next five, 10 years, I think you're going to start having US balance of payments again. And again, it ties into the geopolitical where... I think if we look out in five years, 10 years, two years, we're going to look back at two nights ago, yesterday, as the death of Pax Americana. I think that was the end of the post-war Pax Americana. That's the date they put on the grave side of globalization 2.0. You're going to need to rebuild supply chains like you were just saying, all these stuff.

Luke Gromen:

That has a bunch of other implications, right? The 40-year bond market, disinflationary bond market bull... If you've got to rebuild if globalization 2.0 is over, 40-year bond market bull's over. Now, it doesn't mean I would go and short bonds tomorrow, but on a real basis, I would. It speaks to more, "Hey, I'd rather own gold and Bitcoin than a portfolio of 10-year treasuries at 2%," that kind of thing. I think we're right in, I would say, in between two trapezes almost where we're leaving this world of the last 40 years.

Luke Gromen:

It's been pretty obvious to me over the last five, seven years that we're moving out of that world. And I think it's always these things where... I mean, it's like Lenin said, where there's there's decades where nothing has happens and weeks where decades happen. I think this week was one of those weeks where decades happened, where all of a sudden people are going to realize... And I think they're realizing right now. It's happening, I don't think people know what they're seeing yet.

Luke Gromen:

But when the United States treasury is like, "Well, we can sanction the [foreign language 00:56:28]." The Italians want take out the Gucci loafers and the Belgians want to get rid of diamonds and we can't do oil and we can't do energy. The Treasury document today said there's wood. They're qualifying wood exports as energy out of Russia. Okay, that's a change. I don't think people have really grasped that because of, A, I don't think the context is there for what's happening in terms of some of these changes, multi-lateral, fiscal, et cetera.

Luke Gromen:



But I also think, two, we started off talking about it. It's a fog of war. I think there's a lot of things happening that you don't really know what they are until you get some appropriate distance from them and kind of go, "Wow! That was a really significant thing."

Jacob Shapiro:

Yeah. Well, this was so much fun and I hope you'll come back maybe in a couple months and we can see what's happened once the fog dispels. But Luke, thanks so much and we'll talk to you soon, okay?

Luke Gromen:

Absolutely. Thanks for having me on, Jacob.

Jacob Shapiro:

Cheers.

Jacob Shapiro:

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Jacob Shapiro:

You're listening to the Perch Pod from Perch Perspectives. Hello, listeners, and welcome to another special episode of the Perch Pod. As usual, I'm your host. I'm Jacob Shapiro. I'm also the founder and chief strategist of Perch Perspectives, which is a human-centric business and political consulting firm. Joining me on the podcast today is Sim Tack. Sim is a geopolitical and military analyst at Force Analysis. He's also an old colleague back from our Stratfor days. It was great to get a chance to reconnect with



Sim, but also to get his very insightful views on what is going on in the Russia-Ukraine war. We are recording Monday, March 7th at 9:06 AM Central Time. This should come out as soon as we can get it recorded and up, but if anything happens between now and when you listen to this, apologies for being overtaken by events. Otherwise, as always, please rate, review and send the podcast to anybody you think would be interested in it. Take care, and we'll see you out there. Cheers. Sim, it's nice to be reunited. I wish it was under better circumstances, man.

Sim Tack:

Hi, Jacob. Thanks for the sentiment.

Jacob Shapiro:

Yeah. For a cynical geopolitical strategist, I've always been overly sentimental, but we can psychoanalyze me later. It's Monday morning here, March 7th in the U.S. afternoon European Time. This will probably go out if not today, tomorrow. So a lot can change in 24 to 48 hours, but just where do you see the Russian invasion from your viewpoint right now here Monday morning?

Sim Tack:

Well, right now, we're seeing some interesting developments in the battle around the capital, Kiev. So that's one thing and I'll get back to that. But then separately, we're also seeing the continued efforts by Russia to expand in the South of Ukraine, which is primarily oriented towards the city of Mariupol, which has been catching a lot of headlines, a city that is under siege, right where the advancing Russian line meets the preexisting Donbas line of contact. So the city is wedged between those two lines, essentially being bombarded pretty much permanently. And then on the other side of the Southern movement of the Russians, we have their efforts to try and make it to the city of Odesa, which eventually puts them in a position to capture that remaining part of the Black Sea coast and then possibly connect to Transnistria and Moldova.

Sim Tack:

So those are the big efforts, I think, that Russia's going through. The ones in the south, they're advancing. Things are going very slowly and that's something that we've seen across the Russian operations, the lack of tempo, the lack of momentum. Now, when it comes to that offensive near Kiev, that's where the last several days, we've seen the Russian forces retake that momentum. They have been facing some counter attacks by Ukrainian forces, but now in the past two days, that seems to have turned around again and it's becoming quite a threatening situation for the capital again.

Jacob Shapiro:

Yeah. I was struck by... I feel like at the end of last week, the general media narrative was about how the Ukrainians were counter attacking and they seemed to be slowing the Russians down and the Russians were incompetent. And then suddenly, I was surprised to read some of your maps and things on Twitter this morning. He's @SimTack, folks, if you want to follow him. And it seemed honestly a pretty situation



for the Ukrainians in general. Are you feeling that grimness or do you feel like they're going to be able to counter attack to some of the Russian advances that have been made over the weekend?

Sim Tack:

I feel that grimness a little bit. There's always somewhat of an up and down from day to day. So we'll see days where Russia is not very convincing in its operations and things are looking up for Ukraine, but then as Russia also takes time to catch up, have logistics rejoin the front lines, have fresh forces join the battlefield, that enables to make that utter push and then obviously, things look a little more grim again. But overall, I think it's really difficult to tell whether this is playing out in Russia's advantage or Ukraine's advantage on the long term. It's a really interesting and really complex battlefield primarily because of that limited performance that Russia is showcasing. I think a lot of people had expected Russia to kind of roll through Ukraine without much opposition and we're definitely seeing that that's not the case.

Sim Tack:

And I think such expectations were a little optimistic as well, but the reality is there are certain situations that could develop horribly for Ukraine and that could cause defensive lines to collapse one after the other, allowing Russia to settle on the Dnieper River, for example, and having a defensive from which they can negotiate if they want to. But on the other hand, there's also all of the losses that Russia is facing. Just this morning, I was seeing some figures. Just based only on confirmed losses in videos and photographs, Russia's already lost over 800 individual weapon systems. So vehicles and aircraft, which is immense.

Jacob Shapiro:

Yeah. There's so many questions to ask, but the first I wanted to ask you is Russia obviously has the advantage in terms of number and firepower and even technology and things like that. How much time do you think they have? I mean, is this the sort of thing where they could draw this out for multiple weeks and still be able to continue on their objectives? Or is this the sort of thing where they have to crush the Ukrainian defense in the next couple weeks either from a military perspective or a political perspective that start to become untenable?

Sim Tack:

It's very interesting that you asked that question, because it's one that I've been debating with a couple people intensely in the past few days as well. I think what we're expecting here is that Russia can continue this fight because even though it's going poorly, they still have the ability to push more forces in there. They can keep inching forward even at a great cost, but eventually, these losses are going to add up and there won't be enough capacity left in Russia to actually keep the fight going. And then when I say no capacity left in Russia, I don't mean they would've used up the entire Russian military, but we have to be realistic here and understand that Russia has an interesting maintaining some military capability in other parts of Russia. It has defensive objectives around borders of other NATO and allied countries.



Sim Tack:

It has interest in maintaining some defensive positions in the East towards Japan and even China. It has to maintain a capacity to possibly intervene in central Asia where post Afghanistan, we've seen the recent Kazakhstan uprisings. There are plenty of reasons for Russia to maintain a capacity. And the more that they push into Ukraine, the more difficult it comes for them to do that. So I think there's some wiggle room. It's not an exact line that they can or cannot cross, but I mean, my expectation is that if in the coming few weeks, and I've been putting it at about three weeks until about the end of March, essentially, I think if they haven't reached a defensible position or a negotiation point and in my mind, that primarily consists of reaching the NPA river, if they can't do that, I think they have to seriously start considering pulling out of this.

Jacob Shapiro:

Well, so to push you on that, so do you think they'll get there within the next three weeks or is it just too early to call?

Sim Tack:

It is possible. So there are some significant weaknesses in the Ukrainian defensive setup. So we were talking about how Mariupol is sitting on that location where the advancing Russian front lines are joining those existing front lines around the separate regions of Donbas. Now, that creates a very difficult situation because as those front lines join, Ukraine is forced to abandon some of these fighting positions that it has occupied for over seven years. Very strong, static defensive positions that it now has to abandon to go and defend from population centers or from hasty defensive positions further inland. So that defensive line starts to move back. Now, when that happens, it frees up the Russian advancing forces, as well as those separatist forces they were defending against at one point, and they are able to mass their capacity against that Ukrainian defensive line, possibly pushing it back even further and you get kind of a domino effect and they have to withdraw off from one line to the next until eventually, they're on the other side of the Dnieper River.

Jacob Shapiro:

Yeah. You alluded to how things have gone slowly or not so well for the Russians and obviously some of that is due to, as you said, they weren't expecting as much opposition as they got and leaving aside whether, I mean, that was obvious not the right call at a strategic level, but one of the things that has been baffling for me watching this is the Russian's inability to achieve air superiority. And that seems to be one of the things that is really preventing them from pushing forward. How do you explain that? I mean, everything... I'm not the expert that you are on some of these more tactical areas, but how do you explain Russia not going after Ukraine's air defenses? Was I just underrating Ukraine's air defenses? Were we overrating Russia's air capabilities? Help me understand what's going on in the air bubble?

Sim Tack:

So that's actually one of the really complicated questions. I don't really have a clear cut answer for you on why the Russians are unable to make their air superiority count. The reality is Russia has a much



larger air force than Ukraine ever did. Ukraine, especially after losing a significant portion of its air force in the fighting in 2014, 2015, they have been on a trajectory to rebuild their air force, but the deadline for that, so to speak, was put at 2035. So we're still a bit early to see that modern Ukrainian air force. Some of those elements are in play. One of the big thing that they had been trying to put in place was the essentially building about half of its modern air force out of unmanned platforms. So they've had that big emphasis on developing their own strike drones and purchasing the Turkish-made Bayraktar drones, and we're seeing those have a very significant impact on the battlefield, but those are not air superiority platforms.

Sim Tack:

Of course, they're not going to hold back the Russian Air Force. So to come back to that point of why are we not seeing the Russian Air Force making itself count in this conflict? The only real reason that I can think of here is that they are really not capable of fighting a modern war. And what I mean by that is the Soviet military back in the day, they had a very certain way that they would use air power in combination with land power. They would essentially organize air power at a much higher echelon than their ground operations. So while you had battalions and brigades and divisions running around on the battlefield making contact with the enemy, those troops in the front line wouldn't be calling directly on air power.

Sim Tack:

Instead, you would have separately-planned missions at division level and above for the air force. So a complete misalignment of the use of resources. In the West since the Second World War, the concept of close air support has been developed quite rapidly and you have that direct line through joint tactical air controllers on the ground communicating directly with the aircraft. Now, that is something that Russia has tried to develop in the post Soviet era. Let's say over the past 10 years, that's been something that supposedly was part of their capabilities, but I think right now we're seeing that's not the case. And I'm basing that on the way that we see the Russian Air Force appear on the battlefield, but also based on some of the communications interceptions that have happened by people in the OSINT community and they have actually been able to catch some conversations between ground forces calling for air support and things just go awfully wrong. They clearly don't have a handle on it.

Jacob Shapiro:

Am I right in saying that this was one of the key... I mean, obviously they overran Georgia in the 2008 Georgia conflict, but I seem to remember at the time, that Russia was having many of these same issues that ground forces were not able to communicate with air forces and the left hand didn't know what the right hand was doing and even though the Russian invasion looked very impressive, when you sort of looked at what happened in Georgia afterwards, it was pretty telling that Russia had all these vulnerabilities. And to your point, you would've thought that they would've fixed some of these things, but it seems like there hasn't been much progress since 2008, based on what you're saying. Is that fair?

Sim Tack:



Exactly. And 2008 was one of the reasons that that emphasis on reshaping the interaction between ground forces and air forces was actually being pushed in the Russian military. One of the problems that they faced in Georgia, which is a little bit different from what we're seeing in Ukraine is that in Georgia, one of their big challenges was finding targets. And that was one of the reasons that the GRU, the Military Intelligence Service, saw its role in warfare changed a little bit. They were essentially told afterwards to focus a little more on the intelligence part and a little less on the operational part because during the Georgia war, Russia had the capability to strike, but they didn't have targets at the ready. I think now in Ukraine, we might be seeing the opposite where there are plenty of targets at the ready, but they don't seem to have the capability to actually get the aircraft on that target. Another element that might play into that also is the availability of precision-guided munitions, right?

Sim Tack:

So this is something in the West, we're very used to seeing these kind of air campaigns consisting almost entirely of JDAM munitions and other types of guided bombs or missiles. Most of the ammunitions that we see in Ukraine, the ones that don't explode and are recovered, they are all dumb ammunitions. They're just gravity bombs without guidance. So that makes it very hard for these aircraft to actually hit pinpoint target in tactical situations in a close air support role. And it also means that the aircraft have to take more risky maneuvers to effectively deploy these weapons, which might be one of the reasons why we've seen so many reports of Russian aircraft being shot down.

Jacob Shapiro:

Interesting. Well, here's a curve ball question. What, if anything, are the Russians doing well? Have you been impressed with any of their execution on the ground in any field or has it just been one mistake after the other?

Sim Tack:

Well, I definitely wouldn't say that they aren't doing anything well. Clearly, they have a broad operational plan that seems to make sense in terms of their focus on the capital, Kiev, trying to cut Kiev off. They aren't quite there yet, but I think that is something that we see coming together as we're speaking on the battlefield. Separate from that, the rapid advance through Kherson, so the region just north of Crimea that has given them a significant foothold that allowed them to threaten that Ukrainian position in the South that allows them to threaten further advance to Odesa.

Sim Tack:

So I think there are definitely things that they're doing right here. We might even include the longer range theater missiles strikes, or the caliber cruise missiles and the Iskander missiles that they have been firing very deep into Ukraine at air bases to suppress Ukraine's ability to actually mount its own air force. They've also been targeting a lot of logistical depots and things like that. So I think that has had a significant effect on Ukraine's ability to fight back. The question is is these few things right, going to weigh up against not being able to actually maximize the full power of their ground arm? Because that's essentially what it comes down to. It is about getting those troops on the ground where they need to be.

Jacob Shapiro:

Yeah. And that, they seem to be struggling with. I wanted to go back to something you were saying a little bit earlier. You mentioned Transnistria and for geopolitical nerds, we all know what Transnistria is. We all probably saw Lucas Chenko with his map, flapping his arms around and publishing crazy things. What is Transnistria and how important of a military objective do you think that would be? I can obviously see the political cache in going after that, but is there a military reason for Russia to try and take that region?

Sim Tack:

I think there is. And I've actually only recently when I was having a conversation on a Twitter Space with H I Sutton, who's a really smart guy when it comes to all of the Naval and amphibious capabilities. So he's been talking a lot about that pink arrow that Lucas Chenko drew on the map there. But I think what we arrived at when having in that discussion about Transnistria is that this could simply be some kind of a rescue operation. And what I mean by that is Russia has at least 1,500 troops in Transnistria, if they haven't been quietly able to rise that number in advance of their offensive, but this is a very difficult position to maintain. Transnistria, so it's a part of Moldova. It's a breakaway Republic within Moldova. It's a very thin strip of land, not a lot of great defensible terrain.

Sim Tack:

And on the other side, it is completely encircled essentially by Ukrainian territory. It doesn't have direct sea access and you can only get there by land through either Moldova or Ukraine. So for Russia, it becomes very difficult to maintain that presence there or to guarantee the safety of its troops there once it starts a conflict with Ukraine, because now any kind of land route is out of the question. Countries like Moldova, Ukraine, they're not going to allow Russian military transport over their territory for at least a while. And the only remaining route that leaves is through the air. And I think right now, the airspace over Ukraine, over Transnistria and probably over Moldova as well, is at the very least, little hostile to Russian transport aircraft. So I wonder whether Russia realized that as they were planning an attack against Ukraine, that they were essentially realizing that the guys in Transnistria would get cut off.

Sim Tack:

And in order to prevent that both in terms of not leaving them to get stuck there, but also in terms of being able to employ them at a future date, perhaps they have future intent to actually involve them in the conflict in Ukraine, or to extend future operations toward Moldova, but in order to do that, they need to set up a sustainable line of communication and I think at this point, the most straightforward to do that is to connect Transnistria two territories that are under the control of Russia, or if not, directly connect them to the sea and that way, have their connection to the Black Sea.

Jacob Shapiro:

Sort of embedded in what you're saying then though, is that, I mean, Russia may not mean to occupy all of Ukraine, but it seems like the Russian military is trying to position itself so that it can occupy some of



these key strategic corridors, which goes against what the Russians have said. Well, I mean, everything that has happened has gone against what the Russians have said, but even in the last day or two, the Russians have said, "Yes, just recognized [inaudible 00:22:44] could let us appoint our own prime minister and everything will be fine." It sounds like what you're saying is that's not what their actions are on the ground or telegraph.

Sim Tack:

Well, I wouldn't necessarily read it that way. So I understand what you're saying and Russia is definitely putting in place some territorial gains that will have long term benefit to them. Another one that we could refer to there is the control over the Crimea Canal that Russia has reestablished. So by capturing the areas north of Crimea, they've been able to reopen the canal that is pretty much the only source of fresh water, or at least the only real sustainable source of fresh water for the Crimean Peninsula, which had been a big problem since their occupation of it. So there are some of those localized advantages, but I think on the whole, just because Russia is concerned with the sustainability of its true presence in Transnistria doesn't necessarily mean that they have a goal to permanently occupy Odesa, necessarily.

Sim Tack:

If they can get away with it, I'm sure they will, but I'm not sure if that is really feasible, especially when we're talking about occupying all of Ukraine. I think that's where I have to draw the line and that's simply not feasible. With all of the Tsars horses and all of the Tsars men, they're not going to take the West of Ukraine and control that on the long term. I really don't see that within their capabilities.

Jacob Shapiro:

Yeah. It's hard to imagine that. Zooming out a little bit to big picture questions before I let you go, the first is if you're in Lithuania today or you're in the Baltics, or even in Poland, should you be afraid right now? Should you be scared of what's going on? Or are the Russians actually showing you that they don't have the capability to do much more than they're doing right now? I had a friend in one of those countries literally ask me if they should be making plans to get out and I told them, "Well, I don't think so because I feel like NATO would probably come to your rescue at that point. It's a different question going after the Baltics and the Russians don't seem to be able to push beyond that. But I wanted to throw that question to you to see if I was right telling my friend that and what you would say to that person and what you think about Russia's threat posture whenever this conflict is resolved.

Sim Tack:

So on a conventional level, I think we shouldn't really fear an escalation into facilities and in the Baltics or even on the Finish border or anywhere else. I think at this point, Russia has already chewed off a little more than it can handle and its first priority is probably going to be not completely destroying itself over this. Now in terms of fears and escalation in general, there has been a lot of discussion about potential escalation beyond the conventional with Russia's decision to put its nuclear forces on higher alert, which is a clear signal toward NATO essentially saying, "Don't get too involved in this. We're trying to do our own thing here. And if you push us too hard, we have our nuclear arsenal to strike back." I don't really



see that escalation to a nuclear conflict as that likely. I would hope at the very least that there is some sense of scale and proportion left in Russian leadership that makes it clear to them that would be a really poor choice for everyone, not just for them, but for everyone really.

Sim Tack:

So personally, I wouldn't really be packing my bags if I was in the Baltics, but on the longer term, and that's where I think the greater threat is, if Russia gets away with some kind of a victory in Ukraine, I think we really need to start at asking ourselves, "How are we going to deal with that?" Because we have seen Russia do what it did in Crimea and Eastern Ukraine in 2014. Clearly, they have a problem with accepting the UN charter, the rules-based international community. They're unable to play within the acceptable norms, right? They're showing that again now. So what is going to be their next move if they come away with some kind of a victory in Ukraine?

Sim Tack:

And that's why I think not so much in the sense of should Poland and the Baltics be fearing something here? I think on quite the opposite, they should be seeing a potential opportunity here to put a halt to Russia's ambitions. If Ukraine can be supported to hold strong against Russia in this conflict, I think we could be in a position where stability in Eastern Europe over the next few decades takes on a very different shape. If Russia loses that perception of being all powerful or even more, if they lose the actual physical capability, if they continue to push equipment into Ukraine this way and lose it there, I think that puts Russia in a very weak position that essentially reduces the risks that we've been seeing over the past two decades.

Jacob Shapiro:

On the flip side of that question, if you were a Russian policymaker or strategic analyst and you sort of already alluded to this, are there other parts of the world that you're afraid of? Are you afraid of maybe somebody in the caucuses taking advantage or in Central Asia? I know everybody's talking about Russia and China as friends, but China also lost territory to Russia back in the late 1800s, for those of you who weren't around for it, which is none of us. Do you think that Russia has to be concerned that having overextended itself that A, it is vulnerable on some of these access? I think you'll say yes, but B, that somebody is going to be willing to take advantage of that in the short to medium term.

Sim Tack:

I think so. I think that actually, I think we've seen some actors very actively try to push back against Russia's sphere of influence and the primary one that we've seen in the past five years or so, seven years is Turkey. It started with the clashing interest in the conflict in Syria. We've seen that expand to the conflict in Libya, but most importantly, and you mentioned the caucuses there, if we look back at the Azerbaijan-Armenia war over Nagorno-Karabakh in 2020, I think we're clearly seeing the signs there that Turkey was one of the main instigators or enablers in this conflict exactly to challenge that Russian influence in the Southern Caucuses. And if Russia shows weakness, if Russia loses that capability, then I think that plays in the advantage of Turkey's future efforts to do that.

Sim Tack:

In addition to that, I've mentioned Central Asia before with the Kazakhstan uprisings and potentials for insurgency that might not necessarily be about a competing power challenging Russia, but Russia could be facing some very significant security challenges in that vast area over the next few decades and if they don't have a capability to deal with that, that could spill over into maybe not directly into Russia itself, but into some areas that it has very close economic ties with. And then finally, as we're shifting towards the East here, finally coming to China, the question is how does China start to behave toward Russia if they don't perceive Russia as a significant power anymore, if they even do at this point? But one of the interesting things that I was made aware of yesterday was that apparently China, or at least the Asian Infrastructure Investment Bank has halted its investments in Russia and Belarus over the conflict in Ukraine.

Sim Tack:

So this is the funding vehicle for the Belt and Road Project or initiative. Sorry, The Belt and Road Initiative. So this is something that China has been working very closely on with countries like Russia and Russia's allies. So if the Asian Infrastructure Investment Bank is halting down that funding, what does that say about how China is perceiving this conflict? Clearly, they're not happy with it. Normally you'd expect China to be the country that essentially accepts all of these things and maybe even applauds it for challenging the Western sphere of influence anywhere in the world, but if we are seeing China diplomatically breaking with Russia, I think that a weak Russia falls victim to Chinese interests and then maybe it won't necessarily get invaded, but I think it doesn't really find support there anymore the way that it has in the past.

Jacob Shapiro:

Yeah. I couldn't agree more on that point, Yes, China would like to push back against the sort of Western sphere of influence, but it also does not like when sovereignty of internationally recognized starts getting violated, which is maybe kind of a hard thing for people to keep in their minds because they think of Taiwan, but one of the reasons that China has been so insistent that Taiwan is not an independently recognized country and that it has been getting everybody else not to recognize it is because it doesn't want to be in this kind of situation I think that Russia is in with Ukraine. Second big picture thing to zoom out, it seems like a race for all these European governments to announce how much money they're throwing into their military budgets and how fast they're going to hit 2% of GDP spending on military budgets.

Jacob Shapiro:

I think it's what? A €100 billion from the Germans here in the next year two. I saw even the Danes are throwing their hats in and talking about vastly increasing military spending and even withdrawing some of their current posture towards European defense protocols. So I wanted to ask you, and you're obviously also European, does any of this mean anything to you? Are these real initiatives that will actually increase European military power over a short to medium term? Is this more political signaling



to demonstrate that people are against Russia? How seriously do you take all these announcements about how Europe is going to beef up its military?

Sim Tack:

I think there's some serious realistic consequences that will come out of this, but I think that we need to be a little nuanced in what to expect there. When people talk about European defense, when they push that to the extent of a European army operating under European leadership, I think we're going a few bridges too far there. Europe is barely able to actually bring together a foreign policy, let alone actually take military command, but that said, any of these investments in European defense do pay off what they are actually investing in is not necessarily a single European army, but a burden sharing scheme. Essentially, that's what it is.

Sim Tack:

They are jointly procuring weapons systems. They are jointly developing those. They are generating interoperability between European armies and those are things that pay off when you end up conducting joint military operations. And we've seen that in a lot of the operations that European countries have conducted under EU flag or under ad hoc alliances or under NATO. So all of these investment, I think that's not a wasted effort or a pipe dream, but it's a little limited of the more extreme views that I think some people see President Macron as one of the proponents of actually creating a standing European army.

Jacob Shapiro:

Yeah, he certainly is. He has a lot of faults, but I think from a strategic level, he's been right about a lot of things. I also just wanted to ask from an anecdotal basis, I mean, some of the people I'm talking to, especially in Germany, feel really betrayed by Russia on a deep visceral level. If you look at the polls in a lot of European countries, it seems like broadly, Europeans are supportive of harsher restrictions on Russia, even if it means higher energy prices. Do you feel like there has been a shift in how normal Europeans think about Russia in general, and that Europeans really are willing to stomach much higher natural gas prices at much higher oil prices in the next two to three years, if it means rapidly decreasing dependence on Russia, or do you think that will fade as the realities of this conflict on the ground start to assert themselves?

Sim Tack:

So I think that there is definitely some of that going on. There are people that are taking on a much more critical stance toward Russia that are willing to stomach some of these energy prices. Luckily, for them as well, we're nearing the end of winter here in Europe. So the natural gas demand will start to drop and it probably won't bring prices down to what they were before the winter, but the pain probably won't be the worst that it could have been. But one of the important things to realize here, and I think this is probably the case as much in the U.S. as it is in Europe, but as with every political topic, it's not just about people taking a stance. It's about people taking opposite stances and that polarization of society's something that I am definitely noticing in this conflict as well.



Sim Tack:

I'm seeing very clearly, some people drawing toward pro Russian or Russia apologetic narratives, by which I don't mean to say that there's no room to talk about Russia in anything other than a negative manner, but some people are taking liberties with that, obviously. And especially when we see the way that people are sharing certain narratives from social media, there's propaganda going on, on both sides of the conflict and it becomes very clear once that hits the European social media crowd, which side of other political divides they are on based on which propaganda on the Ukraine conflict they start to spread.

Jacob Shapiro:

Sim, this has been great. Is there anything I didn't ask you that I should have or anything that you're going to be watching very closely going forward that we didn't talk about already?

Sim Tack:

No, I think we've actually covered everything. If you'll allow me, I like to... You mentioned my, my Twitter, @SimTack. We're continue to follow the conflict there, me together with some of the other people I work with being COUPSURE and Detresfa. If you're not following those people, they're doing some really great work on OSINT and [EMENT 00:39:31]. We're going to keep trying to figure out how things are evolving on the ground and how the Russian military has ended up screwing itself over here.

Jacob Shapiro:

Well, I highly recommend Sim to everybody who's listening. Sim, thanks so much for taking the time. I really appreciate it. Maybe we'll have you back on here in a couple weeks to talk about what has happened to over that time period, but in the meantime, thanks again. Cheers.

Sim Tack:

Thanks, Jacob.

Jacob Shapiro:

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