

# Views From the Stream

February 28, 2024

The Monthly Letter covers two topics this month. First, we return to our Great Game of Power series. This month, we focus on The Winds of War, as part of our Great Game of Power Series. These Winds appear rising and beginning to swirl at an ever faster pace. For those of us who studied the runups to World War II and to World War I, there exist eerie parallels with the actions of countries over the past decade. As in those prior eras, countries appear to be arraying the pieces on the chessboard in anticipation of future strife. And this strife could strike at any moment due to either accidental matches lit, such as the assassination of Archduke Ferdinand setting off World War I, or deliberate actions by countries, such as Germany's blitzkrieg in Europe and Japan's coordinated attacks across Asia in World War II. The consequences of such gales and the damage to the global system could produce massive shocks and create unforeseen impacts to countries around the globe. Second, as always, we close with brief comments of interest to our readers on a variety of current topics relevant to the economy and the markets.

## **The Great Game of Power: The Winds of War, The Once & Future Economy, A Modern Marshall Plan & The Free World vs. Totalitarianism, Once More**

*“Every realist knows that the democratic way of life is at this moment being' directly assailed in every part of the world—assailed either by arms, or by secret spreading of poisonous propaganda by those who seek to destroy unity and promote discord in nations that are still at peace.”*

State of the Union Address  
President Franklin Delano Roosevelt  
January 6, 1941

For those familiar with Herman Wouk's great opus, the Winds of War, events of late stand a stark reminder of the 1930s and the run-up to World War II. While Wouk only covered the events from early

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1939 through the bombing of Pearl Harbor in December, 1941, a review of the historical period from 1936 through 1941 provides valuable insight and parallels to much of how events continue to unfold today. During this period, America stood divided, having passed the Neutrality Act of 1935, preserving its neutrality in armed conflicts and embargoing war materials from all parties involved in a war. However, with the threat to democracy rising in the late 1930s, America came to support European and Asian allies through the Lend Lease Act and other methods prior to directly entering the war after the attack on Pearl Harbor.

The events of 1936 stand seminal, as they represent the beginning of the true runup to World War II. The most important event occurred On March 7, 1936, when Germany remilitarized the Rhineland in violation of the Versailles Treaty. This represented the effective end to the peace treaty from World War I, which stood in decline prior to this event. In October, Adolf Hitler appointed Hermann Goring to head Germany's Four Year Plan. The Four Year Plan focused on rearming Germany and making the country self-sufficient across all areas of the economy in just four years. In addition to these moves, a series of wars begins around the world that year. In July, the Spanish Civil War begins. In November, Japan backs Mongolian troops that attack a Chinese Garrison, beginning the war between Mongolia and China. In addition to the wars beginning, various outside countries begin to intervene to influence the outcome of wars outside their borders. Germany's air force intervenes in the Spanish Civil War, backing the Nationalists and Generalissimo Francisco Franco. In December, Italy sends troops to Spain to support the Nationalists. In addition, various countries begin to set up coalitions to further their interests. Japan and Germany enter into an alliance against the Soviet Union, in the event either goes to war with the USSR. Back in China, the Communists and the Kuomintang suspend their civil war to fight the Japanese.

In 1937, events continue against the background of war. In February, the League of Nations "prohibits" foreign intervention in the Spanish Civil War. Germany and Italy ignore the League, rendering the League of Nations irrelevant. Germany then permanently deploys fighter planes to Spain. In July, the "Marco Polo Bridge Incident" occurs in China in which Japanese and Chinese forces shoot at each other. This ends the truce from 1933 and ignites the Second Sino-Japanese War. Japan would subsequently win the battles for Beijing, Shanghai, and Nanking, leading to the Rape of Nanking. In October, President Roosevelt gives the Quarantine Speech in which he calls on free nations to "quarantine" the "epidemic of world lawlessness". The speech backfires as isolationist forces in the US push back. This leads to the Panay Incident in December in which Japan bombs and sinks the USS Panay and several oil tankers on the Yangtze River. Back in Europe, Germany adopts the policy of Lebensraum, the ideal of a greater Germany. And Italy joins the pact between Germany and Japan.

The Year 1938 begins with the Allison Incident in January. The Japanese physically attack the US Consul in Nanking and loot American property there. In March, the Anschluss occurs in which

Germany annexes Austria. Fighting continues in China with Japan. In July, Japan begins a fight with the Soviet Union over the border with Manchuria, which it controls. In March, Germany backs the Sudeten Germans who demand autonomy the next month from Czechoslovakia. In June, Czechoslovakia concedes and recognizes the Sudeten Germans as equals of the Czech people. Hitler threatens invasion and demands autonomy for this area controlled by Czechoslovakia since the 9<sup>th</sup> Century. This leads to the infamous Munich Treaty in which Europe concedes to Hitler's demands, allowing Germany to annex the Sudetenland. At the same time Poland annexes the part of the Sudetenland that adjoins the country. In October, Japan wins the battle of Wuhan and of Canton, totally cutting the Chinese off from the sea. In November, Japan declares the New Order for East Asia, in which it plans to dominate and control East Asia.

The Year 1939 begins auspiciously as Hitler implements Plan Z, a plan to build a huge Navy capable of defeating the British Navy by 1944. In February, Japan occupies Hainan Island, which the British see as a strategic threat to their interests. In March, Germany creates the pro-German Slovak Republic. Then it annexes Bohemia and Moravia-Silesia in violation of the Munich Agreement. With Czechoslovakia ceasing to exist, Hungary invades the Carpatho-Ukraine region. Germany then annexes the Klaipeda Region of Lithuania and demands the return of the Free City of Danzig, an area taken from Germany after World War I. Germany then backs Slovakia in a war with Hungary. Italy demands that Albania turn over control of the country to it. As countries continue to line up on either side, the UK and France announce on March 31 they will back an independent Poland. In April, Franco wins the Spanish Civil War and Italy annexes Albania. Hitler renounces the Anglo-German Naval Treaty of 1935 that limited the size of the German Navy relative to that of Great Britain. In May, the Soviets win the battle of Kalkhin Gol against the Japanese. As a result, Japan decides to focus on the Pacific as opposed to the Soviets. Germany and Italy officially enter into the Pact of Steel. In June, Japan blockades the British in a port in China, as they move to take control of more of the country. In July, the UK tells Germany it will not cede the Free City of Danzig. The U.S. tells Japan it will withdraw from its commercial treaty with them. In August, Germany enters into a pack with the Soviet Union to divide Poland and Eastern Europe, known as The Molotov-Ribbentrop Pact. It then issues an ultimatum to Poland to concede the Free City of Danzig. When Poland refuses, Germany invades Poland on September 1, in what is considered the formal beginning of World War II.

The events in the Pacific mirror those in Europe, just occurring a year later. The Japanese spend the back half of 1939 and the first half of 1940 consolidating their position. Then, in September 1940, Japan invades French Indochina (modern day Vietnam) to blockade arms supplies to China. In 1941, with fears of Japan attacking their interests, the U.S., Malaya, Dutch East Indies, and Australia announce an embargo of oil and other minerals against Japan. Japan viewed this action as an attempt to extort it into submission. In response, it creates the Southern Plan. The Plan focused on seizing key resources and then a defensive perimeter that would force peace. Key resources were located in British Malaya,

Dutch East Indies, The Philippines, Borneo, Burma, and Rabaul. To prevent the Allies staging a counteroffensive, Japan would also seize islands in the South Pacific as well as Midway and the Aleutian Islands. On December 7, Japan simultaneously launched attacks on Pearl Harbor, Guam, Wake Island, Malaya, The Philippines, Thailand, Singapore, and Hong Kong. Thus, truly launching the Pacific portion of World War II.

Fast forward to the past decade. In Europe, Russia invaded and annexed Crimea in 2014. In 2022, Russia then occupied 4 areas of Eastern Ukraine and entered into war to take over all of Ukraine. Ukraine, like Czechoslovakia's Sudetenland, possesses significant industry, resources, and farmland. All these stand attractive to a foreign power. In 2023, Finland signed a mutual defense treaty with the U.S. and agreed to become part of NATO. Russia warned Finland to not get involved with NATO and to not station troops near its border. In 2024, Transnistria, part of Moldova requested that Russia annex that part of the country and then take over the country of Moldova. In response, France and Moldova entered into a treaty whereby France would defend Moldova. This year Russia also terminated the Russian – Finnish Border Agreement and has moved troops and arms to the border with Finland. Over the past year, European countries moved to increase their defense spending significantly to meet the Russian threat.

In the Pacific, in 2015, China adopted its Made in China 2025 Policy to make it self-sufficient of the rest of the world. This stands similar to Germany's Four Year Plan of 1936. In addition, it entered into a massive military buildup, giving it the largest blue water Navy in the world and modernizing its armed forces. China also seized a number of islands in the South China Sea and built seven islands, 3 of which it turned into forward military bases. China and The Philippines continually confront each other over the Scarborough Islands, which China wishes to seize for itself. China routinely harasses Philippine vessels in the area. China continues to stage mock invasions of Taiwan as it prepares to potentially invade the island nation over the next few years. China positioned military and naval forces in the Indian Ocean and East Africa to blunt and challenge U.S. and Indian forces in the region. And it has put up on the Internet video of a Chinese plane bombing the U.S. base in Guam. In response to these actions, countries in the region moved to band together with each other and the U.S. The Philippines renewed its mutual self-defense treaty with the U.S. and expanded the number of U.S. bases in the country from 5 to 9. The U.S., Australia, India, and Japan entered into the Quadrilateral Security Dialogue, known as the Quad. Japan officially boosted its military spending from 1% of GDP to 2% of GDP given China's military buildup.

In the Middle East, Iran, the ally of China and Russia supplied arms to the Houthis who are disrupting shipping in the Red Sea. Iran also supplies Hamas in Gaza and Hezbollah in Lebanon. In addition, Iran continues to supply Russia with significant military equipment, such as drones, to sustain its war effort in Ukraine, building up its defense industry. Meanwhile, in South America, Venezuela, the ally of

Russia, just stationed 150,000 troops on the border of Guyana. Venezuela wants to take over the country due to its recent oil find, potentially one of the largest oil fields in the world. The U.S. rushed military assistance to Guyana in response.

In a more dangerous world, a world that looks like the runup to World War II as well as to World War I, the U.S. economic and foreign policies of the past 30 Years will not work. Those policies, centered around the WTO with far flung supply chains, capital and intellectual property freely flowing across borders, and dependencies on other countries for key technology and resources. This stands inconsistent with a world where Geopolitics and National Security stand prominent. For this world, a new set of policies that revives tools of prior eras of strife need to come to dominate. These policies recognize the reality of a New Cold War, the National Security concerns that this brings, and the changed economic circumstances of the various players around the world. It recognizes that China implemented a massive mercantilist policy underpinned with huge government subsidies to improve its position relative to other countries compared to 30 years ago:

	<i>Share of Year 2000 Global IP</i>	<i>Share of Year 2023 Global IP</i>	<i>Net Gain:</i>
<i>US</i>	27%	16%	(11%)
<i>China</i>	8%	31%	+23%

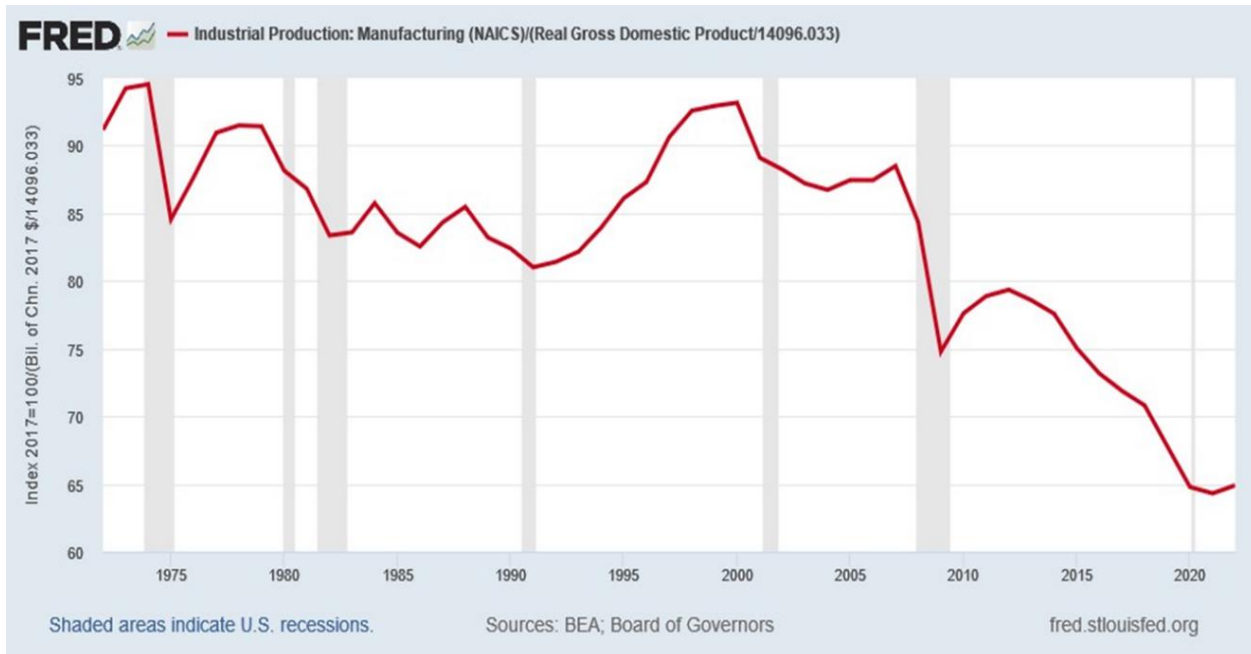
  

	<i>Share of Year 2000 Global GDP</i>	<i>Share of Year 2023 Global GDP</i>	<i>Net Gain</i>
<i>US</i>	31.0%	25.6%	(5.4%)
<i>China</i>	4.0%	18.5%	+14.5%

*Data care of IMF and Eurostat.*

And it will recognize that US Manufacturing collapsed as a result, relative to America's GDP:

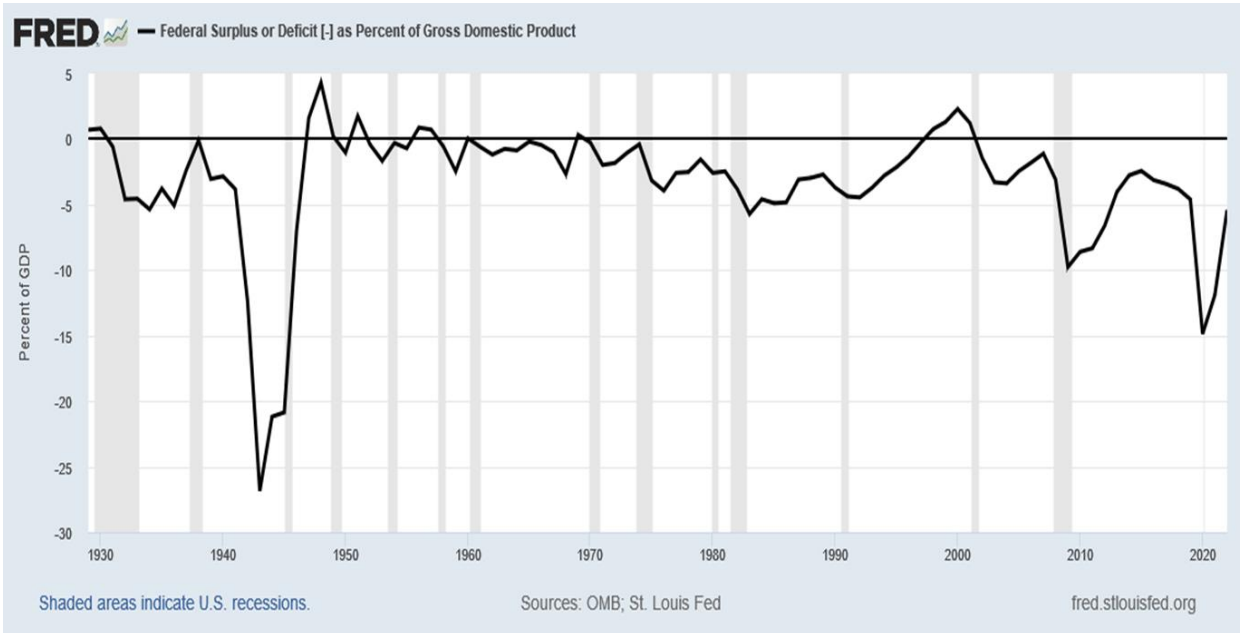




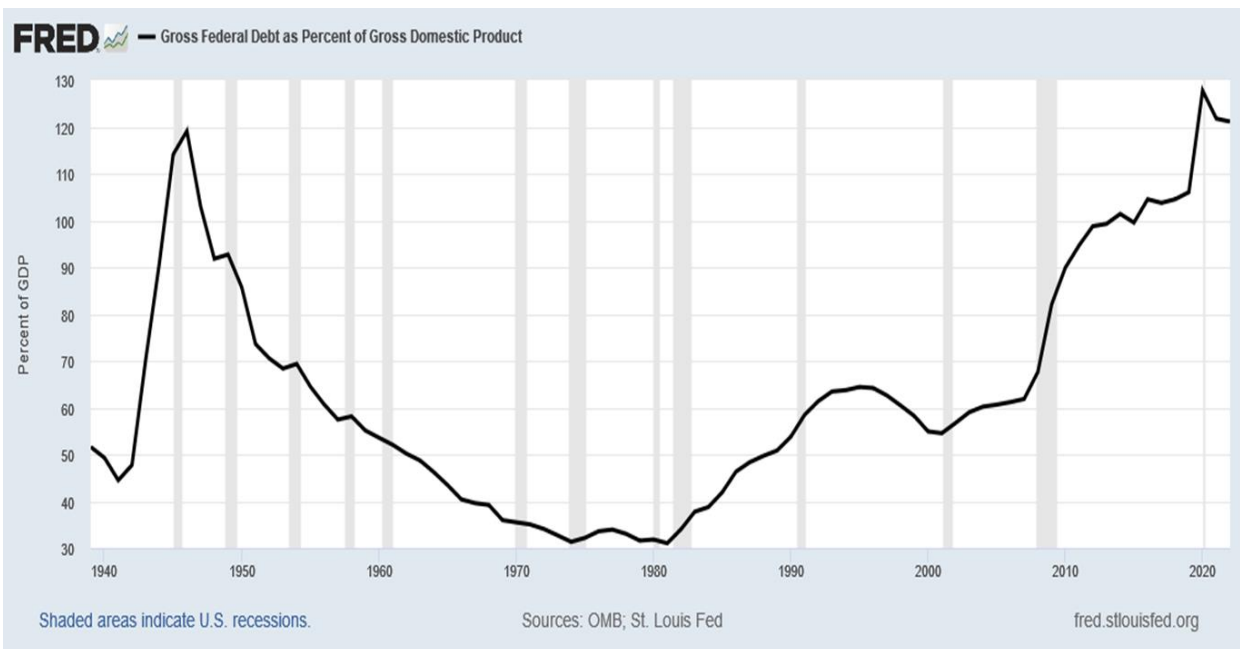
Lastly, it will recognize that such an imbalance and focused mercantilist economic policy, whereby China continues to add significant capacity with no potential to absorb the capacity internally with the only solution through exports, cannot be supported given the Geopolitics and National Security needs of various nations.

To address these Winds of War and to meet the exigencies of Geopolitics, the US moved down the path of The Once & Future Economy since 2017. In this world, the US continues to move at a faster and faster pace to implement the foreign policies from the Cold War and the economic policies centered around the GATT. This means domesticating Supply Chains and creating sources for critical minerals in the event of war. To do this, the United States adopted a war time economic policy, whereby the government runs large deficits to fund the investment and spending needs of the government and does so by issuing prodigious amounts of debt:

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As the graph makes clear, US deficits relative to the economy reached World War II levels.



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As did US Debt to GDP. To achieve its policy goals, the United States focused this Investment across three major pieces of legislation and a fourth major initiative:

**United States Investment Initiatives:**

***Infrastructure Investment and Jobs Act***

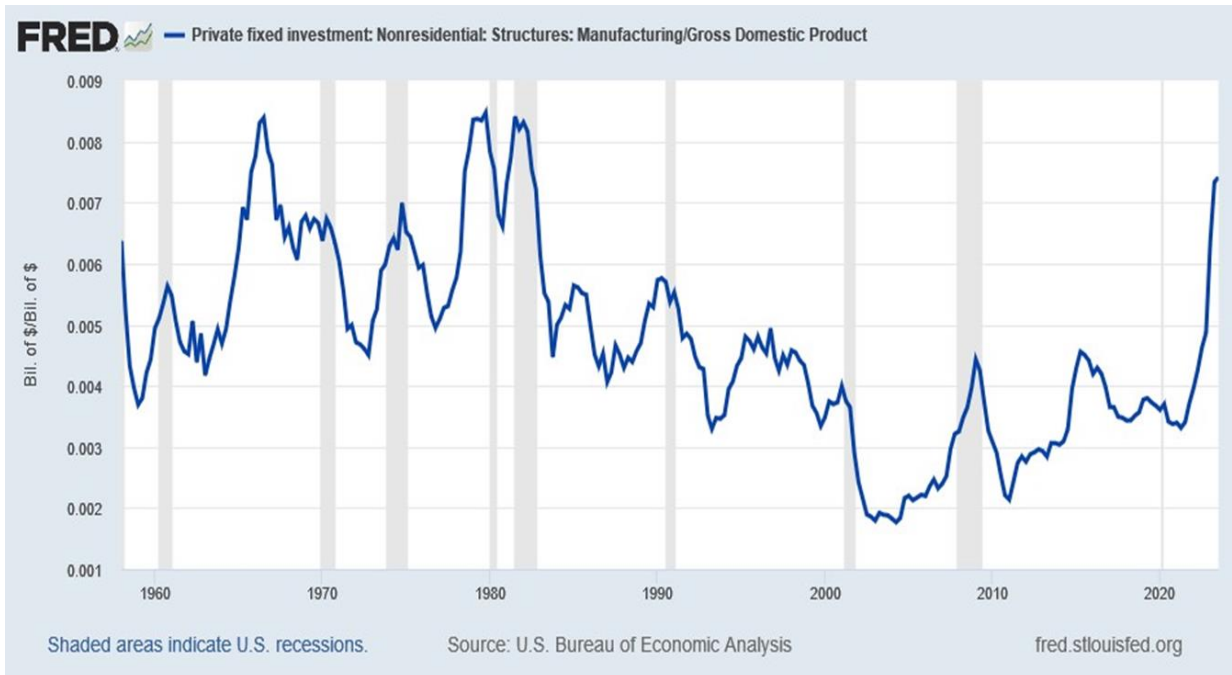
***Inflation Reduction Act***

***CHIPS Act and Government National Security Incentives***

***Industrial Defense Infrastructure Initiatives***

Combined the three legislative Acts will create over \$1 Trillion in Federal Spending, equivalent to 4%+ of GDP. These Acts will incent an additional \$1 Trillion to \$2 Trillion in spending by the private sector, adding another 4% - 8% of GDP to the total spending. In addition, the government will award another \$400 billion in military contracts over the next two years for new technologies, such as drones, satellite defense, missiles, and other defense technology or 1.5%+ of GDP. All told, the Federal Government will spend or incent an Investment into the economy of 9.5% - 13.5% of GDP over the next few years. In effect, to meet its National Security needs and the rising threats from Global Geopolitics, the United States created a Modern Marshall Plan. This stands multiples of the original Marshall Plan, which only totaled 3% of Europe's GDP in the 1940s. That this spending and government incentives already turned the economy on a dime stands clear in US Manufacturing Structure Investment relative to GDP:





This spending exploded upward over the past three years. Of course, this spending excludes the hardening of US infrastructure, such as telecom and utilities, whereby the Federal Government required them to utilize only U.S. or NATO allies manufactured equipment and remove any Chinese technology. In addition, it excludes removing Chinese manufactured industrial equipment from other critical infrastructure, such as the port cranes for cargo ships which were found to possess extra Chinese technology to enable their remote control and sharing of data with China. All this spending will deliver opportunities for numerous companies to grow their industrial capacity here in the United States to redomesticate critical manufacturing. As President Franklin Roosevelt stated in his January 1941 State of the Union address:

*To change a whole nation from a basis of peacetime production of implements of peace to a basis of wartime production of implements of war is no small task. And the greatest difficulty comes at the beginning of the program, when new tools, new plant facilities, new assembly lines, and new ship ways must first be constructed before the actual materiel begins to flow steadily and speedily from them.*

For the US, this clearly applies as ramping capacity and putting in place new capacity continue to take longer than “expected”. Or, as one might say instead, it continues to take the normal time driven by supply chain limits and the need to build plant from scratch.

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On the resource extraction side, contrary to popular perception, the US possesses one of the best geologic resource bases in the world. The country, due to environmental concerns, just chose not to develop them. And this created critical vulnerabilities for National Defense, such as depending on China for 90% of global output of Rare Earth Minerals. With National Security coming to the fore, environmental concerns will now need to take a backseat to defending the country. And the U.S. Government, to meet National Security needs, will incent their development. As an example, the Powder River Basin in Wyoming contains the Bear Lodge Complex of Rare Earth Minerals. The complex stands one of the largest in the world while containing many of the key Rare Earth Minerals needed for defense and technology manufacturing. With the Powder River Basin already seeing major mineral extraction and oil drilling, the hurdles to developing this deposit stand much lower than elsewhere. This likely will lead to a commitment from the US Government to baseload demand for the mine and potentially to subsidize the needed investment. Another example stands Lithium. The US possesses major Lithium resources that the country can tap. In fact, the Thacker Pass prospect in Nevada contains one of the largest Lithium resources in the world, potentially surpassing those found in South America and Australia. The multi-billion dollar development started construction in 2023 and should come online in 2025 or 2026, depending on execution against the mine plan.

With the US supplying both Ukraine and Israel with arms today, in addition to ramping up its own needs, it becomes clear the US began to follow a similar path as in the 1930s before World War II. In the 1930s, America stood technically neutral in the war with Germany, Italy, and Japan. At the same time, Congress passed several Neutrality Acts to keep the U.S. out of war. However, in 1939, Congress passed the Neutrality Act of 1939, which allowed the export of US munitions to foreign governments as long as they moved on the foreign nation's own ships. Then in early 1941, in response to the invasion of Poland, Congress passed the Lend-Lease Act of 1941. It allowed the US to "sell, transfer title to, exchange, lease, lend, ..." military goods to "promote the defense of the United States." Since the US could not just give the goods to the UK and France, the US technically sold them to its allies at a 90% discount. This Act enabled the U.S. to supply its allies and ramp its ability to manufacture defense goods without entering the war. If we fast forward to today, the U.S. appears headed down a similar path. In relation to Ukraine, the Congress passed the Ukraine Democracy Lend-Lease Act of 2022. This allowed the US to lend or lease equipment to Ukraine and other Eastern European countries without having to meet numerous other requirements. Separately, in order to prepare for a potential war, the DOD continues to fund research on new technology which it plans to deploy quickly via over \$400 billion in new orders over the next two years. These missiles, drones, and UAVs cost a fraction of the planes, ships, and armored vehicles they replace, allowing the U.S. to create large volumes of military hardware. In effect, the U.S. continues to adopt the words of Teddy Roosevelt spoken in 1898, as stated in his famous Duties of a Great Nation speech:

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*“To go into war with a first class power without adequate preparation is to invite humiliation and disaster at the outset. In the long run I firmly believe our people would win, but meanwhile there would be incalculable loss and suffering. Therefore it is to our interest to be prepared, both because thereby we are most likely to secure peace, and because, if war does come, we minimize by our preparation the chances of humiliation to the nation and suffering to the individual citizen.”*

For the U.S. today faces an alliance of “first class powers”, Great Powers, in China and Russia, as well as a bevy of Totalitarian countries who have aligned themselves with them, such as Iran, Syria, and Venezuela. And, in response, the U.S. continues to move ahead with “preparation” to meet this challenge. At the same time, the country continues to beef up its with alliances with democracies around the globe, with countries such as India and Australia, as well as to strengthen its military position with traditional allies, such as The Philippines. For the US, as leader of the Free World, the clash ahead clearly will echo that of World War II, with The Free World vs. Totalitarianism, Once More.

With events eerily matching those of the 1930s, the Winds of War appear swirling once again. To meet this challenge, the United States moved to re-create, over the past few years, The Once & Future Economy, an economy that won the Cold War and possesses the ability to win the coming conflict with China and Russia. In order to achieve this, Congress enacted legislation and the Department of Defense allocated funds to create a Modern Marshall Plan, an investment into the United States that would produce the industrial infrastructure needed to meet this challenge. With countries taking sides, Once More, as the Winds of War swirl ever faster, a clash between The Free World vs. Totalitarianism continues to rush to the fore as the future races to become the present. For the United States, the type of wars spawned by the Great Game of Power move ever closer, wars such as Korea and World War II. And, despite its preference to avoid foreign entanglements, America appears once more poised to become the reluctant savior. In January 1941, President Roosevelt concluded his State of the Union address with the following:

*This nation has placed its destiny in the hands and heads and hearts of its millions of free men and women; and its faith in freedom under the guidance of God. Freedom means the supremacy of human rights everywhere. Our support goes to those who struggle to gain those rights or keep them. Our strength is our unity of purpose. To that high concept there can be no end save victory.*

With war in Europe, Chinese militarism on the rise, war in the Middle East, and the potential for war in South America, time continues to rush forward. And, with countries continuing to align and arrange pieces on the board, the Great Game of Power marches forward toward a classic conflict. As the Winds

of War continue to rise to hurricane force levels, for the United States in the coming conflict, there can be no end save Victory with faith in freedom under the guidance of God.

## **Love Those Nukes, A Return to Cocooning, & The Soaring Cost of Cooking**

Finally, we close with brief comments on Love Those Nukes, A Return to Cocooning, and The Soaring Cost of Cooking. First, demand for nuclear power continues to rise globally as countries focus on clean electricity. As such, the demand for Uranium has recovered from its post-Fukushima funk. Add in geopolitics to the mix and Uranium prices are up almost 5x over the past two years. For Uranium mines, you gotta Love Those Nukes. Second, home repair and remodeling spending, which soared during the Pandemic, followed housing turnover down over the past two years, as this spending lags turnover by 6 – 9 months. With mortgage rates dropping and housing turnover beginning to recover, it appears A Return to Cocooning may be in store. And Third, with demand rising and disease impacting supply, the price of Olive Oil soared over the past four years. In fact, Olive Oil prices are up 4x compared to just 4 years ago. In Spain, Olive Oil now stands the number one item stolen. For those who love the kitchen, they will need to endure The Soaring Cost of Cooking.

### **In Closing**

Should you have any questions on how the above issues or the items discussed in our accompanying cover letter impact your family's financial position or your business's future as well as the potential actions you could take in response, please do not hesitate to contact us. We welcome the opportunity to discuss this with you.

Yours Truly,

*Paul*

Paul L. Sloate  
Chief Executive Officer