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## Updates on Russia-Ukraine and Armenia-Azerbaijan

September has been full of dramatic developments in Russia's war against Ukraine and in the broader geopolitics of the region. Indeed, now that we're into autumn and Russia and Ukraine are both trying to improve their positions ahead of winter, it may be a good time to update the recent developments in the war and how they're playing out more broadly. Renewed fighting between Armenia and Azerbaijan in mid-September offers a good example of the broader implications of the war, so we especially want to touch on that. As always, we wrap up this report with a discussion of the implications for investors.

### Ukraine: Beating Back the Russians

Since launching its invasion of Ukraine on February 24, the Russian military has suffered multiple embarrassing setbacks, from failing to quickly seize the capital, Kyiv, to losing vast numbers of troops, tanks, and other vehicles and equipment. However, despite the war slowing down to what looked like a near stalemate in early summer, Russia, at the time, was still making slow, plodding territorial gains in the key Donbas region of eastern Ukraine, where ethnic-Russian separatists had formed Russian-affiliated statelets in 2014.

What a difference a few months can make! Aided by increased flows of advanced weapons from the West, including the U.S. High Mobility Artillery Rocket System (HIMARS), by late summer, the Ukrainian

military was conducting surgical artillery and missile strikes against Russian ammunition dumps, communication lines, command and control headquarters, and troop concentrations far behind the front lines. The attacks quickly blunted the Russians' operations. More importantly, they also set the stage for two important Ukrainian counteroffensives:

- **Kherson Axis:** The Ukrainian attacks behind Russian lines began in the southern region of the country near the key city of Kherson, which the Russians seized early in the war. By mid-summer, Ukrainian officials were openly announcing their intention to launch a major counteroffensive to retake the city and its surrounding region. They even called on Ukrainian citizens in the area to evacuate. Responding to the well telegraphed attack, the Russian military shifted many of its troops out of the northern and northeastern parts of the country to shore up the Kherson line. However, when the Ukrainian attacks against Kherson's occupiers stepped up in September, they were much smaller and more restrained than advertised. There is some debate among Western observers about whether the Kherson operation was merely a feint to draw Russian forces away from the north and northeast. In any case, Ukrainian forces have begun to retake territory around Kherson as of this writing.
- **Kharkiv Axis:** Ukraine's most dramatic success has been its counterattack in the north and northeast. Launched in early September, the Kharkiv attack took

advantage of the Russian redeployment of troops in the south to defend Kherson, leaving only a small number of poorly trained national guard and volunteer units to hold the line. [The attack quickly pushed the Russians all the way back to the northern border \(with some Russian units crossing back into Russia\) and far into the Donbas territories that the Russians had seized at great cost earlier in the war.](#) Although the Ukrainians are being tight-lipped about their operations, it appears the Russians’ retreat was so desperate and chaotic that they left behind mountains of equipment and ammunition that the Ukrainians can now turn against them elsewhere. Casualty figures are unavailable, but Ukrainian officials claim they have taken large numbers of Russian troops as prisoners of war.

The Ukrainians’ September successes don’t guarantee they’ll win the war or be able to push the Russians all the way out of the country. However, the victories are likely to have important impacts over the coming months for the Russians, the Ukrainians themselves, and for Ukraine’s supporters in Western Europe and the U.S.

**Impact on the Russians.** [For the Russians, the key near-term damage includes the loss of still more military equipment, frontline troops, and commanders.](#) They have also been pushed out of swaths of territory where they had been able to attack Ukrainian population centers, and they’ve lost control over important roadways and railroads needed to reposition their forces, such as the railway hub of Izyum. [Politically, the Ukrainian attacks also stopped the Kremlin from holding its sham referendums to annex occupied territory to Russia and spawned widespread criticism of the Ministry of Defense and the uniformed leadership of the military, at least among hardline nationalist commentators.](#) Still, the biggest political cost for Russia may be that its losses have irritated Chinese President Xi Jinping. [In a readout after a meeting between Xi and Russian President Putin at a summit on September 15, the Russians admitted that Putin had been forced to respond to Xi’s “concerns and questions” about the war.](#) As the world continues to break up into relatively separate geopolitical and economic blocs, Putin had already been finding himself locked into the China bloc as a junior partner. Continued Russian failures in the war would likely increase Putin’s political dependence on Xi and further relegate Russia to junior status.

Figure 1



**Impact on the Ukrainians.** As mentioned above, Kyiv’s successes in September have strengthened Ukraine’s strategic position, increased its equipment and ammunition

holdings, and further boosted military morale and national unity, putting [the military in a better position to keep pressing their attacks](#). As with the impact on the Russians, however, the most important benefit may be in the international political realm. The victories have already helped Western governments justify the massive military and economic aid they've provided. With the Ukrainians now looking like winners, it will likely be easier for supportive governments in the West to keep providing support or even increase their support. [By mid-month, for example, German Chancellor Scholz was forced to allow the shipment of advanced tanks and armored personnel carriers to Ukraine](#). Faced with Russia's embargo of natural gas shipments to Western Europe and the likelihood of massive price hikes and shortages there this winter, the Ukrainian victories could also help defuse any resulting social pushback against helping the Ukrainians.

**Impact on the West.** As discussed in the preceding paragraph, current U.S. and Western European leaders supporting Ukraine now have tangible successes to justify their efforts. Everyone likes a winner, so supporting Ukraine could now become a political asset in the West. That could undermine right-wing nationalist forces that are more isolationist or less opposed to Russian-style authoritarianism. [Finally, the clear role of U.S. and other Western weapons systems in pushing back the Russians will likely help maintain plans for massive defense spending hikes and modernization efforts in countries around the world](#). Russia's aggression has generated enough fear that Western governments are now desperate to rebuild their ability to defend themselves. [The dramatic success of U.S. weapons like the HIMARS and the U.S. defense industry's](#)

[relatively better production capacity mean it will probably enjoy the lion's share of new procurement revenues for years into the future](#).

### **Armenia-Azerbaijan: Renewed War**

Armenia and Azerbaijan are in a "frozen conflict" that occasionally "thaws." The two countries are situated in the Caucasus region between the Black and Caspian Seas. The region is bracketed by Russia to the north and Turkey and Iran in the south. The Russian areas of the Caucasus include Dagestan and Chechnya, which have experienced unrest. In 2008, Georgia was invaded by Russia and two areas of the former, South Ossetia and Abkhazia, remain under Russian control. Under the Tzars, these areas were part of the Russian Empire. After the Russian Revolution, various states attempted to break away from the former Empire. Over time, however, the Bolsheviks regained control over these breakaway areas. The Soviet Union was, officially, a series of republics, creating the illusion of local autonomy. In reality, Moscow held a tight grip on the various provinces. However, Kremlin leaders used this republic structure to manage these regions in a fashion similar to how European colonial powers managed various areas under their control. Before Stalin was elevated to General Secretary, he was in charge of minority affairs in the Caucasus region. One of his decisions was to assign the region of Nagorno-Karabakh to Azerbaijan, even though its population was majority Armenian. Since all the area was controlled by the Soviet Union, these allocations didn't matter much at the time. It should be noted, though, that Stalin did give Nagorno-Karabakh a degree of autonomy within Azerbaijan. By creating these divisions, it made it easier for the Kremlin to exert control.

As the Soviet Union began to devolve in the late 1980s, Nagorno-Karabakh asked Moscow to unify with Armenia, but Gorbachev denied the request. In November 1989, Azerbaijan ended the autonomy that Stalin had granted to Nagorno-Karabakh; however, the government in Nagorno-Karabakh refused to disband and proclaimed unification with Armenia. Finally, in 1991, after Armenians in Nagorno-Karabakh approved the creation of a new state, the two newly formed nations, Armenia and Azerbaijan, went to war over Nagorno-Karabakh. The conflict attracted mercenaries from the region as Afghan and Chechen mujahideen fought for Azerbaijan, while Russians and Ukrainians fought for Armenia. By 1994, Armenia essentially controlled Nagorno-Karabakh. Needless to say, Armenia is generally satisfied with the status quo, while Azerbaijan is less pleased.

Since this initial conflict, there have been a series of wars, and the most recent occurred in 2020, when Azerbaijan captured parts around Nagorno-Karabakh that were previously controlled by Armenia. [Russian peacekeepers were deployed to these areas](#), resulting in Armenians leaving and Azerbaijanis moving in. In the 2020 conflict, Turkey supported Azerbaijan, further complicating the array of outside forces trying to influence the region.

The recent flareup just last week has reportedly claimed the lives of over [200 combatants on both sides](#). Armenia, a member of the Collective Security Treaty Organization (CSTO),<sup>1</sup> has invoked the collective defense provision of the group. The [CSTO did not respond to the request](#). At present a ceasefire is in effect. Given the fact that fighting occurs periodically, this recent event may not indicate anything new.

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<sup>1</sup> Which includes Russia, Armenia, Belarus, Kazakhstan, Kyrgyzstan, and Tajikistan.

However, the timing begs the question...is Azerbaijan taking advantage of Russia's war against Ukraine to attack Armenia? After all, Russia is scrambling to find enough soldiers to maintain operations in Ukraine. The Russian peacekeepers clearly did not stop Azerbaijan from attacking Armenia, and it would appear that Azerbaijan does not expect a strong Russian response.

For now, the situation has calmed down. A truce is holding. But much to the chagrin of Moscow, U.S. [Secretary of State Blinken](#) has become active in negotiations to resolve the current clash. [Turkey](#), an ally of Azerbaijan, is also present. Russia appears to be sidelined in the process, allowing Ankara and Washington to step into the breach.

The hostilities in the region may portend a decline in Russian influence across its southern regions. We note that President Xi was welcomed with open arms in the "stans" nations of the Shanghai Cooperation Organization meeting recently, including a [rather gushing appraisal](#) of Xi by Uzbekistan's leader while conferring an Order of Friendship award. Xi held talks with other nations in the region as well. We also note [scattered reports of hostilities](#) between Kyrgyzstan and Tajikistan. If Russia's influence is weakening, latent tensions would be expected to emerge.

And so, Russia's failed war in Ukraine appears to be causing broadening effects, weakening Moscow's grip on its southern border. Russia's geopolitics has perennially called for an expansion of influence to its west and south to protect its core around Moscow. That is likely why Putin invaded Ukraine with the idea that he would press further west. Getting bogged down in Ukraine is not only thwarting efforts to expand influence into Europe, but there is

also growing evidence that the Ukraine conflict is undermining its influence to the south. If a vacuum is being created, it is likely that China, Turkey, and perhaps the U.S. will try to take advantage of Russia's predicament as will the local governments.

### **Investment Ramifications**

Ukraine's stunning successes on the battlefield in September have the potential to affect near-term economic prospects around the world, but their bigger impact may be on global politics and economics in the longer term. In the short term, the further degradation of Russia's military position and President Xi's apparent pressure on President Putin for a course correction could conceivably bring the Russians to the bargaining table. Any effort by Putin to calm the situation could involve goodwill measures like further easing of Ukrainian commodity exports or the resumption of Russian energy exports to Western Europe. If that happened, the prospect of renewed supply would probably bring down commodity prices and might help Europe avoid a major recession this winter. Obviously, that would probably be positive for global risk markets.

Whatever the short-term impacts, investors will also be affected by the longer-term impact on geopolitics. Russia's military, economic, and political losses to date suggest the country will be weakened and chastened for years, while Ukraine and the Western allies are likely to be strengthened. The war is therefore expected to act as an accelerant in the process of regionalization, specifically by solidifying the evolving U.S.-led bloc while pushing Russia even deeper into the China-led bloc as its junior partner. Since China's bloc will include many other major commodity producers like Russia, its consolidation will likely bring forward the day in which it weaponizes commodity supplies in its geopolitical competition with the U.S.-led bloc. In other words, the current trends in the war further support our expectation for continued rich pricing for mineral commodities in the future.

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