Investment Strategy Update

March 2022

We wanted to provide an update with our latest thoughts given the continued volatility across capital markets and the escalating situation in Russia / Ukraine.

1. Russia / Ukraine is clearly having an increased effect on asset prices with each passing day. Headline attention is focused on equity markets, but we can see this most clearly though the aggressive upward move in oil prices along with the sharp move lower in yields (risk off signal).

2. On the other hand, the S&P 500 closed at almost the exact same levels on 1/27/22 (before Russia / Ukraine became a concern for markets) as it did on 3/1/22. In other words, we continue to believe the most dominant force playing out in capital markets is a re-rating of asset prices, as we wrote about extensively in January. Russia / Ukraine has further complicated and stressed already existing dynamics across the economy and capital markets.

3. **No one** has an investment "edge" regarding Russia / Ukraine. Equites are always long duration assets, and making investment decisions based on short term factors rarely works out well.

4. As we have previously discussed, the average correction for the S&P 500 in a midterm election year is -19.6% (*source: Strategas Research Partners & Dan Clifton)*. Stocks don't just go down 15% - 20% for no reason. There is always a "scary narrative" which accompanies these corrections. Is it difficult to believe in the moment, but most corrections are both normal and somewhat healthy in the longer term.

5. History says that market corrections due to geopolitical events tend to not be a huge deal (in hindsight) and are usually relatively short lived. Although US equities have declined by a median of 10% during previous geopolitical crises and market events, they have typically fully recovered within 30 days. (Chart below) The Crimea conflict appeared to have no discernable impact on US equities, in aggregate. While European and EM equities fell by 5% and 2% from peak-to-trough, respectively, both regions recovered their losses within 30 days. *(source: Investment Strategy Group, Council on Foreign Relations, Bloomberg, Datastream)*

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S&P 500 Reaction to Select Geopolitical and Market Events						
Event	Date	% Change				Days to Worst
		Prior Month	Next Day	30-day	To Worst	
Attack on the US Capitol	1/6/2021	0.9%	2.1%	4.3%	N/A	
COVID-19	2/20/2020	2.0%	-1.4%	-31.9%	-33.9%	33
Downing of MH17	7/17/2014	2.0%	-0.2%	-1.3%	-1.2%	1
Crimea Conflict	2/27/2014	2.9%	0.8%	0.7%	N/A	
Japanese Tsunami	3/11/2011	-2.0%	0.7%	2.6%	N/A	
Madrid Bombing	3/10/2004	0.1%	-3.0%	-0.1%	-4.3%	15
US Invasion of Iraq	3/20/2003	2.7%	2.5%	2.2%	-3.0%	12
September 11 Attacks	9/11/2001	-8.2%	0.0%	0.4%	-11.6%	11
Iraq's Invasion of Kuwait	8/2/1990	-1.3%	-3.0%	-9.3%	-16.9%	71
Ronald Reagan Shooting	3/30/1981	2.6%	1.0%	-1.2%	N/A	
Iran Revolution	2/11/1979	-2.1%	0.3%	2.0%	N/A	
Nixon Resignation	8/8/1974	1.4%	-2.2%	-13.6%	-24.6%	57
Arab Oil Embargo	10/17/1973	5.8%	-0.2%	-5.7%	-16.4%	50
Kennedy Assassination	11/22/1963	-1.9%	-2.8%	3.7%	-2.8%	1
Cuban Missile Crisis	10/22/1962	-3.6%	-3.8%	9.4%	-3.8%	2
Pearl Harbor Attack	12/7/1941	-2.4%	-3.8%	-2.9%	-10.2%	23
Median		**0.5%**	**-0.2%**	**0.2%**	**-10.2%**	

Source: Goldman Sachs

6. There are numerous charts summarizing market corrections from geopolitical events floating around right now. The chart below shows that the only periods with negative 1 year forward returns were when the U.S. economy was also in a recession when the "event" occurred.

S&P 500 Performance Around Select Geopolitical/Military Events					
Date	Geopolitical/Military Event	Total Return After Event			
		+1Mo	+3Mos	+6Mos	+12Mos
12/7/1941	Pearl Harbor	-1.0%	-10.2%	-7.2%	7.3%
10/31/1956	Suez Canal Crisis*	-1.1%	-1.0%	2.2%	-6.4%
10/20/1962	Cuban Missile Crisis	8.7%	18.4%	26.7%	36.3%
10/17/1973	Arab Oil Embargo*	-5.3%	-10.7%	-12.6%	-32.6%
11/3/1979	Iranian Hostage Crisis	3.7%	13.8%	5.9%	32.8%
12/25/1979	U.S.S.R. In Afghanistan	6.0%	-6.7%	11.5%	33.1%
8/3/1990	Iraq Invades Kuwait	-6.1%	-8.7%	1.3%	16.2%
1/17/1991	Gulf War	12.9%	20.0%	18.1%	31.8%
8/17/1991	Gorbachev Coup	0.3%	0.0%	8.6%	12.5%
2/26/1993	World Trade Center Bombing	1.2%	3.0%	5.5%	8.1%
9/11/2001	9/11*	0.6%	4.4%	7.7%	-15.5%
3/20/2003	Iraq War	2.2%	14.2%	19.3%	28.9%
2/20/2014	Annexation of Crimea	1.9%	2.3%	9.1%	17.1%
	Average	**1.9%**	**3.0%**	**7.4%**	**13.0%**

. *Economy was in a recession at some point during the measurement period.

Source: Strategas Research Partners

7. Bear markets are often defined by a 20% decline from previous all-time highs. Although that is a technical definition of a bear market, we tend to disagree with it on many levels. Regardless of where the current decline in equity markets ultimately ends, we believe we are currently in a bear market. The good news is that bear markets which are not associated with a recession tend to be shorter, less severe, and ultimately end up being great buying opportunities within the context of a secular bull market.

   Secular bull and bear markets are defined by several year periods of incredibly strong gains (bull) or no progress whatsoever (bear). Historical secular bull markets since 1950 include: 1950 – 1967, 1982 – 1999, 2013 - ?. Secular bear markets occurred from 1968 – 1981 and 2000 – 2013. The chart below shows cyclical bear markets (declines of 15% or more) during a secular bull market.

   In summary, the average decline for a cyclical bear market (down 15% or more) during a secular bull market (1950 – 1967; 1982 – 1999 & 2013 – today) is roughly -23% over the course of 5 months +/-. On average, the market recovers the previous highs 8 months +/- later (*source: Strategas Research Partners & Chris Verrone*).

S&P Cyclical Bear Markets

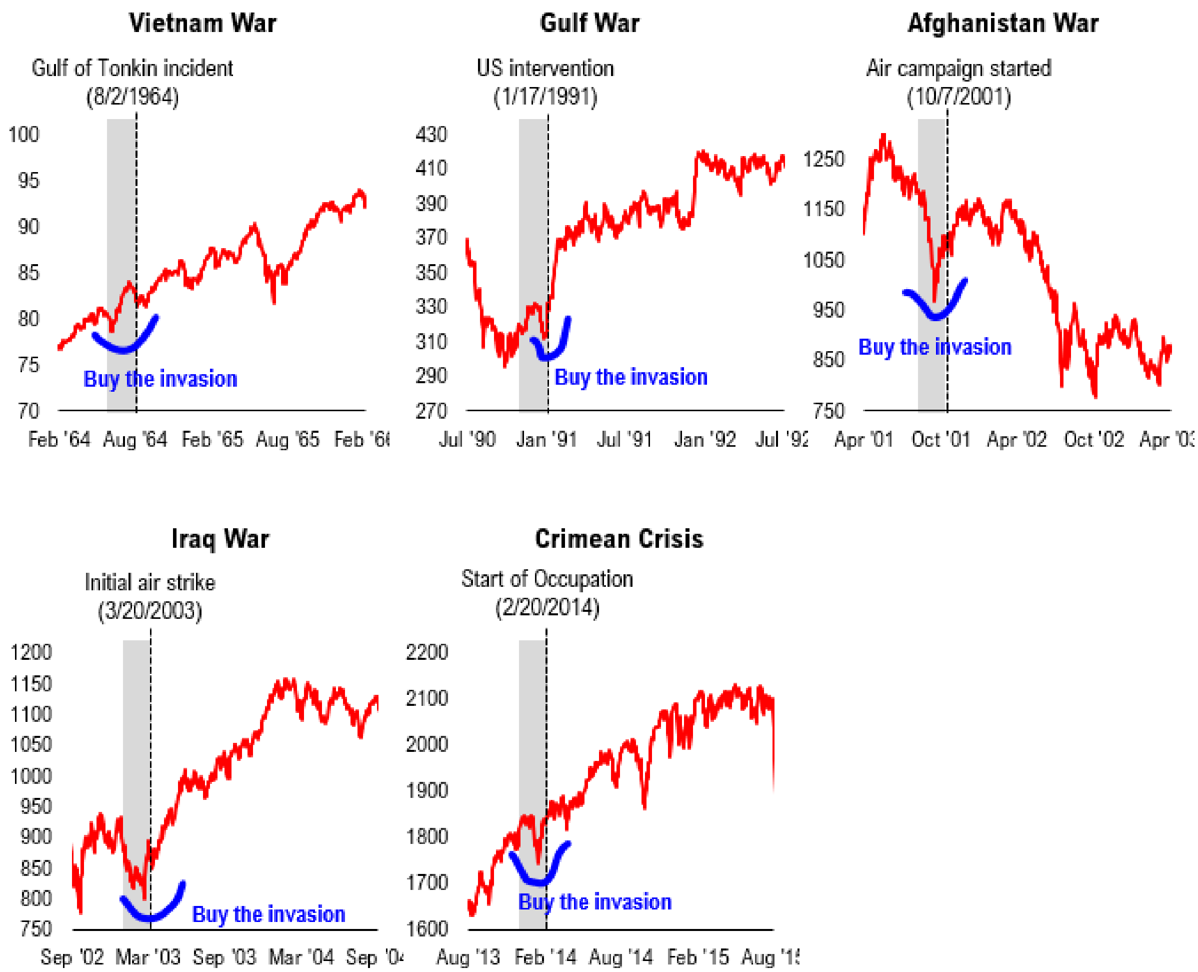
Peak	*Trough*	*Trading Days*	*% Decline*	*Days to Reclaim High*
1/5/1953	9/14/1953	176	-14.8%	121
8/2/1956	10/22/1957	307	-21.6%	233
12/12/1961	6/26/1962	135	-28.0%	299
2/9/1966	10/7/1966	167	-22.2%	143
8/25/1987	12/4/1987	71	-33.5%	414
7/16/1990	10/11/1990	62	-19.9%	86
7/17/1998	8/31/1998	31	-19.3%	59
9/20/2018	12/24/2018	65	-19.8%	81
2/19/2020	3/23/2020	23	-33.9%	103
	Average	**115**	**-23.7%**	**171**

Source: Strategas Research Partners

8. Tom Lee & FSInsight has a saying: “buy stocks when guns are fired.” 4150 +/- is the low on the S&P 500 for this correction, which occurred the morning after Russia officially invaded Ukraine. Many things in our business are counterintuitive. But this is near the top of that list.

5 of 5 times: Stocks bottom just before “invasion”

6 months prior (2 months prior are shaded in gray) and 18 months after



Source: Fundstrat, Bloomberg

9. In the aggregate, our indicators do not indicate that markets are extremely oversold or washed out. That said, some isolated indicators are flashing buy signals and have strong historical track records. The American Association of Individual Investors conducts a weekly survey by asking investors if they are bullish, bearish or neutral in their outlook for U.S. equity markets. The usefulness of this survey is as a contrarian indicator – there are usually not many bullish investors around market bottoms. Roughly 57% of survey respondents were bullish in April 2021 (when most asset classes aside from the S&P 500 peaked out). On 2/18/22, less than 19.25% of survey respondents were bullish (this is around the same % bullish as March 2020). Stephen Suttmeier, CFA, CMT from BofA Global Research put together the following table showing forward returns

after the percentage of bulls falls below 20%. Since 1988, 1 year forward returns were positive 12 out of 13 times. The false signal occurred in January 2008.

Table 3: S&P 500 summary data for forward after first moves below 20% for AAII Bulls

The S&P 500 has much stronger forward returns than average after a first move below 20% for AAII Bulls.

	4-week return	8-week return	13-week return	26-week return	39-week return	52-week return	74-week return	104-week return
Average	1.80%	4.22%	7.36%	11.24%	12.78%	15.22%	19.36%	29.60%
Median	0.92%	3.43%	6.41%	7.20%	13.59%	15.38%	23.16%	28.02%
% time up	61.54%	84.62%	84.62%	92.31%	76.92%	92.31%	92.31%	92.31%
Maximum	23.28%	28.41%	37.56%	48.73%	61.84%	66.63%	64.13%	93.33%
Minimum	-4.98%	-8.48%	-4.87%	-11.53%	-35.82%	-36.45%	-32.46%	-18.28%
Standard Deviation	6.90%	8.81%	10.26%	13.83%	21.82%	22.50%	21.48%	24.64%

Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Source: BofA Global Research & Stephen Suttmeier, CFA, CMT; Where the indicators stand

10. This market correction began with high inflation readings, the Fed behind the curve, and the Fed having to raise rates more quickly than the market previously thought into decelerating economic & earnings growth. The Russia / Ukraine situation further exacerbates these dynamics. Soaring energy prices increase inflation. In addition, once energy prices reach current levels, they often act as a tax on the consumer and slow growth. It was thought that the Fed needed to "thread the needle"(cool inflation, but not stymie growth) before Russia / Ukraine – and this has likely become an even more difficult task.

11. Europe is incredibly dependent on Russia for their natural gas and crude oil imports. Thus, we expect the Russia / Ukraine war to have a disproportionate impact on European economy vs. the U.S. economy. "Contagion" is a word we have not heard very often since the 2008 – 2012 timeframe. But the market action on 3/1/22 showed some resemblance of worries about contagion. U.S. banks declined sharply on 3/1/22 even though they don't have much direct exposure to Russia. But U.S. banks have substantial exposure to European banks, which do have direct exposure to Russian banks.

12. This war only furthers the case for peak globalization being in our rear view mirror. China began this thesis a couple of years ago. This likely means that inflation will continue to be a part of investment conversations for a prolonged period – all else equal.

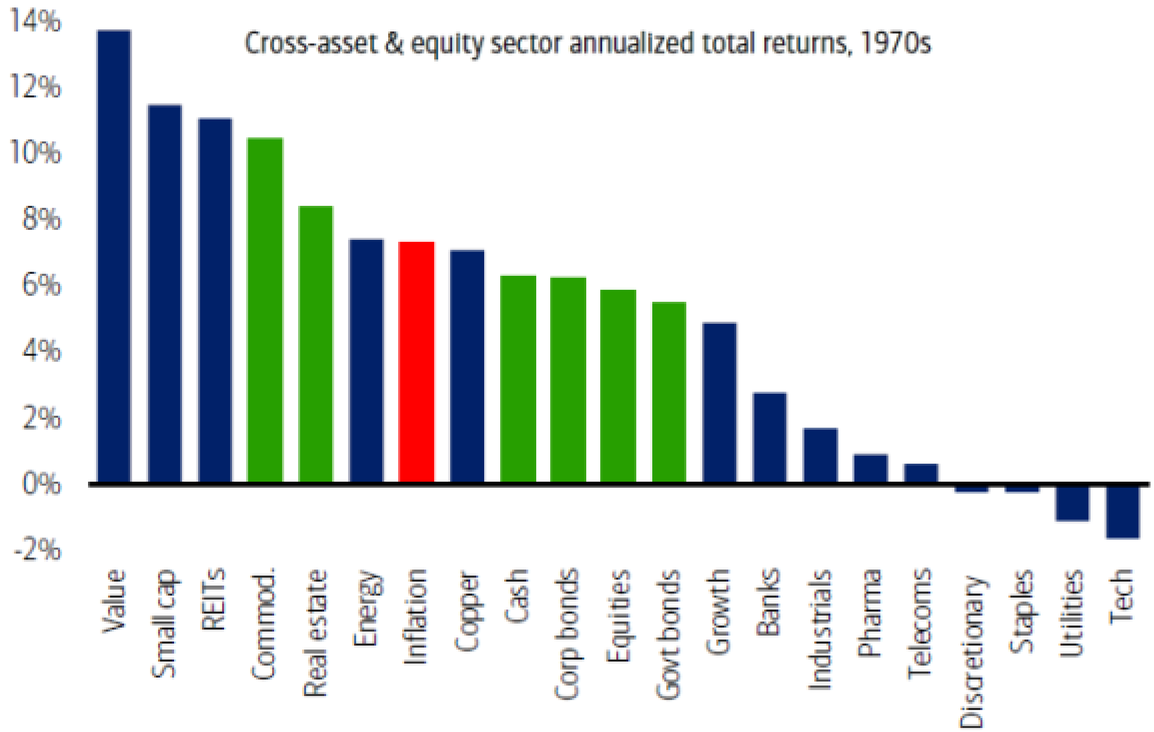
13. Our risk managed equity positions are holding up relatively well year to date. Trend Following equity managers are positioned very defensively right now. Hedged equity and Equity Income strategies have experienced roughly 50% - 60% of the downside vs. the S&P 500 YTD.

14. International equities are down around the same amount as the S&P 500 YTD. Emerging market equities are still the best performing broad equity index YTD. Having said this, we downgraded international equities today (3/1/22) and will continue to watch emerging market equities closely. Europe has enough

structural growth problems as is, and they are the most dependent on Russian natural gas and oil imports.

15. At some point the Fed may have to choose between an economic recession vs. levels of inflation above their stated mandate. We feel strongly that they will choose higher inflation but remain cognizant of the risks that they may unintentionally slow growth more than intended. If (a big if) we enter a stagflationary environment, it may be useful to study asset class returns from the 1970's. These are very different relative outperformers and underperformers vs. 2009 – 2021.

Cross asset & equity sector annualized total returns (1970s)



Source: BofA Global Investment Strategy, Bloomberg, Ibbotson, Fama-French growth/value series, Case-Shiller, Bureau of Economic Analysis, Homer & Sylla, A History of Interest Rates
Note: Prior to 1990 Energy = Oil, Gas & Consumable Fuels; Telecoms = Integrated Telecoms
BofA GLOBAL RESEARCH

Source: BofA Global Research; Michael Hartnett; The Flow Show

16. We have mentioned our thesis of a "valuation reset" extensively over the past couple of months. Nonetheless, it should be noted that valuation is not an issue whatsoever for U.S. mid cap and U.S. small cap equities. The S&P 400 Midcap is trading around 14.3x forward EPS – exactly in line with its average since

2000. The S&P 600 Smallcap Index is trading at 13.6x forward EPS vs. its long-term average (since 2000) of 15.74x *(Source MBL Advisors & Factset)*.

The S&P 400 Midcap is trading at a 26% discount to the S&P 500 on a forward P/E basis vs. its 20-year average of an 8% discount. The S&P 600 Smallcap is trading at a 29% discount vs. the S&P 500 on a forward P/E basis vs. its 20-year average of trading exactly in line with the S&P 500 on a forward P/E basis *(source MBL Advisors & Factset*).

In conclusion, we want to remind ourselves that equity markets hate uncertainty more than bad news itself. Equity markets are no longer priced for perfection but remained concerned regarding the "unknowns" around Russia / Ukraine and The Fed / inflation. As many of the charts above depict, we have seen similar episodes previously, both in regard to war (Gulf War, 9/11, Iraq, Crimea) and the Fed (2011, 2015 / 2016, 2018). The less favorable news is that we haven't seen a Fed tightening cycle run simultaneously to a war in a very long time. Nonetheless, history shows us that market volatility around Geopolitical events or the beginning of Fed tightening cycles is inevitable. In addition, history also indicates that these episodes are usually eventual buying opportunities for investors rather than the beginning of a prolonged bear market. The main economic indicators we monitor are not signaling an imminent recession as of right now. For example, the Manufacturing PMI came in at a very healthy 58.6 on 3/1/22. The rule of thumb is to be on watch when this figure is under 50.

War is always a human tragedy and naturally gets our emotions running higher than usual. We will continue to remain disciplined and long term with our mindset, despite the barrage of jarring short term headlines. Markets are oversold on many short-term indicators and could be due for a "bounce" sometime in the days / weeks ahead. The initial "bounce" almost never seems like it is "the bottom." We are monitoring our dashboard of indicators closely for opportunities to rebalance portfolios. We already feel as though the current market is a more attractive entry point than anything we have seen in 15 months +/- but also remain cognizant that there could be further to go in the months ahead – similar to an average midterm election year correction.

We look forward to continuing these conversations with you in the weeks ahead.

Thanks, Brian, Jonathan, Luther & Billy