Update on Our Outlook

Approximately two weeks into the war in Ukraine, we believe it has become the most important variable for the global economy and asset markets, by far. The primary transmission mechanism is inflation, particularly due to the war's likely impact on energy prices and agriculture markets. Surprises and unintended consequences are piling up fast, requiring a large dose of humility when crafting investment decisions. Here is our current interpretation of events:

- We believe the crisis in Ukraine is not likely to end soon, and there will be more aftershocks to come (we would love to be wrong about this one).
- We can't help but hope for regime change in Russia, but we also recognize Russia is a country with very weak institutions governed by a kleptocracy.
- We suspect the odds of Putin being toppled have risen substantially, but we believe the probability is still relatively low at this time (hope we're wrong).
- Despite the atrocities inflicted by Putin's war, we believe the West will continue to attempt to provide a negotiated off-ramp for Putin to avoid the potential consequences of a desperate tyrant with nuclear weapons who feels trapped in a corner.
- Two weeks ago, we characterized the possibility of a super-spike in energy prices as a tail risk; Today we consider it to be the base case.
- We also expect the global supply of agricultural products could be severely disrupted due to transportation challenges for existing harvests out of Ukraine and Russia, and a potential collapse in acreage planted for next year's harvest in Ukraine.
- Certain metals are also seeing dramatic moves to the upside due to their dependence on production from Russia, Ukraine, or both.
- On the positive side of the ledger, we do *not* expect China to make a move for Taiwan for the foreseeable future, and we expect the pace of monetary tightening may be dialed down in the U.S. and elsewhere.

Putting it All Together (at this point)…

- We suspect the probability of economic recession in the U.S. has risen to more than 50%, while the likelihood of recession in Europe is higher still, in our view.
- We have been adjusting our portfolio strategies to address the changing risk climate, and we plan to do more in the near-term to inject greater flexibility into our investment portfolios:
    - I. Today we accelerated the sale of the U.S. equity sector in the *Dynamic Allocation* strategy from its scheduled review on Friday – This strategy now holds 90% of its assets in cash and short-term Treasuries.
    - II. On Feb. 24th, the day of the invasion, we sold **Sea Ltd. (SE: ~$90)** and **Magna International (MGA: ~$57)** to add a position in **Haliburton (HAL: ~$36)** within the *Managed Equity Growth* strategy.

III. In the *Managed Equity Dividend* strategy, we reduced exposure to **Unilever (UL: ~$44)** which has a Russian subsidiary that sells domestically and exports products.
IV. We have also been accumulating stocks in the energy sector for more than a year in the *Dividend* strategy, bringing the direct exposure to the sector to approximately 18% as of Friday.[1]
V. Clients in the two *Managed Equity* strategies can expect additional changes in the near-term to further adjust to our more cautious outlook.
VI. This week we plan to replace the position in the **SPDR Blackstone Senior Loan ETF (SRLN: ~$45)** with a new position in **SPDR Intermediate Term Corporate Bond ETF (SPIB: ~$35)** to increase the aggregate credit quality of the *Income Bond ETF* model.

- For investors sitting on investable cash reserves, we encourage a slower pace of entry into the equity markets for now – without stopping outright – while remaining flexible to advance the process if we see a regime change in Russia, a negotiated cease fire in the war, or lower prices in the equity markets.
- During times of stress in the asset markets, it is important to stay focused on the things that can go *right,* in addition to addressing the things that can go wrong (or already have gone wrong).
- At the macro level, the war could turn for the better quickly, the Fed could dial-down its tightening pathway, energy supplies could surprise to the upside, particularly if Iran re-starts its idle capacity and OPEC ramps up production.
- At the micro level there will always be innovative companies run by capable management teams poised to create long-term value for investors; Downturns like this one can create opportunities to buy such companies at attractive prices.

[1] Source: Orion; The 18% allocation includes positions in Chevron, Devon Energy, ExxonMobil and Williams Cos as of March 4, 2022.

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