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Market Commentary

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International Politics



Russia continues its invasion of Ukraine. The front line extends for about 1 500 miles, but Russian attacks are limited to a 500 mile subsection. The Ukrainian's estimate that the Russians have absorbed 70,000 casualties in their original invasion force of 180,000 but that they have reinforced by committing an additional 70,000 troops.

These reinforcements are likely to be third echelon garrison troops unsuited to assault operations. The narrowing of Russian aggressive operations is, most likely, a consequence of declining levels of assault troops. Russia has made some improvements to its operations. It appears to have developed effective counter measures to some drone attacks and to have improved its logistical support. It has also shuffled its high command (again), although it is not yet clear whether that will be beneficial or deleterious to its efforts. Primarily, the Russians are relying on massive artillery attack to slowly crumple the Ukrainian lines. This approach has permitted them to advance by a few kilometers over the past month and to complete the capture of Sievierodonetsk. Ukraine by contrast has adequate manpower but deficits in equipment. Approximately three months ago the US and Europeans were dithering about supplying heavy arms to the Ukraine. They have since moved forward with deliveries of artillery. While NATO systems are qualitatively superior to Russian equipment, the Russians quantitative advantage is for the moment adequate to neutralize that superiority and maintain Russian battlefield advantage. In our judgment, Ukraine can only achieve eventual peace by delivering the Russians a stinging military defeat, for this they require material support from the US and Europe that is supplied in full measure rather than being doled out in measured increments.

There are concerns in some quarters that a Russian defeat could topple Putin and lead to massive unrest in Russia. This concern is of course encouraged by Putin's wide flung army of influencers. This premise rests on the example of the Russian defeats in 1917 and 1990, where military failure did unleash revolutionary change. We would counter, however, by the examples of 1905 and 2008. In both instances, a humiliating defeat sparked internal reforms, but no change in the leadership of government.

The European Union has approved both Ukraine and Moldova as candidates for admission. Finland and Sweden are joining NATO. Lithuania has imposed a partial rail blockade on the Russian enclave of Kaliningrad. Important quantities of grain remain bottled up in Ukraine by Russian naval blockades and the result is considerable food insecurity in parts of the Middle East and Africa. If the situation becomes truly dire, it is possible NATO will directly intervene to convoy grain shipments out of the war zone. Its military capacity to do so is clear, but so too is its diplomatic reluctance. Appeals to the Russians to be reasonable lack a strong track record of success, however, and a convoy operation could eventually become a necessity. Recently Ukraine drive out the Russian garrison holding Snake Island which partially clears the obstacle to a grain convoy.

The US and China met at a security conference in Singapore, and each professed itself ready for war with the other. Chinese military demonstrations against Taiwan and Japan have continued. We assess that China feels some show of feather ruffling is in order to comfort its Russian ally, but that actual military confrontation is unlikely now. We do believe China's medium-term goal remains seizure of Taiwan and its ultimate goal is to dominate the Western Pacific. Even conflict short of war, however, can lead to action against foreigner's investments. Given the unsettled relationship with China we continue to advise US investors to avoid acquisition of Chinese investments and to take advantage of market rallies to divest of such investments as they may currently hold.

Iran has not reached accommodation with the United States over its nuclear program and appears to be moving rapidly towards development of an atomic bomb. In Israel the coalition government has fallen, and hard liner Bibi Netanyahu is likely to return to power. President Biden is enroute to the Gulf, where he will meet with the Saudi crown prince in an effort to smooth over relations ruffled by the killing of Adnan Khashoggi by the Saudi intelligence service.



Domestic Politics The Trump Scandals

The House Select Committee Investigating the Attack on Congress on January 6th, 2020 has begun a public presentation of the evidence it has amassed. The great majority of this evidence comes from serious substantive Republicans who at one time were staunch supporters of Trump. Their testimony-not yet tested by cross examination-is that it shows Trump personally directed a

massive effort to reverse the results of the 2020 election in order to retain the presidency. This multi-pronged effort sought to throw the normal electoral machinery into chaos so that the backup machinery would be invoked instead. The backup process is for the president to be selected by the House of Representatives with each state having one vote to cast. Here Trump hoped to win, for while Republicans were in the clear minority by seats in the House, the distribution of seats was such that they controlled 27 of the states. If the vote went on a straight party line Trump could be sure of victory. The only hesitancy would arise from three of the State delegations which consisted of a single member whose loyalty to Trump could not be assumed (Alaska, South Dakota and Wyoming.) Unfortunately for Trump, several Republican officials proved to be men of high integrity who refused to be tools in this plot. His efforts to jam the wheels of the normal electoral process failed and Biden was duly sworn into office.

As the House Committee unrolls this material the greatest shock value lies in the details. Thus, we learn that amid the riotous assault on Congress, Trump tweeted an attack on his Vice President which directly inspired the rioters to attempt to lynch the Vice President and that Trump apparently approved of their actions. Similarly, we learn that the Speaker of the Arizona State House, Rusty Baker, refused to violate the law on Trump's behalf and that to this day a video panel truck regularly passes his home accusing him of sexual crimes. There is a sordid criminality at work here not captured by the anodyne words "perpetrate a fraud on the United States."

Simultaneously the House Select Committee on the Coronavirus Crisis released testimony from Dr Birx, the White House Coronavirus Response Coordinator during the Trump administration. Dr Birx testified that the Trump White House seriously interfered in the management of the pandemic for Trump's supposed political advantage. According to Birx the White House feared that telling the truth about the pandemic would damage Trump's re-election chances. Accordingly, they put out a false narrative minimizing the health danger, they discouraged testing to hide the magnitude of the problem and they routinely suppressed distribution of health guidance to the States. It is hard to escape the inference that this maladministration resulted in hundreds of thousands of unnecessary American deaths.

While Trump was at the center of this misconduct, it is clear that he had many allies and tools. According to one rumor, sixty Congressmen and two hundred staffers petitioned Trump for preemptive pardons covering their efforts to overthrow the election. Meting out the legal and political consequences for these matters will grind on for months to years. On the other side of the aisle, we would hope that the Democratic party realizes that its neglect of "flyover country" has come at the cost of some real peril not only for itself but for the nation as a whole. In our view both parties are ripe for a generational change in leadership, and we think the Trump scandals will both precipitate and shape those changes.

Mass Shootings

The United States has an undoubted problem with mass shootings. During the Obama years there were consistently 20 such incidents per year. Now however the number of incidents has steadily increased and is at 60 per year. The New York Times has collected some interesting statistics on how such incidents resolve. Contrary to popular impression, the shooter survives the incident about half the time. Resolution of the incident is more often due to the shooter's decision than the intervention by the police or public. The police are three times more likely to shoot the perpetrator than to capture him alive. The public, however, is three times more likely to capture the shooter than to shoot him. Presumably this preference stems from the typical bystander being less armed than the police. However, arming the populace sufficiently so that their kill to capture ratio equaled that of the police would change outcomes in only 6% of the incidents. Thus, one cannot endorse widespread arming of the public as a likely effective means for dealing with such incidents.



Congress has enacted a package of measures for dealing with this problem. The package consists of more money for mental healthcare, tightening of restrictions on gun ownership and somewhat better background checks. All these measures focus on the shooter. Unfortunately, active shooters are 1 in 5 million of the population and identifying and stopping the shooter ahead of time will remain an effort to find a needle in a haystack. In terms of reducing the lethality of active shooting incidents a likely more effective approach would be restricting or banning public access to paramilitary equipment. Congress remains unwilling to discuss such measures, however.

The Supreme Court, by contrast, believes public access to weaponry must be increased. In an opinion authored by Justice Thomas, it recently struck down a New York City law which restricted concealed carry of handguns to permitted individuals who could show a personal need for enhanced protection. The law in question had been on the books since 1905. However, the Court

invalidated it under reasoning which it first developed in 2008. The Second Amendment to the US Constitution reads:

A well regulated Militia, being necessary to the security of a free State, the right of the people to keep and bear Arms, shall not be infringed.

In its 2008 Heller decision the Court broke with prior interpretive practice by privileging the second part of the text:

the right of the people to keep and bear Arms, shall not be infringed

and treating the first part:

“A well regulated Militia, being necessary to the security of a free State,”

as decorative rather than expressing a purpose or limitation. The Court in *New York State Rifle and Pistol Association vs Bruen* now takes the further step of reading the Amendment as conferring a right to self-defense which shall not be constrained. This is a masterful bit of textual deconstruction as the original text speaks only of communal defense and not self-defense at all. The Court's procedure for arriving at this result is several steps. First it imposes a particular school of constitutional interpretation itself with no foundation in the Constitution and contrary to the common law bedrock of the country. Following these dicta, it orders judges to follow legal practice in a narrow window of time around the writing of the Constitution (approximately 1760-1810.) Next it forbids them to weigh present needs for regulation against Constitutional privilege. And finally, it silently interjects a modern assumption that guns are for self-defense. We think this the weakest link in the Court's reasoning. At the time the Constitution was written guns were primarily thought of as a source of food (hunting), as a source of communal protection (against foreign invasion by the French and Indian nations) and as a protection of personnel honor (dueling.) The personal protective function against street crime which the current Court identifies, was not top of mind for the framers. Indeed, the flint lock musketry of the day was ill suited to such a role and the sword and cudgel were probably regarded as more effective tools of personal defense. Although pocket pistols appeared as early as the reign of Queen Anne, it was not until Derringer's development of his eponymous pistol in 1830 that guns attained widespread use for personal protection. The dissenting opinion noted that the 44,000-gun deaths per year are a significant source of State concern with gun regulation and opined that in the complex environment of the United States it would be better to leave the matter up to individual States to regulate rather than to seek a uniform national rule. The majority declared however,

“The Second Amendment right to carry arms in public for self-defense is no different [from other Bill of Rights guarantees in the burden's government may place upon exercise of the right]”

The laymen may note, however, that guns frequently result in the death of a citizen, whereas even generous exercise of free speech rights seldom does. Indeed, it is a child's wisdom that “sticks and stones may break my bones but words cannot hurt me.” Perhaps then there is an inherent reason why at least these two rights should be differently burdened.



Further Court Decisions

The same majority which subscribed to this Second Amendment decision also rendered judgment in *Dobbs vs Jackson Women's Health Organization*. Here they concluded that the 1972 case of *Roe v Wade* had been wrongly decided and that the subsequent 1992 case *Casey vs Planned Parenthood* had continued the error.

Accordingly, they overruled both precedents and established the rule that there is no constitutional right to an abortion. This decision leaves each State free to regulate abortion according to its own lights. In a concurring opinion Justice Thomas stated his view that the entire body of the Court's substantive due process jurisprudence was probably in error, and he called for its judicial review. Resting on this body of jurisprudence are several cases directly implicated in the ordinary lives of Americans, among them *Pierce vs Society of Sisters* (the right of parents to control the education of their children), *Loving vs Virginia* (establishing that states could not forbid interracial marriage), *Griswold vs Connecticut* (establishing that states could not forbid the use of contraceptives), and *Obergefell vs Hodges* (requiring states to recognize same sex marriages.) Thomas, however, is apparently unconcerned by the size of the can of worms he is opening. To his mind Federal jurisdiction over any matter not clearly indicated in the Constitution should be peeled away and left to the States to decide. That the result could be the dissolution of the United States into 50 different national states joined in a custom union and military alliance seems not to trouble him. The fundamental question raised by the gun case and the abortion case is when a uniform national rule is necessary. On this question the justices were silent.

In the case *Oklahoma v Castro-Huerta* the Court ruled that the States have concurrent jurisdiction with the Federal government to prosecute crimes committed by non-Indians against Indians occurring on Indian land. On the one hand this is a practical minded decision to deal with a particular set of circumstances. On the other hand, it continues a troubling invasion of Indian Sovereignty. Last month we noted this Court's tendency to privilege States above US territories and this decision continues that trend. Justice Gorsuch dissented from the majority, which continues his different thinking, first exposed in *United States vs Vaello Madero*. On this occasion his analysis was joined by the three liberals on the court.

Finally in *West Virginia vs EPA* (Environmental Protection Agency), the Court made what is perhaps its most noteworthy ruling. In 2015 the EPA adopted a Clean Power Plan to reduce air pollution by carbon dioxide emissions from electrical power plants. The plan allows plants to meet emission targets either by remediating the plant or by substituting an alternate technology through a cap-and-trade system. When the plan was issued, heavy polluters sued to block it. Initially the District court issued an injunction and subsequently it found that the EPA had exceeded its authority in setting up the cap-and-trade system.

However, the Appellate court reversed and permitted the Clean Power Plan to be put in place. Meanwhile, in the six years during which the plan had been in the limbo of judicial review circumstances on the ground had altered. Basically, economic forces had shut down many of the heavy polluters. Accordingly, the EPA announced it was permanently withdrawing the Clean Power Plan and would issue a replacement rule in due course. Before it could do so, the Supreme Court decided to issue its own ruling on the Clean Power Plan. In delivering the opinion of the majority, Chief Justice Roberts followed the same logic as the Court had previously used in overruling OSHA's

mask mandate. He ruled that the policy was a major question, and the enabling law did not adequately authorize cap-and-trade regulatory plans, therefore the EPA could not adopt them. This gratuitous interference by the Court notionally protects the heavy polluters. However, the underlying purpose of the cap-and-trade program was to reduce pollution at lowest cost by approaching the issue systemically rather than facility by facility. The Court's interference ends up inviting the EPA in its current rulemaking to issue stringent facility level regulations which will shutter the operations of the heavy polluters at somewhat greater overall cost with a slower wind down of pollution. Even more troubling, the Court's intervention appears to open the door to continued meddling by the Court. There is little standard for what constitutes a major question and the decision as to whether a regulation flows from enabling legislation or not appears to be simply a judicial beauty contest. From another perspective, issuing an advisory opinion about a dead matter may represent Chief Justice Robert's finest expression of judicial incrementalism yet.

The combination of weak legal logic and a pervasive lack of common sense with strongly political stances about matters touching the Commonwealth deeply is causing the reputation of the Court to plummet. Were the Court a stock we would want to short it. But are its actions good for business? The Court certainly intends their actions to be. We think the jury is out on that one. In the EPA case the coal industry fought off a policy that would have sunsetted the industry only to see economic forces do so more brutally and without the salvage values the EPA plan provided. If it finds its regulatory agencies being hobbled by the Court, Congress can always fall back on the taxation power to reshape the industry. For all the faults of regulation, it is a more nuanced tool than the cudgels of taxation, product liability and Congressional industrial policy. Regulatory agencies are also a venue in which industry lobbyists can be more effective at presenting the business perspective than the hurly burly of elections or the sometimes-wild horse trading of legislation. We think a regulatory structure whose excesses are curbed by judicial review may represent the best achievable outcome for business. Investors, who take a longer-term perspective than business managers, generally do best when turbulence is not injected into the system.



Covid

The pandemic lingers on. As immunity wanes, the virus mutates and the public relaxes in a false sense of security, the preconditions for another surge are being put in place. Currently masking is advised in 20% of the counties of the United States. Fortunately, vaccine makers are proving able to keep up with the mutating virus and a booster vaccination is being prepared for deployment in the Autumn. It seems that we are headed towards Coronavirus vaccination joining flu vaccination as an annual jab. This outcome is probably the happiest for vaccine makers if not for the public. Given the large percentage of needle shy persons in the US, we should expect a winter peak similar to this years.

Economy

In the United States CPI-U inflation is at 9% per annum. After stripping out fuel and food this reduces to 5.9% "Core inflation rate." However, it is only a matter of time until food and fuel prices impound into the core rate. The Federal Reserve increased interest rates by 0.75% on June 14th and is expected to raise it by 0.75% to



1% on July 26th. These interest rate increases have caused the dollar to appreciate substantially against most other currencies, this appreciation will make imports cheaper. Import cheapening will in turn reduce inflation somewhat but will also lead to import substitution versus local manufacturers and thus a cooling of the economy. Abroad, depreciation of the local currency against the dollar will make oil and other internationally traded commodities dearer. Therefore, inflation will be accelerated in the local currency. Europe is harder hit than the United States as decoupling from Russian oil and gas is proving expensive. In China, the economy is cooling due to financial problems in the real estate/banking sector and the Covid lockdowns. We appear to be headed for a global recession.



Financial Markets

Markets continued to fall across the board. Only short dated Treasuries managed a positive return. Notably, the decline in growth and value stocks was nearly equal, so perhaps Growth has hit bottom relative to Value.

Table 1: Recent Market Performance

CATEGORY	ASSET CLASS	6 Month Trend	3 Month Return	1 Month Return
EQUITY	US Large Cap	Falling	-15.86%	-6.91%
	US Large Cap Growth	Falling	-20.61%	-7.03%
	US Large Cap Value	Falling	-10.87%	-6.71%
	Growth-Value	Falling	-9.74%	-0.32%
	US Mid/Small Cap	Falling	-16.50%	-7.73%
	Intl Developed	Falling	-15.41%	-9.57%
	Intl Emerging	Falling	-13.39%	-5.88%
	FIXED INCOME	3-7yr Treasury	Falling	-0.87%
7-10yr Treasury		Falling	-4.17%	-0.71%
TIPS		Falling	-6.18%	-1.64%
Muni		Falling	-2.48%	-1.25%
Investment Grade		Falling	-4.13%	-0.51%
Medium Grade		Falling	-9.59%	-6.24%
Preferred		Falling	-8.78%	-4.21%
COMMODITY	REIT	Rising	-14.68%	-4.27%
	Euro	Falling	3.24%	-1.59%
	Gold	Falling	-6.48%	-2.76%
	Oil	Rising	9.06%	-4.48%

International developed equity was particularly weak reflecting the difficult situation in Europe. Equity values are likely to continue eroding until inflation improves. Short dated bonds offer a partial shelter from erosion, but most tactical allocators will find cash is king in this market moment.

Advice

The next year may prove disappointing for investors, but it is difficult to pick market turning points. Sticking with the correct long term posture will work out best for most investors.

