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Market Commentary

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International Politics

The Russo-Ukraine war, now in its eighth year, continues. July closed with Russia and Ukraine both having made territorial gains and suffered losses. Net gain of territory by either side is at best limited. Battlefield momentum remains with Russia but has been noticeably slowed by Ukraine's roll out of US supplied rocket artillery which has allowed deep strikes against supply depots and command posts.



August opens with the Russians rushing troops from the Donbas to the Southern sector. Here Ukraine is sketchily reported to be mounting a counteroffensive with the immediate goal of depriving Russia of its gains on the west bank of the Dnieper River and perhaps extending to the reconquest of the strategic city of Kherson. Meanwhile, in Russian occupied territory the Russians appear to be preparing for annexation of their conquests. Annexation would both signal an intent to retain the territory permanently and would allow the Russians to deploy draftees to the region. Currently the Russian army is a mix of professionals, mercenaries and draftees. But by law draftees are only supposed to be used in home operations. With mobilization of adequate manpower Russia's greatest military challenge, finessing this legal restriction by means of early annexation has considerable advantages.

The US and China continue to snarl at one another, ostensibly about the status of Taiwan but more so about the balance of power in the western Pacific. China and Russia continue warming their relations with Iran as all three countries agree that their goals of dominating their neighbors are constrained by US power.

Turkey has announced an agreement with Russia for export of Ukrainian grain. This offers considerable hope to many of the world's poorest countries, who otherwise face painful dearth if not outright famine. However, the agreement still needs implementation and doubts as to Russia's sincerity will remain meanwhile.



Domestic Politics

"It's not over until the fat lady sings" is a beloved aphorism of American sport referencing Brunhilda's aria which culminates Wagner's 19-hour long cycle of Ring operas. Normally the aphorism reminds us that a sporting contest is not decided until the clock runs down. In this case the fat lady that sang, or at least warbled, was the US Congress. In quick succession it passed a bill protecting same sex

marriage, a bill funding onshoring of semiconductor manufacture, a bill allocating \$369 billion to climate change initiatives, curtailing some drug prices and imposing a minimum tax on the largest corporations, a bill awarding medical benefits to veterans with cancers tied to poor hazardous

waste disposal practices (“burn pits”) utilized by the US army and a bill protecting consumer access to contraceptives. To be exact, only the semiconductor bill has completed the legislative gauntlet at present, but the others have sufficient legislative momentum behind them that all except the contraceptive bill are likely to pass. Currently the contraceptive bill is held up by a partisan divide over whether interventions which take place between fertilization and implantation should be considered as contraceptives or as abortifacients. Specifically, this debate concerns intrauterine devices and “morning after” pills. The winners in this legislative jamboree were political moderates who shored up the status quo on the nation's social issues and directed meaningful fiscal support to their key climate and medical priorities. Losers were radicals of left and right who had sought larger reordering's in social and fiscal priorities.

The January 6 Committee is taking a break from public hearings. Its vice-chair Elizabeth Cheney has returned to Wyoming where Trump is funding a primary challenge to unseat her as Wyoming's representative in the House. Trump returned to Washington where he gave a speech laying out his program should he be returned to power in 2024. The program included rounding up the homeless and deploying the national guard to enforce law in blue states. Trump seems more than willing to have his program characterized as a frankly white nationalistic program with fascist elements. It was a ballsy stance to take given the possible indictment he faces for organizing an attempted coup. While McConnell is trying to articulate a more traditional conservative program, Trump and his followers remain the dominant force in the Republican party. McConnell appears to hope Biden will solve traditional conservative's problems by incarcerating Trump, but Biden's administration is proceeding at a very measured rate and McConnell has not yet sought to accelerate that motion with legislative concessions.

The Domestic Economy

As expected, the Federal Reserve raised interest rates to 2.5% with expectations of further increases to come. Inflation remains elevated at 9% total/6% core. GDP growth was essentially zero at the end of the second quarter, a very modest improvement on the slight shrinkage in the first quarter resulting from January's Covid surge. The country remains at full employment and consumer cash balances remain high, so rising interest rates are not yet causing a general drop in consumption. Cooling is observed in the housing sector, in digital advertising and in VC driven sectors of the economy, however. We expect the Federal Reserve to continue with incremental increases in interest rates until inflation begins to reduce. The domestic economy is likely to continue cool or to contract mildly through this process. As a relative safe haven, the dollar is likely to continue high or increase further. Sectors open to foreign competition will face pressure accordingly. Results in the Technology space will continue mixed as this sector continues to sort itself out. It is neither the best of times nor the worst of times, but rather ordinary times.



Covid

An outbreak of monkey pox has highlighted (again) the country's insufficient defenses against imported infectious diseases. Covid itself continues its summer surge. A bivalent vaccination (one active against

new and old strains of Covid) is being readied for distribution in the early fall. So far there is no word on who will be eligible for vaccination, however. Uptake of the vaccine among young children is disappointingly slow. Local jurisdictions would be well advised to mandate it as part of the required school vaccination package.



The International Economy

Second quarter results are in for several countries and so we may present our usual cross-country comparison. Our montage (next page) exhibits results for 8 developed economies and 10 emerging economies which collectively account for about 85% of world GDP. In general, easy money conditions prevail with low or negative real rates nearly across the board. GDP is expanding at a moderate 2.14% rate which significantly lags average inflation at 7.3%. Developed economies account for 63% of the total. Their average growth rate (unweighted) is 1.14% as compared to 3.4% for the emerging economies. Thus, the growth premium in the emerging world is 2.3% - a fairly low difference on a historical basis. Capital is considerably cheaper in the developed world, with average bond rates of 1.9% versus 7.6% in the emerging world. The average for the emerging world is currently plumped by three stressed countries (Turkey, Brazil and South Africa.) For five other emerging economies (excluding China and Saudi Arabia) the average bond rate is 4.74% which is a premium of 2.8% over the developed world. Within the developed group the US currently exhibits below average growth, above average inflation and higher bond rates. Within the emerging group China exhibits above average growth, a cost of capital closer to the developed world average than to the emerging world average and low inflation.

Table 1: Leading Economies

Region	Country	GDP (T\$)	Chg GDP (quarter)	Bond Rate (%)	Inflation (%)	Real Rate (%)
Developed	US	23.00	-0.25	2.9	9.1	-6.2
	EU	14.45	2.50	1.1	8.6	-7.5
	Japan	5.39	-0.50	0.0	2.4	-2.4
	UK	3.19	3.10	2.2	9.1	-6.9
	Canada	1.99	3.10	3.2	7.7	-4.5
	Australia	1.54	3.10	3.4	5.1	-1.7
	Switzerland	0.81	1.90	0.8	3.4	-2.6
	Norway	0.48	-3.80	1.4	6.3	-4.9
Emerging	China	17.70	5.30	2.6	2.5	0.1
	India	3.05	1.90	7.3	7.0	0.3
	Mexico	2.41	1.80	9.1	8.0	1.1
	South Korea	1.80	2.60	3.3	6.0	-2.7
	Brazil	1.61	4.00	13.3	11.9	1.4
	Saudi Arabia	0.83	n/a	n/a	2.2	n/a
	Turkey	0.81	4.90	18.1	78.6	-60.5
	Taiwan	0.69	4.30	1.3	3.6	-2.3
	Israel	0.48	-1.90	2.7	4.1	-1.4
	South Africa	0.44	8.00	10.8	6.6	4.2
Summary	Developed	50.85	1.14	1.9	6.5	-4.6
	Emerging	29.82	3.43	7.6	13.1	-6.6
	Total	80.67	2.29	4.7	9.8	-5.6
Wgt Summary	Developed	50.85	0.95	2.0	8.0	-5.9
	Emerging	29.82	4.18	4.7	6.3	-1.6
	Total	80.67	2.14	3.0	7.3	-4.3

Source: Economist and World Bank

Notes: GDP is for 2021. Weighted values are weighted by GDP. Bond Rate is the ten year government bond rate. Change in GDP is for the most recently reported quarter. Inflation is annualized change in consumer price index.

The Financial Markets

Led by Large Cap Growth the US equity market rallied smartly in July. Specifically Large Cap Growth rose nearly 12% while Large Cap and Mid/Small Cap turned in a bit over 8% and income equity added almost 6%. The Growth/Value split was 7.37% favorable to Growth. Last month we commented that the multi-month repricing of Growth versus Value appeared to have run its course and this month's action was certainly consistent with that call. Bonds also rallied, albeit in a more subdued fashion. Ten-year Treasuries added 3.23% and Medium Grade Corporates 5.69%. Other bond categories moved by smaller but still positive increments. Foreign equities also rose but less than US equities. Developed market equities were up 4.92%, while emerging equities barely budged at 0.28%. Oil fell back by nearly 10%, continuing the erosion of its earlier war driven gains. Over the past six months it is now up by only 28%. Generally, this rally would appear to be driven by the view that the coming slowdown in economic activity will be broad but neither deep nor unusually prolonged. Accordingly, we would view recent market action as a bear market rally rather than the commencement of a new bull market. Until inflation is on a clear down trend, we expect markets to remain choppy.

Table 2: Recent Market Performance

Category	Asset Class	6 month trend	3 month return	1 month return
Equity	US Large Cap	falling	-0.47%	8.14%
	US Large Cap Growth	falling	0.62%	11.94%
	US Large Cap Value	falling	-1.60%	4.57%
	Growth – Value	falling	2.22%	7.37%
	US Mid/Small Cap	falling	-1.24%	8.62%
	Intl Developed	falling	-4.02%	4.92%
	Intl Emerging	falling	-5.58%	0.28%
	Fixed Income	3-7 Year Treasury	falling	1.88%
7-10 Year Treasury		falling	3.19%	3.23%
TIPS		falling	-0.14%	2.66%
Muni		falling	2.06%	1.86%
Investment Grade		falling	1.90%	1.69%
Medium Grade		falling	-0.05%	5.69%
Preferred		falling	4.38%	5.30%
Commodity	REIT	rising	-1.42%	6.32%
	Euro	falling	-2.75%	-2.43%
	Gold	falling	-5.35%	-1.94%
	Oil	rising	-6.59%	-9.34%

Advice

In the previous month we advised that that it is difficult to pick market bottoms and we advised investors to stick with their positions despite the bearish overall tone of the market. That advice was followed by a strong rally. We would now caution investors about too readily believing the bear market is over and a new bull market begun. There are several possible developments which could push the market lower, for instance bad news about inflation, the Russo-Ukraine war, confrontation with China over Taiwan, a resurgence/mutation of Covid, or simply a slew of bad earnings reports. We expect markets to remain choppy for some time. Investors keep their eyes on long term objectives and not allow themselves to be thrown off course by transient market turbulence.