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Market Commentary

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Russo-Ukraine War

The Ukrainian summer offensive is widely understood to be bogged down and failing. We do not quite agree with this easy conclusion – much pressed by the Russian propagandists.

Ukrainian pressure has been causing cracks to appear in the Russian forces. The Russian high command has been forced to cashier several competent field commanders for acts of insubordination. The dispute appears to be about strategy. The high command has apparently decided to throw its available reserves into holding and improving Russia's position in the Donbas (i. e. the northern sector with multiple land routes back to Russia), while ordering its commanders in the South to hold the line without relief or reinforcement. The rationale for this strategy was pointedly underlined by the Ukraine, which again cut the Kerch Strait bridge between the Crimea and Russia. As a result the only land supply route into Crimea is a 400 mile highway within range of Ukrainian rocket artillery for half of its length. Ukraine's long range missiles are being used to pick off key ammunition dumps and supply depots in the southern sector. Ordered to hold the line without the resources they considered necessary, the southern commanders appealed to Putin over the head of the high command and got reassigned to Syria for their insubordination. The ranks quickly assessed the situation and units with particularly dire supply situations have been surrendering in platoon size units. Better supplied troops, however, continue a vigorous resistance – likely mindful of the troops to their rear with orders to shoot men pulling out of the front line.

Currently it seems thar Russia's position in the Southern Ukraine rests mostly on well prepared passive defenses. In particular, Russia has established extensive sophisticated minefields which stretch kilometers deep in key ares of the front and which are covered by registered artillery fire. The Ukrainians need to engage in a painstaking process of counter battery fire and manual mine removal to clear these obstacles. An effective air assault capability that would allow them to leapfrog the minefields and push the defenders into the fields in their turn would give the Ukraine a useful countermeasure. However, air assault is quite difficult to mount on the modern battlefield replete with man portable anti-aircraft systems. To date the Ukrainians have not demonstrated this capacity. Nor have the NATO allies provided the Ukraine with the means to maintain air cover above their advancing troops. Instead, they are forced to rely on grit and determination as they nibble their way through the defenses. This half hearted equipage of the Ukrainian forces risks exhausting the Ukrainians before they succeed in exhausting the Russian defenses.

The politics of Prighozin's rebellion continues to roil Russia and keep western analysts working double time trying to read a chaotic collection of tea leaves. What seems clear is that Putin lacks the internal strength/support needed to simply crush Prighozin. In addition, Putin appears to wish to keep the Wagner mercenary outfit together for his own purposes and appears willing to gamble that with just a few personnel changes he can recover their loyalty. Putin's image as the strong man directing Russia and holding its contending factions to his program is in the process of dissolving. The environment of contending political forces, insubordination and hidden treachery is one highly attractive to Psychological Warfare Operations. Whether the Ukraine will demonstrate any skill at such operations, however, remains to be seen. They are not the only player, however. The British agency MI6, uncharacteristically, stepped out of the shadows to issue a recruitment appeal to patriotic Russians interested in striking a blow against the Putin regime.

Russia has withdrawn from the Black Sea grain deal under which export of grain from the Ukraine and Southern Russia was protected from military action. Both Russia and Ukraine have stated they will treat maritime traffic headed to the other's ports as military targets. In an updating of the PT boat concept, Ukraine has exhibited maritime drones with which it intends to attack Russia's surface navy. Russia has pummeled Ukraine's port facilities with cruise missiles and sowed its grain fields with mines. It appears intent on creating a years long decrease in Ukraine's productive and export capacities. These actions will cause significant food stress in the third world and will likely cost Russia some diplomatic support. Higher world prices for wheat will mainly benefit farmers in the US, Canada, France, Argentina and Australia.

A country's historical borders are typically where they are because of unchanging facts of geography and economy. Russia's attempt to grab the Crimea and southern sector of the Ukraine appears to be failing due to overstretched lines of communication which simply express these geographic facts. At the moment it appears more plausible that Russia could hold the Donbas, but if the Ukraine comes to concentrate its full force on that sector, it also could prove to be on the Ukrainian side of a “natural border” secured by unobvious but potent geographic realities.

China

China has been engaged in extensive high level diplomatic activity with the United States. Secretary Blinken's visit to China has been followed by visits by Treasury Secretary Yellen and climate envoy Kerry. Even the centenarian Henry Kissinger has been invited to visit as a friend of US-China relations. On Taiwan it looks as if the current government may secure re-election next year, rather than the pro-China KMT. China would likely appreciate American support in discouraging any political moves on the island which would – in China's view – provoke it into a military response. However, time for palaver is limited. The pending American elections are likely to see competitive China bashing from both parties and increasing support for de jure recognition of Taiwan's de facto sovereignity.

Internally, China continues to struggle with a growth recession. The economy is expanding but significantly more slowly than the recent historic norm. Financial problems are continuing in real estate and municipal finance. The government had to back pedal some of the restrictions it placed on private business to sustain forward momentum in the economy. The labor market is bad for recent graduates and China's poor rate of childbearing promises long term demographic challenges. Meanwhile, the government continues to emphasize autarky in strategic areas of the economy. This policy is being adopted to strengthen China against externally imposed economic pressure. However, it comes at the price of slower growth. Concern about external pressure is causing China to weaken itself even while it follows an aggressive diplomacy that pushes the external world together into an anti-China block.

We were surprised to see an editorial in the Wall St Journal bemoaning US non-participation in Pacific region trade pacts. Initially Secretary of State Clinton negotiated the extensive multilateral Trans-Pacific Trade Partnership (TPTP.) The aim of this pact was to counter-balance China's economic weight in the region and to tie the economies of the region's countries more closely to the US. Despite these nationalistic goals, the pact was opposed by Republicans and savaged by Clinton's rival Trump. The US ultimately chose to not participate in the pact it had architected. However, the pact has survived as the other parties to he pact (notably Japan and Australia) also see the need to counter-balance China. To judge by the Wall St Journal article, some rethink is going on among business conservatives. We favor policy decision making being driven by careful analysis of the US's achievable interests rather than by political posturing and exaggerated rhetoric about our national strength.

AI

The Biden White House has successfully negotiated a self-regulatory agreement with seven major players in AI. AI generated content will be watermarked and the companies will submit AI products to external testing prior to commercial release. We see significant benefits to the companies in this agreement. A layer of external testing will protect the companies from many negligence claims that might otherwise have been levied against them. Similarly an AI watermark may protect them from claims of defamation. At this point AI products are not meeting normal standards of commercial reliability. Reducing the producer's product liability exposure in return for shouldering some regulatory burden is a reasonable trade-off for major players. It may also, as a side benefit, give them a competitive advantage versus less well financed start up competitors. In our recent research note on AI regulation we noted the variety off competing approaches currently being pushed. We think the Bidden administration has shown considerable adroitness in formulating the best policy approach for the current state of the AI art.

Where AI will make its initial economic impact is as yet unclear. Some of the likely areas of early deployment include: bots to answer client support questions, advertising copy writing, machine assisted translation, natural language interfaces to current software systems, and task level rather than process level control of existing software are some of the areas where it is likely to be applied. Any current job activity that involves recognition of patterns, be they visual, numeric or auditory, is also likely to get a substantial boost from AI. Areas of obvious application include military, intelligence, police and private security work, medical diagnosis and monitoring and industrial process control. It may well turn out that an incremental but economy wide improvement in overall productivity will be the primary economic impact of the current AI technology.

A Walk Down Memory Lane

The present business cycle has repeatedly confounded analysts by playing out according to its own script rather than the "usual pattern" which most analysts rely on. Looking for historical guidance, we cast our eyes back to 1946. The Second World War ended in 1945 and the US rapidly repatriated and demobilized the bulk of its forces. It was widely expected (and feared) that removing the stimulus of wartime spending would cause a resumption of the Depression conditions which had preceded the war.

There was almost no appreciation of the United States's actual position. In fact, the industrial bases of its commercial rivals (both allies and enemies) were rubble. Nearly the entire world supply of liquid capital was located in the United States. The war had created huge spin-offs in terms of technology and large scale management and logistics techniques waiting for commercial exploitation. In addition, the war had built enormous manufacturing capacities which the government basically gifted to their corporate operators. In short, the US was poised for a generation long business and manufacturing boom that would change it and the world. However, this reality was invisible to all but the most astute analysts and those who had some inkling of it still grossly underestimated it.

Instead of Depression, the year 1946 was marked by inflation. Checking in at 26% it was in fact the highest rate of inflation ever recorded for the dollar. Its causes are, in hindsight, no mystery. The country had been at "above full" employment during the war. At the same time, purchase of most goods were subject to rationing. As a result, massive savings built up in the banking system. The Federal Reserve pegged both short and long term interest rates. The banks invested the massive savings into Treasury bonds and the government financed the war effort from a combination of bond proceeds and heavy income tax levies. This system of wartime controls was unwound in a series of steps. The first control to be eliminated was rationing and consumers used their savings to go on a spending spree as they released the pent up demand created by rationing. The result was massive inflation and a very clear signal to business that there was a heavy demand to fill. The unwinding of war time financial controls was to be slowed by renewed war (the Korean war began June 1950.) It was only in 1953 that the Federal Reserve stopped pegging Treasury rates.

The year 1946 also saw the White House occupied by a relatively new and untested President Truman. The building itself was on the point of collapse and its executive staff was about one tenth the size of what subsequent Presidents have found necessary to keep up with the press of business. Today Truman is remembered as a strong and forceful president. In 1946 he was seen as hick struggling to fill the patrician shoes of the semi-divine FDR. During the Roosevelt years a vicious partisanship had been directed at the President and his wife Eleanor. A poor excuse for this ugliness was that Elanor often served as the disabled President's proxy at public engagements and had some policy influence. That partisan attack now took in Truman's wife and daughter – both of whom were apolitical people. Truman's voting base was organized labor, but he was forced to take action against a railway worker's strike which threatened to lock down the economy. Truman's attempts to pass civil rights legislation was anathema to the conservative wing of his own party and the best he could do in this direction was issue an executive order desegregating the Army. Republicans controlled Congress and they passed the important Taft-Hartley Act reducing the power of unions and two income tax cuts, all over Truman's veto. It was in foreign policy that Truman made the mark which was to define his standing in history: the atomic bombing of Japan (August 1945) and further development of nuclear weapon technology, the Truman Doctrine (March 1947) committing the United States to counterbalancing the USSR, the intervention in Greece and Turkey (May 1947) and the Marshall Plan (April 1948) were all highly consequential decisions which Truman took in his first term. Even so, his weak standing at home made him an underdog in the 1948 election. He was not helped by the splintering of his party. The liberal wing reformed as the Progressive Party under Henry Wallace, while the conservative wing (the “Dixiecrats”) split off as the States's Rights Democratic Party under Strom Thurman. Truman faced Thomas Dewey, the well respected governor of New York , who for the second time led the Republican challenge for the Presidency. Dewey was endorsed by 78% of the press and the best respected pollsters confirmed his upcoming victory. Reportedly, bookies offered odds of 15-1 against Truman. In a squeaker of an election, Truman carried three swing states by 29,000 votes and the electoral college mechanism transformed that narrow margin into a 303-189 victory. In the popular vote Truman garnered 49.6% of the vote to Dewey's 45.1%. The national conventions had ended with polls showing Truman's support at 38%. This result and the received wisdom of the day that voters decided their vote at the end of the Convention season and that post Convention campaigning changed no minds were responsible for the general underestimation of Truman's chances. In fact, Truman's pugnacious style served him well in the underdog role and his vigorous late season campaigning built the groundswell of support which, just barely, carried him to a second term. The economy had been in a mild recession in 1947 (-1%) and this also had helped to set the tone against Truman. Its vigorous rebound in 1948 (+6%) undoubtedly helped to sweeten the electorate on Truman, while making less impact on the more sheltered class of political commentators.

We picked this period for a stroll down memory lane because we feel it helps illuminate certain features of our current situation. During the pandemic government support sustained national income even as quarantines reduced spending. Savings built up and banks, faced with recycling savings in an environment of low loan demand from credit worthy borrowers, pushed the funds into the long end of the Treasury bond market. When the pandemic ended, pent up consumer demand fueled by high saving created an inflationary surge. Unlike in 1946, the Federal Reserve has rapidly unwound its monetary controls and in the process created significant stress in the banking sector. The post pandemic inflation surge topped out at 9% rather than the 26% of 1946. The post surge GDP slowdown looks to bottom at 0-1% rather than the -1% of 1947. Resumed GDP growth in 2024 is very unlikely to reach 6%. So the basic macroeconomic drivers in the two periods are similar, but the present economy is less perturbed.

Politically we have an interesting comparison between Biden and Truman. Biden is about as unloved and ill respected as Truman was. However his wife has not had to endure the treatment that was dished out to Bess Truman. In some respects American political partisanship has mellowed – even if we believe otherwise. Biden's domestic legislative program has been much more successful than Truman's. So far Biden has managed to stand strong abroad while keeping the country at peace – an accomplishment not seen since Eisenhower secured the cease fire in Korea. Yet despite the incumbent's strong record, the 2024 election is widely expected to be as close as the 1948 election was. What the two eras most likely have in common is being periods of transition for America's political parties. In 1948 the coalition FDR built was beginning to dissolve. In 2023 we see the Reagan coalition already deeply split between radical right and traditional right groupings. As the tectonic plates of American politics grind and shift a sense that "anything could happen" hangs in the air. Not many living today experienced 1946 as a mature adult. Consulting our local centenarian we asked her to compare Biden and Truman. Her instant reply came as a surprise: "Biden is much more of a humanitarian than Truman. FDR because of his disability truly understood human suffering. But Biden is the only President since to have shared in that understanding."

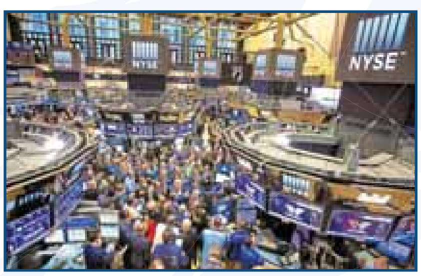
Domestic Politics

Trump was indicted on 3 counts of conspiracy to steal the 2020 election and 1 count of obstructing a government proceeding. His so far unindicted co-conspirators were apparently 6 of his legal advisors. This indictment did not directly tie Trump's activities to the assault on Congress. If convicted on these charges, Trump could face a sentence of 5 to 20 years, which for a 77 year old is effectively a life sentence. Registered Republicans responded with tribal loyalty to their man. Seventy-five percent of them tell pollsters that they think Trump did the right thing. Pollsters report more than half of them intend to nominate him as the party's Presidential contender in 2024. But registered Republicans constitute only 25% of the electorate. In the other 75% of the electorate, opinions are just as strong that Trump is guilty as charged. Thus Trump's true believers amount to 19% of the electorate and his sceptics to over 60.% A fourth indictment on state charges is expected to be brought in shortly by the Fulton County prosecutor in Georgia. Would be rivals to Trump for the Presidential nomination have been largely rejected by the party base. We think it is a good year for Republican hopefuls to seek their party's nomination for Vice President.

Chief Justice Roberts has apparently failed in an attempt to have his fellow justices on the Supreme Court voluntarily adopt a code of ethics. It is unfortunate that one of America's major institutions should struggle with a not so difficult task. Lest we grow too pessimistic about public morality, however, we remind ourselves that Congress – normally a bastion of irresponsibility – appears to have improved its self discipline with regard to insider trading in the past year.

The Domestic Economy

In our prior market commentary we noted that inflation had slowed to the 3% level. The latest inflation reading confirmed what we already knew to be true and the stock market continued to rally. Second quarter GDP increased at a 2.4% rate, while tightness continued to ease out of the labor market. The Federal Reserve raised interest rates by a quarter point, which satisfied inflation hawks. Another midnight bank merger took place, but without much ruffling of feathers. Republican political hopefuls were quick to grouse that even though inflation might be slowing, house and car prices remain burdensome. We take this as a recognition that the Democrat's reputation for being weak on the economy might be seeping away. In fact factory construction is booming, up 80%, in response to government efforts to reshore certain manufacturing operations.



The Markets

There was little change in the markets this month. US equities continue bullish with strength spreading beyond the leadership mega-cap tech sector to value and small cap. In private markets, VC appears to have bottomed and AI start ups are hot. International equities are also positive but with less conviction. US fixed incomes ticked down in response to the Federal Reserve interest rate raise, but basically remain in a holding pattern. Oil is currently testing the upper boundary of its range as sentiment turns against a hard landing scenario for the US economy.

Table 1: Recent Market Performance

Category	Asset Class	6 month trend	3 month return	1 month return
Equity	US Large Cap	rising	8.62%	1.52%
	US Large Cap Growth	rising	10.10%	1.15%
	US Large Cap Value	rising	6.48%	1.99%
	Growth – Value	value catching up	3.62%	-0.84%
	US Mid/Small Cap	rising	8.90%	2.92%
	Intl Developed	rising	-1.97%	-0.47%
	Intl Emerging	range trading	3.45%	2.20%
Fixed Income	3-7 Year Treasury	range trading	-2.96%	-0.61%
	7-10 Year Treasury	range trading	-4.97%	-1.92%
	TIPS	range trading	-3.71%	-1.40%
	Muni	range trading	-1.31%	-0.83%
	Investment Grade	range trading	-3.31%	-1.44%
	Medium Grade	range trading	-1.19%	-0.83%
	Preferred	range trading	-1.57%	-0.61%
Commodity	REIT	range trading	1.43%	1.13%
	Euro	range trading	-0.75%	0.17%
	Gold	range trading	-2.77%	2.20%
	Oil	range trading	11.10%	12.95%

Advice

The old farmer's advice is to make hay when the sun is shining. In the ever changing capital markets its difficult to know ahead of times which day the sun will be shining, so the advice translates into holding steady with ones positions and catching the sun when it graces us with its presence. The last few months have reaffirmed the value of that advice. Analysts have been almost uniformly dour in their predictions. They were sure a recession was coming and many have expected years of subpar investment returns. In fact, the economy and stock market do not much read analyst forecasts and have been going their own way. Investors who held to their core positions and eschewed the attempt to time the business cycle have made a little hay from the sunshine. Our recommendation is to put effort into determining ones correct strategic positioning and then hold to it in all but the most aberrant conditions.

About Us

Lloyd Tevis Investments LLC is a registered investment advisor offering its services over the internet to US individual investors and their families. Our Precision investing ™ service provides clients with highly personalized investment solutions tuned to the client's specific circumstances and objectives. We believe the strategic asset allocation decision is the key decision faced by our investors. Accordingly, our monthly commentary focuses on matters which can shape the longer term performance of asset classes. We do not time market swings or pick individual stocks. Discussion at this level of detail is made for the light which it throws on relative valuations and such discussion should not be read as an investment recommendation. Indeed, we our investment focus is on maximizing diversification, careful risk budgeting and maximizing implementation efficiency. These are the proven builders of long term investment success.

In evaluating political and social developments our perspective is that of long term investors. We believe the investor's interest is best served by a stable environment in which change occurs incrementally as broadly supported policies rather than by an environment of abrupt changes and frequent U-turns driven by transient partisan advantages. Finally, our assessments should always be read as what we consider likely to occur and not as expressions of what we would like to see come about. To learn more about our firm visit us at https://www.lloydtevis.com.

Cover Photo

We show three photos from Truman's first term which illustrate the technological and social transitions then underway. In the first photo we see a typical Truman whistlestop campaign appearance. In the 1948 campaign Truman conducted a train campaign tour of the eastern United States. His train would draw into a local station; he would give a short speech to the assembled crowd; he would greet local dignitaries and then the train would head on to the next destination. It was a grueling way to market a candidate to a mass audience. It was a technique obsoleted by the spread of television technology in the 1950s. The second photo shows the X-1 Bell rocket plane in which Captain Charles “Chuck” Yeager broke the sound barrier on October 17, 1947. The third photo shows the first bikini modeled by Micheline Bernardini. The swim suit was named after the US atom bomb test of July 1, 1946 at Bikini atoll. The garment broke a different sort of barrier. So reluctant were women to embrace the new look that the designers had to look beyond their usual models for someone to wear it. Bernardini was a Parisian exotic dancer. In the early 1950s Brigitte Bardot set a trend for the bikini that was followed by Marilyn Monroe, Anita Ekberg and Sophie Loren, However it was not until 1960 that the swimsuit would succeed with the mass public in the United States.