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Market Commentary

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Russo-Ukraine War

After an embarrassing repulse before Kiev, Putin consolidated battlefield command of the war in the hands of his most senior general in theater Aleksandr Dvornikov. Dvornikov is the natural choice based not only on past successes but also on being the only general to have achieved much progress in his sector in March.



The Russian forces that were attacking Kiev have been withdrawn and sent to reinforce the campaign in the Eastern Ukraine.

The stated goals of this campaign are to take full control of the Donets Coal Basin, or as it is more commonly known the Donbas, to consolidating the corridor along the Sea of Azov to the Crimea, and by new conquests to establish a corridor along the Black Sea coast to Moldavia. Achieving these aims would cut off Ukraine's maritime access rendering the rest of the country economically impaired. We think, therefore, that the ultimate war aim remains annexation of the Ukraine and Moldavia. If so much hard fighting lies ahead. To achieve these goals Dvornikov has on paper 130 battalions. But many of these units are hollowed out by prior combat, so his effective resource is probably about 100 battalions – a steep draw down from the 160 battalions with which Russia commenced this war. In April the Russians continuously probed along the frontier in Eastern Ukraine between their zone of control and the Ukraine's. They have made little progress in breaking through prepared defenses. Where such defenses were lacking, they have made some modest halting progress.

Comparing the Oryx data for February/March and April one at first has the impression that Russian losses have been halved (table 1.) However, when one adjusts for the greater number of days in the earlier period and for the lower number of engaged units in April, one finds that the overall loss rate in April equals that in the earlier period. Fighting and Russia's losses remain just as intense and Russia's apparent reduction in losses simply reflects their shrinking army. Within the loss figures there are some interesting shifts. Losses of manned aircraft and helicopters are much reduced as the Russians are apparently not putting these high value assets at risk. Losses of logistic vehicles also are reduced. However losses at command posts and communication facilities are dramatically increased – probably as a result of Ukrainians stepping up their targeting of these nerve centers. Cumulative personnel losses are estimated at 15,000 killed (British Intelligence), 12,000 captured (Ukrainian report) and 45,000 wounded (our inference from number killed.) The total loss would be 72,000 or 40% of the initial force.

Our assessment is that the Russians have thus far failed to make a strategic breakthrough and that their success in April is limited to consolidating their hold on the Azov Sea corridor connecting Russia to the Crimea. We think continued losses at the current rate are unsustainable in view of the lack of progress and the Russians will soon need to switch over to the defensive. Arrival on the

battlefield of enhanced NATO supplies to the Ukrainians will make the change in objective increasingly imperative.

In the occupied South Eastern Ukraine the Russians have been raising statues to Lenin, flying the Red Flag, introducing the ruble as the functional currency and preparing to declare a People's Republic which in due course can seek reunion with the restored Russian Empire. Meanwhile Ukrainian counterattacks are nibbling away at the boundary of this proto-entity. The regional capital of Kherson is the pivotal hub for both the Sea of Azov corridor and for the projected Black Sea corridor. It was captured in early March by the Russians, but their control has been continuously contested. It seems likely to become the key point which determines the ultimate success of the Russian campaign.

Table 1: Russian Material Losses

Comparison of losses in February/March period to April period

Item	Total Units Lost		Ratios	
	February/March	April	April%Earlier	Adjusted
armor	355	251	71%	128%
mechanized infantry	760	442	58%	105%
air cavalry	38	1	3%	5%
artillery	158	78	49%	90%
All Strike Forces	1,311	772	59%	107%
command & communications	14	57	407%	738%
engineering vehicles	68	54	79%	144%
anti-aircraft guns & missiles	54	19	35%	64%
radar systems	10	8	80%	145%
All Supporting Forces	146	138	95%	171%
Aircraft	35	40	114%	207%
Logistics	657	223	34%	62%
All Forces	2,149	1,173	55%	99%

Aircraft losses in the earlier period were largely piloted aircraft while losses in April were mainly drones.

Adjustment of the raw ratio is based on 30 days in April versus 34 in the February/March period and on 100 battalion tactical groups (effective strength) engaged in April versus 160 at the start of the invasion.

Source: www.oryxspioenkop.com

The Russian withdrawal from the environs of Kiev exposed hundreds of instances of soldiers brutalizing the civilian population with rape, torture, summary executions and random killings. President Biden found the killing so widespread as to express the opinion that it constituted genocide. While lawyers argued as to whether the undoubted war crimes were the expression of state policy (the key element required for the crime of genocide), Putin apparently settled the matter by bestowing an honorific title on the unit responsible for the killings. President Zelensky of the Ukraine stated it was difficult to continue negotiations with Putin in the circumstances and further stated that Ukraine would never accept the loss of currently occupied territories. The Western powers began shipping heavy armaments to the Ukraine, including long range artillery, tanks, helicopters and fighter aircraft. The US in particular seems to be moving to the recognition that its

task is to train and equip an army which can defeat the invasion force. A bill currently before Congress will raise US military support from \$800 million per month to \$4 billion per month – a 5x increase.

In mid-month the Russians lost the cruiser Moscow, flagship of their Black sea fleet (displacement 12,490 tons.) It was apparently cruising in a fixed pattern with its long range radars turned off. It was hit by two Ukrainian missiles which started fires in its superstructure and hold. Final loss of the ship is variously attributed to inexpert firefighting technique leading to a capsizing or to the fire spreading to the magazines with the ship blowing up. Of the 500 crew it seems most went down with the ship. Russia's remaining Black Sea fleet consists of two modern frigates and one 40 year old frigate (combined total displacement 10,600 tons) and about 6 diesel submarines which are most effective in a coastal defense role. In addition there are various small corvettes, river patrol boats and amphibious warfare vessels. Finally there is a modern frigate and two submarines currently on station in Syria which could return to the Black Sea if relieved by units from Russia's Northern fleet. Loss of the Moscow impairs air cover to the Black Sea fleet and thus limits its operating area. In addition, the loss definitely limits Russia's ability to intervene in the Mediterranean. Russia's client Assad in Syria is looking increasingly unsupported. A loss of one of Russia's remaining frigates to further missile attack would definitely shake Russia's position in the Black Sea. Turkey, in particular, has approximately 8 frigates in the sea and about 6 diesel submarines.

Western sanctions are eroding the Russian economy and war effort. Putin has attempted to respond by threatening to withhold wheat from the global market. The price of wheat has risen as Russia's reputation as a reliable supplier has tanked. These threats are causing grave concern in the Middle East and Africa, but Russia gains little advantage from frightening these countries.

Currently the initiative lies with Russia and the world waits to see if Putin will risk his regime by throwing away the remains of his army in the Ukraine or if he will settle for more limited goals and thus preserve his combat power for a future day. We think the Western sanctions will be maintained until Russia withdraws from all occupied territories – including the Crimea. If he preserves his army Putin could probably survive such a humiliation. But if the next month brings him losses comparable to March and April, he might not be able to maintain control in Russia's client states.

There are definite signs of strain in Russia. Five Gazprom executives have been killed and in two cases their families were murdered as well. These killings are widely assumed to be the handiwork of the security services. The brutal murder of wives and children in particular is taken to be a message from Putin to his subservient circle of oligarchs. Arrests and dismissals of generals and intelligence officers are continuing. At this point it must be obvious to the military that stated political goals are far in excess of what available forces can achieve. Similarly business executives must realize that Russia's reputation as a reliable commodity supplier is gone irretrievably and that Russia is engaged in economic warfare with an entity some 25x larger than itself. Yet Putin appears bent on escalation.

In China the domestic press and junior diplomats have been rabid verbal supporters of Russia. Senior officials have been more circumspect and material support for Russia is apparently limited. One could say China has laid the foundations for siding with Russia but is waiting to assure itself that it is not backing a losing team. In fact, communist China and oligarchic Russia are united by little more than resentment of the United States. China has stepped up modernization of its strategic

nuclear force, probably in recognition of Russia's declining ability to invest in nuclear balancing with the United States. Chinese support for Russia, combined with a slowing economy and a political crack down on the Technology sector has triggered a degree of disinvestment by foreigners. The yuan has fallen in response to capital outflows.

The war is also deepening a split in church alignments. Generally Ukrainian Christians are divided between Catholics and Orthodox. The Catholics may celebrate according to either the Latin or Byzantine rites, but in both cases look to the Pope as the final religious authority. The Orthodox are now divided between the Russian and Ukrainian Orthodox. They both use the Byzantine rite. The Russian Orthodox look to the Moscow Patriarch as the final authority, while the Ukrainian Orthodox regard the Metropolitan of Kiev as the head of their Church. The Ukrainian Orthodox Church is recognized by the Ecumenical (Orthodox) Patriarch of Constantinople (Istanbul), but not by the Moscow Patriarch. These divisions are likely to persist for generations – long after the current war is forgotten.

In Europe, Finland and Sweden appear likely to join NATO. This juncture will help stabilize NATO's position in the Baltic and will leave the Russian enclave of Kaliningrad in an ever more anomalous position. In fact, Russia has only weak historic claims to this city, which under its historic name of Koningsburg was for most of six centuries (1255-1870) the capital of Prussia. The USSR acquired the territory at the Potsdam conference of 1945 which was focused on punishing Germany for its war of aggression. The USSR expelled the German population and resettled it with Russians. Today the city has a dual role as the headquarters of Russia's small Baltic fleet and as a transshipment point for goods imported to Russia.



Covid

A federal district judge has struck down the mask mandate applicable to public transportation. This is of course a basic public safety measure for slowing the geographic spread of disease. Besides weakening the management of Covid, the decision will also handicap defense against other pandemics when they arise. We think the Biden administration

made a strategic error in not seeking clear legislative authority when it first took office and public concern about the pandemic was at its height. Its failure to do so has opened the door to interference by federal judges philosophically opposed to Federal power. The precedents they are setting now are going to make management of the next epidemic much harder.

In China nearly a third of the population – some 350 million people are under lock down to prevent the spread of Covid. This number of people approximates the total population of the United States. Idling their labors will slow the world economy and continue the supply chain shortages which have contributed to the strong burst of inflation we are experiencing currently. Lock down was necessary to avoid mass casualties given that China has been slow to vaccinate its population of seniors and the vaccines it is employing are only partially effective against the recent strains of Covid. China has announced various measures – notably a capital goods investment program – to stimulate its lagging economy.

Covid itself continues to mutate and spread much as before. Only a combination of vaccines, masks and social distancing can control it. A perception of a decreasing threat of death is causing most countries to give up on this effort. As a result a lucrative revenue stream is being established for vaccine manufacturers who can look forward to selling booster vaccines for many years. Currently Covid is the number three cause of death in the United States, behind cancers of all types.

Domestic Politics

The January 6 committee has released emails from Donald Trump Jr, the former President's eldest child, to Mark Meadows, the then White House Chief of Staff, which were sent two days after the 2020 presidential election concluded. At this moment it was becoming clear that Trump was likely to lose, although the margin of defeat was yet undetermined. Trump Jr urged Meadows to use the full panoply of presidential power to secure his father a victory in the election. In short, he clearly advocated for abuse of power to set aside the electoral outcome. Additional



communications from other parties reveal a concerted effort by major Republican politicians to overturn the election which was ultimately decided by an electoral college vote of 306 to 232 in favor of Biden. Some of these players dropped away as the frank illegality of the scheme became clear, while others persisted up to the violent assault on Congress on January 6. This was clearly an extraconstitutional attempt to retain power – in short an attempted coupe. Preservation of constitutional government requires firm discouragement of such efforts. Imprisonment of malefactors is seldom a satisfactory deterrent as their political allies usually release them when they next gain power. For this reason, most countries shoot failed coupe makers shortly after the attempt fails.

The US tradition has always been somewhat different. The first insurrection against Federal authority occurred in the presidency of George Washington. In the so called Whiskey rebellion Pennsylvania farmers rose in arms against paying the Federal excise tax on whiskey. Washington led the army into the field, defeated the rebels in a brief engagement and handed his prisoners over to a military tribunal. The tribunal condemned the prisoners to death and Washington then exercised the presidential power of clemency to waive punishment of those who had not committed capital crimes. Those who had killed someone or committed arson, however, were hanged. A similar procedure was followed after the far larger Civil War. The southern military and political leadership were debarred from political office but were otherwise left at peace. However the governor of the notorious Andersonville prisoner of war camp was hanged for war crimes.

The case of Trump now raises a new circumstance. The impeachment trial held in the immediate aftermath of January 6 when Trump's involvement was strongly suspected but not yet fully delineated could have resulted in his debarment from further political office. However, the Republican senators - who certainly had private information about Trump's doings - largely closed ranks behind party unity and declined to impose this penalty. In the aftermath Trump has been able to consolidate his control of the party and his supporters have worked assiduously to change state voting procedures to make more possible the seizure of power which Trump attempted in 2020. This situation is a clear danger to constitutional government. Biden has been assiduously ignoring it, but ultimately it may be the most important issue of his Presidency.

Meanwhile Florida's governor de Santis is positioning himself as Trump's political successor should Trump himself ultimately be unable to run. To this end de Santis has embraced a number of highly emotive but ultimately minor political issues – among them how society should accommodate (or not) transsexual persons. His early legislation on this front has caused great dismay among those who care about this issue. Pressed by its employees, the Disney corporation stated that it would no longer give political donations to de Santis. De Santis responded by abolishing the special tax district in which Disney's Orlando theme park is situated. This district was set up initially to entice Disney to locate its facility in a then undeveloped part of Florida. In return for Disney locating to Florida and bringing significant employment and tourist spending to the state, the corporation was granted control of municipal services in the immediate environs of the park and the power to issue municipal bonds to fund infrastructure development. Disney has been the ultimate obligor of nearly \$2 billion in bonds outstanding from this development district. Abolishing the district now throws the obligation upon the adjacent counties, and one can anticipate they will attempt to tax Disney. None of this is good news for bondholders or Disney shareholders. These special tax districts are a fairly common device in American life and if such political shakedown attempts were to spread more widely it would be a definite negative factor for investors. We have noted previously that the Trump Republican party is no longer the reliable political partner which business and investors have been accustomed to.

The Supreme Court has issued an important ruling for retirement planning. A US citizen resident in New York State qualified for a certain Social Security benefit (the Supplemental Income benefit.) This particular benefit is paid to the elderly who are blind or disabled. When he moved to Puerto Rico the government asserted he had lost that benefit as the particular benefit had not been extended to US territories. The Supreme Court in a 7-1 decision upheld this position, stating that as the government had established special tax rules for Puerto Rico it was also entitled to have special spending rules. We find this logic opaque since Social Security benefits are insurance benefits earned by individuals, while taxes are imposed on political subdivisions. We do not believe a private insurer would be allowed to terminate benefits to a paid up policy holder on the grounds he had moved to a community from which the company collected minimal premiums. At this point, US citizens living in foreign countries (which of course pay even less Federal tax than Puerto Rico) remain eligible to collect Social Security benefits. We note, however, that they have long been barred from claiming Medicare benefits which are funded, like Social Security, via a Federal payroll tax. Persons hoping to retire to US territories or foreign countries should continue to monitor this issue. The Supreme Court appears to be drifting towards a position in which only citizens of the United States who are also citizens of a state enjoy the full rights of citizenship. Enthusiasm for changing the traditional concept of citizenship are not limited to conservatives incidentally. California is eager to tax deferred executive compensation of persons who move out of state once they retire.

Many matters are appealed to the Supreme Court. Historically most are disposed of by summary orders while substantive matters are granted a full hearing after which a written judgment together with any concurring or dissenting opinions are issued. In recent years, however, conservative majorities of justices have been content to settle some substantive matters by the order route. This has been protested by the liberal minority of justices. It has also exposed the Court to charges of politicization, since if justices are not willing to expose their reasoning it is easy to conclude that they are reaching for results rather than following defensible logic. In a recent case the conservative majority decided to curtail certain rights of States under the Clean Water Act of 1972 by the summary order route. In this instance Chief Justice Roberts joined the three liberal justices in protesting the abuse of Court process.

The United States is faced with a broad and very aggressive push by a right wing political faction to rewrite foundational rules under which the country operates. This creates a complex and somewhat dangerous environment for businesses and individuals who are invested in the status quo. On the left also, there is a group of eager revisionists. In our judgment, however, the left wing's chances of success are currently minimal and we do not see them as a factor in investment planning.



The Global Economy

The global economy skipped a beat in the first quarter. US GDP fell by 0.035% as the Omicron surge of Covid impacted the country. In the Euro area GDP expanded by 0.02% in the face of the Covid surge. China's GDP increased by 1.3% despite the broad Covid lockdown and the cyclical economic slowing.

Expectations for the second quarter are muted. The US economy is expected to remain in zero growth mode as the Federal Reserve ratchets up interest rates to control inflation. In Europe soaring energy and food prices due to the war are expected to trigger a mild recession. China's lock down is still increasing, but the government is adopting counter cyclical spending policies to counteract the negative impacts on the economy.

Market Developments

Stocks and bonds fell across the board. Both markets are now in established falling trends. Declines for equities ranged from 5.3% to 11.7%. Declines for bonds ranged from 1.9% to 8%. Areas of relative strength were US large cap value stocks (-5.28%), intermediate term Treasuries (-1.85%), Municipals (-2.67%) and TIPS (-3.55%). The dollar and gold remain in rising trends but both gave

Table 2: Recent Market Performance

Category	Asset Class	6 month trend	3 month return	1 month return
Equity	US Large Cap	falling	-13.26%	-8.59%
	US Large Cap Growth	falling	-19.77%	-11.68%
	US Large Cap Value	range trading	-5.99%	-5.28%
	Growth – Value	falling	-13.78%	-6.40%
	US Mid/Small Cap	falling	-12.39%	-7.55%
	Intl Developed	falling	-13.54%	-9.36%
	Intl Emerging	falling	-13.98%	-8.15%
Fixed Income	3-7 Year Treasury	falling	-7.11%	-4.13%
	7-10 Year Treasury	falling	-10.54%	-3.55%
	TIPS	falling	-7.84%	-3.55%
	Muni	falling	-8.43%	-2.67%
	Investment Grade	falling	-9.86%	-4.33%
	Medium Grade	falling	-10.05%	-4.40%
	Preferred	falling	-14.90%	-7.98%
Commodity	REIT	range trading	-11.44%	-7.97%
	Euro	falling	-7.57%	3.58%
	Gold	rising	3.57%	-3.11%
	Oil	rising	38.31%	5.84%

up some of their gains, falling 3.58% and 3.11% respectively. After a meteoric rise, oil appeared to be plateauing with a gain of just 5.84%.

In June of 2020 we noted that most of the US markets upward momentum was due to a handful of large cap stocks. We take this moment to reprise their subsequent performance (table 3.)

At first glance it is a very heterogeneous group of companies. The common factor is that each of these companies applied new technology to become dominant in their principal industry. In many

Table 3: Selected Technology Stocks

Company	Industry	Base to Peak	Price Change		P/E Current
			Base to Now	Peak to Now	
Alphabet (GOOG)	Online Advertising	110%	66%	-21%	21
Apple (AAPL)	Hardware	109%	86%	-11%	26
Amazon (AMZN)	Online Retail	27%	-10%	-29%	38
Meta Platforms (FB)	Social Media	67%	-7%	-44%	15
Microsoft (MSFT)	Software	64%	40%	-15%	30
Nvidia (NVDA)	Parallel Processing	244%	106%	-40%	51
Tesla (TSLA)	Electric Cars	430%	318%	-21%	184
Average		150%	86%	-26%	52
Average ex TSLA		104%	47%	-27%	30

cases they actually created that industry or at least gave their part of the industry a unique characteristic separating it from predecessors. These companies all prospered during the pandemic, with their stocks peaking between October and December of 2021. Since then they have sold off, although in most cases not dramatically. A cursory glance at the table shows that Tesla is somewhat exceptional to the rest of the group and so we compute averages excluding it. On this basis the group advanced 100% base to peak or 47% from base to now – a good showing for a two year run! Common to the group (excluding Nvidia and Tesla) is that success in the core business has left the company with excess funds to invest in new ventures. Here they all face the challenge of success – its hard to follow a stellar success with another stellar success and even a solid success will somewhat pull down their performance record. The companies are grappling with this issue in different ways. Alphabet has taken a portfolio approach of investing in a diverse set of emerging technologies. Apple and Microsoft have stuck closer to their core competences and have looked to build solid pipelines of new product within their basic footprint. Amazon has focused on making its core business more efficient and powerful while also developing opportunities in technology spin-offs (notably cloud services.) Nvidia is exceptional to the group in being a much smaller more focused company. Its challenge is to keep its technology edge in the face of strong competition. Tesla is also exceptional to the group in being a disrupter of an established industry. Its challenge is to meet competition from powerful entrenched firms. Finally Meta is something of a fallen angel. Operating problems in its core asset (Facebook) have chilled consumer adoption and caused investors to lose confidence in its executive leadership. The company's response has been to focus on developing what it identifies as the next dominant technology in its space and to largely ignore the issues with its current business.



To a certain extent one can read the company's P/Es as a measure of market confidence in the firm's business strategies. Apple and Microsoft engender a lot of confidence with their proven replicatable strategies and set a valuation benchmark in the 26-30 range. Alphabet draws something of a conglomerate discount at 21 and Meta's gutsy bet the farm approach is discounted even more at 15. Amazon gets a premium at 38 based on an operations focused strategy that seems lower risk than a new product strategy. Nvidia and Tesla are still pouring effort into their core products and do not face the reinvestment challenge of their more mature brethren. The market currently likes the well defined potential they represent.

Does the group's recent pull-back represent a buying opportunity? The firms are probably fairly priced at present. Additionally, technology is not likely to return to a market leading position in the near term. In the medium term success or failure with the individual firm's strategy is likely to govern the course of their stocks. As noted, the strategies are quite heterogeneous and business maturity varies across the group.

For the capital markets the dominant issue remains a Fed tightening cycle driven by the need to control inflation. Equities and bonds are likely to drift or slip until the market sees the Federal Reserve getting a handle on the situation. News that Mr Putin has taken a one way trip to Beijing could spark an abrupt bear market rally however.

Advice

We would hope our readers are not carrying margin debt. If so, now would be a good time to pay it down. Otherwise we recommend sticking to ones long term strategy.

