Beyond March Madness

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"Bracket Busters"!! "Upset". "Who will be this years' Cinderella??" "It's double-overtime folks!!"

Of course, we are talking NCAA Basketball here – March Madness – and much of the nation gets easily swept up in the action, even those who rarely follow the games during the long regular season. NCAA Finals are one of the biggest venues for betting in all of sports. The champion won't be crowned until well after this letter reaches you, but there has already been a number of spectacular upsets and close games so far (as there always is!). Many professional announcers have speculated that this is the year where there is no such thing as a "Top Four". More teams from the middle may have their best shot at taking home the winner's trophy in this year's tourney.

Unfortunately for many around the globe, the year 2022 is also seeing another sort of "March Madness" but this one has much higher stakes and will be more consequential in its outcome. Russia has moved forward with their threat to realign their region to its prior 1997 status, a time when there were fewer countries in the NATO alliance and where Russia enjoyed a much greater geographical buffer zone. As the Soviet military moved across the Ukrainian border and begin the siege, many governments around the world stood in unison against the invasion while others have remained more neutral (China and many African countries). I'm unaware of any developed national government that has wholeheartedly and openly embraced the Soviets with an allegiance of support (so far). Of those against the Soviet invasion, none want to send their own militia in to do combat in defense of Ukraine. Their alternative is to employ sanctions, mostly in the form of financial restrictions such as freezing credit lines, denying the exportation of goods from the Soviet state, depriving the Soviet citizens of imported goods, and more. As the war has expanded in its destruction, those societies on the outside who are aghast at the invasion have amped up their restrictive sanctions.

There is an old saying that is very appropriate here, “Be careful what you wish for”. Just as government policies can (and do) have unintended consequences, there is no doubt in my mind that many of the sanctions that are being levied may result in catastrophic unintended consequences that could engulf the global economy. Prior to 2020, the world had been operating commercially with a finely tuned “just-in-time” inventory model whereby assembly goods, raw materials, and component parts arrived regularly and reliably on schedule so that many manufacturers and processors did not have to keep large supplies of inventory on hand. Money was saved and costs were lowered when big business did not have to pay for supplies that weren’t immediately needed. The spread of the COVID virus in 2020 severely disrupted this highly coordinated and well-refined system of global distribution. These supply lines have not been the same since, and they have been further complicated by political squabbles, hoarding behavior, and by many accounts, policy blunders. War is not going to make things any better; in fact, it may make them much worse.

I am neither a policy expert nor an industry insider to manufacturing, processing, or transportation, but it doesn’t take a genius to understand that when you have an economic super-power country like Russia that supplies the world with significant amounts of critical natural resources, eliminating that with the snap of a finger is dangerous. When you have a lesser contributor such as Ukraine (but nonetheless an important one) as a major supplier of wheat and a significant supplier of some critical gases that are essential to the manufacturing process of a broad range of semiconductors (among many other raw materials), there is going to be even greater disruption across the global economy. When the largest airplane manufacturers can’t get titanium, when the electric auto industry can’t get enough nickel and lithium, when the agricultural economy finds shortages of fertilizer, and when the food processing industry runs low on inventories of wheat, soybean, and sorghum inputs, we should all expect there to be the increased potential for that to take a bite out of top line revenues and bottom line earnings for many global companies. By extension, and although on one can predict the markets with any certainty, many stocks have the potential to deeply disappoint if this

continues. **As investors, we don't have the luxury of waiting until the potential diminished results hits the tape.**

In an ideal world, the Soviet/Ukraine conflict should come to some sort of cease-fire (or a halt altogether), and soon. When you create chaos such as this other March Madness, it may only take one political misstep by one or more members of NATO to trigger a much wider and destructive outcome. This other March Madness could mean that one too many sanctions might result in an unexpected and negative reaction by the Putin regime. Once the fuse is lit, no one knows how quickly things can get out of hand or how much collateral damage can be done. In the interest of humanitarian concerns, we can all do something to make a contribution but as investors (and for all who are concerned about their retirement plans), this is very likely one of those moments in time where the smarter move may be to <u>play defense rather than play offense</u>. I believe that some terrific opportunities may avail themselves down the road, but at this juncture the risks appear much higher than the potential rewards on most financial asset categories.

For several months now I have described how the bubble in glamour stocks, recent and highly touted IPO stocks, and the plethora of money-losing "New Era" stocks have taken a massive hit to their share prices as perhaps some reality for valuations has finally seeped into the market. Many are viewing this as a real bear market in stocks. However, I have been constantly issuing the following warning about stock behavior within a bear market cycle …. the biggest and sharpest of upward rallies don't happen in bull market cycles nearly as much as they do in bear market cycles. Simply put, we need to be aware that those sharp upward rallies have the very high potential to be a "head fake" (otherwise known as a "bear trap").

On the other end of the spectrum, long-ignored and "left-for-dead" commodity and natural resource related issues have found some life. Energy stocks have risen, fertilizer company stocks have gone more vertical, copper and aluminum and titanium (and other metallurgical company stocks) are making steady gains. There are reasons for this …. expectations for much healthier future returns has been lifted for these areas just as reports of much higher inflation

pressures have grabbed the headlines. One of the most significant outcomes of inflation fears is that many people (and companies) want to buy more goods before they continue to go up in price and that has the effect of creating a squeeze on the supplies, particularly for raw materials where it is difficult to make fast adjustments to output.

Don't shoot me, I am just the messenger. However, as in every major market cycle, there will be dangers to avoid and opportunities to embrace, and it is our jobs to make every effort to get out in front of the latter. As long-time readers already know, I have advocated basic materials, energy, and consumer staple sectors, as these areas were expected to benefit most from the anticipated change in the cycle of the economy. Additionally, the past two months has seen a nice recovery in the precious metals (PM – specifically gold and silver) but for some reason the PM miners haven't yet validated this persistent upward climb. Gold and silver are, in part, inflation hedges. We came within a whisker of having gold break out to a new "all-time high" price per ounce the second week of March, but then it retraced lower and now looks to be re-consolidating (as of this writing gold is priced at about $1,935, so we need another $150 an ounce!). If gold can break out above the prior highs, I would expect the miners to then lead that charge from there.

The Federal Reserve has FINALLY decided it is time to raise the base interest rate. I have said for many years that the Fed may have put themselves behind the eight ball by not raising interest rates sooner. I still believe that. Their forward policy guidance now puts them on the pathway of a series of rate hikes, perhaps as many as five more this year of 1/4% each. There is a relationship between interest rates and price; rising interest rates are offset by declining prices of fixed income securities (aka, bonds). I have advocated to keep your fixed-income holdings very short-term so as to be least exposed to this price-reducing dynamic and I stand by that yet. Lastly, there has been a noted increase of market volatility in 2022 and that might persist. And whip-sawing prices may lead to more opportunity to improve returns. Buying known values for less than "a dollar-on-the-dollar" is a noble goal for all long-term investors and perhaps a more volatile environment can create unexpected opportunities, but at the same time I believe that an investor should not to get too far away

from a long-term personal investment strategy of building your income sources while seeking growth at reasonable prices.

If you have any concerns about how you are currently positioned given the current March Madness conditions, please call us at (715) 362-1719, or, e-mail me at holperind@stifel.com. The next several weeks will be critical, in my opinion, as to the direction many of the current chaotic episodes might lead to.

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Indices are unmanaged and are not available for direct investment. Past performance is no guarantee of future results and no one can predict the markets with any certainty. Index returns include the reinvestment of dividends but do not include adjustments for brokerage, custodian, and advisory fees. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. Due to their narrow focus, sector-based investments typically exhibit greater volatility. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains.