Monthly Commentary 4th of April 2022

March was good for US and Japanese equities, whereas other equity markets did not move much. Fixed income fell very hard as yields continue to rise, with US Treasuries tanking by more than 3%! Commodities (+9.7%) were very strong, as was Bitcoin (up 9.9%). Finally, the USD was also well up (+1.66%).

Where are we and where are we going?

In our commentary last month, we cited research from Deutsche Bank that "*markets fall about 8% when war breaks out, but then recover within weeks or months, not years. Of course, we acknowledge that matters are very fluid and keep changing".*

A month ago, it seemed a brave thing to say, especially as we were seeing markets (and thus) portfolio values fall hard. Fast forward a month and while the atrocities in Ukraine have gotten much worse, developed markets are all higher than where they were when war broke out on February 23rd. This is especially true for the world's largest market, the US, which is up more than 7% since Russia invaded.

What now? We agree with Ethan Harris, the head of Global Economics Research at Bank of America Securities who wrote: *Forecasting the impact of the Russian invasion is like catching a falling knife. Expert opinion has been repeatedly wrong about the course of events. If we believe the experts, Putin would have never invaded, Ukraine would have offered weak resistance and sanctions would be limited. Looking ahead, this lack of guidance makes it hard to put probabilities on outcomes. The consensus has been a bit of a deer in the headlights, unsure what new baseline to assume. However, retaining the old benign baseline and saying "risks are heavily skewed to the downside" is not very useful. It is time to get off the fence. In this piece we change our baseline, picking the middle of three plausible scenarios. In particular, we argue:*

- *There is no clear off-ramp for Russia, hence our base case assumes many months of high uncertainty, tough sanctions and elevated energy prices.*
- *Russia is entering a deep recession, Europe will slow significantly, but the rest of the world will likely only slow modestly.*
- *For markets this means more dollar strength, some upward pressure on interest rates and ongoing downward pressure on risk assets.*

Stepping back, it is important to be clear about what we feel confident about and what we don't. In our view, this is clearly not a temporary risk-off event that the economy and markets shrug off and return to business as usual. On the other hand, we have very little confidence in predicting the exact course of events. Hence, in this instance, presenting a range of outcomes is not a dodge, it is being realistic.

So there you have it. We don't know what might happen, hence the range of different scenarios.

Talking of scenarios, Bloomberg Intelligence (BI), which is staffed by top analysts, posted four different ones based on their "fair value" model. Below are their predictions:

Market	1-Year Expected Return Base	1 Year Expected Return Bull	1 Year Expected Return Bear (stagflation)	1 Year Expected Return Bear (recession)
U.S. (S&P 500)	3.7%	13.4%	-50.4%	-17.3%
Europe (Stoxx 600)	17.6%	27.3%	-14.7%	2.6%
Emerging Markets (MSCI EM)	4.8%	21.7%	-39.1%	-12.2%
Global (MSCI World)	5.3%	17.0%	-41.6%	-13.3%

As you can see, their base case, which has a 55% probability of being right (according to BI) expects mid-single digit returns for the markets in the next year, with Europe being an outlier with much stronger returns. Their worst case – to which they assign an only 5% probability- is if we get stagflation (stagnating growth together with inflation), in which case, markets are expected to fall very hard. Hopefully the Fed will use all its tools to avoid such a scenario – read raise rates aggressively.

How is Elgin positioned?

We have had several enquiries on asset allocation lately and below is a short summary of where we stand.

- We maintain a neutral/slight overweight position in equities, mostly due to the continuing strength in economic fundamentals
- We favour developed markets, mostly through broad ETFs.
- Emerging markets have a low single-digit weighting, if any. Note that the exposure to Russia is about 3% of this low weighting, making it less than 0.15% of the total. i.e. insignificant.

- We are strongly underweight in bonds, and have been for a while. We reduced our investment-grade exposure to half of normal in favour of cash. Despite inflation, which erodes cash, bonds have performed much worse, losing unprecedented value in the last year. The fall in bond prices have been even more dramatic YTD.
- We have initiated a small position in a commodity ETF in January and February. This has helped portfolios.

In allocating to different classes, we are always cognizant of the below "mosaic" (from Bank of America & Bloomberg) of markets' performance in the last 22 years. Markets are indeed there to confound most predictions, and do so consistently:

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022*
Commodities 58.2%	US Treasuries 6.7%	Commodities 39.5%	MSCI EM 56.3%	REITS 32.0%	MSCI EM 34.5%	REITS 37.5%	MSCI EM 39.8%	US Treasuries 14.0%	MSCI EM 79.0%	Gold 29.2%	US Treasuries 9.8%	REITS 23.8%	S&P 500 32.4%	S&P 500 13.7%	S&P 500 1.4%	Commodities 17.5%	MSCI EM 37.8%	Cash 1.8%	S&P 500 31.5%	Gold 24.8%	Commodities 46.3%	Commodities 26.8%
US Treasuries 13.4%	Global IG 4.6%	Gold 25.6%	MSCI EAFE 39.2%	Commodities 28.7%	Commodities 33.7%	MSCI EM 32.6%	Commodities 33.0%	Gold 4.3%	Global HY 62.0%	MSCI EM 19.2%	Gold 8.9%	Global HY 19.3%	MSCI EAFE 23.3%	REITS 11.7%	US Treasuries 0.8%	Global HY 14.8%	MSCI EAFE 25.9%	US Treasuries 0.8%	REITS 27.4%	S&P 500 16.3%	REITS 33.2%	Gold 5.3%
REITS 8.5%	Cash 4.4%	Global IG 14.9%	REITS 33.5%	MSCI EM 26.0%	Gold 17.8%	MSCI EAFE 26.9%	Gold 31.9%	Cash 2.1%	MSCI EAFE 32.5%	REITS 15.9%	Global IG 4.5%	MSCI EM 18.6%	Global HY 8.0%	US Treasuries 6.0%	Cash 0.1%	S&P 500 12.0%	S&P 500 22.0%	Gold -1.9%	MSCI EAFE 22.8%	MSCI EM 15.8%	S&P 500 26.9%	Cash 0.0%
Cash 6.2%	Global HY 3.1%	US Treasuries 11.6%	Commodities 30.1%	MSCI EAFE 20.7%	MSCI EAFE 14.0%	Gold 23.2%	MSCI EAFE 11.6%	Global IG -8.3%	REITS 31.7%	S&P 500 15.1%	Global HY 2.6%	MSCI EAFE 17.9%	REITS 0.7%	Global IG 3.2%	MSCI EAFE -0.8%	MSCI EM 11.2%	Gold 12.9%	Global HY -3.3%	Commodities 20.1%	Global IG 10.3%	MSCI EAFE 8.8%	US Treasuries -4.9%
Global IG 3.1%	Gold -0.7%	Cash 1.8%	Global HY 30.7%	Global HY 12.4%	REITS 10.7%	S&P 500 15.8%	US Treasuries 9.1%	Global HY -27.9%	S&P 500 26.5%	Global HY 13.9%	S&P 500 2.1%	S&P 500 16.0%	Global IG 0.1%	Gold 0.1%	REITS -3.4%	Gold 8.6%	REITS 11.5%	Global IG -3.4%	MSCI EM 18.6%	US Treasuries 8.2%	Global HY 1.4%	Global HY -7.7%
Gold -5.4%	MSCI EM -2.4%	Global HY -1.1%	S&P 500 28.7%	S&P 500 10.9%	S&P 500 4.9%	Global HY 13.5%	Global IG 7.3%	S&P 500 -37.0%	Commodities 26.1%	Commodities 13.3%	Cash 0.1%	Global IG 11.1%	Cash 0.1%	Cash 0.0%	Global IG -3.8%	Global IG 4.3%	Global HY 10.2%	REITS -3.9%	Gold 17.9%	Global HY 8.0%	Cash 0.0%	Global IG -8.4%
Global HY -5.8%	REITS -7.8%	REITS -2.4%	Gold 19.9%	Global IG 9.4%	Cash 3.1%	Global IG 7.2%	S&P 500 5.5%	Commodities -42.6%	Gold 25.0%	MSCI EAFE 8.2%	Commodities -2.6%	Gold 8.3%	Commodities -2.1%	Global HY -0.1%	Global HY -4.2%	REITS 1.3%	Global IG 9.3%	S&P 500 -4.3%	Global HY 13.7%	MSCI EAFE 5.4%	US Treasuries -2.4%	S&P 500 -8.6%
S&P 500 -9.1%	S&P 500 -11.9%	MSCI EM -6.0%	Global IG 14.5%	Gold 4.6%	US Treasuries 2.8%	Cash 4.9%	Cash 5.0%	MSCI EAFE -43.1%	Global IG 19.2%	Global IG 6.0%	REITS -9.4%	US Treasuries 2.2%	MSCI EM -2.3%	MSCI EM -1.8%	Gold -10.4%	US Treasuries 1.1%	Commodities 7.6%	Commodities -13.1%	Global IG 11.4%	Cash 0.5%	Global IG -3.0%	MSCI EAFE -9.8%
MSCI EAFE -14.0%	MSCI EAFE -21.2%	MSCI EAFE -15.7%	US Treasuries 2.3%	US Treasuries 3.5%	Global HY 1.5%	US Treasuries 3.1%	Global HY 3.0%	REITS -50.2%	Cash 0.2%	US Treasuries 5.9%	MSCI EAFE -11.7%	Cash 0.1%	US Treasuries -3.3%	MSCI EAFE -4.5%	MSCI EM -14.9%	MSCI EAFE 1.0%	US Treasuries 2.4%	MSCI EAFE -13.2%	US Treasuries 7.0%	REITS -7.6%	Gold -4.1%	REITS -10.3%
MSCI EM -30.6%	Commodities -21.4%	S&P 500 -22.1%	Cash 1.1%	Cash 1.3%	Global IG -3.0%	Commodities -0.2%	REITS -10.0%	MSCI EM -53.2%	US Treasuries -3.7%	Cash 0.1%	MSCI EM -18.2%	Commodities -0.3%	Gold -27.3%	Commodities -29.3%	Commodities -29.4%	Cash 0.3%	Cash 0.8%	MSCI EM -14.3%	Cash 2.2%	Commodities -15.0%	MSCI EM -4.6%	MSCI EM -12.3%

Source: BofA Global Investment Strategy, Bloomberg. *2022 YTD

BofA GLOBAL RESEARCH

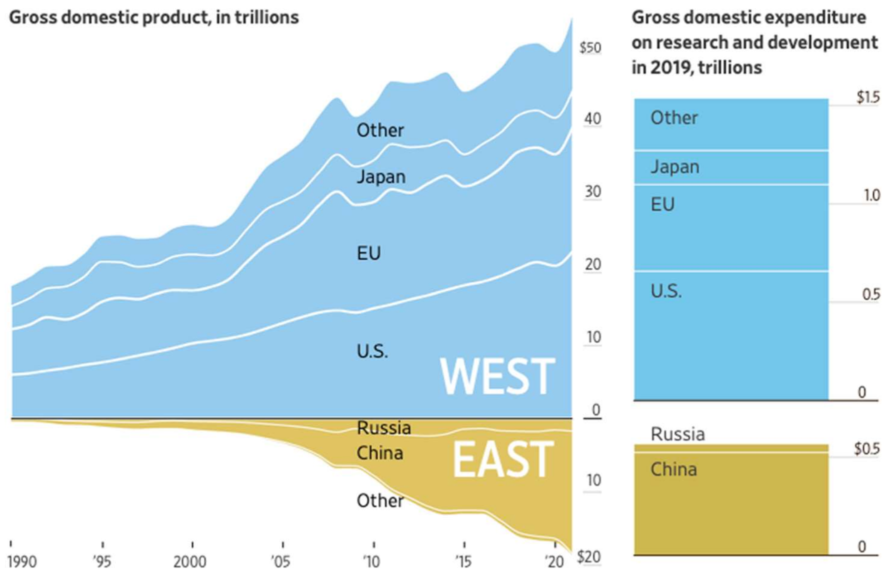
Geopolitical East v West

The war in Ukraine has brought back the argument about which system is best when it comes to future prospective economic growth - the democratic west (US, Europe, Canada, Australia, New Zealand, Japan, South Korea, Taiwan), or the autocratic east (China, Russia, Kazakhstan, Belarus, Pakistan, North Korea)? The Wall St Journal addressed the issue of "How the West can win in a power struggle" in the following article:

https://www.wsj.com/articles/how-the-west-can-win-a-global-power-struggle-11647615557

They conclude that long term economic advantage will come from technology and knowledge, arguing that in commercially useful technology Western companies lead in almost every field, from commercial aviation and biotechnology to semiconductors and software.

As the graphic below illustrates, the U.S. and its democratic, market-based allies in Europe and Asia together generate far more economic output and spend much more on research and development than China, Russia and countries aligned with them.



Note: GDP converted from local currency to dollars at market exchange rates. Research and development spending is for 2019, converted from local currency to dollars at purchasing power parity.
Sources: IMF (GDP); OECD (expenditure on R&D)

We welcome this conclusion.

Communication

If any of you would like to communicate with us or have any specific concerns about the current state of your portfolios, please contact your advisor or us directly at pmt@elginamc.com. If you need to talk to one of us, we shall be happy to oblige and can set up a call.