The Ukraine Situation

This week Russian forces invaded Ukraine. We are sensitive to the humanitarian situation and pray for peace. The purpose of the Note below is to address investor concerns around the situation. Our remarks are focused on financial markets and ability of investors to achieve long term financial goals.

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The title of our annual letter was The Fasten Seat Belt Sign is On. The premise - 2022 will be a volatile year for markets. Rising interest rates and inflation were the areas of concern, but a Russian invasion of Ukraine is also a factor. We address the situation in 5 parts:

History of Russia / Ukraine: The Ukraine has a long history of being dominated by foreign powers, including the Mongols, the Austria-Hungarian Empire, the Ottoman Empire, the Russian Empire and, most recently, the Soviet Union. Ukraine gained independence upon the dissolution of the Soviet Union in 1991. In light of its adjacency to Russia and shared historical and cultural linkages, there are many Russians residing in Ukraine and the Russian language is the predominant language spoken in Ukraine's larger cities. Despite its stated independence, Ukraine was controlled by Russian-friendly autocrats until 2014 when a pro-European government was installed. Putin soon after invaded parts of Eastern Ukraine and annexed the Crimean Peninsula in what now seems to be the first step in regaining control of all of Ukraine.

In short, this invasion is not a surprise. In fact, since 2014, the U.S. military and its NATO allies have exhaustively war-gamed this exact invasion. Therefore, NATO's preparedness should be high and responsiveness swift. Let us hope that this translates to an even swifter reduction in hostilities but for now the base case assumption is that Putin will forcibly install a Ukrainian government favorable to him.

Why are US markets worried? The focus of this Note is the impact on US markets because that is where the majority of our investments are concentrated. The US has minimal direct economic exposure to Russia. However, there are companies in Europe that have more financial exposure to Russia and Ukraine. Germany is an example as Russia is a source of much of their natural gas. All investment outside of the US must be closely examined for impact related to the region or ensuing sanctions.

The most pronounced financial impact in the US is the price of oil. While we do not rely on Russia for oil, there are disruptions including higher gas prices for Americans. The concern is that higher gas prices will cause less discretionary income available for spending on goods and services, thus lowering the growth of the economy.

The larger risk to the US stock market is sentiment. A decline in investor sentiment is common during the start of a conflict. If we analyze past conflicts, the trend is a short-term spike down in stocks followed by a rebound. In fact, before this invasion, there has never been a military crisis in history when stocks did not rebound. The question is the length of time? The chart on the next page displays data of declines during past conflicts and the time it took to recover the losses. The average draw-down of the S&P 500 was 5% and the average days to recovery was 47 days.

Geopolitical Events And Stock Market Reactions

		S&P 500 Index		Calendar Days To	
Market Shock Events	**Event Date**	**One-Day**	**Total Drawdown**	**Bottom**	**Recovery**
Iranian General Killed In Airstrike	1/3/2020	-0.7%	?	?	?
Saudi Aramco Drone Strike	9/14/2019	-0.3%	-4.0%	19	41
North Korea Missile Crisis	7/28/2017	-0.1%	-1.5%	14	36
Bombing of Syria	4/7/2017	-0.1%	-1.2%	7	18
Boston Marathon Bombing	4/15/2013	-2.3%	-3.0%	4	15
London Subway Bombing	7/5/2005	0.9%	0.0%	1	4
Madrid Bombing	3/11/2004	-1.5%	-2.9%	14	20
U.S. Terrorist Attacks	9/11/2001	-4.9%	-11.6%	11	31
Iraq's Invasion of Kuwait	8/2/1990	-1.1%	-16.9%	71	189
Reagan Shooting	3/30/1981	-0.3%	-0.3%	1	2
Yom Kippur War	10/6/1973	0.3%	-0.6%	5	6
Munich Olympics	9/5/1972	-0.3%	-4.3%	42	57
Tet Offensive	1/30/1968	-0.5%	-6.0%	36	65
Six-Day War	6/5/1967	-1.5%	-1.5%	1	2
Gulf of Tonkin Incident	8/2/1964	-0.2%	-2.2%	25	41
Kennedy Assassination	11/22/1963	-2.8%	-2.8%	1	1
Cuban Missile Crisis	10/16/1962	-0.3%	-6.6%	8	18
Suez Crisis	10/29/1956	0.3%	-1.5%	3	4
Hungarian Uprising	10/23/1956	-0.2%	-0.8%	3	4
N. Korean Invades S. Korea	6/25/1950	-5.4%	-12.9%	23	82
Pearl Harbor Attack	12/7/1941	-3.8%	-19.8%	143	307
Average		**-1.2%**	**-5.0%**	**22**	**47**

Source: LPL Research, S&P Dow Jones Indices, CFRA, 01/06/20

The Portfolio: If an investor is waking up today and looking to position their portfolio for the invasion of Ukraine or volatility, they are a little late. The following are details of how the Lear Global Vigilance portfolio was positioned before the invasion:

- 5-7% Cash
- 18-20% short duration fixed income
- 10-12% Commodity exposure – including gold and crude oil
- 6-8% in natural gas related stocks (MLPs and liquid natural gas exporter)

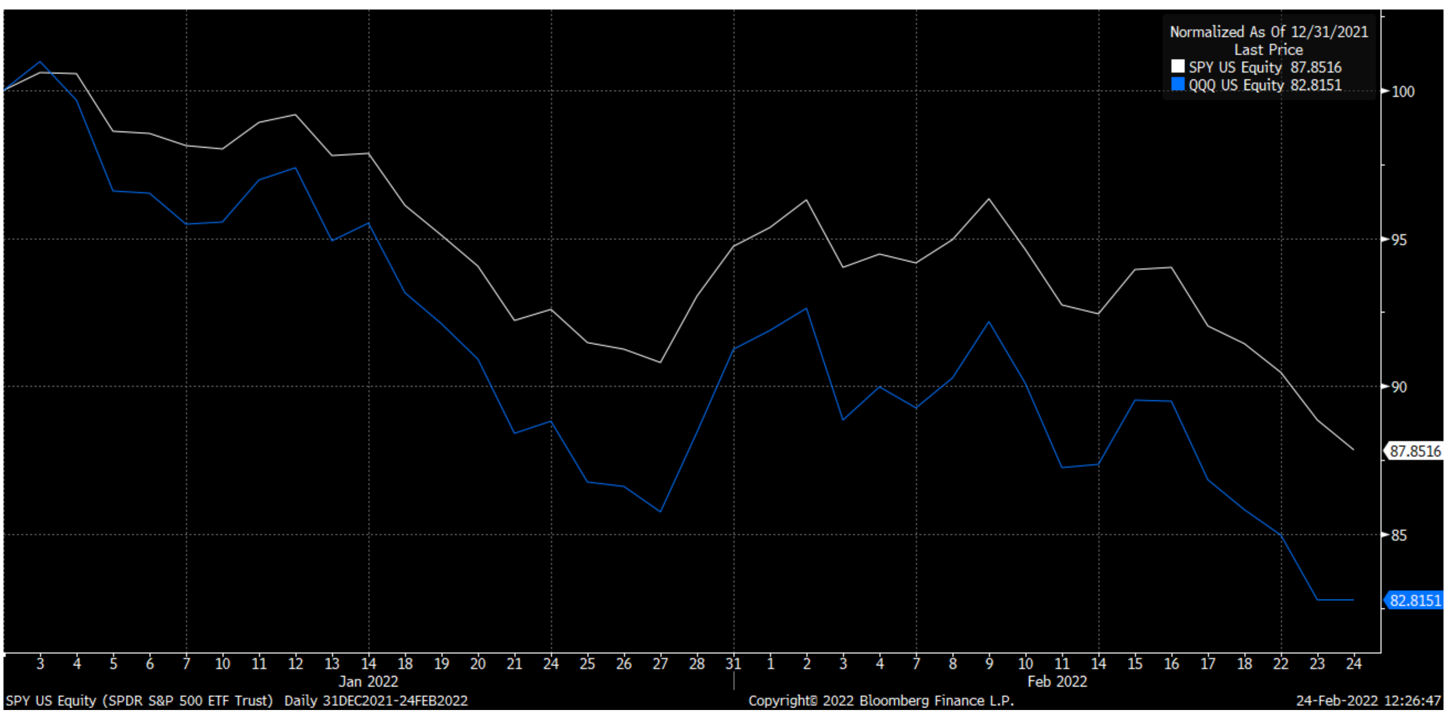
The result is a defensive position in approximately half of the portfolio. The positioning was created to shield the portfolio against inflation, but also works well for this military conflict as resulting higher commodity prices.

The other half of the portfolio is in a carefully curated selection of stocks. There is 10% exposed to international companies. We are carefully reviewing each to determine the impact of this crisis on their operations.

The Markets: The Federal Reserve and inflation are the main area of focus for 2022. The question many investors are asking: Does the conflict cause the Fed to move more cautiously in the interest rate hiking cycle?

We do not believe the Ukraine conflict will have a large impact on the Fed's plans to raise rates as inflation is still a concern. We remain focused on the Fed and any changes they may make to their forecast. At this time, there are not significant changes to the outlook.

The stock market as measured by the S&P 500 (white) and NASDAQ (blue) has corrected -12% and -17% respectively in 2022. The majority of the decline was before the invasion. We view this correction as natural and healthy part of the market cycle.



What to Watch: The situation is fluid and will continue to evolve over the next several days. We are watching several areas for clues to the length and severity of the impacts on the economy and markets. The areas we are monitoring:

- Spread of invasion to other areas outside of Ukraine

- Cyber attacks
- Sanctions on Russia – including access to the SWIFT system
- Actions or dialogue from China and Iran (relationship between Russia, Iran and China)
- Commodity prices and energy security
- Speed of the Ukraine fall to Russia
- Supply chain disruptions

In Conclusion: Military conflict usually causes a swift, short-term decline in stocks followed by a recovery. All conflicts are unique because of the underlying economic conditions and stage in the market cycle. Today, the US is late in an economic cycle characterized by high inflation and a hawkish Fed. The focus turns to one question: will the financial impact of this conflict fast-forward the time to a US recession?

As of today, we believe the financial impact will not be significant and select stocks will continue to perform well as underlying economic conditions in the US are **STILL** very favorable. Recall, our analogy for the US economy as an airplane descending from an unusually high altitude to something more normal. Citizens of the US have jobs, are experiencing higher wages and continue to spend on goods and services.

We pray for peace and are closely monitoring the situation for changes to the portfolio. Our goal remains to help investors achieve their financial goals over the long run. The team continues to work tirelessly to navigate this crisis and all other events.

Disclosures