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## 2022 First Quarter Review

Greetings Clients:

In the first quarter, U.S. stocks declined 4.6%, world stocks were down 5.4%, and bonds declined 5.9%, as represented by the S&P 500 Index, the MSCI All Country World Index, and the Bloomberg Barclays Aggregate Bond Index. But do you have a sense of how these asset classes have performed since the early pandemic plunge? Would you believe 109%, 90% and 1%? That's right, the US stock market has more than doubled since March 23, 2000. This is a major reason why our portfolios, in general, are meeting their long-term goals.

This is a very uncertain and scary time. We expect volatility to continue and we can envision multiple short-term outcomes: We could see markets continue to vacillate +/-10%. We can also imagine that they recover and give us double digit returns by year-end. Or we could see another 20% to 30% drop like we experienced a little over two years ago. Ultimately, Chief Allocation Strategist Steve Bobo and I continue to believe that the next short-term scenario will be immaterial. We believe this because:

1. Markets tend to overreact and then moderate quickly;
2. We know a correction will come, but we could have a much longer period of appreciation before it does. As Steve says, trends can persist for a very long time before changing suddenly;
3. Declining asset prices enable us to purchase our investments at a discount, which can provide higher returns later when we need cash;
4. Most consumers are overreacting to price increases. Yes, we need to avoid inflation expectations, but look where we are after a global pandemic;
5. The economy is strong! Employment is nearly full and we are buying stuff even though we complain about high gas prices;

6. Our polarized elected leaders succeeded in working together to soften the financial blow of the pandemic and prevent the permanent destruction of jobs and industries;
7. Interest rates *should* be higher. Savers *should* be able earn 5% on bonds, mortgage rates are still incredibly low, and the financial markets would be healthier if money wasn't so cheap.
8. The Federal Reserve has done an exceptional job and we believe a soft landing without a recession is possible;
9. But when we one, recessions are normal and we are prepared. Most of our clients have growth portfolios with 30% of their assets in mostly short-term bond funds. Let's talk if you are rethinking your aggressive portfolio because you are closer to retirement or you just want more stability.

The rest of this letter will focus upon geopolitics. Partly because we spent a vast amount of time studying and asking the question, “Is this time different? Is our investment methodology up to the task?” (Answers: No and Yes.) And partly because we believe the risks and uncertainty that we face politically provide insight into the risks and uncertainty that we face financially.

First, we are deeply moved by the resolve and bravery of the people of Ukraine. Their willingness to take up arms and their remarkable president's ability to inspire has changed the course of history. This is not hyperbole. See interview with Adam Tooze below. The immediate political reaction to Putin's invasion by Europe and the US was one of jaded realpolitik (politics based on practical objectives rather than on ideals: a pragmatic, no-nonsense disregard for ethical considerations). 40% of Germany's natural gas comes from Russia, so Germany and the US accepted as a foregone conclusion that Putin would take Ukraine. But photos of schoolteachers in their civilian parkas and running shoes learning how to use assault rifles, videos of missiles blowing up hospitals, and Zelensky's stirring words changed people's minds. Citizens demonstrated in western Europe, and over the weekend governments rejected realpolitik: their leaders rapidly mobilized to impose sanctions, seize assets and isolate the aggressor.

Geopolitics is a messy, complicated business that requires the coordination of dozens of nations. The only thing we know for certain is that resolution will take years, there will be setbacks, and the outcome will differ from any scenario that we can now imagine. But there is a growing possibility that Putin's attempt to challenge western dominance will backfire entirely, that a

rules-based world order will be strengthened, and that US power and wealth will augment as Germany replaces Russian pipeline gas with American liquified natural gas in the intermediate term. Perhaps this tragedy will also accelerate the global energy transition to renewables.

That last paragraph is the shortest summary that I can manage. But I want to share the sources that went into it. Here are the brilliant experts (with hyperlinks) that had the biggest impact on my thinking:

1. [Ezra Klein interviews energy expert Daniel Yurgin](#)
2. [Ezra interviews Russian/American journalist Masha Gessen on Putin's Anti-Modern Worldview](#)
3. [Ezra interviews Fiona Hill on the war that Putin is really fighting](#)
4. [Adam Tooze explains to Ezra how everything changed](#)
5. [Fresh Air: A Crash Course on NATO History](#)
6. [Fresh Air: Former US Ambassador to Ukraine, Marie Yovanovitch](#)
7. [Fresh Air: Former State Department Official Michael Kimmage on How the War Might End](#)

The Yurgin interview also underscores one of Ridley Cove's investment themes that Steve identified when we wrote our framework nearly seven years ago: The US's relatively recent energy independence has and will be a game-changer. As Yurgin explains the transformation: In 2003 it was predicted the US would be the world's largest energy **importer**, and in 2008 we only produced 40% of our energy domestically. Today we are net zero. We are the world's largest oil producing nation, with Russia and Saudi Arabia tied slightly behind us. And this year we will become the world's largest exporter of liquified natural gas even though we only entered the industry in 2016.

Including the knowledge of the five other experts, Putin's invasion was a grave miscalculation. Germany has completely changed its energy policy in the last three weeks and has announced that it will build LNG terminals to receive US liquified gas. Putin invaded Ukraine last month partly because he saw a momentary competitive advantage in the tight energy market amid a secular strengthening of America's energy dominance. And partly he miscalculated because he has insulated himself from the real world and believes that he is infallible (this insight from Kimmage). As Yurgin concludes, "The days of Russia as an energy superpower are over, and Putin has signed the death warrant."

This hopeful longer-term outlook does not change the fact that Ukrainians are paying a horrific price. The aid must continue and there must be reparations. If you want to do something yourself, closer to home, consider a charitable gift of cash or medical supplies - or both. My friend Tatyana Melnik at Eastern Bank (she has helped several Ridley Cove clients obtain home equity lines of credit and business loans) has been supporting her homeland and family and friends in Ukraine by collecting medical supplies. Please join us in making monetary contributions to Newton-based Sunflower of Peace (here is the link to donate) as well as in-kind contributions of medical supplies such as ibuprofen, antiseptics, sterile and non-sterile gauzes. I just went to CVS and used all these coupons that I usually ignore and that weird membership program to get two huge bottles of ibuprofen at a deep discount. I told the cashier what I was doing and she helped me save even more. It was fun and made me feel great. Tatyana will accept the supplies at her new Eastern Bank office at 1433 Highland Avenue in Needham: tell her Ridley Cove sent you.

Investing, like geopolitics, is a messy, complicated business. It requires acceptance that we do not have control or even knowledge of what will happen next. But one thing we know for certain is that volatility diminishes with time, and we can be methodical and disciplined to get us to our goals. Focus on the things that you can control, be patient and keep the faith.

We have uploaded your quarterly reports to your portals, and you can access them with the following link:

<https://main.yhlsoft.com/auth/users/webportal/ridleycove>.

Please contact me if you have any questions about your investments, our strategy, or your financial goals. Our money is invested right alongside yours.

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