Market Volatility and the Russia-Ukraine Conflict

ANDY SIEG: Hello, I'm Andy Sieg, President of Merrill Wealth Management. The Russia-Ukraine conflict is having an impact on us all. The humanitarian crisis that we see unfolding is tragic to behold. On a human level, we're watching with great empathy. Closer to home, we share concerns about the impact this crisis is having on oil prices, inflation, the economy and the markets. We know that our clients at Merrill, Bank of America Private Bank and our customers across Bank of America are concerned and have important questions about the conflict and all of its implications. For answers, we brought together leading thinkers on geopolitics, the economy and the markets to help you better understand what's happening and how you can best prepare.

First, Chris Hyzy, Chief Investment Officer for Merrill and Bank of America Private Bank will catch up with Ian Bremmer, President and Founder of Eurasia Group and one of the most sought after experts on rapidly changing global events. Ian will offer some context on the current situation and where things may be headed next. Then, Chris will speak with two leaders from B of A global research, Savita Subramanian, Head of U.S. Equity and Quantitative Strategy, and Ethan Harris, Head of Global Economics. They'll look closely at the impact of the conflict on U.S. and global markets and investments and share some thoughts on what you can do during this difficult time. I hope you find this program useful, and we want you to check back in with us. In the near future, we'll be back with Ian, Chris and members of our global research team for additional updates as this conflict unfolds. With that, Chris and Ian, over to you.

CHRIS HYZY: Thank you, Andy, and thank you so much for joining us, Ian. Before the current conflict, the Eurasia group cited the global power vacuum as a key geopolitical risk for 2022, and for well over a decade, you have called this a G0 world. This has unfolded before our eyes vividly. Since the conflict started, how, if at all, has this affected that assessment?

IAN BREMMER: Well, first, why did Putin make this decision? And he made the decision in part because he saw not a G7, not a G20, but a G0, and there are two different ways that that plays out. First the long term where back in 2008, Putin took a piece of Georgia and wasn't much of a reaction. 2014, took two pieces of Ukraine. You know, four years later, he was hosting the World Cup and there were European leaders that were visiting him in Russia even though he still was occupying Ukraine. 2016, the intervention in the U.S. election or before that, in BREXIT, not much of a response. I mean, consistently what Putin saw was that as long as the acts that he was taking were not of direct massive national security consequence for major American and Allied countries, he could get away with it. He had impunity. So, I think that the first big piece here is that if the United States doesn't want to be the global policeman, if the Americans don't know what it means to promote democracy and don't agree on that message, that provides a lot more room for Putin in his backyard to reconstruct the empire that he lost in places like Belarus and Ukraine and Moldova--clearly what his effort has been. But then, more proximately, Chris, over the past few months, you had this disastrous American withdrawal from Afghanistan, a unilateral decision that the Allies really weren't on board with, certainly not the execution. You had the Americans focusing much more on the pivot to Asia, on China. Merkel was gone, the new German chancellor untested, a three-party coalition, his own Social Democrats more focused on having a better relationship with Russia. You can understand in that environment why a Russian president would think that he could invade Ukraine and get away with it, especially just a couple of weeks after Putin travels to Beijing and the Chinese government says, "You're our best friends on the global stage. We're going to work with you economically, diplomatically, even militarily." I think that was, in some ways, the final piece of the puzzle that proved to Putin that in this G0 world, this was the time for him to redress the perceived wrongs from losing the Cold War and disintegrating the Soviet Union, which he considers to be—and he's said this many times publicly—the greatest geopolitical disaster of the 20th Century.

CHRIS HYZY: So, let's talk about security in general, Ian, national security, the access to technology, the access overall to natural resources, energy security in and of itself, this power vacuum creating regional alliances. This started all the way back—you could argue—many years ago, or even during the tariff and trade war starting in 2018. Take us through all that.

IAN BREMMER: Well, the easiest way to think about it is that in 1989 when the Berlin Wall fell, we were very excited about a peace dividend that especially the fact that the Europeans would no longer have to concern themselves with the prospects of an invasion on their territory of significant military defense. It was no longer – national security was no longer going to be a top priority. They certainly weren't going to have to pay for it, and they weren't going to have to prioritize it as they thought about policy. Instead, they could focus on their economic development, and they could focus on their social contract at home. I think that we can now say clearly and definitively, Chris that the peace dividend is over. So, that means, I mean, Olaf Scholz, the new German chancellor, gave a speech a week ago. It was the most important speech by any European leader since 1989 when the wall came down, and it was a speech that not only said the Germans were going to provide weapons, advanced weapons to the Ukrainians which they would use to fight a nuclear-armed Russia, that Germany would do that-- inconceivable two weeks ago you would have seen that—but also, that Germany was going to spend over two percent of their GDP on defense going forward, that Germany was prepared to take the hit on their own economy in terms of ongoing necessary gas inputs by putting major sanctions, including SWIFT sanctions, including helping to freeze Central Bank assets and Russian currency all over the world. The Germans are much more reliant on the Russians than the Americans are. They're prepared to do that. They're prepared to decouple themselves from the Russia economy. And no, they can't completely do that 100 percent on day one, but the decision has been made. So, even if you had a peace deal tomorrow with the Russians and the Ukrainians, and no more Ukrainians died and all the Russians withdrew from Ukrainian territory, it would still be too late to recouple the Europeans with Russia. And so, what we are now seeing, I mean you tried. It was Bush tried to get the Germans to spend on defense. Obama tried, Trump tried, Biden tried. They all failed. Putin succeeded. Putin has succeeded in decoupling the Europeans from the Russian economy. He's succeeded in creating Russia as an international pariah insofar as we talk about advanced industrial democracies. That includes Japan, it includes Australia, but it does not include China or India or Brazil. So, we are seeing not just the decoupling between the so-called West and Russia, but we're seeing friend sourcing—not insourcing, not outsourcing, but you're increasingly only aligning your supply chains with the countries that you find politically palatable. That is a – obviously, it's a radically different way of thinking about the global markets, of commodity flows, of capital flows and it's expensive. It's not the way that

CEOs want to do business. They want to do business where the markets are. They don't want to do business where the politics are problematic or happy, but that's the world that we have just entered back into after 30 years of not having to particularly deal with it very much.

CHRIS HYZY: So, let's press on that point for a second. You've talked about in one of your other books the end of free market capitalism as we see it. You've just touched on that a little bit between what governments are doing and what corporates are doing and given the crisis in Ukraine and what you talked about, the extension of a G0 world. Are the sanctions working from your perspective? Is it a situation where this end of free market capitalism takes a whole other event forward?

IAN BREMMER: The sanctions are working insofar as they are destroying the Russian economy. I mean, in a matter of days, you're going to have massive goods shortages in Russian cities in winter, and the people are going to be very unhappy about that. A lot of them will blame the West. The amount of disinformation that comes from Russian state media is immense. It's much worse than what you'd see in the United States or Europe, much more all-encompassing, and the Russians have shut off all of their independent media and they've cut off Twitter and Facebook and the BBC and CNN and the Voice of America. So, you're not getting the information you used to get, with the exception of a relatively small number of young, educated, digitally savvy urban Russians. But still, they're going to be very unhappy about this. There are already over 10,000 Russians that have been arrested for peaceful anti-war demonstrations in the last week-and-a-half. Those numbers will go way up as the Russian economy collapses, and the Russian economy is collapsing directly as a consequence of the sanctions that are being put on. Most importantly, the fact that their war chest has been frozen, a majority of access to Russian currency globally is gone. Furthermore, the oligarchs are getting sanctioned, the banks are getting sanctioned, United States is cutting off its direct energy imports from the Russians. There are some limitations that are coming in Europe too. And then, of course, you have so many of the Western corporations that were doing business in Russia that are pulling out. Some because they're told they have to, many because they just don't want to be there anymore. They understand from a brand perspective, it's just a reputational disaster for them. Again, they're not coming back.

So, in that regard, the sanctions are working, but they're not working in the sense that they're not going to change Putin's behavior. I mean, the biggest problem here and the reason that I am quite negative about the outlook on this Russian invasion is because I can't see any circumstance under which Putin emerges from this conflict in remotely close to as good a shape as he was before he invaded. And I say that that's both true in terms of his domestic political situation, certainly in terms of Russia's economic environment, but also—and this is critical—in terms of Russia's geopolitical position in Europe. And remember, this is ostensibly why Russia invaded to begin with, is because Putin was so unhappy about his position in the European security environment, that he said that status quo was unacceptable. Well, you know what? It's just gotten a lot worse because you've got Finland and Sweden, non-NATO countries that are sending weapons to Ukraine. And further, they're now saying, a majority say they want to join NATO. That's never been true in history before. You've got Denmark saying that they're going to get rid of all the restrictions on their dealing with NATO and the European defense organizations. That's going to be a problem. You've got the Baltic states wanting permanent NATO bases right on Russia's border. You got forward deployments in countries like Poland and Bulgaria and Romania. They're not going to go away. You've got, as I mentioned, the Germans spending massively more on their defense capabilities. I mean, NATO today is an organization with a mission. It's a revived stronger and more consolidated organization that's focused on Russia, and before Putin invaded Ukraine, that wasn't true. Before Putin invaded Ukraine, you had a whole bunch of European countries that are saying, "We don't really trust the future of the United States. We don't really know what we're doing here. We want to work with the Russians economically, we want to work with the Chinese." All that's out the window. It's all looking worse for Putin. And even in Ukraine, I can't see how he can – he can overthrow Zelenskyy, the Ukrainian president. He can take over Kiev, and I expect, by the way, both of things will occur, but he can't control Ukraine. I mean, the cost of occupying a country that is incredibly hostile that will likely have a government in exile in western Ukraine with massive economic and military support from the entire West, which will be deployed in service of continuing to attack Russians on the ground, that's nowhere close to what Putin clearly thought was going to happen militarily when he orders 190,000 troops across the borders to all go in. So, unless Putin is going to be removed from power--which I mean, is an outside possibility, but you wouldn't bet on it in this environment--in any other circumstance, Putin is angrier, he's more insecure and he's vindictive, and he's prepared to take actions against other countries, including NATO states.

CHRIS HYZY: Given that, is there an end game here? Is there a timeline that it's possible, or is this just still multi-scenarios that could still play out as we work through this?

IAN BREMMER: In the last two weeks, so many people have been asking me, "What happens when this is all over?" and my response has been, "What do you mean over?" I mean, when you say that the peace dividend is gone, it's gone. So, I mean, I can see an end to the actual fighting in Ukraine. We've now had almost two weeks of fighting. There are two million Ukrainian refugees—a million a week. You've seen nothing like that since World War II. I expect five to 10 million refugees before this is over. Out of a country of 44 million, that could be as many as 20 percent of Ukraine's total population. Imagine what would have to happen to your country for one in five people to simply say, "We're out, we're gone, we're done!" It's unimaginable! So, I mean, that's part of the reason why this is so incredibly dangerous. But once Kiev is overthrown, once the government is gone, at that point, I could see the Chinese together with the French and the Germans with a new Normandy format. The Chinese have just had a phone call, Xi Jinping, with Macron and with Scholz. This was clearly prepped in advance with Russian president, Putin on the idea of a new format for what negotiations over Ukraine should be. "We don't want to talk with the Americans, we want the Europeans, who we think are more balanceable, and we want the Chinese at the table, who are our buddies." Very interesting to see the Chinese and the French and the Germans kind of lining up for that. We want to watch that very carefully. So, that would be – as that emerges, that'd be one thing I watch very carefully. And then, again, after Zelenskyy is gone, if you're Putin, you can argue domestically that you've kind of accomplished your approximate goals, and then you have to talk more broadly about these issues of European security, which will not go well, but where China is on your side and where a whole bunch of European countries at least want to keep investing in China. Maybe that creates a bit of a wedge that allows some light back into the Russian economy. That's probably what Putin is thinking about right now. But I want to be clear—and this is something that is not well understood in the West right now—in the United States and Europe, there is an assumption that you can't do a nofly zone because that could lead to World War III, that could be NATO fighter pilots fighting Russian fighter pilots. You can't do American troops or NATO troops in Ukraine defending the Ukrainians because that could lead to World War III. We could be shooting each other, but it's perfectly fine to send the most advanced fighter jets and sniper rifles and anti-aircraft and anti-tank weapons to the Ukrainians to blow up Russia, and it's perfectly fine to provide real-time intelligence to the Ukrainians on the disposition of Russian forces on the ground to better allow the Ukrainians to blow them up, and it's perfectly fine to do everything possible to destroy the Russian economy in the service of forcing them to capitulate or to destabilize the Russian regime. Now, I'm not saying I disagree with those policies. That's not the purpose here. The purpose here is to explain that from Putin's perspective, which obviously matters here, from Putin's perspective he sees all of those as acts of war and he's willing to retaliate. The idea that this is just a war that involves Russia and Ukraine and doesn't really involve NATO, even though NATO is taking all these steps against Russia, that's not realistic. That's not sustainable, and it's part of the reason why this conflict is so much more important than Yemen or Syria or Libya or Myanmar because none of those had those direct knock-on global implications. Ukraine does.

CHRIS HYZY: So, let's speak of the NATO alliance. Let's speak of this theme of deglobalization that many have talked about to either regional economic zones, regional alliances. We've talked about energy security, even technology security, cyber security, national security in general. Let's now pivot over to China. China's desire or not a desire to move further away from the West. Take us through what China's thinking right now. You touched on it before, but take us through what they're thinking and ultimately, what's the relationship with the U.S. as we move forward.

IAN BREMMER: So, China has decided—decided by President Xi Jinping when he invited Putin to the Olympics, that geopolitically, he sees the global order similarly to that of Russia. Xi Jinping sees what the Americans are trying to lead with the Quad, the relationship with Japan and Australia and India as a similar effort at Chinese containment in their backyard to what Putin sees with an expansion of NATO. The Chinese see American sanctions against Huawei and other key areas of national security, dual use in the Chinese economy, as similarly to the way the Russians see efforts by the Americans and the Europeans post-2014 in hurting the Russian economy through sanctions. So, they are obviously much more friendly, and that friendship has not been shaken by the Russian invasion in Ukraine. Having said that, the Chinese would prefer a diplomatic outcome here. They have announced on numerous occasions, they recognize the territorial integrity of Ukraine. That's a longstanding policy of China. It certainly reflects China's views on Taiwan as being part of a sovereign China. They wouldn't want to, in any way, upset that policy background, but I want to be very clear, the Chinese are not neutral on this issue, even though they abstained at the United Nations Security Council. They support the Russian position. If you look at Chinese media, they are censoring anything that is pro-Ukrainian. It's all pro-Putin. There are Chinese media organizations actually physically embedded with Russian troops as their war fighting in Ukraine, beaming that back into China. I don't think a lot of Americans are aware of that right now, but it's very important to understand. Furthermore, something that's not public but I'll share with you because it's not like I got this out of intelligence—the Chinese ambassador to Russia has just organized a meeting of all of the top Chinese investors in Russia to say, "Hey, there's a unique opportunity here, and as the West is pulling out, now is when we should be investing, now is when we show our commitment to

Russia. We could be building our relationships on the ground for decades. So, it's a better position for us." I mean, obviously that is not a government that is trying to align with American sanctions on Russia or with American pressure on Russia. So, having said that, the fact that the Chinese are reaching out to Macron and to Scholz in Germany does reflect the fact that the Chinese don't want their economy to be decoupled from the West. Unlike Russia, which is a global power that is expressed almost exclusively in their military capabilities, for China, it's much more about their economic capabilities and their inter-dependence with companies all over the world. And they intend those investments largely to continue, whether it's the financial sector or it's the technology sector, its manufacturing, its luxury goods, you name it. So, I do think that the Chinese, even though they've made their bed with Putin, they want to be seen publicly as a more mature, responsible power that you can still do good business with.

CHRIS HYZY: So, with that mindset, what does that change or not in terms of China and Taiwan's presence together or not in the coming years?

IAN BREMMER: In the near future, Chris, it doesn't change much at all for precisely the reasons I just mentioned. The Chinese do not want to be seen, by the Europeans in particular, as being opportunistic in the fog of war in suddenly creating a second front with Taiwan, because that would drive a much more unified NATO and a more unified Quad into cutting off relations with China. They don't want that. And they don't need it, because frankly, unlike Russia which is a country that's been in decline in so many ways for decades now, China's not in decline at all. The Chinese economy continues to grow. By 2030, they're likely to overtake the United States as the largest economy in the world. Most importantly, by 2030, their military capabilities in Taiwan and around Taiwan will be so much more asymmetric compared to those of the United States and its allies. So, there is no hurry for China here.

CHRIS HYZY: So, let's end on this final question. From a U.S. perspective, do you see any policy response other than what we've already discussed in the next few years to be able to try to gain some of that balance back?

IAN BREMMER: I think that the United States investing heavily in American capabilities and in friends' capabilities really matters. The biggest silver lining that comes from this entire crisis is just how much more aligned the French, the Germans, the Brits, the Italians are with the United States right now. I mean, the UK-EU relationship is much more functional because of the Russia-Ukraine crisis than it was at any point in the last six years given BREXIT. If you were watching the State of the Union speech with Biden and you squinted for the first 10 minutes with all of the standing ovations from Democrats and Republicans, you could be forgiven for believing that the U.S. was actually a pretty strongly functional representative democracy. So, I do think that there is an opportunity in this crisis to put aside a lot of divisions and focus on the baseline of shared values, shared institutions and shared investment, which is not global. We thought it was global. A lot of people after the Soviet Union collapsed believed it would become global. It ain't. But precisely because it's not global, it becomes more critical to defend and to bolster. And I do think that there are a lot of people that are thinking that way today, and they weren't thinking that way just a couple of weeks ago.

CHRIS HYZY: Ian, in this crisis and in these unprecedented times, I want to thank you very much for this fascinating discussion today. Thanks again.

IAN BREMMER: Yeah, Chris, we've been working together for decades now, and it's really good to have the relationship at a time like today.

CHRIS HYZY: So, that was a great discussion with Ian about the power vacuum that's going on around the world. And with me here today to talk about the economy--the global economy, the U.S. economy—and markets is Ethan and Savita. So, thank you both for joining me on what I believe will be a great discussion.

ETHAN HARRIS: Thank you.

SAVITA SUBRAMANIAN: Thanks for having us.

CHRIS HYZY: So, let's first start with you, Ethan. Ian talked about gone is the peace dividend, at least in his view. We talked about the power vacuum, the fact that there's the extension of the G0 world, given the accelerating crisis that's going on in Ukraine. Tell us your thoughts about how to think about the ramifications for the global economy.

ETHAN HARRIS: Well, I think the first thing to keep in mind here is it's a very uncertain environment. I mean, we've had a lot of predictions that have come wrong, and so, we've got to be humble going forward. I think what we can say with some confidence is that there's going to be a pretty challenging period ahead. This crisis isn't going to go away quickly. We're probably in a world of high sanctions and geopolitical risk for a year or maybe longer. So, the way we look at this is we kind of look at it on a scenario basis--a kind of benign scenario where things ease back a bit in the next three to six months; a baseline view where we kind of stay where we are now—very tough sanctions, Russia stays in the Ukraine so that crisis continues; and there's ongoing pressure on the global economy with that environment. And then, finally, there's the big escalation, and that would mainly come from putting sanctions on all Russian energy exports. So, we need to think about a broad range of outcomes.

CHRIS HYZY: Speaking of broad range of outcomes, given the scenario analysis, we all could put into our model certain inputs and look at what comes in the output through straight line math. You mention these three scenarios. In your opinion, how much is the ultimate scenario driven by the energy complex, the security of energy, the security of commodities, natural resources, etc. at least in the intermediate term?

ETHAN HARRIS: Yeah, I think the energy story is the centerpiece here. The connections between Russia and the rest of the world economically are very small outside of commodities. I mean, they just are not important to the global economy or global markets. What they can do though is disrupt energy supplies, and there, we need to take that very seriously. Energy has been a big factor in a lot of downturns historically. Beyond that, we need to look a bit at the psychology of this. This is creating a risk premium in the markets and a risk premium in behavior. So, that isn't – we need to think a little bit about psychology as well as the oil picture.

CHRIS HYZY: Fantastic point because you can't model in psychology. Savita picks it up in valuation and investor sentiment. So, with that as the backdrop, Savita, let's talk a little bit about the repricing of risk, the revaluation. Everybody – it was waiting for something like this, but when it happened so quickly, then the fear gauge goes up and all of a sudden people go risk off, risk adverse and they're waiting for signals. Give us your best ideas about where are we in that process.

SAVITA SUBRAMANIAN: Yeah, it's a great question. I mean, so first of all, what we've seen so far is actually relatively normal within the context of a geopolitical shock. And if you go back over time and you look at prior shocks that we've had, the market has sold off pretty quickly and pretty extremely, on average by about five to ten percentage points. So far, we've seen about eight percentage points given up from the day that the news broke. So, this isn't that unusual relative to prior geopolitical shocks. I think what we need to make sure that we do at this point is sort of recalibrate our view of the world in light of the fact that, as Ethan points out, this probably isn't going to end quickly. This could be a protracted period where energy supply is challenged. Fortunately, the U.S. is a net producer of energy, which I think is a big positive for the S&P 500 and for the U.S. consumer. But I think volatility is the name of the game and with that as the playbook, we would stick with quality, we would stick with yields, safe attractive income. And I think the equity risk premium just took a little bit of a step function higher. Even if this resolves itself, I think the world that we're in right now is something that has been building, which is the idea that we're at a peak globalization and those benefits that we've seen for companies in the U.S. may be stalled out temporarily or potentially longer. So, I think those are the things we need to think about.

CHRIS HYZY: It's a great segue to this concept mixing with the psychology, and if you're a company, pick your industry. Your outlook now has been clouded a lot more than what it was even in the face of Fed tightening and other things that we were worried about heading into this year. And what we've been doing in the Chief Investment Office is trying to rebalance around the high-quality areas, the U.S. versus non-U.S., large and small, small having a – small caps having a more difficult time. And then, on a sector basis, Savita, talk to us about this big run we've had in energy.

SAVITA SUBRAMANIAN: Yeah.

CHRIS HYZY: Big run in some parts of commodities, certain commodities going up 150 percent in two days—unprecedented—and we've still got the question, "What do you do with unvested capital right now? Is it too late in energy? Could energy and defense and aerospace and other places actually be high quality?"

SAVITA SUBRAMANIAN: You know, I think that's the real question is what is quality today? And when you look at energy, these are companies that are generating free cash flow, they've gotten the memo from, you know, ESG investors and they have essentially committed to transforming themselves. They are much more capital disciplined than we've seen energy companies in the past. Their dividends are sacrosanct. We're seeing preservation of dividends as job one. So, I actually think, to your point, that energy might be a new kind of a higher quality sector relative to the oil price volatility and the vagaries that we've seen over the last 10 to 20 years. Now there’s always a risk with energy companies, which his that they derive their value from the underlining commodity, and I think that’s what we also need to watch. I cover ESG as well. It’s hard to be bullish on energy and cover ESG, but I think right now, it makes sense to be bullish on energy given that we haven't gotten to this net zero world, and we need oil and energy to keep the lights on in the factories as we transition. So, I still – we’re still overweight energy. We think there’s a lot more to go. Interestingly, investors haven't necessarily caught up to the stellar performance that we’ve seen within the sector. So, we’ve seen energy double, triple over the last couple of years, but the average institutional investor is still a little bit gun shy, still underweight, and I think that suggests that there could be more upside than downside risks to the sector.

CHRIS HYZY: Perfect, perfect. Now, let’s switch over a little bit to something less important—very much less important. Let’s talk about the Fed. The Fed’s kind of in the background.

ETHAN HARRIS: Well, they count anymore, okay?

CHRIS HYZY: They don’t count anymore, all things considered.

SAVITA SUBRAMANIAN: We forgot about the Fed.

CHRIS HYZY: Does the crisis in Ukraine and the extension of this power vacuum—not to mention what may or may not go on between China’s relationship with the U.S.—what’s the assessment on the Fed for this year, and then into next year?

ETHAN HARRIS: Well, there’s a pretty good playbook for Central Banks when you have a big oil shock like this, and that is the first thing you do is you watch, and you try to figure out what exactly is the problem we’re facing. Are we facing an inflation problem or a growth problem? Obviously, it’s both, and the question is, which is the worst challenge? Right now, I think the Fed is kind of on railroad tracks. They’ve waited a long time to start hiking rates. I think they’re behind the curve frankly. The natural course for the Fed, all else equal with none of these events going on would be to hike regularly at every meeting until they feel like they’re closer to normal. What the crisis does is just creates a little bit of uncertainty around that exit strategy, but I still think they’re going to hike at every meeting this year. They have seven rate hikes. That’ll get them up close to two percent, which is close to neutral, so they’re kind of in a more normal place by the end of the year. And then, they’re going to feel their way forward next year. While the events have been quite dramatic for the economy, for inflation, and certainly, geopolitical events have been awful here, for the Fed, it kind of leaves them on the same path.

CHRIS HYZY: Which is not necessarily the prevailing thought that’s always out there. When you have supply shock driven situations driven by the terrible events that we’re all witnessing, you’ve got the supply shock, you’ve got price inflation that’s being extended based upon it. At the same time, there’s growth worries now, and the Fed hasn’t even lifted rates yet. So, from a market perspective, you can understand why there’s a repricing and revaluation, and there’s always thoughts of “What’s the counter party risk out there? Who do I know that can’t get access to liquidity that might need it at a time of crisis?” That will likely overhang us, but Savita, taking what Ethan just said about the Fed, let’s talk a little bit about how you view the yield curve and does that affect what your thoughts are for the path forward for equities for the remainder of the year? Flattening the yield curve obviously, but parts of the yield curve are still steep. Tens to thirties are steep, relatively speaking. Fed funds to the 10-year steep, but the twos to tens spread is the lowest we've seen in, well, a few years. Take us through your thoughts on how that translates to your theme for the rest of the year.

SAVITA SUBRAMANIAN: Sure. I mean, I think our theme for the rest of the year is, if the Fed is going to hike rates seven times, that's great for cash. One of the positive factors about the S&P 500 today, as well as the U.S. consumer, is that we've seen this liquidity transfer from the Fed and from the government to consumers and corporates. So, consumers and corporates are sitting on close to $20 trillion dollars of cash, which is a huge positive in an environment where cash yields are going from zero to close to two percent in a pretty short period of time. So, I think that's the first point I would make, is that the Fed hiking seven times could actually be unusually positive for some of these cash rich areas of the market, and that would be healthcare, even energy companies, financials. A lot of companies are throwing off a lot of cash. Tech companies have lots of cash, net cash. So, that's the positive. And then, I think on the long end of the curve, that's where I'm a little less certain, and I think we're all sort of in wait and see mode as to what growth expectations really pan out to be. So, if this geopolitical conflict that we're seeing is actually crippling to growth and to consumer confidence and corporate confidence, I think that would be a reason to get a little bit more defensive, maybe cool your heels on the more cyclical areas of the market. But I still think that you could benefit from buying some of these cash rich companies that have – haven't necessarily taken on the same amounts of leverage that you would normally see coming out of a recession.

CHRIS HYZY: See, we think that makes sense as well for a variety of reasons, but if you have a core portfolio and you're looking to rebalance that core, you want to look at the high quality, and that has been indiscriminately sold off for obvious reasons –

SAVITA SUBRAMANIAN: Absolutely.

CHRIS HYZY: - but perhaps gone too far. Some of that may be also established tech.

SAVITA SUBRAMANIAN: Yes.

CHRIS HYZY: Not the concept, long duration, low profitability areas, but the established tech.

SAVITA SUBRAMANIAN: Absolutely. So, I think that within the tech sector, we've been writing about this and every week there's a whole new field to sift through of beaten down tech companies. And I think what's interesting is that you're right, we've seen a lot of companies trade down so aggressively that their free cash flow yields are now at a level that would warrant stepping in and buying, and these are in software, in semiconductors, IT services. So, not necessarily the super high growth long duration tech stocks, but some of the more household names that haven't necessarily benefitted from geopolitical risk but have essentially been thrown out. The baby's thrown out with the bath water during the tech sell off.

CHRIS HYZY: Right. Let's toggle back to the engines of growth that we all point to for any economy and then add to it the excess savings that's still out there. Job growth recently was extraordinary. You wrote about it. Haven't seen it like this before in the context of what we're going through. What's the probability of U.S. recession in the next 12 months?

ETHAN HARRIS: Low. I mean, you need – listen, go back historically. Oil is always one of the factors in recessions, right? But it can't do it on its own. You need something else to go wrong. In recent crises, we've had obviously the Covid shock. We've had the great financial crisis. These are things – those are the main things that caused the last two recessions, not high oil prices. We had record oil prices in 2008, and we wouldn't have had a recession if it wasn't for the credit crisis. So, oil matters, it's going to hurt a bit. If we get the worst case scenario and you have the big disruption to energy supply, now you're taking about a weak growth economy, not a small accident but a big accident—weak growth. But even that, I don't think we'll get an outright recession.

CHRIS HYZY: And we haven't even fully reopened yet, technically speaking.

ETHAN HARRIS: Yeah, I mean, the economy is, in some ways the timing of this shock isn't that bad because it comes at a time when the Covid crisis is fading. People are ready to get out and start consuming services again. As you pointed out, they are flush with cash. I mean, bank accounts that are at record levels, personal saving is at record levels. The household sector is in pretty good shape to handle a big energy price spike. The low end, obviously, again, you're going to hurt. They don't have all that liquid savings, but even there, wage growth is quite high. So, we're in pretty good shape to weather the storm in the U.S.

CHRIS HYZY: Savita, any final thoughts for investors with excess cash right now, for investors looking for opportunities, any final thoughts?

SAVITA SUBRAMANIAN: Yeah, absolutely. So, I'm lucky enough to cover the U.S., the equity market, and I think there's a lot of places to go within the market. So, let's think about what's scarce right now. Inflation protection is scarce, and income is scarce. And if you look at equities, they sit right in the middle between kind of commodities, which are all inflation protection but no income, and bonds, which are all income but no inflation protection. The great thing about U.S. stocks is that earnings grow with inflation in most cases. So, our advice to investors is take that excess cash, look for the opportunities within the market that are undervalued, offer protection against potentially a longer cycle of inflation than we were expecting, and also offer growing dividends. I think that's really the mantra that we've been repeating over and over again, and so far, it's worked. We've seen stocks with inflation protected yield outperform the market significantly this year, and I would expect that to continue.

CHRIS HYZY: We would also agree, and we're looking for opportunities right now to rebalance not necessarily at the highest of volatility, but as volatility does come down and hopefully order is more restored over the coming weeks and into the summer months, we'll be looking to do that as well. I want to thank both of you for a great discussion. Thank you for your time as always and thank you all for listening. Some final thoughts before we close.

In this time of highest uncertainty, concerns have risen significantly and accelerated by a terrible crisis. Stress in the system has increased, but yet still at low levels. Concerns over Europe's and the U.S. economic growth path are also picking up in the face of a tighter Fed and still high inflation. So, what do we do? We still remain calm, we stay balanced, and we revisit our goals. Allow extreme volatility the markets and uncertainty to subside, consider rebalancing in areas that have fallen too far based upon your own personal targets and relative to the more attractive trends, we still see developing within the equity markets. Use diversification across assets to help lower volatility overall and stay disciplined, review your strategy and have a plan for when some stability begins. And again, thank you all for your time today.