Positioning Recommendations - March 4th, 2022

Will the nightmares ever stop? After two years of coping with a global pandemic, humanity is now faced with images of Russian attacks on an operating nuclear facility. V. Putin's not-very-veiled threats to use nuclear weapons only intensify the Kafkaesque conditions.

In last week's note, I stated that the odd decline in commodity prices at that time was likely a buying opportunity. That certainly has turned out to be the case, but I can't say I'm happy to have it play out so quickly and powerfully, given the pain these prices spikes are causing. When it comes to coal, fertilizer, natural gas (at least in Europe), and oil (with Brent hitting $115 today), this latest upsurge is increasing the odds of a severe recession in Europe. (In not great news for home builders and buyers, lumber prices are also going vertical.) Crucial ag commodities, such as corn and wheat, are also riding up the hockey stick, with ominous implications for food prices.

Here's an excerpt from last week that I think merits a repeat:

"Despite the stock market's cavalier attitude toward the tragedy in the Ukraine, it's my view that it is a substantial negative in a number of ways. The main risk is that this situation intensifies what is already a brutal energy crisis in Europe. There is the very real possibility that it causes oil and natural gas prices to rise on a global basis from already lofty levels. In turn, this makes the dreaded economic condition of stagflation a greater risk. As regular *EVA PR* readers know, I've been anticipating an inflationary boom later this year, and the war in Ukraine could work against that outcome."

That last part is the key. Barring a cease-fire and assuming continuing military escalation--as France's President Macron sadly warned after an hour-long call with Putin yesterday—the odds of an inflationary boom are falling. Similarly, the chances of 1970s style stagflation have risen materially.

Consequently, it's appropriate to revisit what worked well back in the disco decade. The reality is that it was a pretty short list. It was a punishing ten years for investors, other than for resource-related sectors, with long-term bonds especially struggling.

Energy stocks have obviously had monster moves of late and, actually, going back to the fall of 2020. Are they extended and, thus, vulnerable to a correction? Yes. Are they still seriously undervalued and under-owned? An even more emphatic yes.

Gold and silver mining stocks are a different story. As I've conceded multiple times, they have been big laggards all the way back to the late summer of 2020. Ironically, it was about the time that energy came alive that the precious metal miners went into a pronounced correction. This year, though, it has been a different story.

Even as the best performing major index of the last five years, the Nasdaq, has tumbled 15% in 2022's first quarter, the leading gold and silver mining ETF, GDX, is up 15%! Yet, inexplicably, investors remain apathetic toward this sector. In fact, there continues to be widespread frustration, even among gold fans/bugs, with its performance.

Yet, to me, the massive returns it produced in 2020, along with being up mid-teens in a brutal year for most asset classes, is a reason to rejoice. The fact that the precious metals miners are

so unloved, despite this commendable showing, is why I think they have further upside. Again, as with energy, could they correct near-term? Absolutely. In reality, they had a number of nasty spills back in the 1970s, as did gold and silver themselves, even as they were all on their way to a spectacular decade. By 1980, they were the epicenter of a full-blown—literally—bubble… one that was about to explosively pop, as all bubbles are wont to do.

These pages have consistently advised patience with this sector. As of right now, that patience is being rewarded. However, I believe there is much more reward up ahead, particularly as investors come to terms with the Fed's inability to tighten in a meaningful way. Mr. Putin has made Mr. Powell's job much, much harder in that regard.

Positioning Recommendations

LIKE

As the old saying goes, it's better to be lucky than good, and the tout of oil field service (OFS) stocks last week was fortunate indeed. Arguably the best positioned OFS company in Texas's Permian Basin has jumped almost 20% since last week. Given the magnitude and speed of the move in many of these names, it's likely best to back off a bit on any new commitments.

For those that followed our numerous touts of copper producers, it's also time to savor the win. In fact, doing some profit taking—reducing, not getting out—may be in order. This sub-sector is extremely volatile.

- Large-cap growth names at a reasonable price.
- Certain international developed markets, especially Japan
- Publicly traded pipeline partnerships, i.e., MLPs and other mid-stream energy securities.
- Gold-mining stocks
- Gold
- Silver
- Select international blue chip oil stocks
- **Oil field services companies, particularly those well exposed to the Permian Basin**
- Short-term investment grade corporate bonds
- Emerging market (EM) bonds in local currency (focusing on stronger countries, particularly in Asia)
- Large-cap value
- High-dividend equities with *safe* distributions
- Most cyclical resource-based stocks
- BB-rated corporate bonds
- Canadian REITs
- South Korean Equities
- Certain "Virus Victim" equities such as refiners, homebuilders, and select retail stocks
- Investment-grade floating rate corporate bonds
- The higher quality mortgage REITs
- Floating rate bank loans
- **Copper producers**
- Healthcare stocks

NEUTRAL

Please note the big bump in the third bullet below regarding available yields on intermediate-

term investment grade bonds. Previously, this yield was 2% (though rates have been rising all year). There are even bonds we like with yields in the 5% range, offering decent inflation erosion protection.

- Uranium and uranium producers
- Renewable Yield Cos
- **Intermediate-term investment-grade corporate bonds, yielding approximately 4%**
- Mid-cap value
- Emerging stock markets; however, a number of Asian developing markets look undervalued
- US-based Real Estate Investment Trusts (REITs)
- Cash
- Canadian dollar-denominated short-term bonds
- One- to two-year Treasury notes
- Traditionally “safe” sectors such as Staples and Utilities
- Virus Victors
- Small-cap value
- European banks

DISLIKE

Last week we highlighted the vulnerability of the Indian stock market, the Sensex. In fact, I disparagingly referred to it as the “Senseless Sensex”. In my view, it remains exposed to a dangerous combination of extremely high valuations and the vulnerability of the Indian economy to exploding energy prices. (India is a massive importer of oil.) It has fallen roughly 4% this week, but it appears to have an even further downside.

- **The Indian stock market**
- A wide range of high-income securities, including preferred stocks
- Intermediate-term Treasury bonds
- Small-cap growth
- Long-term treasury bonds
- Long-term investment grade corporate bonds
- Most municipal bonds
- US dollar
- Many semiconductor tech stocks
- Mid-cap growth
- Lower-rated junk bonds
- Green energy stocks
- SPACs
- Most new issues
- Despite a disastrous February, 2021, most of the popular Reddit/WallStreetBets meme stocks still have material downside.

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