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SUMMARY

- US stocks have been resilient due to US' energy independence, in our view.
- However, we see the rise in long-term interest rates as a greater threat.
- Our risk management is on high alert; watching key market levels closely.

DATE 10.24.2023

2023 isn't 1973:

Why the US Market Response to Gaza Crisis Has Been Muted

The horrifying events of October 7 – when Palestinian terrorist group Hamas staged a surprise attack on Israel that has left thousands dead and many missing - have led to comparisons with the Arab Israeli 'Yom Kippur' War of 1973. That war, which began 50 years ago almost to the day, helped mark the 1970s as an era of 'stagflation' in the US, due to a pan-Arabic oil embargo among some OPEC (Organization of Petroleum Producing Countries[1]) members protesting US support for Israel. Oil prices tripled in the span of just 3 months in 1973 and stayed elevated through the embargo's end in 1974. This painful period helped usher in a series of rolling recessions for the US throughout the decade, damaging stock and bond returns.

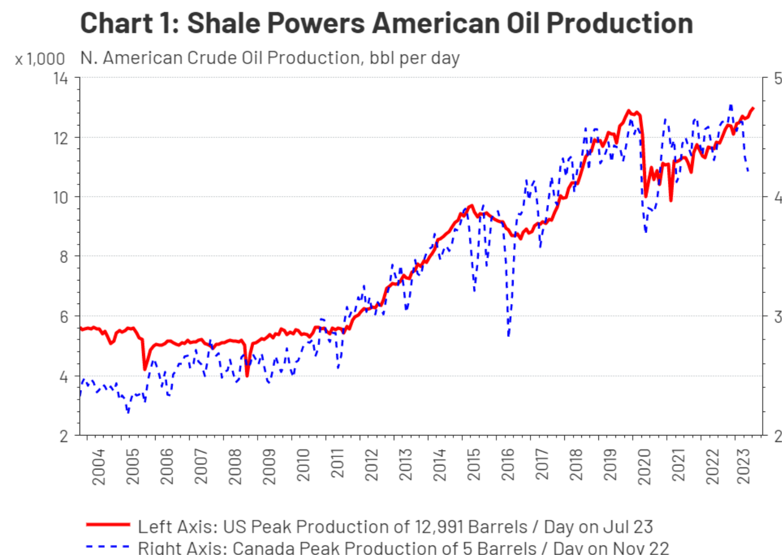
The analogs between today's conflict and the 1970s have prompted investors to fear what this may mean for the price of oil and risk assets. **We think US energy supply characteristics are dramatically different today than they were in the early 1970s... and thus we believe the current war in the Middle East is less likely to lead to runaway oil prices and stock declines.**

US's Energy Independence a Key Differentiator Versus the 1970s

In 1973, the US was the world's largest importer of petroleum. America was in the unenviable position of having to rely heavily on foreign oil – especially that of Arab nations – to meet its large and growing oil consumption. According to the US Energy Information Administration (EIA), U.S. petroleum imports rose sharply in the 1970s, especially from Arab OPEC members.

However, today the landscape for US energy supply is dramatically different, with a production rebirth in areas like the Permian Basin in Texas and New Mexico. This rebirth over the last two decades has been in large part due to the 'shale revolution' in US and Canadian energy extraction, combining horizontal drilling with hydraulic fracturing. These technologies have unlocked vast oil stores, changing the supply characteristics of North American oil and gas, in our view. This change can be seen in Chart 1 (right), which shows how US and Canadian production has ramped up significantly since the early 2000s.

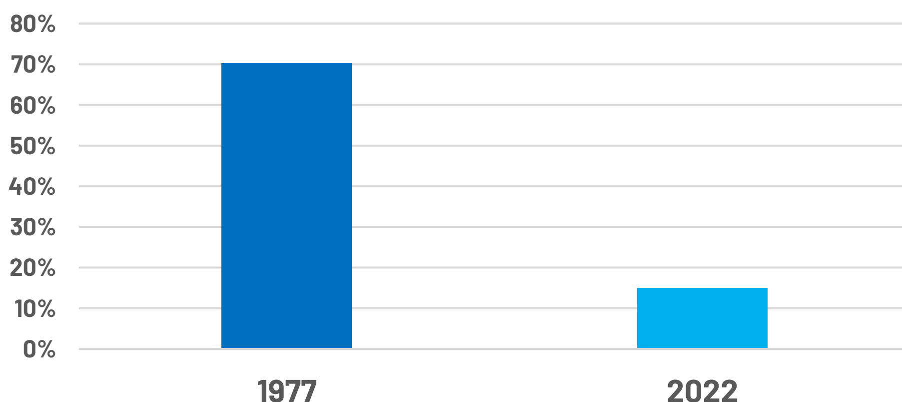
Chart 1: Shale Powers American Oil Production



Source: LSEG Datastream, RiverFront. Data monthly as of July 14, 2023. Chart shown for illustrative purposes.

[1] Current OPEC members: Algeria, Angola, Equatorial Guinea, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, the Republic of the Congo, Saudi Arabia, the United Arab Emirates and Venezuela.

This production revolution now makes the US the world's largest petroleum producer, bigger now than Saudi Arabia or Russia. For the first time since the late 1940s, the US is now a 'net exporter', meaning the US exports more petroleum to the rest of the world than it imports. Today the US only sources about 15% of its total petroleum imports from OPEC nations such as Saudi Arabia and Iraq, versus roughly 70% in 1977 (see Chart 2, right).



Source: EIA, RiverFront. US Energy Information Administration, Monthly Energy Review, Tables 3.3a, 3c, and 3.3d, September 2023. Chart shown for illustrative purposes.

Hamas Does Not Have Broad Support Outside of Iran

Despite the much-improved supply dynamic for US petroleum, the global price of oil is still likely to spike higher if the military conflict spreads to Iran and other Arab countries, as it did in the early '70s. However, thus far the conflict has remained predominantly contained between Israel and Hamas. Israel's arch-enemy Iran - along with Iran's proxies in areas such as Iraq, Lebanon, Syria and Yemen - have yet to formally enter the war. This may explain why the impact on the price of Brent crude oil so far has also stayed relatively contained, similar to the Israeli wars in Gaza in 2014 and in Lebanon in 2006.

While political support for the Palestinian people is widespread throughout the Arab world, support for a terrorist organization like Hamas is much less so. Also, there has been a general thawing of relations between Israel and many Arab nations in recent times, with Bahrain and the UAE having recently normalized relations with Israel. Even Saudi Arabia, under Muhammad bin Salman, has been forming deeper ties with Israel than once thought possible.

Crisis Impacts on US Stocks Tends to be Short-Lived

Regardless of how the Gaza war evolves from here, history shows that stock behavior around geopolitical crises is generally more benign than many expect. Our friends at NDR Research have performed a comprehensive study of the impact of what NDR considers to be 56 geopolitical 'crises' on the Dow Jones Industrial Average (DJIA), starting at the turn of the 20th century and running through the invasion of Ukraine in 2022. We believe NDR's data shows just how ephemeral market impacts from geopolitical crisis tend to be. Across more than a century of data, the average returns are positive for the Dow Jones Industrial Average (DJIA) one month, 3 months, 6 months and a year out from the reaction dates, as the table below indicates. Furthermore, in approximately 80% of these 56 instances, the market had positive returns 6 months later, by an average of +9.4%. In the four crises explicitly defined by NDR that we think have the most in common with the current situation – the Gulf War in 1991, the Iraq War in 2003, the Israel bombing of 2006, and the last Israel invasion of Gaza, in 2008 – the DJIA was significantly higher in all four instances both six and twelve months later.

	DJIA performance during reaction dates	1 month after reaction date	3 months after reaction date	6 months after reaction date	12 months after reaction date
Mean	**-7.1**	**4.2**	**5.9**	**9.4**	**15.0**
Median	**-3.0**	**4.7**	**6.1**	**9.2**	**16.9**

Source: NDR Research, RiverFront. Data monthly as of October 9, 2023. Past performance is no guarantee of future results. Chart shown for illustrative purposes. An investment cannot be made directly in an index.

Conclusion: Interest Rates are Bigger Issue for US Markets Than Oil; Watching Market Levels Closely

While 2023 is not like 1973, the economy faces some headwinds none the less. We believe that the geopolitical crisis in Israel will not escalate into a bigger crisis, and the US has better control of its own destiny this time around. Oil prices may increase somewhat due to the Israeli conflict, but we do not believe it will be the catalyst to derail the US economy. The bigger issue facing stocks at this point, in our view, has to do with Fed policy in the face of strong US economic data, which is reinforcing a 'higher for longer' view on interest rates.

Portfolio Implications: We continue to favor US energy stocks in our portfolios, due to their cash flow and dividends. Going forward, our risk management process is on high alert across all portfolios. A few things we are watching closely:

- **S&P 500 Levels: 4200 important support**
    - At time of publication, the S&P 500 is right at what we view as important support near 4200. The next important level, should 4200 break decisively, is 3800 in our opinion.

- **Treasuries: 5.3% on 10-year Treasury bond important resistance**
    - We view the 5.3% level on the 10-year Treasury as an important resistance level; if we break meaningfully above 5.3%, it will be cause for the portfolio management team to revisit our view that inflation will eventually ease over the next year.

- **US Earnings: Expecting a solid season**
    - We anticipate a solid Q3 earnings season and believe it could provide a catalyst for a market bottom to be formed.

- **Crowd Sentiment: Increasingly pessimistic… a contrarian positive in our view**
    - According to our tactical processes, crowd sentiment has now entered into short-term extreme levels of pessimism… a contrarian positive according to our tactical rule of 'beware the crowd at extremes." (See *Weekly View* from October 2nd)

- **Seasonality: May start to be in investors' favor, come November**
    - October has historically been the month with the most stock market bottoms formed, while November and December tend to be some of the best return months; we believe we could be near the end of a bottoming process here.

Risk Discussion: All investments in securities, including the strategies discussed above, include a risk of loss of principal (invested amount) and any profits that have not been realized. Markets fluctuate substantially over time, and have experienced increased volatility in recent years due to global and domestic economic events. Performance of any investment is not guaranteed. In a rising interest rate environment, the value of fixed-income securities generally declines. Diversification does not guarantee a profit or protect against a loss. Investments in international and emerging markets securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. Please see the end of this publication for more disclosures.

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All charts shown for illustrative purposes only. Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

Principal Risks:

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

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Changes in the value of foreign currencies compared to the U.S. dollar may affect (positively or negatively) the value of the portfolio's investments. Such currency movements may occur separately from, and/or in response to, events that do not otherwise affect the value of the security in the issuer's home country. Also, the value of the portfolio may be influenced by currency exchange control regulations. The currencies of emerging market countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the portfolio.

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Index Definitions:
Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

The Dow Jones Industrial Average (DJIA) is a stock market index that tracks 30 large, publicly-owned blue-chip companies trading on the New York Stock Exchange (NYSE) and Nasdaq. The Dow Jones is named after Charles Dow, who created the index in 1896 along with his business partner, Edward Jones. Also referred to as the Dow 30, the index is considered to be a gauge of the broader U.S. economy.

The 10-year Treasury yield describes what 10-year U.S. Treasury notes will pay over 10 years if bought today.

A bond yield is the return an investor realizes on a bond. Put simply, a bond yield is the return on the capital invested by an investor. Bond yields are different from bond prices—both of which share an inverse relationship. The yield matches the bond's coupon rate when the bond is issued. Bond yields can be derived in different ways, including the coupon yield and current yield. Additional calculations of a bond's yield include yield to maturity (YTM) among others.

Definitions:
Stagflation is an economic cycle characterized by slow growth and a high unemployment rate accompanied by inflation. Economic policymakers find this combination particularly difficult to handle, as attempting to correct one of the factors can exacerbate another.

The term Organization of the Petroleum Exporting Countries (OPEC) refers to a group of 13 of the world's major oil-exporting nations. OPEC was founded in 1960 to coordinate the petroleum policies of its members and to provide member states with technical and economic aid. OPEC is a cartel that aims to manage the supply

of oil in an effort to set the price of oil on the world market, in order to avoid fluctuations that might affect the economies of both producing and purchasing countries.

The Energy Information Administration (EIA) is a government agency formed in 1977. The EIA is responsible for objectively collecting energy data, conducting analysis and making forecasts. The EIA's reports contain information regarding energy-related topics such as future energy inventories, demand, and prices. Its data, analysis, and reports are available online to both the public and the private sector.

Beware the Crowd at Extremes – Terms correlate to the NDR Crowd Sentiment Poll and its measurement of Extreme Optimism (Bearish), Neutral, or Extreme Pessimism (Bullish).

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