THE DANA VIEWPOINT

March 15, 2022
Dow: 33,544

A New Kind of World Disorder

A brave new world began on February 24, 2022. It is always easy to spot the mistakes that were made in hindsight, but the Western world clearly did not do enough to deter Putin over the last 20 years. He took advantage of U.S. miscues in Syria, and he was clearly testing the West with his incursion into the Crimean and the Donbas regions in 2014. He believed that he could invade and conquer most of the Ukraine, even though Russian puppet leaders have been driven from Ukraine twice in the last 20 years. The failure of the West was a failure to take the threat of invasion seriously and to provide serious deterrents prior to the invasion.

If the Russian invasion is stopped or turned back within the next few weeks, the consequences for the U.S. economy will be minimized. Russian population is less than half that of the United States and declining, and their GDP is 1/12 that of the U.S. The companies in the S&P 500 Index with the greatest sales exposure to Russia still derive less than 10% of their total sales from that country. Historically, bear markets in the U.S. have been driven by economic slowdowns causing recessions – not geopolitical events.

The U.S. economy was in the process of emerging from the COVID-19 pandemic when this equity correction began. While inflation and imminent Federal Reserve rate increases have also been clouds hanging over the market, the economy added 678,000 jobs in February as the impact from the omicron variant wound down. Personal balance sheets are healthy, the housing and auto markets are very strong, and wage growth is robust. Corporate America in aggregate has over $1 trillion in cash on their balance sheets, and they'll likely continue to use it in ways that benefit shareholders, including boosting dividends, buying back stock, investing in their businesses and doing accretive acquisitions.

Even though cost pressures are intensifying, many companies have been able to overcome both increasing cost pressures and supply chain dislocations over the past seven quarters. Oil prices have spiked during the conflict, but the U.S. economy is far less dependent on oil as an input than it was fifty years ago. U.S. petroleum consumption has been roughly 20 million barrels per day for the last 45 years, even as GDP has more than tripled. The U.S. has also gone from importing 60% of its consumption in 2005, to being a net exporter of petroleum products in 2020.

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As most of our clients understand, we are investors and asset allocators, not market timers. The events taking place in Eastern Europe are horrendous, but the state of the U.S. economy is strong. Equity investors should be aware that -10% market corrections are a normal and regular occurring event. While they can be stressful for investors, they typically occur every year even though U.S. equity markets have advanced over 10% annually since 1926. After a rough 2022 start, many equity investors have begun to forget how strong markets were in 2021 with the S&P 500 Index hitting 70 new all-time highs and only briefly experiencing a modest 5% decline. Last year's 28.7% advance for the S&P 500 Index without significant volatility was exceptional and not typical. Corporate earnings of S&P 500 Index companies are forecasted to grow more than 10% over the next few years, and U.S. productivity and innovation remain strong. Based on this backdrop and on yields of other asset classes, we expect equities to remain the best performing long-term asset class and see no reason why they won't provide returns similar to their historic average over the next market cycle.

While we caution clients about making emotionally driven allocation changes based on temporary setbacks, there are opportunities to reduce risk and generate consistent investment income with bonds and other asset classes. The Federal Reserve is meeting this week and is expected to begin a tightening cycle by increasing the Fed Funds rate by at least 0.25%. Our adjustable-rate focused Limited Volatility bond strategy will certainly generate higher income as the Fed increases rates. In our equity strategies, we are focused on adjusting our industry exposure within the industrial sector and taking some profits in higher valuation stocks that have been perceived as safe havens over the past few years. We continue to monitor inflation expectations, which we believe will be higher and more persistent.

Clearly these are challenging times for investors, and we are ready to meet these challenges by following our time-tested investment strategies and making adjustments based on our evolving outlook. We will continue to share our insights and welcome your questions.

Random thought: "There are decades where nothing happens; and there are weeks where decades happen" - Vladimir Ilyich Lenin

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