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View From the EDGE®

War in the Middle East

As the month turned from February to March, the U.S. and Israel carried out a series of attacks on Iran, sparking a conflagration in the Middle East. Iran has responded with attacks across the region. As a direct result of the conflict, the production and delivery of oil and gas from the Gulf has been severely impacted. The Strait of Hormuz, through which around 20-25% of the global supply of oil and gas must travel, is effectively closed to ship traffic. The war has created what is being referred to as the largest supply disruption in the history of the global oil market. In response, the IEA has agreed to release 400 million barrels of oil from its Strategic Petroleum Reserve (which represents roughly three weeks worth of supply).

Additionally, concerns over the health of the private credit markets continues and job growth appears to have stalled with an unexpectedly high level of job loss alongside downward revisions to prior reports.

Global markets have responded with an increase in volatility, however there has not yet been a significant equity market drawdown, as investors continue to pin their hopes on a relatively swift resolution of the conflict. Our model research has shown a clear shift in the relative attractiveness of global equities, and in particular international equities since Europe, Asia and the Emerging Markets are more reliant on imported oil and gas and therefore their economies are at greater risk from an increase in the cost of energy.

Taken together, there is a risk of stagflation, whereby inflation increases and economic growth slows. However, should this conflict quickly abate, we could see a snap-back relief rally. As usual, we remain vigilant keeping a keen eye on the output from our model research and market activity for signs in either direction and will respond accordingly.

Asset Class	Negative	Mixed	Positive
Equities:			
U.S.		█ ←	
Europe	█ ←		
Dev. Asia		█ ←	█
EM/China		█ ←	█
India	█ ←		█
Fixed Income:			
Rates		█	
Credit	█		
Short Term Fixed Income & Cash			█ →
Hard Assets:			
Gold		█ ←	█
Commodities			█ →

Equities:

- ▶ **U.S. Equities:** Our outlook for US equities has shifted downward to a neutral outlook as a direct result of the US-Israel-Iran conflict. In addition to the continued excessive overvaluation, we've seen a loss of positive investor psychology and a widening in credit spread measures. The risks to a downside selloff have increased markedly should this conflict drag on.
- ▶ **European Equities:** European equities have similarly shifted downward to a negative outlook as a result of this global conflict. Despite a lowering of growth prospects, inflationary pressures may preempt further rate cuts.
- ▶ **Japanese Equities:** Japan has been negatively impacted by the closure of the Strait of Hormuz as the country imports over 90% of its oil from the Middle East. Despite the exuberance surrounding the new prime minister and her pro-growth plans for the country, the downside risks nearer-term from the Middle East conflict offset the potential for equity gains.
- ▶ **Emerging Market / Chinese Equities:** The outlook for China and Emerging Market equities has declined due to a loss of positive investor psychology from the ongoing turmoil in the Middle East as well as the strengthening U.S. Dollar. China is not as directly exposed to Middle Eastern oil as Japan and has other oil providers including Russia and Brazil. However, knocking out the Middle East component is likely to have a damaging effect near-term until the other routes can potentially pick up the slack. President Trump and

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About 3EDGE

3EDGE Asset Management is a multi-asset investment management firm serving institutional investors and private clients. 3EDGE strategies act as tactical diversifiers, seeking to generate consistent, long-term investment returns, regardless of market conditions, while managing downside risks.

The primary investment vehicles utilized in portfolio construction are index Exchange Traded Funds (ETFs). The investment research process is driven by the firm's proprietary global capital markets model. The model is stress-tested over 150 years of market history and translates decades of research and investment experience into a system of causal rules and algorithms to describe global capital market behavior. 3EDGE offers a full suite of solutions, each with a target rate of return and risk parameters, to meet investors' different objectives.



View From the EDGE[®]

War in the Middle East

President Xi Jinping have a scheduled summit at the end of this month (March 31 – April 2) originally intended to focus on trade negotiations following the truce in October of last year. Presumably geopolitics will be in play as well with the Middle East conflict potentially still ongoing and China's continued threats over invading Taiwan.

- ▶ **Indian Equities:** Despite India's trade deal with Europe and the U.S. as well as the U.S. concession to allow India to purchase Russian oil for 30 days during this conflict, the outlook has shifted more negatively. Beyond the negative investor psychology that was forming even before the Middle East conflict, the research has shown several months of widening credit spread measures that are concerning and weighing on the outlook.

Fixed Income:

- ▶ **Rates:** Inflation expectations, as measured by the one-year breakeven inflation rate, started the year at just over 2% and have now risen to 4.5%. The potential for rising inflation and therefore rising yields more broadly is a risk we continue to monitor. The Fed is truly in a tough position with their dual mandate of full employment and price stability, as their crude tool of short-term interest rates needs to be used in opposite manners to solve both in the current state, i.e., lowering rates to help employment, raising rates to combat inflation. Given the geopolitical uncertainty globally as well as uncertainty surrounding US monetary policy, we continue to support concentrating fixed-income investments in shorter-term maturities.
- ▶ **Credit:** We maintain that corporate credit spreads remain historically tight, making the additional yield over and above so-called "risk-free" U.S. Treasuries unappealing at this time. Risks of rising inflation, the potential for a larger global equity market sell-off due to the Middle East conflict, and trouble brewing in the private credit market increase the prospect for rising credit spreads and consequently losses in corporate credit.

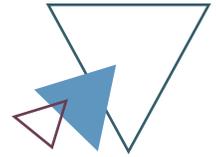
Hard Assets:

- ▶ **Gold:** We have lowered our outlook for gold, though still positive. Typically in a risk-off environment with indiscriminate selling, gold often times will also fall as investors who lose money with other investments sell gold to help pay their margin calls. Over the longer-term however, gold can be an excellent hedge against geopolitical turmoil, global conflicts, wars, uncertainty, etc. We expect central banks around the globe to continue to diversify away from U.S. Dollar-based holdings while increasing their gold holdings. Should the Federal Reserve lower rates to respond to weakening employment rather than raise rates to combat rising inflation, gold could see additional upside as well.
- ▶ **Commodities:** Like gold, weakening demand for U.S. dollars may also benefit commodities more broadly. In addition, broad-based commodity exposures that contain energy and agriculturally focused commodities may continue to benefit while the Strait of Hormuz remains impassable. The outlook remains positive.

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3EDGE Solutions Designed to Smooth the Ride

Seeking to manage volatility and downside risk while providing the potential to be additive to investment returns



3EDGE Strategies	Risk Intensity	Asset Class Ranges [^]				Potential Use Case
		Equities	Fixed Income	Hard Assets	Short-Term Fixed Inc / Cash	
Tactical Core Solutions						
Conservative Strategy Typical time horizon: 1-3 years		6–30%	10–88%	4–22%	2–80%	Fixed income, core bond, or annuity replacement
Total Return Strategy Typical time horizon: >3 years		13–60%	10–81%	4–35%	2–73%	Traditional 60/40 portfolio replacement
Growth Strategy Typical time horizon: >5 years		20–80%	10–81%	4–35%	2–73%	Growth replacement with an emphasis on minimizing volatility
Tactical Income Solution						
Income Plus Strategy Typical time horizon: >3 years		Equity Income Sources 0–40%	Fixed Income Sources 55–90%	Non-Traditional Fixed Income 5–25%		Income replacement strategy targeting a high yield with emphasis on minimizing drawdowns
Tactical Equity-Focused Solutions						
Aggressive Strategy Typical time horizon: >10 years		60–100%	0%	0–60%	0–60%	Equity complement or outright replacement of equity holdings
Global Equity Strategy Typical time horizon: >10 years		98%	0%	0%	2%	Global equity complement or outright replacement of ACWI holdings
International Equity Strategy Typical time horizon: >10 years		98%	0%	0%	2%	International equity (ex U.S.) complement or outright replacement
U.S. Equity Strategy Typical time horizon: >10 years		98%	0%	0%	2%	U.S. equity complement or outright replacement of S&P 500 holdings
Tactical Crypto Solution						
CryptoPlus Strategy Typical time horizon: >10 years		0%	0%	98%** **crypto ETFs	2%	Alternative store of value (i.e. cryptocurrency holdings in place of gold/real assets)

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