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Dear Clients & Friends,

This morning, Russian forces significantly escalated their military incursion into Ukraine, launching direct attacks on the country's capital and other cities. Financial markets initially declined 2-3% before reversing sharply in the final hours of the day.

The S&P 500 is down approximately 10% on the year (and was down nearly 14% this morning before wildly swinging from losses to gains on the day). The near daily barrage of news about Russia's encroachment into Ukrainian territory has led to a steady creep lower in stock prices in February. This still pales in comparison to the volatility we observed in the throes of the pandemic in March 2020 – when stocks prices were rising and falling by 8% a day – but it represents the deepest decline since that time.

We note that Russia and Ukraine itself are relatively small in the context of the global economy and financial markets. Russia's stock market represents just 0.3% of the global stock market, while its GDP is less than 2% of the world's total output. Russia's economy is smaller than several US states including California, Texas, and New York.

The potential for a broader spillover, however, is clearly a significant risk factor for investors. At this stage, the US and Europe have made clear that they will not become militarily involved in the Ukrainian situation. While that stance has likely encouraged some of Putin's aggression, it also reduces the risk of a broader military conflict. (If the latter scenario were to unfold, we would have a significantly different (i.e., more negative) view of the market risks of these events).

Ultimately, our opinion is that while the Russia-Ukraine conflict is a tragic and unjust invasion by Russia, the long run investment implications should not be significant. In the near term, we likely have to endure elevated energy prices, disrupted supply chains, and more inflation. Outside of the major World Wars, however, stock markets have typically recovered quickly following geopolitical conflicts. Once the uncertainty regarding the scope of the conflict becomes known, markets typically find firmer footing.

We are not taking the current crisis lightly, however, and will continue to monitor the situation for any signs of deterioration. Even after recent declines, stock markets are not cheap, so we see limited scope to add exposure to fully invested portfolios. Likewise, we have yet to see real cracks in the credit markets that have presented opportunities in the past. If that changes, we will be in contact with you to reposition portfolios.

If you would like to discuss the markets or your portfolio further, please do not hesitate to contact us at your convenience.

Sincerely,

Your Next Capital Team

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