

Russia Ukraine Client Update

25 February 2022

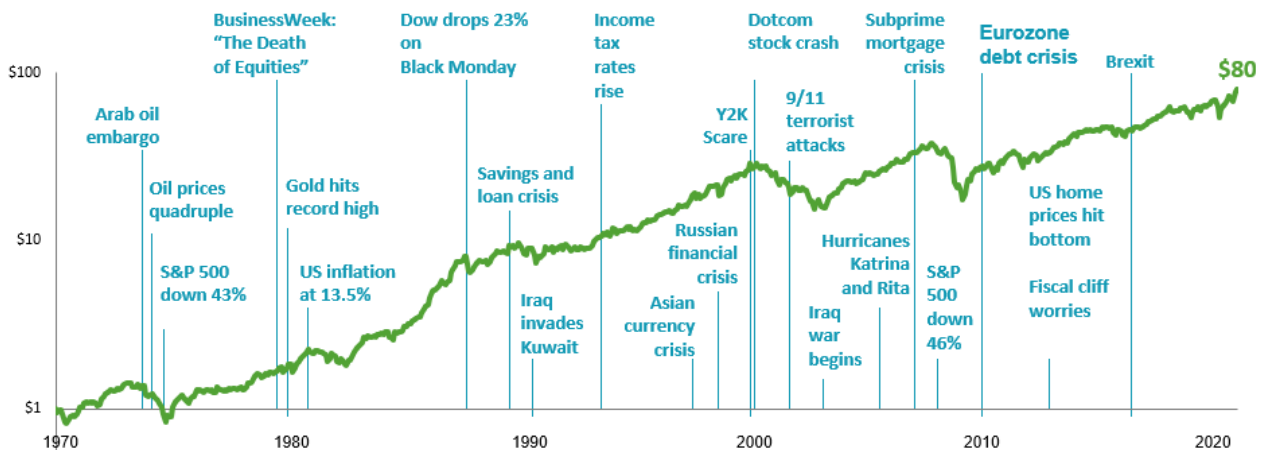
Event

On 21 February, Russia asserted its view on the independence of the Donetsk People’s Republic and the Luhansk People’s Republic and began mobilising troops to conduct peacekeeping operations in these areas. This was a violation of Ukraine’s sovereignty and independence, the Minsk agreement, and has been widely denounced by the West. Subsequently, Russia has instigated military strikes on Ukraine and has invaded.

What does this mean for investors - long-term implication for portfolios

Historically, the market impacts of localised geopolitical events like this have typically been short-lived. Further, global shocks are more common than you may think. The following graph illustrates this observation well.

A disciplined investor looks beyond the concerns of today to the long-term growth potential of markets.



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Source: Dimensional

In US dollars. MSCI data © MSCI 2020, all rights reserved. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results.

Our diversified model portfolios are built on a Strategic (Long-Term) Asset Allocation foundation that includes stress testing for geopolitical events such as this.

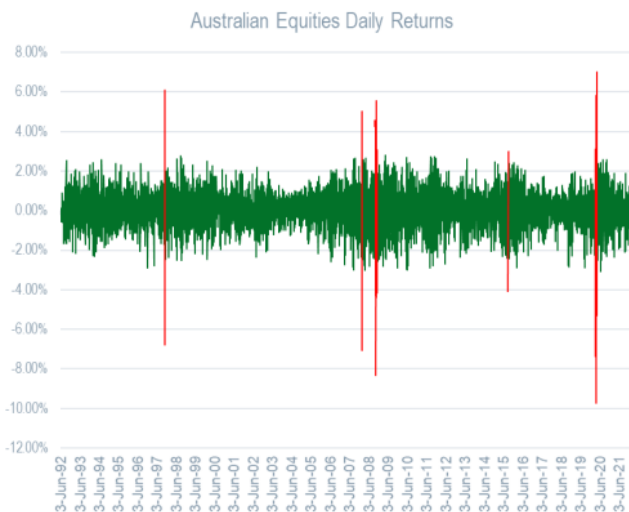
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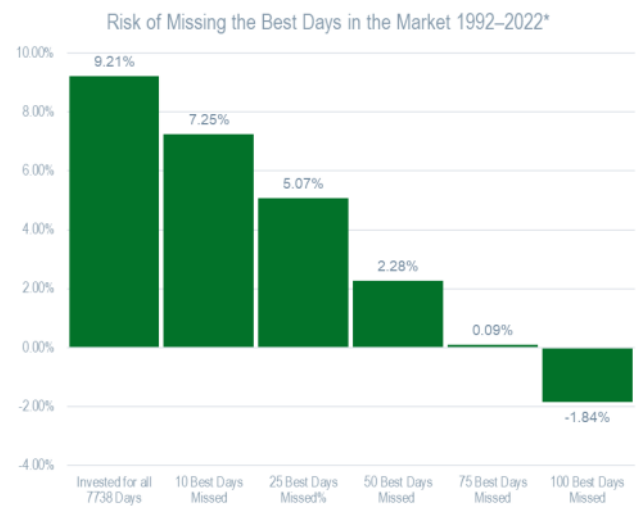
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We will continue to monitor the situation closely as events unfold. Further deterioration in this conflict may necessitate the need to implement defensive portfolio changes. At this stage we are not making changes and keeping a watching brief on our Asset Class weightings. There is a fair degree of defensiveness built into current settings.

From a very long-term perspective, we note that volatility has historically tended to cluster (both to the upside and downside) as per the chart below on the left, so if investors react to the large negative movements by selling out of equities, they run the risk of being out of the market for the large positive days. The consequences of missing just a handful of these “best days” can be substantial, as evidenced by the chart below on the right.



Source: ASX



*27 January 2022

Please give our office a call if you have any questions or concerns. Clients who would like more information on the conflict, please read on.

Russia has initiated a full scale military assault on Ukraine

The build-up of Russian forces on the Ukrainian border in recent weeks has been a clear indication of intent to take action in Ukraine. In response the U.S. and NATO Member nations had for some time been providing Ukraine with military aid, including lethal weapons, anti-armour missiles, anti-armour artillery, heavy machine guns, helicopters, small arms, ammunition, radio systems, medical equipment, and spare parts. Monetary aid has also been provided. The U.S. Administration has pledged aid to Ukraine of some \$650 million to date. The U.K, Danish and Dutch Governments have also provided material monetary support.

None of this deterred Russia from taking action and invading Ukraine with missile strikes and border crossings. Russia has seized key strategic assets such as the Chernobyl Nuclear plant and have attacked both military and civilian sites.

U.S. and EU Member State Sanction Reactions

Post the initial move on Ukraine by Russia, sanctions were imposed. Post the missile strikes, further sanctions have now been imposed by the U.S. and other countries. Further sanctions and action may be taken as events unfold.

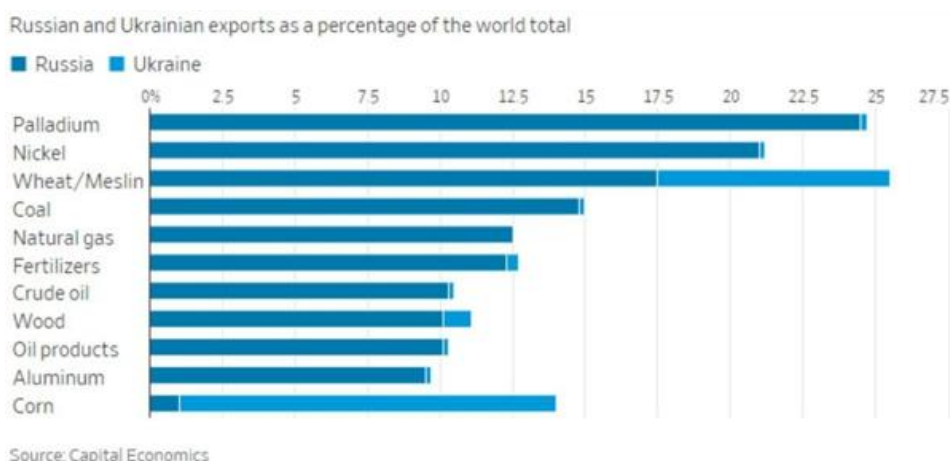
The U.S. has sanctioned Russia's foreign debt, meaning it can no longer raise money from Western financial institutions. This will impact Russia's ability to finance its military efforts. Further sanctions by the West are likely as Russia deepens its invasion of Ukraine. All 27 EU Member states have agreed on a range of anti-Russia measures. Russian banks have had their assets frozen in the U.K. and certain wealthy Russian billionaires have been issued travel bans and their ability to access funds from EU banks has been denied. Further to this, trade between EU and the two rebel-held regions has been banned.

Germany has halted major infrastructure projects with Russia, including those involving the Nord Stream 2 gas pipeline, refusing to allow it to open. In addition to this, some 351 members of Russia's Duma, or parliamentary lower house have been hit with restrictions. Further restrictions that may be imposed include excluding Russia from the global financial messaging service known as Swift, used by most banks worldwide. That would seriously curtail Russia's ability to do business.

At some point, further sanctions would start to harm the economies of those imposing them, as countries such as the U.S. and Germany have strong ties with Russia via trade.

Equity Market and Sector Impacts

The Russian move into Ukraine will cause further increases in equity market volatility. We will also continue to feel the impact in terms of rising energy prices. As can be seen from the graphic below, Russia and Ukraine account for a material amount of Oil and gas products at around 22% of global exports combined.



Russian gas exports to Europe account for 40-50% of its import requirements. Energy markets have been tight as COVID related lockdowns have abated and travel gradually resumes. We overlay this with increasing concerns around ESG and banks in western economies under pressure to cease funding for fossil fuel projects, which has further underpinned already tight supply demand dynamics. We suspect there is already a premium in energy prices for current tensions, with more upside in prices likely should full scale war break out. This feeds directly into inflationary concerns which are already a dominant theme in equity markets with most companies in the current reporting season citing rising cost pressures in terms of both materials and labour.

Soft Commodities

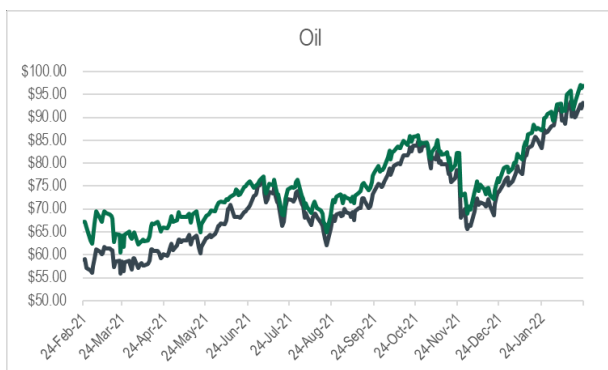
Soft commodities such as Wheat and Corn would likely be impacted given Russia and Ukraine account for 25% of global exports. This could potentially be an export boost for Australia if supply is restricted or sanctions placed on exports from Russia. Furthermore, not included in this graphic is ammonium nitrate, of which Russia is responsible for around 65% of global production. This is the

primary ingredient used in fertilisers. Russia banned the export of this mineral product recently, with the ban to extend to April 2022. Should sanctions remain in place for an extended period then the impact of inflation on food prices could be enduring.

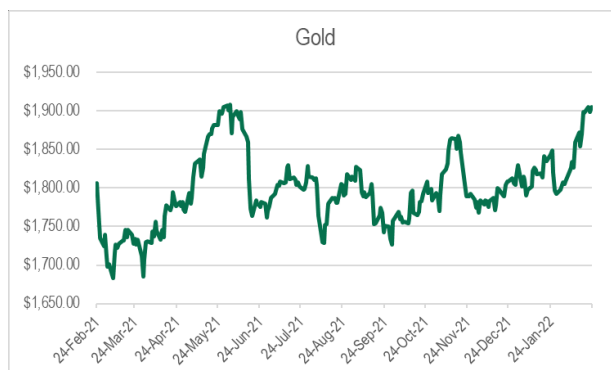
Asset Class Impacts Since the Russian Move into Ukraine

Commodities

Both Oil and Gold have rallied in recent weeks, with the spectre of reduced oil supply driving prices higher. Gold has performed its traditional role in periods of market stress, with investors seeking some protection via the precious metal.



Source: Iress



Interest Rates

Interest rates have been largely driven by inflation and market expectations of rate hikes over the next 12 months, however US Bonds saw some buying as investors shifted allocations in a flight to quality given uncertainty inherent in equities markets during times of elevated uncertainty.

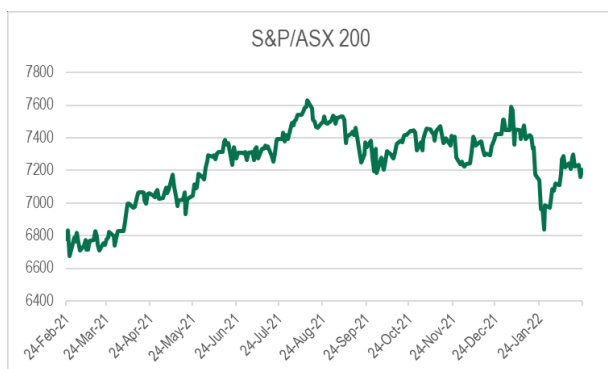


Source: Actuate Alliance Services



Equity Markets

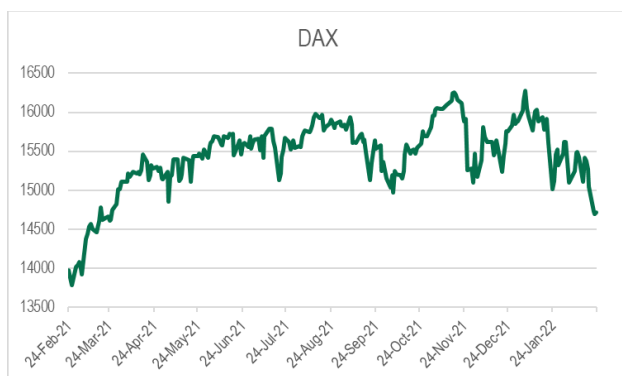
Equity markets have been volatile for some time, with high growth stocks particularly suffering over the past 3 months, as the potential for rate hikes became clearer, however the increased volatility presented by the Russian invasion of Ukraine has dominated the market narrative since late January.



Source: Iress



German markets have seen the most volatility among the major European exchanges, whilst Emerging markets have been languid over the past 12 months compared to their developed market peers. Whilst the read-through impact of any conflict on Emerging Markets as a whole is likely to be varied, the potential higher inflation (and consequent higher US Interest rates) is likely to be a headwind, however the relatively higher exposure to the energy sector (6.8% in EM vs 3.8% in Developed Markets) may mitigate some of the volatility.



Source: Actuate Alliance Services



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