



## Portfolio Management Memo

Russia – Ukraine War

March 7, 2022

### BACKGROUND

We are now about two weeks into Russia's unprecedented and unprovoked invasion of Ukraine. The Russian military buildup on Ukraine's border began nearly a year ago, and tensions between the two countries escalated towards the end of 2021. By January 2022, U.S intelligence agencies began to warn that Russia was likely planning a major military offensive, which ultimately began on February 21, 2022. At this point, there are a lot of unknowns, including the scope and duration of the military campaign; Putin's ultimate ambitions in Ukraine and Eastern Europe; the range and severity of Western sanctions; and the implications for geopolitical alliances. All of these issues will have economic and financial implications.

Russia's invasion of Ukraine has triggered a swift response from U.S. and European governments. While Russia represents a small portion of global gross domestic product (2%) and capital markets (0.2%), it is a large commodity producer. Russia is responsible for 17% of global natural gas production, 12% of oil production, and is a major exporter of agricultural commodities, as well as industrial and precious metals. Russia only accounts for approximately 1.5% of the MSCI Emerging Markets Index. However, since Russian markets are essentially untradeable currently, MSCI is removing Russia from its indices on March 9<sup>th</sup>. While our core portfolio investments have little direct exposure to Russian securities (less than 1%), this will have indirect implications for global markets and economies.

### MARKET IMPACT & OUTLOOK

To some extent, equity markets are forward looking, and information and expectations are quickly priced into equities. The S&P 500 declined 8.6% prior to the invasion, but less than 1% (as of Friday's close) since the assault began. That being said, volatility has spiked, and the conflict has impacted daily market activity. International markets, both developed and emerging, have been hit much harder. European markets, highly dependent on Russian energy and commodity exports, have declined significantly. Emerging market performance has diverged by region, with Latin America and the Middle East having benefited from rising energy prices.

The conflict has also impacted the fixed income markets, as investors have sought perceived safe havens, driving longer-term U.S. Treasury yields lower. The reality of slowing global growth and fewer rate hikes has also helped to push yields lower. Credit sensitive sectors of the bond market have also struggled in this "risk-off" environment, while inflation linked bonds have rallied.

According to the U.S. Energy Information Administration, Russia is the 3<sup>rd</sup> largest producer of oil and natural gas. It is the second largest oil exporter behind only Saudi Arabia. While oil had been in a steady upward ascent for the past 2 years after bottoming out early in the COVID 19 pandemic, the price of oil is now over \$100 a barrel. In 2014, when Russia invaded Crimea higher oil prices were a drag on global economic activity. Moreover, Russia is a major producer and supplier of natural gas to Europe. While the threat to Europe's economy is far greater, the U.S. is almost certainly to feel the impact as well. Rising energy prices were a problem prior to the invasion and have continued to move higher. This could continue to impact inflation rates, which are already at decade highs. This impacts consumers' purchasing power and spending, which accounts for about 70% of U.S. economic activity. This puts even more pressure on the Federal Reserve, which has signaled its intentions to begin raising short-term interest rates.

## HISTORY REPEATS ITSELF...

Recent conflict between Russia and Ukraine is an important reminder that geopolitical risk is a part of investing in global markets. Investors in global equity portfolios inevitably face periods of geopolitical tensions, and we cannot predict when these events will occur or exactly what form they will take.



During these times it is important to stay committed to your long-term goals. Investors with a long-term perspective can benefit and persevere through the chaos — be it war, inflation, or recession. Stay focused on your path and do not let external events derail your objectives. We are continually monitoring your portfolios in light of these events. Uncertainty is always a factor in investing. We believe remaining committed to a diversified strategy that meets your financial goals and risk tolerance is more important than ever. We encourage you to reach out to us if you want to discuss any questions or concerns.