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Market Update

Russia Invades Ukraine

What Has Happened?

After months of mounting tensions, Russia attacked Ukraine on Thursday. The move marked a serious escalation in a region that has been a hotspot for tensions between Russia and the West for years and added uncertainty to the global economic outlook.

On Thursday, Russian President Vladimir Putin announced the start of a “special military operation” in Ukraine and explosions were reported in several parts of the country. Ukraine’s interior ministry said Russian troops had landed in the port city of Odessa, marking the beginning of the invasion. US President Biden said he would announce “severe sanctions” against Russia for the “unprovoked and unjustified attack”. While the situation remains extremely fluid and the scale of the invasion isn’t yet clear, what has taken place over the last 24 hours is toward the more extreme end of the spectrum of military actions that we anticipated.

Financial markets were hit badly as news of the invasion unfolded. European equity markets tumbled by 3%–5% as of 11:30 a.m. London time. Russian stocks were at one point down as much as 45%. Investors fled to safe haven assets such as government bonds and gold. Oil prices surged, with Brent crude rising by more than 7% to exceed $100 a barrel for the first time since 2014. Some European energy and materials stocks were up.

Potential Scenarios

We do not know how far Russia will go. Some headlines have suggested that Putin is targeting infrastructure and military targets, others that his eventual aim is to remove the government and install a Russian-friendly President in Kiev. Regardless of the eventual outcome, we expect the latest actions to trigger tougher sanctions from the West, with much more serious consequences for Russia.

Earlier this week, the US and European allies began to impose sanctions on Russian interests amid Russian moves into two disputed border regions. These included penalties on Russian banks and certain individuals considered close to Putin. Restrictions were imposed on the trading of Russian debt issued after March 1, 2022 on US and European markets. Germany said it would halt approval of the Nord Stream 2 pipeline project, designed to import Russian natural gas—a crucial energy source for Germany and much of Western Europe. These sanctions are relatively mild, commensurate with the degree of severity of Russian actions until today. We believe the West has much more significant sanctions on hand that can be used against Russia, and are awaiting details.

Market Outlook

Amid the uncertainty, investors will need to gauge potential secondary consequences of the invasion. Rising energy prices will add to inflationary pressures, particularly in Europe, where natural gas prices have already soared. In turn, the outlook for macroeconomic growth might also be affected, potentially inflicting more damage in Europe. Given its proximity to the conflict, this could affect business confidence and the earnings prospects of some European companies.

Before the crisis erupted, investors were already coping with shifting monetary policy. The US Federal Reserve recently moved toward a more hawkish stance, signalling imminent interest rate hikes and an end to quantitative easing purchases in March. Investors will need to gauge whether the potential cascading effects of the Russia-Ukraine economic crisis will slow the path of rate hikes and how that could affect the attractiveness of individual securities across asset classes. For many companies, however, the Russia-Ukraine war will not have a significant impact on long-term business fundamentals.

The escalation in the conflict will accelerate a flight to quality, making Treasuries, especially longer dated ones attractive. We continue to expect the Fed will maintain its hawkish stance and raise interest rates although the scale of the first move may be moderated versus prior market expectations. In addition, we do not anticipate the ECB will tighten into a supply-side energy-led inflation event. While a Russian invasion would have a negative impact on credit in general, we believe some energy companies will be beneficiaries. In this scenario, we will regard sympathy selling in risk assets that are less affected, such as securitized assets, as buying opportunities. The further increase in energy prices is likely to put pressure on countries with large energy import bills.

Our portfolio managers and analysts across asset classes are monitoring the fluid situation and the potential impact on individual holdings, particularly in the affected regions. Please contact your advisor for more information about your portfolio.

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