State of Play

3 March 2022

It's been a week since Russia invaded Ukraine, and investment markets have been trying to assess whether unprecedented and co-ordinated sanctions will provide enough pressure to motivate President Vladimir Putin to seek a resolution at proposed peace talks. What does it all mean for investors? Our Investment Specialist, Simon Durling, shares his thoughts in this week's State of Play.

The Ukraine crisis

The extraordinary and massive sanctions against Russia announced at the start of this week, in addition to those already announced last week, focus on blocking Russia's access to financial markets and the international operating capacity of some of its leading companies. These sanctions, which will undoubtedly affect Russia's growth, are also aimed at promoting a rapid resolution of the conflict. Russian banks have been cut off from the international Swift payment network which allows the quick and smooth transfer of money across different countries. Even Switzerland has broken its long held traditional neutrality by announcing that it will adopt the European Union's (EU) sanctions and also impose their own personal financial restrictions on President Putin, Sergey Lavrov, (Foreign Minister), and Mikhail Mishustin, (Prime Minister), which brings it in line with the United Kingdom (UK), United States (US) and the EU, with immediate effect.

As the Russian currency, the rouble, plunged in value, Russia more than doubled the base rate from 9.5% to 20% to prop-up its value after hitting record lows against the dollar[1]. The Russian stock market remains closed as the authorities try to avoid a huge sell-off. Russia's state-run media Sputnik and Russia Today have been banned across the EU and the Champions League Final, due to be held in the city of St Petersburg, will be moved, as part of measures banning Russia and their sportsmen and women in competing in various sports. Whilst sport and politics in the past have been uncomfortable partners, this show of solidarity with Ukraine, is designed, like all the other measures, to avoid the use of any military force in response to Russia's invasion. This point is significant because although this crisis provides enormous uncertainty for people around the world, especially those in the EU who share a border with Russia, the position reiterated yesterday by the EU, US and the North Atlantic Treaty Organization (NATO) of non-intervention in Ukraine substantially limits the impact on international economic growth.

Apart from the obvious uncertainty the crisis in Ukraine creates the knock-on impacts of the invasion of Ukraine are far reaching. Clearly financial sanctions aimed at hurting Russia have created several complications for companies and financial organisations trying to remain within rules laid down where sanctions have been imposed. In addition, as expected, oil prices have risen sharply from $90 per barrel of Brent Crude on 20 February to $118 per barrel as at time of writing (3 March), pushing up petrol prices further beyond their recent record highs.[2] As Germany, alongside other EU partners, suspend their approval for the Russian Nord Stream 2 gas pipeline, wholesale gas prices have rocketed 27% in the UK earlier this week.[3] Remember, British households face a 54% increase in the energy cap due to be implemented from next month taking the average household bill to just shy of £2,000 per year.[4] This maintains pressure on rising prices which no doubt will occupy the minds of central banks as they meet in the next couple of weeks to discuss interest rates and winding down the various financial stimulus packages.

Market reaction

Russia's invasion into Ukraine has provoked a sharp increase in volatility, as although markets had been pricing in this possibility in recent weeks, the speed and scope exceeded forecasts. European share prices have been hardest hit alongside emerging markets, although last week's steep fall on Thursday (24 February) was quickly followed by an almost as large rebound on Friday (25 February).[5] Understandably, investors are finding it hard to separate out the humanitarian tragedy that is graphically displayed on news and 24-hour social media channels, from a more pragmatic evaluation of what these events may mean for their portfolios in the short-term.

My expectations remain that the global economy should continue to grow this year, albeit, as I explained in last week's update, not as much as the very high numbers seen in 2021. Most of the market's attention, beyond the crisis, will be on central banks and how they respond to the threat of additional inflationary pressure caused by rising energy and oil prices versus the concern that global growth expectations may cool following this week's events. I have noticed in recent weeks that some commentators were forecasting the Fed may even increase rates by 0.50% instead of the normal 0.25% but this may have cooled now following the invasion. Central banks are likely to be mindful of ratcheting up interest rates too fast and too high thus triggering a potential recession in trying to bring down the rise in prices. Their language used in their updates will be closely analysed by the market to try to interpret their thinking. Bond yields in recent days indicate the bond market is likely to factor in exactly this scenario as the spike in yields in recent weeks has reversed somewhat since the crisis began.[6]

Turning to stock markets, geopolitical risk was already being factored into the process of adjusting to monetary normalisation that had begun in January and which is reflected in the falls so far this year. Although uncertainties persist, over the medium-term horizon the fundamentals that have been driving stock markets are maintained in terms of economic growth and earnings estimates, plus more attractive valuations given the falls, factors that were evident earlier this week in the recovery of the US stock market and in the recovery of European stock markets at the start of the week.[7] In the midst of this scenario where uncertainties persist and volatility becomes common place, markets are likely to remain nervous for now which for some provides investment opportunities. For the average retail investor, it remains vital that they regularly review their portfolio ensuring that their investments are aligned to a combination of their individual long-term goals and risk appetite. Maintaining a diversified portfolio matched to these factors can typically help to ride out short-term market volatility, helping to reach those goals.

Find out more!

Listen **here** to our latest Market Views from our Head of Systematic Research for TAA and Alpha, Stefano Amato, as he shares his thoughts on the impact of the Ukraine crisis on markets.

Note: Data as at 1 March 2022.

[1] Investing.com, Central Bank of the Russian Federation, 28/02/2022
[2] Investing.com, Brent Oil, 3/03/2022
[3] The Times, Supply fears raise the price of gas and oil, 1/03/2022
[4] Ofgem, Price cap to increase by £693 from April, 3/02/2022
[5] Investing.com, Euro Stoxx 50, 1/03/2022
[6] Investing.com, United Kingdom 10-Year Bond Yield Overview, 1/03/2022
[7] Santander Asset Management, 28/02/2022

Asset Management

Important Information