

Market Flash Note

Russia/Ukraine



Market Update

Markets have responded negatively to the news that Russia has launched a military offensive against the Ukraine in the early hours of this morning. Although such an outcome was flagged in news media, the escalation of events is greater in scale and intensity than had been expected by most commentators and had not been discounted by markets. It is not known how any response by US, European and NATO forces will be received by Russia and what that might mean for global stock markets or, more importantly, the people of the Ukraine.

The situation is volatile and changing quickly but the short term market reaction has been:

- > US and Asian markets indicating down 2/3% while European markets are down almost 5%.
- > Oil has risen with Brent +7.5% to \$104 per barrel.
- > European gas prices +39% to €124 per megawatt hour.
- > Safe haven assets, like US 10yr bond yields are -13bps to 1.86%, while German 10yr bond yields are -9bps to 0.13%. Gold is +2.0% to \$1958 oz.

MAPS/Empower Funds

However, we know from experience that markets can be subject to periods of volatility, which can be unsettling for investors. For that reason, funds like Empower/MAPS were specifically designed to reduce the impact of volatility and remain focused on delivering returns over the medium to longer term.

Our underlying principles of risk management and diversification are particularly important in periods of heightened volatility, and we've already seen the benefit of that year to date with a number of strategies, like Alternatives and Low Volatility, providing a level of downside protection in a period where markets have fallen.

Outlook

Short term, we expect to see further pressure on commodity prices given Russia accounts for 17% of global gas production, 12% of oil production, 5/6% of supplies of many metals. Russia and Ukraine combined also account for around 25% of the global trade in wheat. Russia also supplies approx. 25% of European gas. Higher commodity prices may add to already high inflation and reduce growth through lower consumption.

Sanctions placed on Russia earlier this week were relatively modest. Additional sanctions are expected in coming days which will have a significant negative impact on the Russian economy but will also have repercussions for the global and European economy with Russia accounting for 4% of European exports.

They include:

- > Removing Russian access to the SWIFT settlement system, blocking convertibility of the Russian ruble into other foreign currencies.

- > Further direct sanctions on individuals and Russian corporates and limiting trade with Russia and its access to key technological imports.

The ability of global monetary and fiscal authorities to provide offsets to the negative economic fallout from the crisis through support measures is more limited in the current environment of high inflation and already high fiscal deficits. There is some scope for central banks such as the Fed to slow the pace of rate rises compared to current expectations but faced with the possibility of even higher inflation post commodity price rises probably means a steady pace of rate hikes is still likely in the US.

Given the greater risks posed to European growth, European monetary and fiscal authorities might be more inclined to provide additional support to offset the negative consequences of the crisis on the European economy.

Summary

The history of geopolitical events is generally that markets react swiftly but recover relatively quickly also. However, there is still a lot of uncertainty as to how and over what period the crisis will play out and equity markets could remain volatile in the short term until greater clarity is evident. Investors have typically been rewarded for staying invested through these periods and focussing on their longer term investment objectives.

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