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Markets Update: Russia-Ukraine Crisis

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At ILIM, we are all saddened by the shocking events unfolding in Ukraine. Our thoughts are with the people of Ukraine and we all desperately hope for peace and Ukranian sovereignty to be restored.

As your investment manager, I also want to take this opportunity to share our perspectives on the latest market developments and the actions we are taking to manage risk across our funds and deliver to on your long-term objectives.

Market Update

Russia's invasion of Ukraine has added uncertainty to an already complex investment backdrop of high inflation, slower growth and a tighter policy stance from central banks. In the immediate aftermath of the Russian invasion, we saw a flight to safety as risk assets such as equities sold off; oil and energy prices surged on scarcity concerns given Russia's significant share of global commodity and energy supplies; and market volatility spiked.

While intraday volatility remains high, global equities have recovered initial losses and are now trading +1.2% since the start of the invasion. This recovery is mainly linked to the US, which is the most immune to events in Ukraine. European equities are down -4.3% given their greater sensitivity to the crisis.

Energy and commodity markets moved higher on supply concerns, with Brent oil prices rising from $97/bl to as high as $115/bl while European gas prices have risen 70% in the last week. The risk of further increases is possible if we see an escalation of international sanctions on Russian energy supplies.

While the global economy enters this crisis on a relatively solid footing, developments in Ukraine have added to the headwinds which markets were already facing in the early part of the year and we expect market volatility to remain elevated in the short term as this situation evolves.

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Sanctions and Economic Impact

While the swift and significant sanctions already imposed by western governments are expected to have a meaningful impact in the long term, they may not constrain Russia actions in the near term. The impact on the Russian economy will be immediate and severe and it is expected to contract at an annualised rate of 30% in Q2 and by up to 10% for the year as a whole.

There will be negative repercussions for the global economy resulting from the crisis and the sanctions imposed in the form of slower growth and higher inflation, in particular for Europe given its heavy dependence on Russian gas imports.

Managing this balance between harsh sanctions and economic impact will be critical in sustaining a unified response from the west and buffering the impact on economic growth (especially in Europe).

Central banks now face a policy dilemma given the risks of lower growth and higher inflation. It is possible that the previously planned pace of monetary policy unwind will be slowed, particularly in the case of the ECB, with greater focus on the threat to growth. A fiscal response is also possible to combat the growth slowdown with Europe, more likely than others, to increase stimulus given the greater risks to growth.

Russian Exposure

Our clients' total direct exposure to Russian securities is small; approximately 0.12% of our assets under management and are mainly held through index funds which are required to match benchmark holdings.

We have been actively engaging with leading index providers to clarify the treatment of Russian holdings in global indices. We have already seen several of these providers announce Russia will be deleted and expect other providers to take similar action. Where Russian holdings are deleted from indices we will seek to sell holdings as soon as practically possible and hold at zero value until that point.

Across our discretionary and active funds which are highly diversified, our direct exposure to Russian assets is minimal (c.0.03% of firm assets under management). In respect of these strategies we are committed to an orderly divestment and plan to do so as the market allows.

Navigating short-term volatility

Our flagship discretionary portfolios, MAPS, are specifically designed with a risk management focus and in this environment have helped to reduce the impact of market volatility for our customers. For example, global stock markets have experienced declines of c.8%, with European markets down c.-11% as of close of business March 1st. In contrast, our most popular discretionary funds, MAP 3 and MAP 4, are down -4.3% and -5.3% respectively for the same period. This helps demonstrates the benefit of the diversified and defensive allocations within the funds we manage.

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Staying the course

From a historic perspective, markets tend to overreact to geopolitical stress and corrections are typically short-lived. Several examples worth noting include Desert Storm 1990 -19.9%, the Iraq Invasion 2003 -14.1% and the Crimea 2014 decline -5.8%.

If we look back at previous geo-political events over the last century, equities on average have fallen c.9% but tended to recover quickly (c.2% higher on average after 3months) if no significant impact on growth. There are of course exceptions to this average experience, but this weight of history does act as a useful guide and helps temper any knee-jerk reactions to such events in the short term.

Bottom line for investors

In the face of such uncertainty, we caution against reactionary moves at this time. In the near term we expect volatility to remain elevated as the situation in Ukraine evolves. However, we do not see higher volatility as a reason for clients to change course if invested in appropriately diversified portfolios that are aligned with their investment objectives. The market has already priced in meaningful downside risks and trying to establish a re-entry point is very difficult and historically costly. We would emphasise the importance of staying invested during such periods. Our discretionary portfolios are well positioned and designed to help reduce the impact of volatility and help clients stay the course.

We are in a fast-moving market which is evolving daily. At ILIM, we remain focused on managing risk to achieve our clients' long-term objectives. We will endeavour to keep you informed on key developments and continue to share our insights and the actions we are taking for our clients. We thank you for your continued support and our thoughts are with all those affected by this conflict.

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