GHC Capital Markets

The Crisis in Ukraine

It is now clear that Russia has invaded the Ukraine.

At this time, we do not know how much resistance there will be, whether the Russian military assault will cost more casualties than President Putin had bargained for and also how much time it will take to pacify Ukraine. However, the likelihood of a major conflict in Europe is now greater than at any time since 1945.

The response from the EU and the NATO Alliance countries will be based around sanctions which could include a ban on exports of certain technologies to Russia and sanctions on all Russian banks. This would limit Russia's ability to trade. If Russia is excluded from the SWIFT financial messaging system and sanctions are imposed on Russia's energy firms this would do the most harm to their economy. However, the cost to Europe would also be severe due to its dependence on Russian gas.

The Russian economy is in a much stronger position to withstand sanctions than in 2014, but harsher sanctions than previously imposed will still cause real damage to the Russian economy. Capital Economics estimates that Russian energy exports amount to $240bn, or 15% of Russia's GDP per year. Russian banks would probably need to use their foreign exchange reserves to prop up the banking system. The combined effect of these sanctions could reduce Russia's GDP by 5%. On a protracted basis this would cause severe hardship in Russia and could result in Putin's policies being questioned at home. Russian domestic markets have already fallen by over 50% in the last ten days which is already putting strain on Russian businesses and investors.

The first reaction that we have seen in global investment markets is as follows:

- Equities have fallen in value – remember that markets fell by more than 20% when Iraq invaded Kuwait in 1991 but they recovered quickly and then continued to rise
- Government Bonds have strengthened on a flight to safety
- Gold has risen to around $1,980 per ounce
- The price of oil has risen above $100 per barrel
- Inflation may remain higher for longer due to more expensive energy costs

Within our Optimised Portfolio Service, we have no exposure to Russian or Eastern European equities. Lower risk portfolios hold UK government bonds which are strengthening and Index Linked Gilts and UK Commercial Property which help protect against inflation. Higher risk portfolios hold commodities which continue to rise.

We believe in our current positioning, which is prudently accounting for the current market realities. We continue to monitor the situation closely and will take action based on our top-down views if necessary.

Asset Allocation Committee
GHC Capital Markets
24 February 2022

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