Subject: Select Wealth - Portfolio Response to Russian Invasion of Ukraine
Date: Friday, 25 February 2022 5:09:17 pm

Having trouble viewing this email? **View Online**

Select WEALTH MANAGEMENT

SOPHISTICATED INVESTING MADE EASY

Portfolio Response to Russian Invasion of Ukraine (to share with your clients)

The conflict in Ukraine has added to the increased level of uncertainty prevailing in financial markets this year, which were already grappling with concerns over high inflation and the expectation of higher interest rates. However, until yesterday it was unknown whether an all out war would occur. Consequently when it was announced that Russia had invaded Ukraine, share markets fell sharply and commodity prices including oil rose. Even the New Zealand market was impacted with the S&P NZX50 index falling 3.3% and the Australian share market falling 2.2%.

A fall in share values has been the markets' historical response to the threat of war. Yet perversely once the campaign has started, the focus of markets moves on to other issues and share markets have typically rebounded. This theme occurred last night when the S&P 500 was initially down 2.6% only to end the day up 1.5%.

Clearly there will be some longer lasting economic and political impacts of the conflict. The extent of the economic sanctions and the removal of financial linkages with Russia are designed to punish Russian aggression and will likely draw a commensurate response from Russia. The imposition of sanctions will likely persist over the long-term. However, the economic impact is likely to be more punitive on Russia than on western economies.

From a New Zealand perspective, the extent of trade with both Russia and Ukraine is limited. Russian exports to New Zealand during 2020 were approximately US$252 million, overwhelmingly mineral fuels and oil. New Zealand exports to Russia consist primarily of dairy products and are of a similar order of magnitude in terms of value. Trade with Ukraine is insignificant.

Wider implications might be drawn in terms of the price of globally traded commodities most notably oil. The oil price has already surged with Brent crude trading at over US$100 per barrel. Given Germany's dependency on Russian natural gas, continued elevated electricity prices are likely in Europe. However, natural gas is not yet an internationally traded commodity so this impact should be limited to just Europe.

A rise in the price of energy is a two-edge sword from a monetary policy setting perspective. While it feeds through into a higher inflation rate, it also depresses discretionary spending. This means that central banks may not have to increase interest rates as rapidly or as high given the increased cost of oil will reduce demand for other goods and services.

Other commodities that could be impacted include grain - Ukraine is the bread basket of Europe - aluminium and nickel. Russian based Rusal is one of the largest global aluminium producers, while Norilsk Nickel is the world's largest Nickel miner. The conflict may therefore have second round effects and some unexpected consequences.

Importantly, there are many companies that will not be impacted by the conflict. Exactly why both the New Zealand and Australian share markets should fall so sharply is perplexing. The impact on both economies is likely to be limited with the direction of interest rates and the return to normality post COVID much more important. Similarly, the United States, the largest global share market, will only be marginally impacted. Again, the direction of inflation and interest rates will be more important in the long term to this market.

In summary, outside the significant human cost and the possibility for further increases in the price of petrol, the impact on the global economy is likely to be minimal. This implies the long-term impact on client's portfolios is also likely to be minor. Share markets experienced a similar fall in 2014 when there was unrest in the Ukraine and Russia annexed Crimea. Yet after the initial decline, share markets rebounded and largely forgot about the ongoing conflict. Therefore, we believe the prudent course of action is to look through any immediate tendency to over react and focus on core investment drivers such as what is happening to inflation and interest rates and how are companies reacting to the economic environment.

We do not believe that there should be any material changes to clients' portfolios, solely because of the Ukraine situation.

Regards,

The Select Team