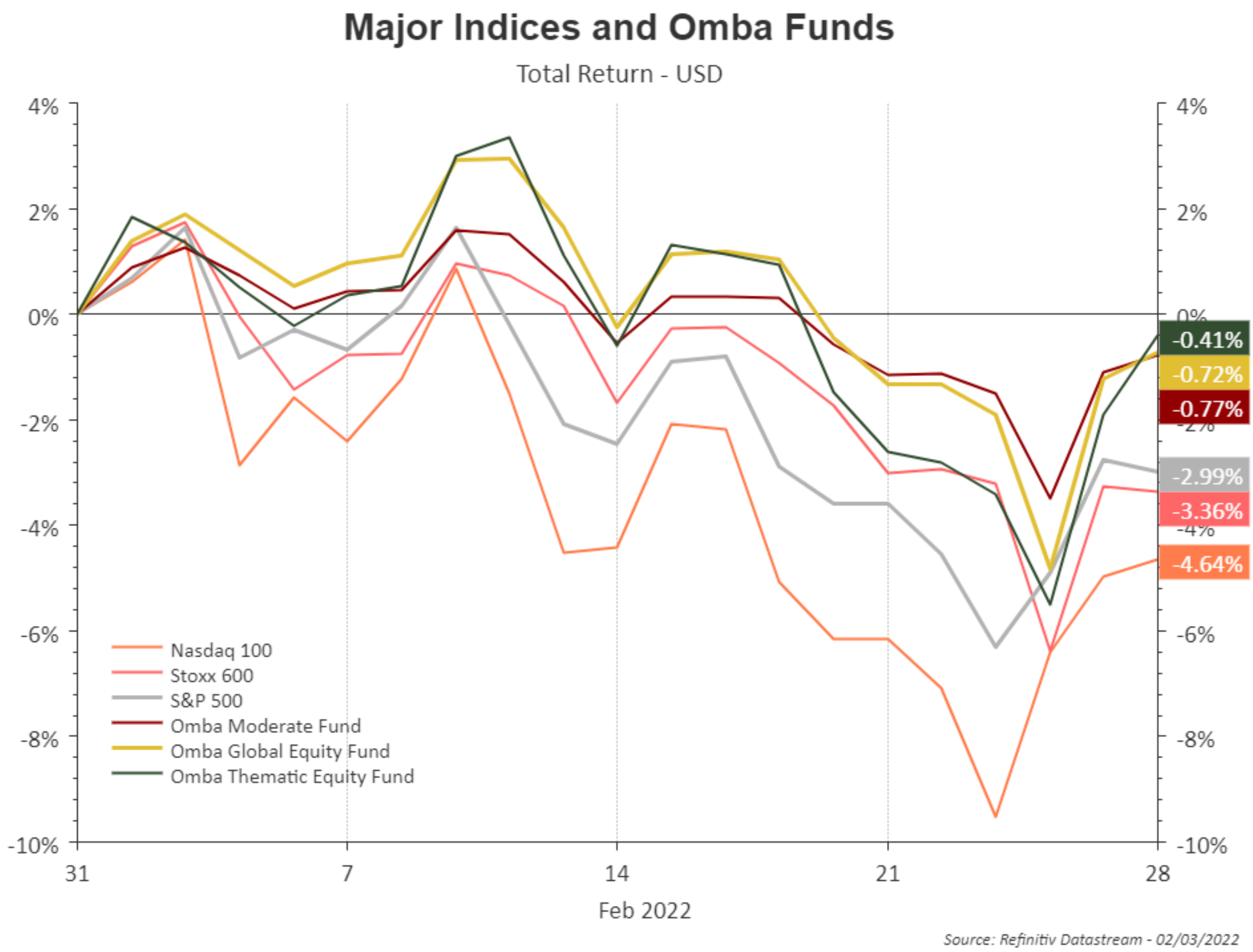
UKRAINE INVASION: A NEW PARADIGM FOR EUROPE

March 2022

It would be remiss of us not to acknowledge what a difficult and miserable time it is for many at the moment and to reaffirm our thoughts and support to all those affected.

Tensions that escalated in April 2021 after Russia amassed more than 100,000 soldiers near the Ukrainian border developed into a full-blown military invasion in the early morning of February 24th 2022, sending shockwaves across financial markets. Immediately, commodity prices spiked with Brent surpassing $100 a barrel. European economies are more exposed than other regions due to geographical proximity and the knock-on effects of economic sanctions, including rising energy input costs, and potential for supply chain disruption as well as the humanitarian costs associated with war and refugees fleeing the conflict areas.

Markets have already suffered a tough start to 2022 as elevated levels of inflation have been putting pressure on central banks to increase rates. The BoE has already increased its base rate twice from 0.10% to 0.50%, while the Fed has also indicated that it will increase its funding rate with some regional presidents requesting a 50bps hike at the next meeting. The Russian invasion has panicked already nervous investors.



Although February has been a volatile month we're pleased that our positioning and diversification has meant our funds and strategies have not suffered as much as the broader market as shown above.

BIGGEST WINNERS (MoM)		
Bahrain	Bahrain All Share	+8.50%
Luxembourg	LuxX Index	+4.33%
South Africa	JSE 40	+3.28%
Israel	TA 35	+2.91%
Saudi Arabia	Tadawul All Share	+2.59%

BIGGEST LOSERS (MoM)		
Russia	MOEX	-30.02%
Hungary	Budapest SE	-18.17%
Slovenia	SBITOP	-14.97%
Austria	ATX	-11.81%
Poland	WIG20	-9.49%

The Ruble has lost 42% of its value against the US Dollar YTD, while the Russian MOEX and other markets with economic ties to Russia or in the proximity of Ukraine were the biggest underperformers in February as one might expect.

The S&P500 has fallen 8% for the year as of 28 February. The tech heavy Nasdaq has fared worse, having closed 14% below its previous all-time high but has started to gain renewed inflows as investors (including ourselves) shift away from Europe in favour of the US – we initiated a shift recently out of broad European equities in favour of Nasdaq100.

Market selloffs during times of turmoil are common. Rebounds after these selloffs are also the most probable scenario, but these recoveries often take months to unfold. This time it took less than one trading session for markets to edge higher as we saw on Friday 25th but they continue to whip-saw as news relating to the invasion is interpreted by investors.

WHY DID MARKETS RESPOND THAT WAY?

Initially there were arguments put forward that Russian forces were advancing quickly and the invasion would be short lived before either Russia took control of Ukraine, Ukraine surrendered or a truce would be agreed. The view that the West's dependence on Russian energy would deter the EU from taking any strong countermeasures, such as cutting banks off the SWIFT (Society for Worldwide Interbank Financial Telecommunication) network and imposing harsh sanctions resulted in a strongly positive day on February 25th which erased the previous day's losses.

COMMODITIES	28 FEB 22	Δ vs 31 JAN	Δ YTD	Δ 3-YEAR
Gold	US$ 1'908/toz	+6.2%	+4.3%	+45.3%
Silver	US$ 24.42/toz	+8.9%	+5.0%	+56.5%
Platinum	US$ 1'043/toz	+2.5%	+8.4%	+19.9%
Copper	US$ 4.44/lb	+2.9%	-0.2%	+50.7%
Brent Crude	US$ 100.99/bbl	+10.7%	+29.8%	+52.9%

FOREX	28 FEB 22	Δ vs 31 JAN	Δ YTD	Δ 3-YEAR
EUR/USD	1.1221	-0.1%	-1.3%	-1.3%
GBP/USD	1.3421	-0.2%	-0.8%	+1.2%
EURCHF	1.0287	-1.2%	-0.8%	-9.4%
USD/JPY	115.01	-0.1%	-0.1%	+3.2%
AUD/USD	0.7263	+2.8%	+0.0%	+2.4%
USD/CAD	1.2677	-0.2%	+0.3%	-3.7%

EM CROSSES**	28 FEB 22	Δ vs 31 JAN	Δ YTD	Δ 3-YEAR
USD/BRL	5.1602	-2.7%	-7.4%	+37.6%
USD/MXN	20.471	-0.8%	-0.1%	+6.2%
USD/ZAR	15.369	-0.2%	-3.9%	+9.1%
GBP/ZAR	20.704	-0.0%	-4.4%	+10.8%
USD/CNY	6.3093	-0.8%	-0.7%	-5.7%
USD/TRY	13.8487	+4.0%	+4.0%	+159.5%
USD/RUB	106.041	+37.1%	+41.8%	+60.7%
USD/INR	75.521	+1.3%	+1.4%	+6.6%

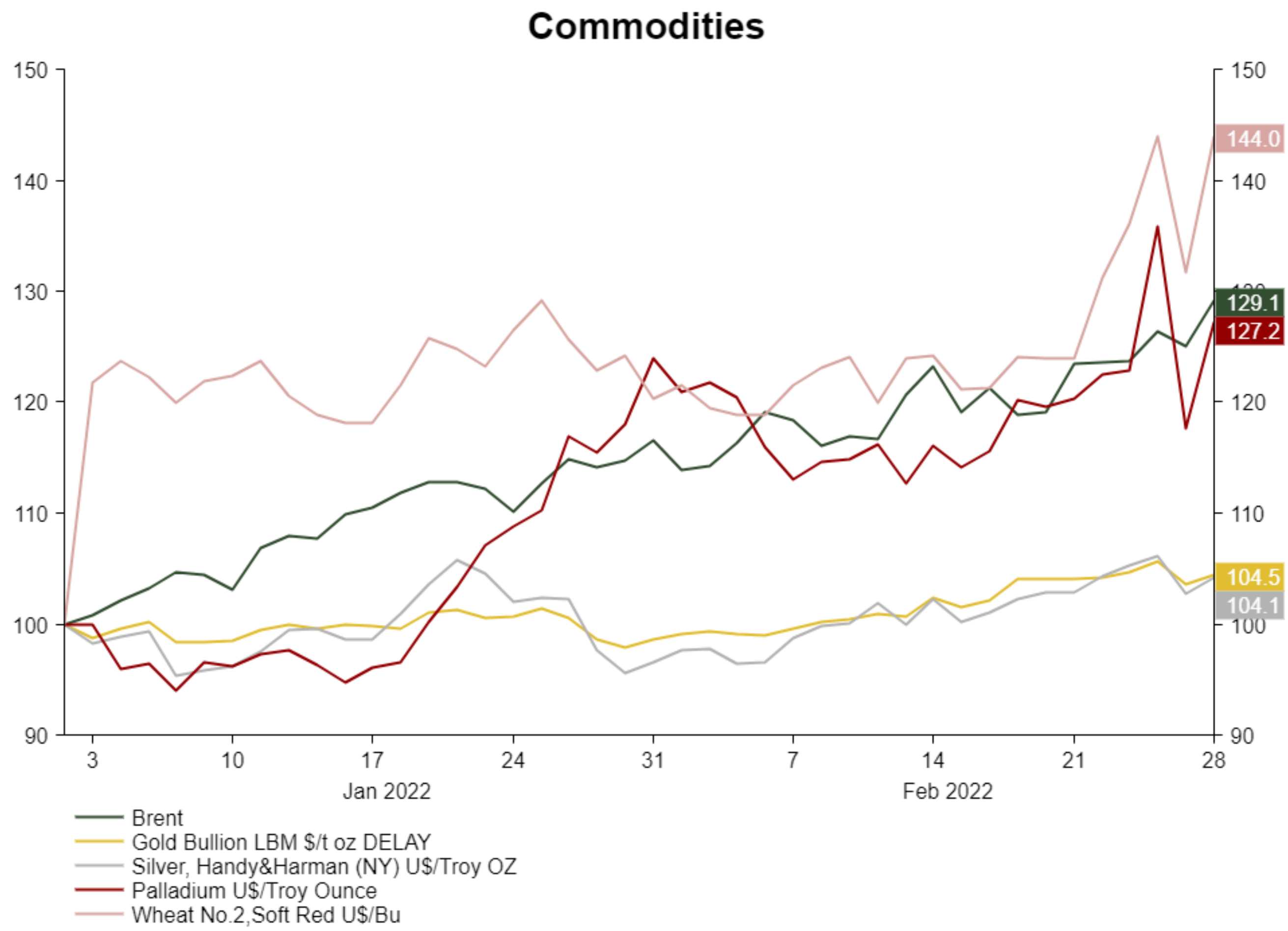
***Red bar showns a weakening of EM CCY.* *Source: Refinitiv*

There was a "swift" change of course over the weekend when Western leaders announced that alongside other measures, major Russian banks will be removed from SWIFT. The Russian Central Bank will now also find it difficult to access more than $400bn of their foreign reserves, worth $630bn, after the EU and US froze its assets and banned financial institutions from transacting with the Russian Central Bank, the country's National Wealth Fund, the Russian Finance Ministry and the Kremlin's sovereign wealth fund: the Russian Direct Investment Fund. In recent days Russians trying to withdraw their Rubles or convert them to hard currency have formed queues outside bank branches in Moscow potentially causing a run on Russian banks. Not only will Ukrainians suffer due to the invasion but many Russians will feel the economic effects of the invasion which may prompt political change. This may take time.

ENERGY AND OTHER COMMODITIES

On the 1st of March the International Energy Agency (IEA) announced it would release 60 million barrels of emergency oil reserves to alleviate supply concerns, but these numbers are insufficient to meaningfully impact the supply shortage. Only a faster ramp up in production could potentially rebalance supply or demand may wane at these higher prices resulting in a better supply-demand balance. i.e. elevated energy prices are likely to persist for several weeks and potentially months in our view.

Already strained supply in many commodities could be further impacted by the indirect effect of the sanctions. Russia is a top 3 producer for many energy commodities, base metals, bulk metals, precious metals, soft commodities and fertilizers with many of these markets already tight due to volatile production and supply chain disruptions. These and further disruptions will have a meaningful impact on Western prices and the knock-on effect of further inflationary pressures. In late January we initiated a position in the European Energy sector which benefits from higher energy prices and has thus far been the right decision. We have also retained our overweight to basic resources which is a sector we've liked for over a year. At the moment we're looking closely at particular commodity exposures (like Palladium, for which Russia makes up c.45% of global supply), countries which benefit from higher oil prices (like Brazil) and the upstream oil producers in the USA.



Source: Refinitiv Datastream-01/03/2022

HOLDING THE COURSE

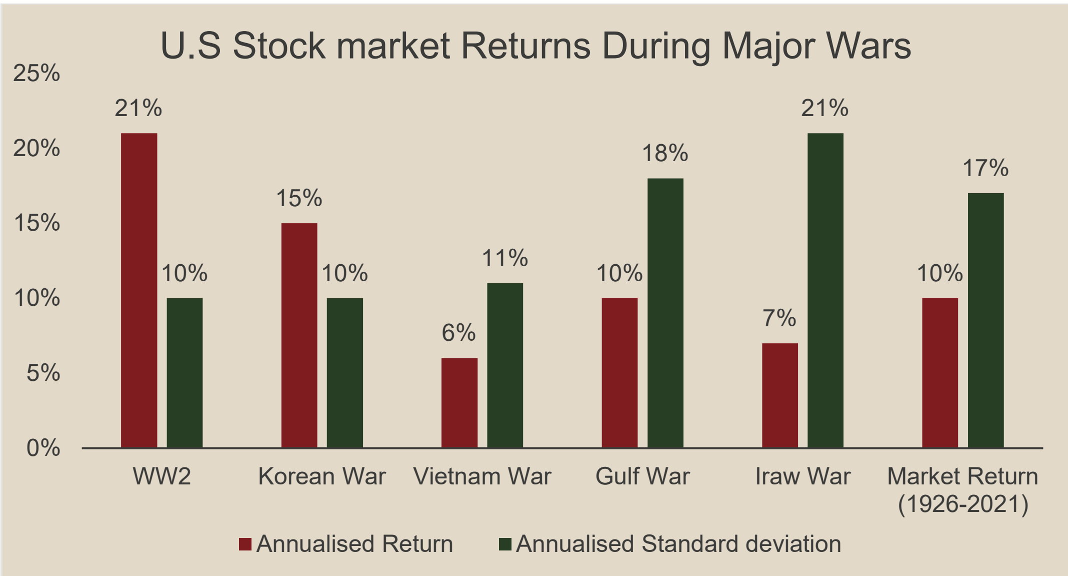
Volatility is the only certainty in such times, but what can an investor do?

We believe that in the long run these dips present buying opportunities. We must remember that stocks represent ownership of companies that continue to produce products and offer services that consumers need even in times of crisis. Although investors sell "risky" assets during times of crisis demand for goods and services sold by many companies around the world does not completely disappear and certain goods and services are often in more demand (for example cyber-security companies, defence companies and many energy companies which have experienced a rally during this correction). We do not want to draw any conclusions on the outcome of this war because armed conflicts are always unpredictable, however, previous geopolitical events have most often resulted in market corrections that eventually gave rise to higher equity prices as presented in the table below:

Event	Date	S&P 500 (% since event date)		Crude Oil (% since event date)		MSCI World ex USA (% since event date)	
		Initial reaction	90 Days	Initial reaction	90 Days	Initial reaction	90 Days
Cuban Missile Crisis	19/10/1962	-3.78%	17.16%	-	-	-	-
US Bombs Cambodia	29/04/1970	-15.30%	-4.94%	-	-	-10.45%	-16.07%
USSR Invades Afghanistan	24/12/1979	-2.27%	-7.78%	8.33%	8.33%	3.94%	11.85%
US Invades Panama	15/12/1989	-2.06%	-3.43%	2.82%	-6.21%	0.00%	-7.04%
Gulf War	24/12/1990	-4.16%	12.10%	17.75%	-31.32%	1.75%	15.96%
911	11/09/2001	-11.60%	4.34%	-4.09%	-31.98%	-8.48%	5.48%
US Invades Iraq	20/03/2003	2.49%	15.57%	-8.16%	-6.54%	1.53%	22.05%
Crimea Annexation	26/02/2014	1.16%	3.62%	-3.77%	-0.92%	-2.42%	3.25%
Average all events		**-4.44%**	**4.58%**	**2.15%**	**-11.44%**	**-2.02%**	**5.07%**

Source: Citibank, CGWI OCIS, Bloomberg as of 22/2/22

Furthermore, looking at the performance of the US stock market over various wars one can see a positive return in all instances.



Source: Ken French Data Library
Dates for each war: WW2: 8/12/41-2/9/45, Korean War: 27/6/50-27/2/53, Vietnam War: 8/3/65-29/3/73, Gulf War: 2/8/90-28/2/91, Iraq War: 20/3/03-15/12/11, Market return data: 1/7/26-31/12/21

We refer you to one of our previous research publications, Holding the Course, which stresses the importance of staying invested in times of uncertainty. In our publication, we argue that between 1 January 2001 and 1 July

2021, missing the best return day of the MSCI ACWI in each calendar year would more than halve your investment return. Trying to time the market is a difficult pursuit.

DIVERSIFICATION IS IMPORTANT

One never knows where the next geo-political flair up will take place with many tensions often cited from North Korea to the Middle East to Latin America. Diversification across countries and sectors ensures that over-concentration to one region or country won't destroy accumulated wealth too meaningfully. Using other asset classes or other regional exposures allows global multi-asset investors to position the portfolio opportunistically in times of chaos. Some regions and sectors often benefit from geopolitical instability in others, hence counteracting the negative effect of such events on portfolio performance.

For example, allocating capital in a region such as Latin America can provide exposure to assets with lower correlation to European markets. Latin America is a commodity and energy producing region that can benefit from higher prices of exported commodities, leading to higher earnings for LATAM stocks and equity indices, lower spreads for local government bonds etc. This year, for example, Brazil is up almost 20% in US Dollar terms as of 28th of February.

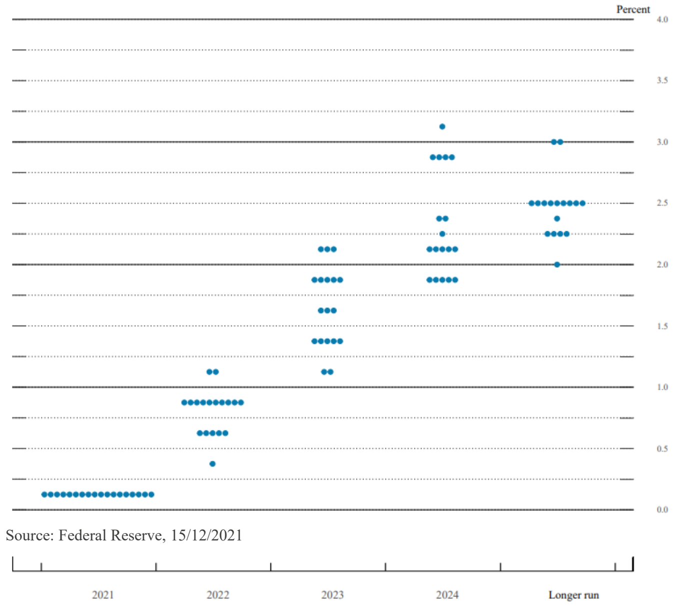
The S&P 500 Energy Sector is another example of regional and sectoral diversification and has outperformed the European Stoxx 600 Index by 10.7% in February, as investors fled to a sector that benefits from elevated energy prices and potential disruptions in the supply of Russian gas to Europe.

EQUITIES REMAIN THE BEST LONG-TERM HEDGE AGAINST INFLATION

Supply chain bottlenecks and rising energy prices have led to higher input costs for companies around the world. However, companies can pass these costs to consumers providing a natural hedge to inflation. In addition, indices contain companies from several sectors including energy and commodity producers.

Company earnings grow faster than inflation and the stock prices reflect that over time.

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



Source: Federal Reserve, 15/12/2021

The other important driver of markets this year has been the change in interest rate expectations from major central banks, particularly the Federal Reserve. Although the ECB in Europe may have to adjust course due the current crisis the Fed are unlikely to reverse course on hiking rates. The Federal Reserve Open Market Committee projected the federal funds rate would reach 0.75% by the end of 2022. However, the market implied rate as of 28/2/2022 is almost 1.5%. Continually high inflation readings give the Fed no other choice but to begin increasing rates. This on the one hand tightens monetary conditions which will have an impact on expenditure and earnings but our view is that the first 1% to 1.5% of hikes will not be enough to stall growth and thus the current sell-off presents an opportunity to increase equity exposure for clients able to do so. Equities are also more attractive on a relative basis to safe-haven fixed income as bonds will drop in value as interest rates rise and the curve continues to shift upwards. For now, we're pleased we've maintained treasury and gilt exposure in portfolios as they are performing their safe-haven function in this uncertain time. We hope for the sake of humanity this war ends soon.

DISCLAIMER