

## Update: Market volatility and the Russia-Ukraine conflict

**CHRIS HYZY:** Hello and welcome. I'm Chris Hyzy and I'm very pleased to have Ian Bremmer, President of Eurasia group and GZERO Media with me again today. He'll share his expert insights on the latest developments in the Russian-Ukraine conflict. We'll look at whether sanctions as well as the bravery of the Ukrainian people and President Zelensky's impassioned appeals to the world community are having their intended effect. And we'll discuss the prospects for a possible diplomatic resolution.

Next, I'll speak with Michael Hartnett, Chief Investment Strategist for BofA Global Research. We'll look at the economic and markets' impacts of the conflict on Europe, Russia, and the rest of the world.

This program is the latest in our commitment to help keep you informed, as rapidly changing events unfold.

Ian, Michael, and other analysts from BofA Global Research and the Chief Investment Office will join me again on April 5<sup>th</sup> in a program we're calling **The Big Shift, New Market Forces, and Ways to Prepare**. There, we'll look beyond the Russia-Ukraine conflict to other major pivots reshaping the markets and creating new investment risks and opportunities. We hope you tune in then.

With that, welcome Ian.

**IAN BREMMER:** Chris, always good to see you.

**CHRIS HYZY:** You too as well. Here we are. We talked a lot about the power vacuum that has been developing for the better part of a decade or so. Accelerating right now. We're three weeks into the crisis in Ukraine. The humanitarian effect is absolutely tragic.

Take us through the latest developments now and how do we move forward over the next few weeks, perhaps months?

**IAN BREMMER:** Well, maybe you start big picture because there are a couple things that are very clear that have already happened and there are a couple of big questions that are out there. A couple of things that have already happened is that the Russians will end up, and Putin in particular, will end up in a radically worse position than he was when he invaded.

The decoupling that you're seeing economically from the G7, the sanctions that are being levied on, the fact that the Germans, just in the past two days have said that they will never come back to their level of integration on the energy side. They've signed a massive long-term deal with the Qataris. They're the most important economy in Europe. Everyone is following the German lead.

Russia is an international pariah in terms of the advanced industrial democracies of the world, that's done. The Europeans are going to be spending vastly more on national security. They are going to take this on the chin economically. They're prepared to deal with that. The level of

integration of NATO, the level of defense spend, the desire of the Swedes, the Finns, to join NATO. The demand for stronger American leadership from these countries, that is something that is just radically different from where we were even four weeks ago.

Europe is going to see less populism. Macron is going to win his election with a slam dunk, not even a lay up. The support for a strong Europe across all of the European countries, even a country like Poland, which was one of the problems in terms of rule of law and independent judiciary. They're now taking the lead in terms of a strong European response vis-a-vis Russia, as there are over 2 million Ukrainian refugees in Poland right now.

So the idea that any European leader could do well on the back of saying, "I'm skeptical of Europe, I want less Europe, I want out of Europe." Four weeks ago, that was one of the things everyone was talking about. It's gone. It's gone. What are the things we don't know yet, two big ones. The first is, to what extent is the United States going to maintain the same form of leadership on Russia that the Europeans are? Right now we have a strong bipartisan agreement between Democrats and Republicans that Putin is the problem. And the general orientation towards we will even take economic pain at home, for our own citizens, in order to respond effectively to Russia. We'll pay more at the pump. You don't hear that very often from Americans. Democrats, Republicans, together. But is that likely to be maintained?

I would say the Europeans see this as an existential threat to democracy. The Americans see it as a problem for Ukraine. A big problem, but not a threat to Americans long term. And as we move towards the mid-term elections, the likelihood that you'll see much more focus on internal division, and less willingness to lead NATO. What does that mean to the Europeans? The hedging of China and all the rest. That's a big, open question.

Final point is China. We will have a cold war with Russia going forward. They will be decoupled. Will China be included? So far, the Chinese have been much more supportive of the Russians and Xi Jinping has been much more supportive of Putin, his best friend on the international stage. But will they maintain that as the Russian situation gets much, much worse economically, politically and geopolitically. A huge, open question.

The most important meeting that Biden has had his entire presidency, was just a few days ago; his phone call, two hours long, with Xi Jinping. Nothing was accomplished. The Americans told the Chinese what their perspectives were, said "we will make you pay if you decide to help the Russians avoid and evade American-European isolation." So far the Chinese have said, "Well, let's talk about Taiwan." They haven't yet provided military support to the Russians. They haven't tried to evade American sanctions. Is that going to continue? And what happens with Xi Jinping's best friend, who Biden calls a war criminal. That's a big question. Those are the big, moving pieces as we see them right now.

**CHRIS HYZY:** Speaking of moving pieces, shifts, speaking of geopolitical risk in general, you've been doing this for many decades. There's scenario analysis to all of this and trying to figure out those scenarios is one thing. The timeline is another.

Take us through the timeline and potential end game possibilities with the conflict and then coming out the other side. What does that mean?

**IAN BREMMER:** What's very interesting on the military side is that the ability of the Russians to actually take Ukraine, take Kyiv, and overthrow the existing Ukrainian government, increasingly looks like it's a step too far for the Russian military. And what we're seeing in the last few days is they're calling up some reservists and they're bringing some volunteers from Syria, from Chechnya, even from the Central African Republic. This is Russians, calling those volunteers to fight on the ground in Ukraine. But they're not doing a general mobilization of Russian forces. And given that, the likelihood that Russia would be able to encircle and take a city of 4 million Ukrainians, the capital, the city of Kyiv, looks like they can't do it. Now, that doesn't mean they're not fighting. And what we've already seen is that Mariupol, which is on the Sea of Azov, which means it's the land bridge between Crimea, which the Russians took, and the occupied territory, the Donbas -- 430,000 Ukrainians, that city has been destroyed.

The Russian government demanded surrender or there will be military tribunals for citizens of Ukraine. This is no longer not targeting citizens anymore, even publicly. There's no way for the Russians to square that with their policies on the ground. Already over 10,000 Ukrainian civilians dead on the ground in Mariupol. Will the Russians be willing to take their strategy in a city of almost half a million in Mariupol, and apply that to other cities across the country that they can't take? In other words, will they level to the ground, like they did in Aleppo in Syria, like they did in Grozny in Chechnya, will they do that for Kyiv? Will they use weapons of mass destruction? These are the questions going forward.

In the next week or two, the likelihood of a negotiated breakthrough between the Russians and Ukrainians, seems to be de minimis, close to zero. The likelihood that the Russians will continue to fight and potentially target more civilians and that we could see a step change in the kind of death that we've had on the ground in Ukraine, from the first few weeks when civilians were hit but they largely weren't targeted in most cities. That's a big, open question right now.

**CHRIS HYZY:** Sanctions and other financial restrictions have been used, in many cases, very harsh sanctions. We know it's going on already with the Russian economy. Can that economy come back in the next few years or are they in a depressive state for a very long period of time, in your opinion?

**IAN BREMMER:** It's a depression. There is likely to be a contraction of a minimum of 10-15% of Russian GDP this year, on the back of an economy that was already underperforming, given 2014 sanctions from the last invasion of Ukraine, much smaller. The fact is that they're still presently making a lot of money because they're selling a lot of energy, particularly gas, to the Europeans, at high market rates. That is going to be over. Half of that will be over within the year. Next winter, done. And within two to three years, it'll be over functionally. And the ability of the Russians, they don't have the infrastructure to suddenly move their entire economy to China.

Yes, the Chinese, absolutely, they can buy Russian grain, they'll continue to buy Russian arms. Arms exports, that's been important. They'll buy more energy. But that's very different from saying there's any substitution affect. The impact on the Russian economy is functionally permanent. And this is not only the 11<sup>th</sup> largest economy in the world and going down real fast, but this is also one of the most important commodity producers in the world. We're talking about grain, we're talking about a lot of rare Earths. Of course we're talking about oil and gas. And so the knock on impact for the global economy is going to be extended. There's no question.

**CHRIS HYZY:** So you talked about grains, big importer - big exporter, I should say, of a variety of different natural resources, not just energy to Europe, but as you mentioned before, grains, wheat. Is there a food crisis here?

**IAN BREMMER:** There's a food crisis. There is a food crisis. We are now about to enter the planting season and the Ukrainians, for example, they have no labor to engage in that. Seed, I mean is not in the hands of the people that would need to be able to plant it, presently. Fertilizer, massive challenges, and export controls, coming from the Russians, who are incredibly important in terms of potash, for example, going into fertilizer.

The Ukrainian harvest, and they're the fifth largest exporter in the world of wheat, is basically a lost cause. The Russian harvest is going to be a significant challenge, especially in terms of supply chain and export from ports, for example. You put those things together, on the back of what was already inflated food prices over the course of the last two years of the pandemic. And in terms of the global economic impact, this is probably the single most important issue.

You have about 9 million people that died of starvation in the last 12 months in the world. That number could honestly be an exponential step change. It could be 10x over the next two years, on the basis of what we are presently seeing from Ukraine and from Russia. And this needs to be the top issue of the IMF spring meetings coming up shortly. The global economies must respond immediately because it's the poorest people in the world that are going to be affected by this.

**CHRIS HYZY:** Speaking of immediate response, is there a point in the conflict, is there an activity, an event that brings NATO more involved, outside of just sanctions? Is there a certain event by the Polish border, again, something close to NATO bases or something like that that would bring that coalition together in a more forceful way?

**IAN BREMMER:** Since you and I spoke just a couple of weeks ago, we've already seen missile strikes from the Black Sea to a 1,000 kilometers away, Lviv, which is the major city in Ukraine on the western border. In other words, only a few miles away from Poland. What's the possibility that as you see more of these missile strikes one might inadvertently, or "inadvertently" hit Poland? It's not zero. What about cyber attacks on these front line countries? What about terrorist attacks?

The Russians view NATO engagement in this fight, NATO provision of weapons, NATO provision of intelligence to the Ukrainians, allowing them to fight the Russians more effectively, they consider that to be war fighting. And the Russians in four weeks, have already taken more casualties in this fight than the Americans did in the wars in Iraq and Afghanistan in 20 years. So this is real for Putin and he will respond.

But I want to be clear, that the NATO countries do not want direct confrontation with Russia. They want a proxy war. They want to help the Ukrainians but they don't want to go directly in. There have been plenty of places where we could imagine an accident would be a problem. Just in the last week we had the prime ministers of Poland, Slovenia and the Czech Republic get on a train and go to Kyiv, a war zone, which, to be fair, there was only a little bit of bombing was going on at that point, but there was bombing going on. What would have happened if one of

those leaders, or all three, had been killed by the Russians when they were there? Would there be a direct response by NATO against Russia? Of some form, I think the answer to that is yes.

Right now I can tell you there are no circumstances where there would be a direct response that would show either a no fly zone that would lead NATO planes to be in direct confrontation with Russian planes. Or sending NATO troops, even peacekeepers, as the Polish government has recently floated, into combat in Ukraine against the Russians. But as we see direct Russian intervention, cyber, disinformation, terrorism, against NATO front line states, that could change. And so I think it is important to understand that while we're now focused on a war in Ukraine, the Russians see this as a war against NATO. And it is certainly plausible that over time NATO will see this as a direct confrontation against Russia.

**CHRIS HYZY:** Let's bring it full circle. Let's get to any positive developments. You talked a lot about the NATO alliance coming tighter together that was unforeseen four weeks ago. In addition to that, as we hopefully get through this, what other positive developments worldwide, on the world stage, do you see coming out of this?

**IAN BREMMER:** A few. Four weeks ago, you would not say that Democrats and Republicans would agree that Putin was a bigger problem for them than their opponents across the aisle domestically. You would say that now. It may not last, but for the time being, that's a positive. I think the vote in the House to strip Russia of normal trading status was 424 to 8. In a country like the United States, unheard of. But this is a big confrontation. So that's one.

I would also mention Japan. The fact is that the Japanese government is now taking refugees from Ukraine. The Japanese government is providing defense support for Ukraine. For the Japanese, that is an enormous deal. That's the kind of step that you're seeing from the Germans in terms of 2% of their GDP going to defense.

I also would say, even though it is clear that the Chinese are far more supportive of the Russians than they are of the U.S. or Europe in this fight, so far, the Chinese have not provided military support to Russia and they have not attempted to directly evade or breach American and NATO sanctions against Russia. And that is a big deal, especially given what the alternative would look like.

**CHRIS HYZY:** Ian, always great being with you. Thank you for being here with me today.

**IAN BREMMER:** It's my pleasure, Chris.

**CHRIS HYZY:** Michael, we just heard from Ian Bremmer on his insights on the geopolitical landscape. And given we're three weeks in to the crisis in the Ukraine, the destabilization of the energy markets, financial markets in general, changes in the dollar, the difference in performance between Europe and the US, what's going on right now in financial markets, with the accelerating crisis that is happening in the Ukraine?

**MICHAEL HARTNETT:** Well I think three things, Chris. I think one, there's a much greater appreciation of commodities being an asset class that some money needs to be dedicated towards, because we are seeing not just oil prices rise, but also nickel, wheat. This obviously is something that feeds through to number two, which is that the bond market is quite weak.

And I think that while the war inevitably gets people thinking about commodities, perhaps the impact that it's going to have on the bond market is going to be even greater because it's going to open up greater spending on defense, energy independence, Europe, which of course has been under austerity for the past 20 years. So perhaps there's a real sort of sea change with regards to the bond market too.

For equities, it's a little bit of a tug of war. Obviously, recession risk has risen because of the Ukraine and that's why a lot of the cyclical stocks have got hit hard, some of the banks got hit hard and there's been some rotation to technology. But I think really what's happened within the equity market is a big flight to safety, that's really been the primary move.

**CHRIS HYZY:** You speak with global asset allocators every day. Talk to us about a lot of the flow work that you've done and some of the indicators you're watching. Are we close to a buying opportunity here, all things considered?

**MICHAEL HARTNETT:** Well I think sentiment as you say, is very poor and often when sentiment is very poor it's a good idea to start nibbling at the markets. I think the great difference here though, Chris, is that while everyone speaks a bearish game and everyone has a whole list of big worries that they have, partly because you didn't really have an alternative to stocks the last couple of years. I mean commodities, no one was thinking about two years ago. Bond yields are incredibly low. People are still stuck in equities.

So I think that while there is a case for a rally in equities, just because it's simply very oversold and everyone is very, very bearish, it's not like people are starting with incredibly low allocations to equities and so I think the case for this providing a great long-term entry point is very, very low. Short term entry point it could well be.

**CHRIS HYZY:** Taking a look at what's going on right now. We talked about it being three weeks into the crisis. Tough to see an endgame here at this point. What does that tell you for financial markets given the crisis? What are you looking at specifically that has really changed?

**MICHAEL HARTNETT:** Well, I think that inflation is the big change. And it's not the inflation is going to be meaningful higher on the back of Russia and Ukraine, but everyone's expectation that inflation would come tumbling back down to where the Fed was predicting it and therefore, the Fed would not have to raise interest rates significantly because the inflation would be transitory, the landing for the economy would be soft. And I think that's what the war has changed.

There's much less confidence that inflation is going to come back down and as a consequence, there's greater risks of a policy error and a hard landing. And that's why I think that it's going to be very difficult, until you remove those risks, for a sustained move in the equity market through the course of the next six to nine months.

**CHRIS HYZY:** So final question, tough one: Can central banks thread the needle on inflation and still manage to not have growth enter a hard landing?

**MICHAEL HARTNETT:** Pretty tough. It's pretty tough. I mean of course they can, but they need a lot of luck. They need the end of the war, they need the oil price to come down. They

need the supply of labor in America, the participation rate to pick up so that we put a little bit of downward pressure on wages. So they need a heck of a lot of luck to thread the needle.

I think again, one of the things we're seeing in 2022 is just an increased risk premium for all risk assets, simply because you're asking questions like can they thread the needle? Just asking the question means that you need to place greater risk premium on these assets.

**CHRIS HYZY:** As always, thanks for joining me, Michael.

**MICHAEL HARTNETT:** Pleasure.

**CHRIS HYZY:** And thanks all of you for joining us for this program.

Here are a few final thoughts to keep in mind. The ongoing crisis in the Ukraine has accelerated certain trends, supply chain disruptions, repricing in the energy and broader commodity markets, and even how the Federal Reserve adjusts its approach to tamping down inflation. We believe it also means that inflation could be with us for some time.

With so much uncertainty in the markets, diversification becomes increasingly important. I would encourage you to review your asset allocation regularly and rebalance as necessary, keeping your risk tolerance, goals and time horizon, and liquidity needs in mind.

An advisor is a great resource for helping you understand how the ideas discussed here fit in with your overall financial picture. If you're currently working with an advisor, we hope you'll continue this conversation.

Thanks again for watching and I hope you'll tune in to future programs from us on the impact of global events on the markets and your investments.

## **Important Disclosures**

**The views and opinions expressed are those of the speakers as of the date of this webcast and are subject to change.**

Ian Bremmer and Eurasia Group and GZERO Media are not affiliated with Bank of America Corporation.

**Investing involves risk, including the possible loss of principal. Past performance is no guarantee of future results.**

This material does not take into account a client's particular investment objectives, financial situations or needs and is not intended as a recommendation, offer or solicitation for the purchase or sale of any security or investment strategy. Merrill offers a broad range of brokerage, investment advisory (including financial planning) and other services. There are important differences between brokerage and investment advisory services, including the type of advice and assistance provided, the fees charged, and the rights and obligations of the parties. It is important to understand the differences, particularly when determining which service or services to select. For more information about these services and their differences, speak with your Merrill financial advisor.

Bank of America, Merrill, their affiliates, and advisors do not provide legal, tax, or accounting advice. Clients should consult their legal and/or tax advisors before making any financial decisions.

This information should not be construed as investment advice and is subject to change. It is provided for informational purposes only and is not intended to be either a specific offer by Bank of America, Merrill or any affiliate to sell or provide, or a specific invitation for a consumer to apply for, any particular retail financial product or service that may be available.

The Chief Investment Office (CIO) provides thought leadership on wealth management, investment strategy and global markets; portfolio management solutions; due diligence; and solutions oversight and data analytics. CIO viewpoints are developed for Bank of America Private Bank, a division of Bank of America, N.A., ("Bank of America") and Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S" or "Merrill"), a registered broker-dealer, registered investment adviser and a wholly owned subsidiary of Bank of America Corporation ("BofA Corp.").

BofA Global Research is research produced by BofA Securities, Inc. ("BofAS") and/or one or more of its affiliates. BofAS is a registered broker-dealer, Member SIPC and wholly owned subsidiary of Bank of America Corporation ("BofA Corp.").

Asset allocation, diversification and rebalancing do not ensure a profit or protect against loss in declining markets.

Investments have varying degrees of risk. Some of the risks involved with equity securities include the possibility that the value of the stocks may fluctuate in response to events specific to the companies or markets, as well as economic, political or social events in the U.S. or abroad. Bonds are subject to interest rate, inflation and credit risks. Treasury bills are less volatile than longer-term fixed income securities and are guaranteed as to timely payment of principal and interest by the U.S. government. Investments in foreign securities (including ADRs) involve special risks, including foreign currency risk and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are magnified for investments made in emerging markets. Investments in a certain industry or sector may pose additional risk due to lack of diversification and sector concentration.

Nonfinancial assets, such as closely-held businesses, real estate, fine art, oil, gas and mineral properties, and timber, farm and ranch land, are complex in nature and involve risks including total loss of value. Special risk considerations include natural events (for example, earthquakes or fires), complex tax considerations, and lack of liquidity. Nonfinancial assets are not in the best interest of all investors. Always consult with your independent attorney, tax advisor, investment manager, and insurance agent for final recommendations and before changing or implementing any financial, tax, or estate planning strategy.

Merrill Lynch, Pierce, Fenner & Smith Incorporated (also referred to as "MLPF&S" or "Merrill") makes available certain investment products sponsored, managed, distributed or provided by companies that are affiliates of Bank of America Corporation ("BofA Corp."). MLPF&S is a registered broker-dealer, registered investment adviser, Member SIPC and a wholly owned subsidiary of BofA Corp.

Investment products:

<b>Are Not FDIC Insured</b>	<b>Are Not Bank Guaranteed</b>	<b>May Lose Value</b>
-----------------------------	--------------------------------	-----------------------