

CHIEF INVESTMENT OFFICE

# Investment Insights

## Russia/Ukraine Market Update

January 2022

All data, projections and opinions are as of the date of this report and subject to change.

### OVERVIEW

The bulk of Russia's geoeconomic power and its influence on financial markets comes from its significant share of energy production (and European reliance on Russian energy) and its military might. It accounts for a relatively small share of the global economy by various metrics and less than 4% of Emerging Market (EM) Equity capitalization. Given the current tensions and potential military action between Russia and Ukraine, the Chief Investment Office suggests revisiting strategic exposure to defense stocks and commodities for their diversification benefits, as well as our tactical preference for U.S. Equities over International Equities within a diversified portfolio.

AUTHORED BY:

**Chief Investment Office**

Data as of 01/28/2022 and subject to change.

### Russia's economy is not considered large enough to significantly move the global growth needle<sup>1</sup>

- Currently ranked 11th of the largest economies in the world. In purchasing power parity (PPP) terms, it is 3.1% of global gross domestic product (GDP).
- Nominal GDP was \$1.7 trillion for 2021—slightly smaller than the New York metro area. The U.S. economy is 13 times larger, China's 10 times larger.
- Their share of global consumption is 1.6% of global total.

### Russia is a heavyweight in the global energy markets<sup>2</sup>

- Produces 10 million barrels of oil per day or more than 10% of world production, and exports 43.1% of that production.
- Europe is heavily dependent on energy from Russia, leaving it vulnerable in the event of conflict.

### U.S.-Russia commercial linkages are insignificant.<sup>3</sup>

- Exports (goods and services) account for 26% of GDP but account for just 2.3% of the global total.
- Top five export markets: China, the Netherlands, U.K., Germany and Turkey.
- U.S. exports to Russia are an insignificant share of total U.S. exports (<1%).
- U.S. corporate exposure to Russia is minimal: On a cumulative basis from 2000 to Q3 2021, Russia accounted for just 0.2% of total U.S. foreign investment outflows.
- In 2020, the last year of available data, they accounted for less than 1% of total U.S. foreign affiliate income (a proxy for global earnings).

<sup>1</sup> Sources: IMF/Haver Analytics. Data as of January 24, 2022.

<sup>2</sup> Sources: Department of Energy, BP, and Bloomberg. Data as of January 24, 2022.

<sup>3</sup> Sources: IMF/Haver Analytics. Data as of January 24, 2022.

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## Russian Equities are relatively minor to the overall EM universe<sup>4</sup>

- They are just 3.6% of the MSCI EM Index market capitalization.
- Resource-dependent nature of economy reflected in Equity sector weightings:

Russia market capitalization weights by sector

Energy	49.1%
Financials	20.3%
Materials	17.9%
Communication Services	8.3%
Consumer Staples	3.0%
Utilities	0.7%
Consumer Discretionary	0.6%

## Post-Crimea sanctions had little long-term effect on the global markets<sup>5</sup>

Market reaction following 2/20/2014 start of Russia military operations against Crimea

	1 week	3 months	6 months	12 months
MSCI Russia Index	-1.5%	-0.6%	-4.5%	-30.1%
Russian Ruble (RUB)/US Dollar (USD)	-1.0%	3.2%	-1.4%	-42.4%
MSCI EM Index	-0.3%	8.0%	13.1%	2.7%
S&P 500 Index	0.9%	3.1%	8.4%	14.7%
EURO STOXX Index	0.7%	0.5%	-2.4%	11.7%

- Initial (one-week) reaction from risk-off beneficiaries: U.S. dollar trade-weighted index vs. major currencies (+0.6%), Yen trade-weighted index (+0.1%), Gold (+1.5%)

**Performance would differ if a different time period was displayed. Short-term performance shown to illustrate more recent trend. Performance during periods of exceptional market conditions should not be expected to be repeated in a normal market environment.**

## Could this time be different?

- With inflation already running hot in most major economies, we believe a Russian invasion of Ukraine would likely add to inflation pressures in Europe, the U.S. and globally, putting central banks on high alert. Higher energy prices act as a drain on global liquidity.
- Higher energy prices likely give Russia more of an opportunity to be bold, given that oil prices drive economywide revenues.

## What could be the possible market implications of a Russian/Ukrainian military action?<sup>6</sup>

### BULLISH

- Commodities: Oil and natural gas, but a supply response (for example, from Organization of the Petroleum Exporting Countries (OPEC) or U.S. Strategic Petroleum Reserves) could make a spike short-lived. Also bullish for natural gas alternatives (coal and nuclear), fertilizers, food.
- U.S. dollar.
- Defense stocks.

### BEARISH

- Russian and Ukrainian risk assets.
- European high-Russian-gas-dependent countries.
- European low-gas-storage countries.
- European energy-intensive industries.
- Energy-vulnerable EMs (Turkey, India).
- Food-vulnerable EMs.

<sup>4</sup> Sources: MSCI. Data as of December 31, 2021.

<sup>5</sup> Source: Bloomberg. Data as of January 24, 2022.

<sup>6</sup> Sources: Chief Investment Office; Signum Global Advisors LLC as of January 24, 2022.

**Past performance is no guarantee of future results. Please refer to index definitions at the end of this report.**

## Glossary of Terms

**Tactical allocation** is a dynamic investment strategy that actively adjusts a portfolio's asset allocation.

**Purchasing Power Parity (PPP)** is an economic theory that compares different the currencies of different countries through a basket of goods approach.

**Dollar trade-weighted** is an index created by the Fed to measure the value of the USD, based on its competitiveness versus trading partners.

## Index Definitions

**Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index.**

**EURO STOXX Index** is a stock index of Eurozone stocks designed by STOXX, an index provider owned by Deutsche Börse Group.

**MSCI Emerging Market (EM) Index** is used to measure the financial performance of companies in fast-growing economies around the world.

**MSCI Russia Index** is designed to measure the performance of the large and mid cap segments of the Russian market.

**S&P 500 Index** is a, widely regarded as the best single gauge of the U.S. equities market, includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

**U.S. dollar trade-weighted index** is an index created by the Fed to measure the value of the USD, based on its competitiveness versus trading partners.

**Yen trade-weighted index** is calculated using the weighted geometric average of the yen's exchange rates against 15 major currencies.

## Important Disclosures

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

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