CIO NOTE
01.03.2022

In light of events in Ukraine, please find here a brief note from The Investment Desk

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WHAT HAS HAPPENED?

Vladimir Putin has begun a full-scale military invasion of Ukraine.

WHAT HAS BEEN THE IMMEDIATE MARKET IMPACT?

- Oil prices rose above $100 per barrel, having started February at less than $90 per barrel:
  - If situation continues to deteriorate we could see Brent closer to 120 USD, at which point we would expect a coordinated intervention by global suppliers
- Russian Equity market down -42% YTD (As at 24 February - trading in Moscow has since been suspended)
- Losses across all global equity markets in February:
  - Euro Stoxx 50: -7%
  - FTSE100: -1%
  - S&P 500: -3%
  - NASDAQ: -4%
- Lower Government yields:
  - 10-year US Treasuries fell 0.16% to 1.83%
- Gold Higher:
  - The price of gold rose by more than 6% in February (+8% this tear)
- FX:
  - Russian Rouble trading almost 30% lower (trading at a record low ever vs USD)
  - EUR and GBP fell a bit against USD (not big moves)

WHAT ARE MAIN MACRO IMPLICATIONS?

- Inflation will be pushed higher by the shock to gas and energy prices
- This will have a negative impact on consumers as real incomes will be hit (lower purchasing power)
- This will have a cost impact on businesses that are structurally reliant on commodity prices. Pricing power will be key to deal with this
- Central Banks have a lot of experience (now) and tools to deal with exogenous shocks like this. They will be monitoring closely and if the situation deteriorates they will slow down the pace of tightening

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WHAT IS THE FIXED INCOME IMPACT AND OUTLOOK?

- Flight to quality ongoing: major sovereign yields dropping by 7-10 bps
- Credit markets operating efficiently
- The underlying theme of Central Banks withdrawing ultra-loose policy remains the main driving force for markets
- Europe at the epi-centre could result in a more cautious stance by the ECB. We have already seen rate expectations being curtailed somewhat
- Heightened market volatility may well impact credit spreads further but this will pass as companies and banks are in good health. Our 3 key indicators remain unaffected:
  - Low refinancing risks
  - High liquidity levels
  - Low leverage or deleveraging

WHAT IS EQUITY IMPACT AND OUTLOOK?

- Ultimately we need to assess the impact of a shock like this on equity earnings
- No change in our equity view despite the military escalation which was somewhat inevitable
- History suggest that these investor fears will pass as the fundamental impact to earning will likely be limited. Markets should recover as a result.

Please note, the table below is based on all available DJIA back to 1986

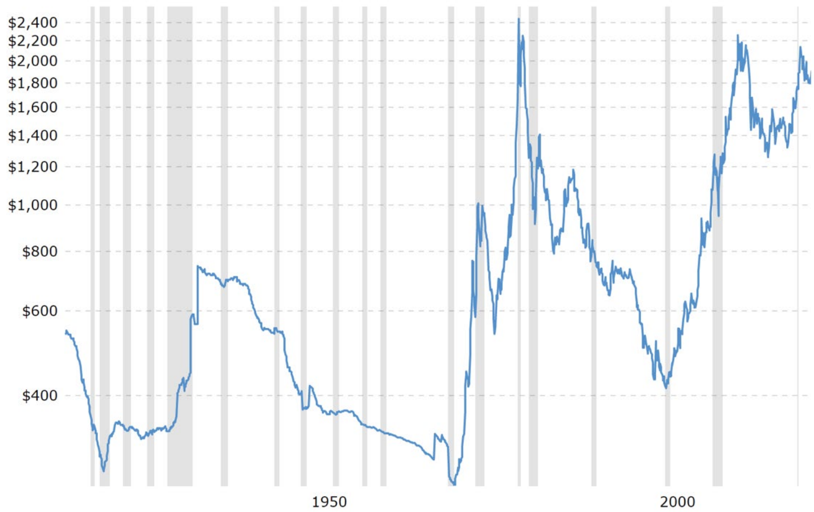
DJIA After Closing in Correction Territory							
DJIA	One Week	Two Weeks	Three Weeks	One Month	Three Months	Six Months	One Year
Average	2.7%	2.7%	2.8%	3.3%	4.5%	5.2%	8.7%
Median	0.7%	0.6%	1.2%	1.0%	1.2%	4.0%	6.6%
% Positive	57.8%	56.3%	56.3%	57.8%	52.6%	58.5%	62.2%
Source: Dow Jones Market Data							

SOURCE: DOW JONES MARKET DATA

WHAT IS IMPACT ON PORTFOLIO DIVERSIFIERS LIKE GOLD?

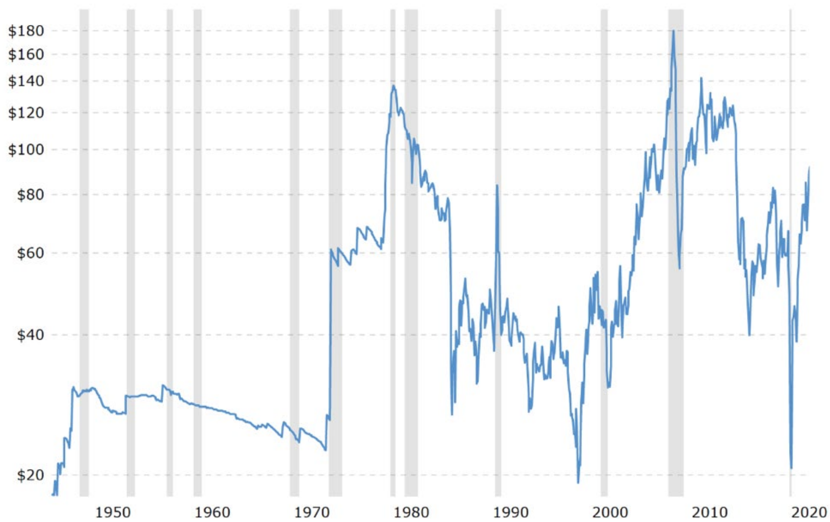
- Gold is up circa 6% YTD in a year when interest rates are rising and expected to keep rising. A possible way to reconcile this goes back to the size of the stimulus that has been provided: The US fiscal response to COVID from 2020 to 2021 approximated 27%, and monetary-policy response saw Fed's balance sheet double to $8.9 trillion, or 36% of GDP. Can all this support be taken away without dramatically slowing down economy?
- This is where the price of gold provides important clues. It is a prescient indicator of reflation or deflation and it tends to move in advance of policymakers.
- Gold should continue to do well and prove itself as a good diversifier to risk within portfolios. Medium/longer term investment thesis remains intact (currency devaluations / store of value / diversifier).
- As a "War Hedge", Oil can also be effective, but overall we prefer Gold as a risk off diversifier as it also has medium term benefits (devaluation currencies, store of value etc.)
- The longer term price charts show this:
  - Gold (bottom right to top left) as the gold price rising over time.
  - Oil just mean reverts, spikes and collapses around a longer term average.

GOLD



SOURCE: BLOOMBERG

OIL



SOURCE: BLOOMBERG

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WHAT IS FX IMPACT AND OUTLOOK?

- As you would expect the US Dollar has made gains following the most recent escalation, but up to now the spill over into major currencies has been quite limited. The DXY is only 0.5% higher over the week, suggesting currency market moves up to now have been driven just as much by position adjustment in favoured trades, as an outright flight to safety.
- USD should continue to benefit from the short-term flight to safety and the increased downside risks the Ukraine escalation poses to global economic momentum. Typically, the US Dollar outperforms when macro conviction is lower.
- Our medium-term view was already constructive on USD on the back of relative monetary policy divergence and the expectation of higher volatility this year.
- Where possible in USD base portfolios foreign currency had already been minimised, whereas in GBP and EUR base portfolios we had previously introduced higher allocations to the USD (leaving portfolios relatively well positioned).

ANY FINAL SUMMARY THOUGHTS?

- In shocks like this, one should always step back and reassess the credit impact on the companies we are lending money to (fixed income) and on the earnings of the names we own (equities).
- Opportunities will arise, but not a time to bottom fish as too much uncertainty.
- Treasuries have been a terrible “risk off” hedge since November. That should not last long.
- Bond market signals are consistent with our defensive, value, quality and large cap tilts (STAR).

PAU MORILLA GINER
Chief Investment Officer

“All successful long-term investors are continuously acting on a plan. All the failed investors I’ve ever encountered up close were continually reacting to current events”
Nick Murray

“In politics, the short term is crystal clear, and the long term is murky; in financial markets, the short term is murky, but the long term is crystal clear.
David Gergen