EDMOND DE ROTHSCHILD

All eyes on Ukraine

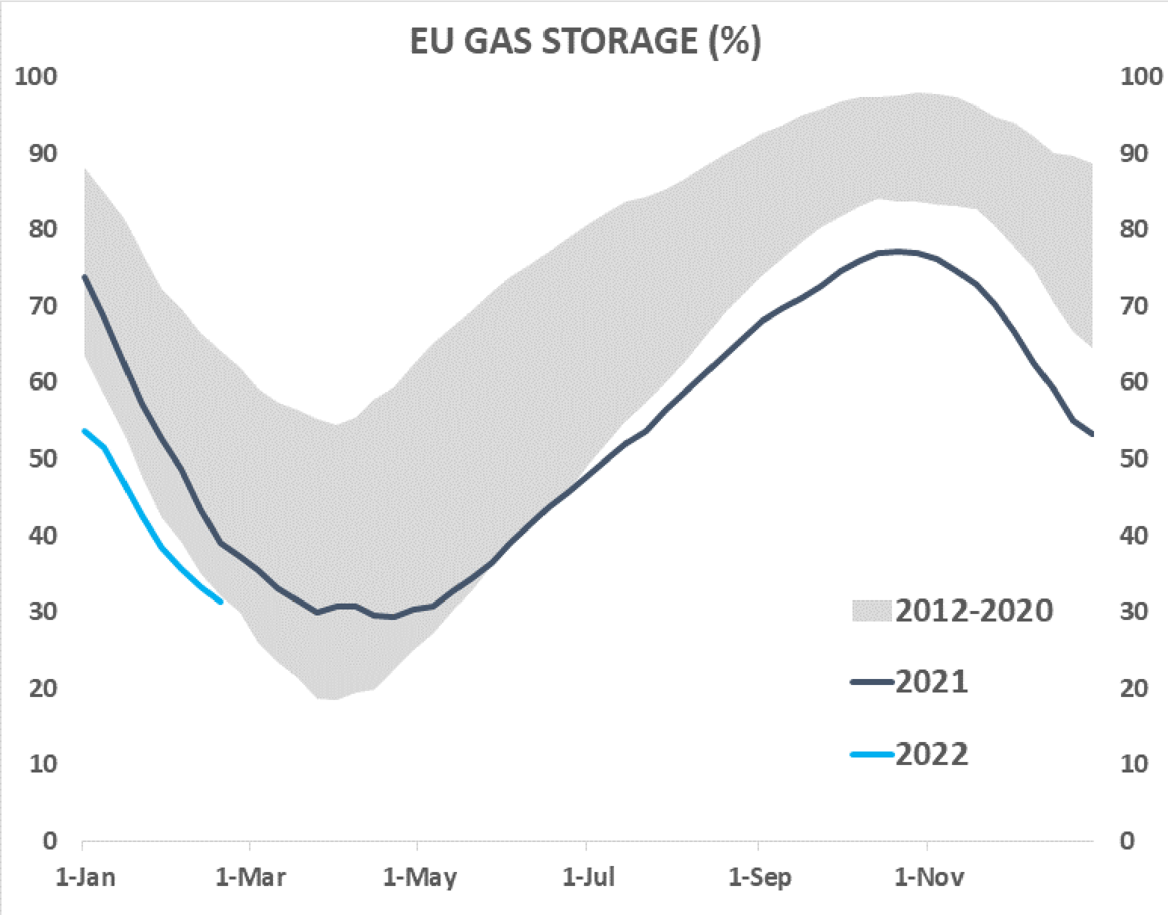
Russia's overnight invasion of Ukraine is the worst case scenario for the Ukrainian population and a massive jolt to the global, geopolitical picture. It is also a shock to investors who were slow to consider this eventuality as a stark probability.

Lots of questions are still unanswered, starting with Vladimir Putin's intentions. Is he looking for a guarantee that NATO will not admit Ukraine and for recognition that Crimea is now officially part of Russia? Is he trying to impose buffer zones for countries that are at Russia's mercy? Does he want to turn Ukraine into another Belarus or simply annex it? Does his ambitions go beyond Ukrainian territory?

It will take time before we have a clearer view and the situation looks like remaining highly uncertain.

Energy prices in question

Russia and Ukraine count among Europe's relatively modest trading partners but Germany and Italy import close to half of their gas from Russia. Energy prices had already surged even before the risk of a conflict emerged so the threat to trading between Europe and Russia is bad news for prices. Gas inventories are now generally low in Europe but the mild winter and the approach of spring should limit the risk of shortages in the near term. The problem will be rebuilding inventories ahead of next winter as Europe depends on Russia ; deliveries had already been reduced in 2020. A move to liquid gas could only be limited as there are not enough liquefaction and regasification terminals, leaving supply out of kilter with demand. We will have to find other energy sources and that presents another problem, especially if we are talking about coal. We would also have to consider energy saving measures.

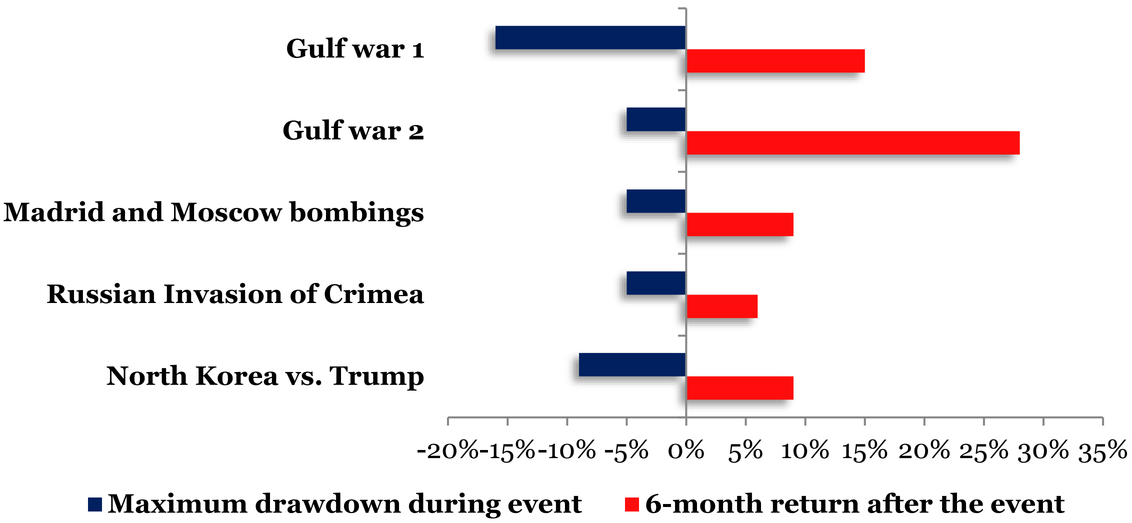


Source: Edmond de Rothschild Asset Management ; Bloomberg.

"Buy when the war starts"??

At the time of writing, market reactions to the invasion are moderate. European markets were down around 3% and futures indicated a 2% drop for the S&P 500 and a reasonable widening in credit spreads[1]. Historically, geopolitical crises are a good buying opportunity.

[1] The spread is the difference between the actuarial rate of return on a bond and the rate of return on a risk-free loan with the same maturity.



Source: Edmond de Rothschild Asset Management ; Bloomberg.

After all, we say "Buy when the war starts". But for a buying opportunity to arise, markets need to overreact and this is not yet the case. With inflation still rising amid an energy crisis and now this shock to investor confidence, we need to evaluate this crisis fully before gauging its impact on the outlook for growth. And we are still unsure if Europe will be able to secure energy supplies at the end of 2022. It is interesting to see the first indications from the ECB that it is monitoring the situation but the chances of central banks going back to reinjecting liquidity to shore up economies and markets are still remote.

We chose not to be overweight European markets pending better visibility on the Ukrainian situation, preferring Japan instead. Recent events have not provided any clarification on Russia's intentions or Europe's ability to ensure reasonable energy supplies. Nor have investor reactions been excessive. As a result, we have left our asset allocation unchanged but will continue to keep a close eye on developments.

Benjamin Melman, Global CIO Asset Management

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