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Market Insights

What Does the Ukraine Conflict Mean for Investments?

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I am not going to write a lot discussing the Ukraine-Russia conflict. First, I am not a military or geopolitical strategist; second, there is nothing I can write that would add any insight to the millions of words already written; and third, there are too many hypotheticals. So I will confine my comments to outlining the framework

(Alexey Nikolsky/AFP/Getty Images)

within which I am making investment decisions. It goes without saying that we are very saddened by the death, pain and destruction inflicted on the people of Ukraine, but I shall focus on investments.

While having a framework, it is also critical not to be too convinced of one's chosen scenario since no-one knows how this will play out, and the possibilities are quite divergent: Putin, having made his point, tries to negotiate a settlement; or he goes for broke with tactical nuclear weapons against Ukraine and even western countries supporting it; Russia is drawn into a long no-win Afghanistan situation; or he is overthrown in a coup. There are more possible outcomes, so one needs to be ready to change one's approach to changing conditions, while equally avoiding over-reacting to every slight shift in fortunes.

Markets fall: Many factors at work

Against the background of over-valued markets and rising interest rates, the Russian invasion has caused stocks to fall, but not in one cataclysmic drop. In fact, the markets have reacted to any developments, including rallying on potential positive news. Markets also reacted positively to Fed Chairman Jerome Powell last week making clear he was against anything more than 25 basis point increase in rates, at least initially. Any increase in rates now, with the U.S. consumer tapped out as inflation becomes entrenched, would be potentially damaging to the economy.


(The Great Dictator/Getty Images)

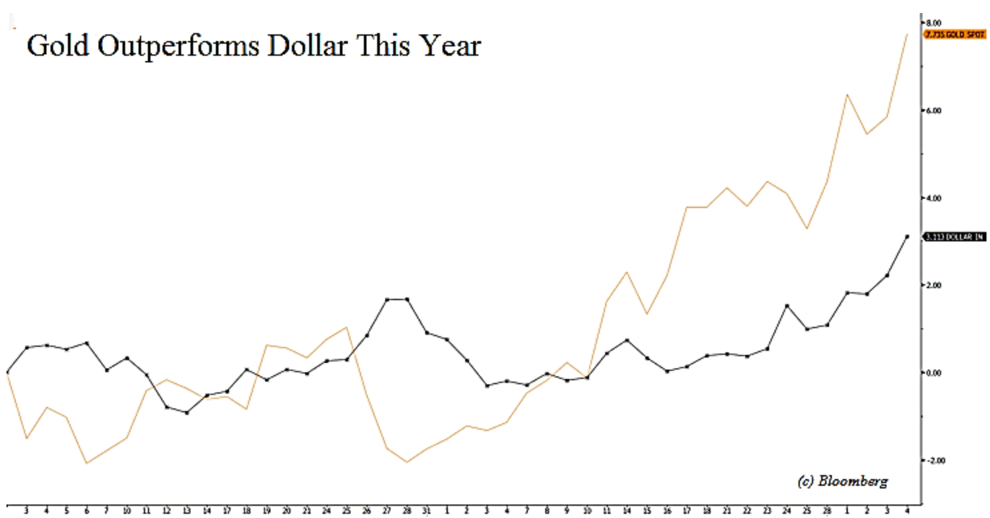
Which sectors and companies are most affected?

If the conflict is relatively contained, however, on balance I do not think stocks will collapse. Clearly, companies with specific exposure to Russia or Ukraine will see their stocks drop. The more general impact would come from a sharp rise in the price of oil, such as we have just seen, which not only boosts most cost inputs and hurts many sectors, but almost always leads to a recession. If the price of oil or other results of the conflict lead to economic contraction this would affect all companies to a greater or lesser extent.

Most commodity prices, including oil and palladium, have shot higher on expectations of reduced supplies from Russia; gold has moved up on geopolitical concerns. Against the background of nearly record lows in inventories across the board *before* the Ukraine situation, then these are logical moves but they are unlikely to be permanent. Russia's commodities will find an outlet, and so will not affect global supply by very much. If Russia's oil, for example, or palladium does not flow to the West, it will go somewhere, offsetting other supplies. The oil fields and palladium mines will likely not be destroyed. So the higher prices will be temporary.

Gold and the dollar

Similarly, gold's geopolitical premium will dissipate at some stage, sooner or later, and gold will move back to its longer-term trend line and trade on monetary factors. We have discussed these before and feel they are very bullish for gold, without additional geopolitical factors. We are likely to see higher prices continue; following another CPI high (7.9%), almost overlooked amid the war, higher oil and commodity prices will flow through the system to yet higher CPI numbers. For gold, there is a risk, though, that if the conflict continues for a long period, there may be some selling of gold from Russia and Ukraine to raise cash, offsetting only to some extent other factors (in my opinion).



More fundamentally, however, China and other countries might see the writing on the wall and decide to diversify their reserves away from reliance on the dollar and other paper currencies, given how easily the U.S. could freeze Russian assets. This might account for the less-than-robust response of the safe-haven dollar to events in Ukraine (less than two years ago at the onset of covid).

Again, this trend would revolve to the benefit of gold, being the only financial asset that is not someone else's liability and potentially outside the control of others.

The major potential for *destruction* of supply will likely be in Ukraine, a country which is a large exporter of wheat. Neighboring Belarus, which is also under sanctions, is the world's third largest producer of potash, after Russia. Russia Friday called for a halt on potash and fertilize exports. We have exposure to companies that will benefit from disruptions in the potash market, which was strong anyway.

This too shall pass

We know that the price spikes because of the war will not be permanent, so the puzzle for investors is to try to determine which supply shortages are likely to be very temporary or more long-lasting; and which commodities have strong fundamentals regardless. We do not want to miss the opportunity to take at least some profits from sharp price spikes which are likely temporary.

The gold and silver miners have benefitted from the higher prices, more so the majors than the intermediates and juniors, which remain undervalued. We are not aggressive selling gold and silver stocks that have rallied, though again there may be opportunities to exit some stocks; a little profit taking would be prudent.

Very little is undervalued now

About the only assets fundamentally undervalued right now, apart from smaller gold and silver miners, would be Russian stocks and bonds. Apart from the moral dimension, it is impossible to buy most of the individual stocks or mutual funds right now, in Moscow, London, or on the OTC where trading in most stocks has been halted.

The situation could definitely be prolonged and worsen, and with most assets fundamentally overvalued (global markets), or having experienced a strong move recently (resource markets), risk-aversion would not be a bad place to start a review of holdings. Foregoing a gain is not nearly as painful as experiencing a loss, particularly if that loss if broad and deep.

President & CEO

If you are interested in discussing the possibility of a managed account, please contact our office. It would be our pleasure to serve your investment needs.