February 25, 2022

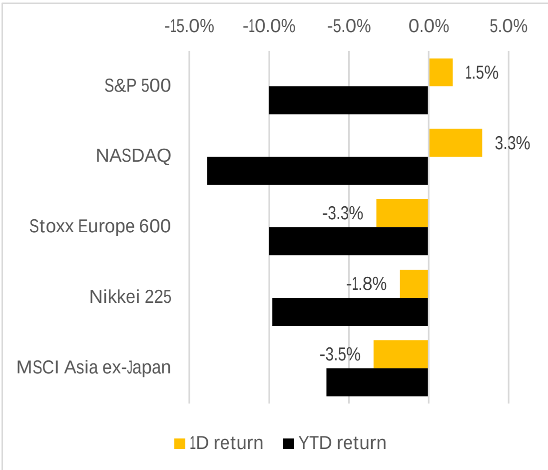
Russia-Ukraine conflict

Escalating geopolitical tensions

On 24th Feburary, Russian President Vladimir Putin ordered an attack on Ukraine, declaring the beginning of a "special military operation" aimed at the "demilitarisation and denazification of Ukraine". Explosions were reported in multiple cities within Ukraine including Kyiv, Odessa, Kharkiv and Mariupol. The attack came days after Putin recognised two pro-Russian, breakaway regions in eastern Ukraine (i.e. Donetsk and Luhansk or collectively known as Donbas) as independent and ordered Russian troops into the region on a "peacekeeping mission".

The escalation of geopolitical tensions has led to increased volatility in risk assets. Following the news, the Stoxx Europe 600, the Nikkei 225 and the MSCI All-Country Asia ex-Japan retreated 3.3%, 1.8% and 3.5%, respectively. The S&P 500 also dipped as much as 2.6% before closing 1.5% higher. In contrast, oil prices moved higher with Brent crude surpassing the USD 100/barrel mark at one point. Gold also initially gained as investors piled into safe-haven assets but lost most of the ground later in the day.

Figure 1: Performance of selected equity market indices



Source: Bloomberg | 24 February 2022

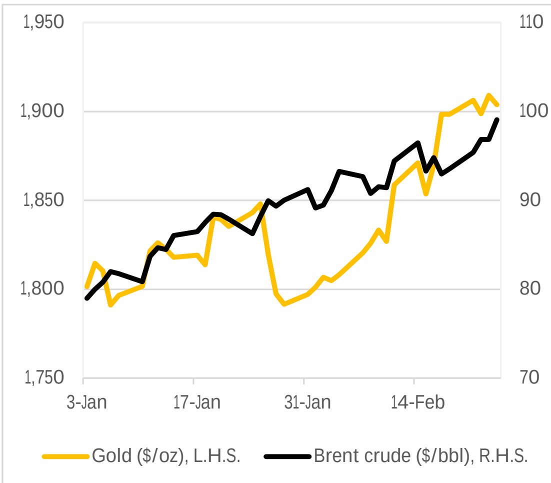
What could happen next?

The officials from the U.S., Europe and Ukraine have condemned the attack. In particular, Ukraine's Foreign Minister Dmytro Kuleba has called for "heavy sanctions" on Russia, more weapons as well as financial and humanitarian assistance from the Western countries. Notably, the U.S. and Europe have already imposed a set on punitive measures on Russian individuals, financial institutions and sovereign debt. Germany has also announced it was halting its approval for the Nord Stream 2 gas pipeline, which was designed to transport gas from Russia to Germany and the rest of Europe. More sanctions will likely be imposed on Russia after the latest military move.

While the Western nations have supported Ukraine with financial aid and military hardware, it is unlikely they will retaliate directly against Russia with military means given the potentially high economic and political costs. Notably, Ukraine is not a member of the NATO – the military alliance formed of Northern American and European nations – so NATO is not bound to defend it.

Separately, Russia may stand down if it is satisfied that its objective is achieved, which many believe is to isolate Ukraine from NATO's expansion. This could involve a change in Ukraine's

Figure 2: Oil and Gold prices have moved higher year-to-date



Source: Bloomberg | 24 February 2022

political leadership, leading to a pro-Russia regime in Kyiv.

Impact of geopolitical events tends not to last

The escalating geopolitical tensions will likely impact financial assets and commodities in the near term. Russia and Ukraine have a high share of global commodities production, in particular palladium, corn, wheat, oil and gas. Notably, Russia is the third largest crude oil producer and any disruption in Russian oil supply would lead to higher oil prices and add to the current inflationary pressures.

Given the current uncertainties, global equities could remain volatile and dip by another 5-7% should the conflict escalate even further. From an economic perspective, Europe is more vulnerable relative to global peers given the closer ties with Russia and higher dependence on oil and gas imports. Notably, selected European banks in Austria, France and Italy are more exposed to Russia. Certain Asian economies such as Thailand, South Korea and India are also more vulnerable as their current account balances could worsen due to higher crude oil prices.

Having said that, the current crisis has yet to derail the global economic recovery. While the overall situation remains fluid, markets could recoup the losses very quickly once the tensions dissipate. Notably, previous episodes of geopolitical events rarely have a lasting impact on the economy and markets as long as the military conflicts remain relatively localised. The reverse will likely happen to the safe-haven assets including U.S. Treasuries and Gold, as well as Oil. Prices could go higher for now but retreat once there is a de-escalation of the situation.

However, should there be a large-scale military conflict that extends beyond Ukraine over a protracted period of time, the negative impact could be more severe. Global equities could tumble more than 10% from current levels with economic growth and corporate earnings being more significantly affected. Nevertheless, this remains a low probability event, in our view. We continue to maintain the base case that a negotiated resolution is still the preferred option for the parties involved to minimise economic and political costs.

Investment implications

Despite the near-term uncertainties, we continue to see reasonably attractive risk-reward in equities as returns will likely remain supported in the medium-term by above-trend economic growth and robust corporate earnings. Having said that, investors may want to phase-in their equity investments as markets may remain volatile until we get more clarity on the Russia-Ukraine situation, as well as normalisation of monetary policies.

In addition, we retain our preference for selected Asian markets including China and Singapore, which are still trading at undemanding valuations, and their economies are relatively

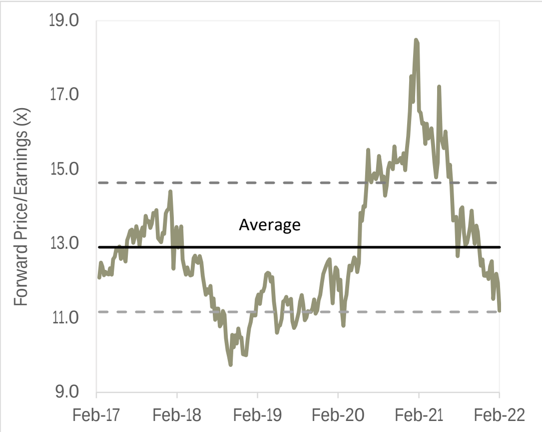
Figure 3: Past episodes of military conflicts tended to have a short-lived market impact

Date	Conflict	+1W	+1M	+3M	+12M
02-Aug-90	Gulf War	-4.7%	-8.9%	-12.8%	12.8%
07-Oct-01	Afghan War*	1.9%	3.0%	9.8%	-24.2%
20-Mar-03	Iraq war	-0.5%	2.4%	14.3%	29.2%
17-Dec-10	Arab Spring	1.2%	4.2%	1.6%	0.2%
23-Feb-14	Crimea Annexation	1.6%	0.5%	3.5%	16.8%
S&P 500 (Average returns)		**-0.1%**	**0.2%**	**3.3%**	**7.0%**

*Note: Afghanistan War coincided with the bursting of the technology bubble in 2000 and the economic downturn thereafter.

Source: Bloomberg | 24 February 2022

Figure 4: MSCI China is trading below historical average valuation



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more shielded from the Russia-Ukraine situation. Investors may also wish to increase the quality of their portfolio by switching to companies with stronger pricing power and/or balance sheet that can better cope with the rising costs and interests.

Beyond equities, investors should have exposure in other asset classes including Fixed income and Gold. In addition, we suggest investors to maintain a cash buffer and ensure the portfolio is not over-leveraged to mitigate the downside risks. Notably, safe-haven currencies such as JPY and CHF could do better should the risk-off situation intensifies. By maintaining a diversified portfolio, it would help investors better mitigate the current uncertainties in order to achieve more resilient investment returns.

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