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What does the Ukraine crisis mean for investors?

22 February 2022

As the conflict between Russia and Ukraine intensifies, Guy Foster, our Chief Strategist, explains why investors should hold their nerve despite heightened stock market volatility.

Escalating tensions between Russia and Ukraine are weighing on already jumpy global stock markets. News of sanctions and fears of a full-blown invasion are, understandably, causing concern among investors. But while we are likely to see volatility in the short term, we believe the outlook for equities remains positive, and that it is important for investors to maintain a long-term view.

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Do geopolitical tensions affect stocks generally?

Events on the Eastern border of Ukraine have been taking a worrying turn for several weeks. In fact, those weeks have seen an escalation of tension that has been simmering for more than eight years. In 2014, the ousting of pro-Russian Ukrainian President Viktor Yanukovych triggered a political crisis in the region. The first action was Russia's invasion and subsequent annexation of the Crimean Peninsula from Ukraine in February to March 2014. Global equities barely changed in response, while Ukrainian stocks actually rose.

A rise in stocks can seem puzzling given the anxiety that geopolitical tensions trigger, but it reflects the fact that investing is rarely intuitive. Stock markets don't just react to news; they try to anticipate it, and are often juggling multiple possible considerations. This can lead to a rather curious phenomenon in which stock markets perform well at seemingly the most inappropriate times. Global stocks lurched higher during the combat phase of both the first and second Gulf Wars. UK stocks performed well during the Falklands War. During the 13 days of the Cuban Missile Crisis, when the world came closest to the widespread deployment of weapons of mass destruction, stocks hardly moved.

The phrase that is often used to encapsulate this surprising behaviour is 'buy on the sounds of gunfire' and is often attributed to Nathan Rothschild. It describes how the onset of hostilities often provides an opportunity to buy at a time when uncertainty is at its highest and stocks are reflecting that anxiety. From that moment onwards, much-needed clarity tends to emerge.

What impact is the Ukraine crisis having on financial markets?

How do these observations relate to the current investment environment? Russia's actions are disturbing, and it is disappointing that no de-escalation has been brokered. The potential for tensions to intensify has been a factor in the recent weak performance from major Western stock markets. The larger factor, however, has been the increase in inflation and, in fact, high inflation and Russian aggression are not wholly independent of each other. The potential for a dispute with Russia to interrupt energy supplies has been reflected in the prices of energy commodities, which themselves drive inflation. And because inflation is generally high in Europe, it is likely that President Vladimir Putin believes this will reduce European governments' willingness to retaliate with firm sanctions or otherwise – in other words, they wish to avoid compounding their inflationary problems. That perceived reluctance is probably emboldening the Russian president.

What is the longer-term outlook?

With the response from European and US governments unclear at the moment, there is certainly scope for anxiety to grow. Oil prices have been rising sharply in recent weeks in anticipation of potential military action. Nobody can be sure how far Russia wants to push this current situation and that uncertainty complicates investment strategy. However, experience has shown that disinvesting at times when investor sentiment is already weak, as it is right now, is unwise.

The fact that equities have only recently slipped back from all-time highs is further evidence of stock markets' ability to overcome episodes of stress and anxiety, more than recouping short-term losses. Moreover, the economic growth environment for 2022 remains positive, driven by increasing economic activity and strong jobs growth, particularly in the US. A further increase in the oil price should not to be enough to offset that strength.

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Stock market volatility will remain, but beyond that the outlook for stocks is positive. High inflation and low interest rates mean stocks currently represent the most attractive option for investors looking to grow the real value of their savings over the long term.

Guy Foster, Chief Strategist

Guy leads Brewin Dolphin's Investment Solutions team working to align our investment capabilities with the needs of clients. He also provides recommendations on tactical investment strategy to our investment managers and strategic recommendations to the group's Asset Allocation Committee. Guy has a Masters in Finance from London Business School. He is also a CFA charterholder, holds the CISI Diploma, and is a member of the Society of Business Economists. He frequently discusses financial issues with the written and televised media as well as presenting to the staff and clients of Brewin Dolphin.

BDM3655 01/22