Markets Memo

February 2022

Octavia Wealth Advisors Perspective: Russian Invasion of Ukraine

Tensions between Russia and Ukraine, which have been rising for years, came to a head this week. The Russian military operation against Ukraine is causing concerns about the potential impact on markets and the global economy. Below we offer our financial perspective on the Russia-Ukraine conflict, and hope for a swift and peaceful resolution to the crisis.

SUMMARY OF EVENTS

Following weeks of troop movements and political tensions, Russia has realized the worst fears of much of the world with a full-scale invasion of Ukraine. Beginning late at night on February 23, Russian forces launched a series of coordinated attacks on military targets, airports, and other infrastructure across Ukraine.

Russia's reasoning for the attack, as stated by President Putin, was to protect and support Russian citizens in the separatist Ukrainian territories of Donetsk and Luhansk, which declared independence from Ukraine in 2014 and over which Russia has sought control.[1] Western governments have indicated that the invasion is likely also about seeking control over Ukraine as it seeks to join both the North Atlantic Treaty Organization (NATO) and the European Union, which would strengthen its ties to Europe while distancing it from Russian influence.

The United States and its NATO allies are expected to react aggressively while trying to avoid provoking an all-out war. Dozens of nations have imposed strict sanctions on Russian financial institutions, exports, and heads of government, with the goal of preventing Russia's ability to finance a war. NATO has also shifted military assets, including U.S. troops and aircraft, into NATO countries that border Ukraine, including Poland and the Baltic states.

IMPACT ON FINANCIAL MARKETS

The global reaction to the invasion has been a flight from risk assets to safety. Equity markets tumbled across the globe while bond markets rallied. Gold leapt more than 3% in U.S. markets to nearly $2,000 an ounce. The U.S. dollar, which is often treated as a safe haven relative to other global currencies, gained as well.

Oil and natural gas prices surged, with crude oil briefly reaching $100 a barrel based on threats of reduced energy supplies in an already-tight market. Russia is the third largest oil producer in the world, and the largest supplier to many European nations. Other commodities produced in Russia, such as aluminum and wheat, also saw substantial price increases.

WHAT'S THE NEAR-TERM IMPACT ON YOUR PORTFOLIO?

We expect the near-term effects of the invasion to cause substantial volatility in portfolios, especially for investors with greater equity exposures. Equity markets were already under pressure from supply chain snarls, weak labor force participation, rampant inflation, and the threat of rising interest rates meant to help curb inflation. The S&P 500 entered a correction (10% drawdown from most recent high point) on Tuesday, and heightened volatility is expected in the near term.

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[1] Marc Champion, "Why Donetsk and Luhansk Matter to Putin and the West," *The Washington Post*, Feb. 24, 2022, https://www.washingtonpost.com/business/energy/why-donetsk-and-luhansk-matter-to-putin-and-the-west/2022/02/24/cc2cd1d2-955c-11ec-bb31-74fc06c0a3a5_story.html.

Bond markets are likely to be pulled in opposing directions, with buying pressures ramping up as investors seek safety from volatility while selling pressures remain due to impending interest rate hikes.

Over the longer term, however, we do not expect this particular event to have a substantial impact on the overall trend of financial markets. We had already entered 2022 prepared for greater volatility, and while this invasion represents a serious political concern and a tragic humanitarian crisis, we do not see it being so significant as to disrupt the expected trajectory of financial markets for years to come.

U.S. equity sell-offs following geopolitical conflicts tend to be short-lived, with a duration of around three weeks to reach a bottom and another three weeks to recover to prior levels.[2] In fact, the S&P 500 has been higher 12 months after a geopolitical shock event in 9 of the last 12 instances.[3] Those instances include Pearl Harbor, the Cuban missile crisis, and the beginnings of the Gulf War and the Iraq War. The three instances in which the index did not fully recover within one year coincided with economic recessions in 1957, 1974, and 2001.

HOW DOES THIS EFFECT OUR LONG-TERM PLANNING?

In the long term, this Russia-Ukraine conflict does not change our overall financial plan that we create together with you. There will always be investment risks that we encounter—geo-political crises being one of them. These events have occurred many times in the past, and history has shown that markets tend to rebound swiftly from the initial drop, presenting buying opportunities for long-term investors.

Please reach out to your Octavia wealth advisor if you have any questions about what this means for your portfolio. We are here to help you review your investment plan, make any adjustments, and navigate market volatility with confidence.

[2] "How will geopolitical tensions affect markets?", *Financial Times,* February 20, 2022, https://www.ft.com/content/6f198784-c938-4674-af6f-d760b18fcb2d.
[3] Brian Sozzi, "Russia-Ukraine Crisis: What happens to the stock market amid geopolitical shocks," *Yahoo News*, February 14, 2022, https://news.yahoo.com/russia-ukraine-crisis-what-happens-to-the-stock-market-amid-geopolitical-shocks-175610742.html.