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War in Europe

February 24, 2022 Market Update

AT A GLANCE

- After weeks of threatening troop buildup at the border, Russia finally made its first wide ranging assault on Ukraine last night...
- Russian President Putin is saying they are only targeting military installations and are seeking to “demilitarize” the country...
- US President Biden is conferring today with allies and has promised to announce further consequences on Russia for this incursion.

After weeks of threatening troop buildup at the border, Russia finally made its first wide-ranging assault on Ukraine last night attacking the country on four fronts. Russian President Vladimir Putin is saying they are only targeting military installations and are seeking to “demilitarize” the country although he did warn ominously about the consequences of foreign interference with the operation. U.S. President Joseph Biden is conferring today with allies and is promising to announce further consequences for Russia for this incursion.

While we are all admittedly reduced to speculation at this point, it appears Putin’s political goal is regime change in Ukraine. He is testing the will of the western allies to defend Ukrainian sovereignty. The U.S. has ruled out sending troop support, so the only possible response are economic sanctions. However, questions exist over whether the European allies would favor broader sanctions on Russian energy exports or any restrictions on financial flows both of which could prove too damaging to their own economies.

In a somewhat ironic twist, a muted response from the allies would likely favor the markets as it may allow energy prices to settle back with no likely supply disruptions. Heightened geopolitical risk may also provide the cover needed for the Fed to be more measured in implementing their monetary tightening program. Note that bond yields have declined over the last few days as a reminder of the role of core fixed income in helping to diversify portfolio risk.

We expect little impact on the U.S. economy unless greater escalation and resulting sanctions lead to an even greater spike in energy prices which would greatly hamper consumer spending. As of now, the risk of a near term U.S. recession remains rather low. The Biden agenda may have to pivot in the near term to prioritizing energy security allowing easier U.S. production. The European economy would be much more heavily affected with Germany being the most vulnerable due to its strong reliance on Russian natural gas.

While the situation remains very fluid as we await the response from the U.S. and its allies, the year-to-date market correction is exclusively driven by a contraction in valuation as current and expected earnings growth is comfortably positive. To the extent interest rates only increase gradually in this more uncertain environment, we can expect buyers will be drawn into the markets at what are now more attractive valuations.

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