Blackfinch Asset Management

# Russia-Ukraine Conflict Update

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The conflict in Ukraine has sadly yet to improve and the devastating impact continues to be felt across the world. As we are all too aware, the situation continues to be highly volatile with no immediate signs of de-escalation from Russia. We wanted to update our investors on portfolio movements and the prospects for financial markets from here, while also recognising the social impacts resulting from this terrible situation.

Investment markets are struggling to accurately price the risks and long-term consequences of Russia's actions and we are seeing large price swings in equity markets (sometimes in excess of 5%) in single trading sessions. At the time of writing, the oil price is soaring, sending negative shock waves through financial markets. From a portfolio management perspective, our investment portfolios are insulated – to a degree – from the equity market price moves due to the range of non-equity based assets we hold. Even so, our portfolios are not immune from equity market sell-offs, so we wanted to highlight the areas that are most negatively affecting portfolio performance in the short term.

Since Russia's invasion of Ukraine on 24th February, European equities have understandably suffered severely. European countries are particularly exposed to the risk of conflict, not least because of being situated so close to the conflict, but also because of the heavily reliance many European nations, particularly Italy and Germany, have on Russian energy imports. Instability over future energy supply, coupled with strongly rising energy prices coming off the back of the COVID-19 pandemic recovery has been the primary cause for the sharp increase in energy costs. Furthermore, escalating sanctions imposed by the West, and a deteriorating outlook for the Russian economy, leaves the reliability of energy supply under increased threat, compounding the issues further.

Away from Europe, Global Equities have also experienced a broader decline. Surging energy prices are doing nothing to ease global inflationary concerns, which were already troubling markets before the invasion. Moreover, rising energy costs threaten to put the brakes on global economic growth. The increasing levels of sanctions being placed on Russia are resulting in further notable pressures on global equity prices too. While the intention with sanctions is, of course, to inflict as much economic damage on Russia as possible, it is inevitable some of that damage will also affect other regions, countries and companies. This is certainly one of the dilemmas facing equity markets right now as investors attempt to accurately price in the medium to longer-term impact or opportunities these measures will create.

A further area of challenge within portfolios has been Emerging Market (EM) bonds. These assets tend to be linked more closely to the economic fortunes of EM economies and during periods of uncertainty, safe haven assets such as the US dollar (USD) appreciate in value. This isn't great news for several emerging economies, as it can increase the cost of their finance (as countries and companies issue debt in USD) and can also put pressure on EM central banks to hike their interest rates to protect the values of their currency (potentially stifling economic growth).

On a more positive note, amid the current market volatility our Alternatives funds, which include infrastructure and renewable energy assets, have been performing well. Renewable energy has seen increased investor interest as nations have stressed the need to invest heavily into this area to reduce over reliance on single nations such as Russia for significant quantities of their energy supplies. Infrastructure assets are also performing well due to their ability to keep generating cash through periods of economic and political unrest. As a reminder, many of these cash flows are linked to inflation, so are also seen as an attractive way to 'hedge out' inflation risk.

Elsewhere, developed nation government bonds and global corporate bonds with strong credit ratings have also been performing relatively well in the portfolios. Such assets can often act as another safe haven for investors seeking shelter from equity market volatility and this time is no different. The prospect of stable interest payments from financially-sound counterparties makes the returns of these assets slightly more predictable. This means investors are willing to take a lower rate of return to compensate them for the reduced financial risk.

Our multi-asset portfolios are designed to respond to market volatility in ways that will shield investors from the worst of any major bouts of selling in specific asset classes. As previously touched on, funds in our Alternatives portfolio have different characteristics to traditional asset classes, such as equities and bonds, which means they perform differently. Owning investments that are uncorrelated to other asset classes can help limit the 'downside' moves experienced by multi-asset portfolios during times like this.

It is worth highlighting that we do not invest directly in commodities, as we view these assets as highly cyclical and volatile, as illustrated by the recent oil and gold price action. However, investors should note that many of the investments within our funds are held in companies that are benefiting from higher commodity prices, which will feed through to portfolio returns over time. As always, we will keep you updated and informed of any portfolio action taken during this difficult time and above all else, we hope for a swift and safe resolution to this crisis.