Key Event Updates
February 2022

Russia Invasion of Ukraine – Event Update

- On 24th February,_Russian President Vladimir Putin announced a military operation in Ukraine to defend separatists in the Donbas region. Russia called on Ukrainian soldiers to lay down their arms and justified the invasion by claiming a "genocide" in east Ukraine. In response, US President Biden warned of "consequences" for Russia and said the world would "hold Russia accountable" for its actions. NATO's chief has also condemned Russia's "reckless and unprovoked attack" on Ukraine.

- Europe is expected to be directly impact imports/exports between Europe and Russia if the sanctions take effect. Russia accounts for 46% of its solid fuels, 26% of its crude oil and 38% of its gas needs. Russia was also the 5th largest trading partner for EU in 2020. Asian economies are largely net oil importers hence rising oil prices would be negative.

- Russia is a major producer in crude oil (10% of global production), gas (6% of global production) and in various commodities like platinum, gold, wheat, nickel, aluminium and coal. The possible impact would be higher commodity prices, especially energy prices, inducing inflationary pressure. Russia is also a major producer of potash—a compound used in fertilizer. Any cuts in potash supply would raise fertilizer costs for agriculture/plantation companies. Ukraine is a major producer of semiconductor process gases, such as neon, krypton and xenon. Any curtailment of supply may disrupt semiconductor production.

- The US treasuries have rallied by about 10bps as investor seek for safe haven on the day of the news, but they have also given up the gains just as quickly the day after. The fixed income market in Asia at present is more concerned with domestic factors than impact from the conflict, unless it expands beyond Ukraine and the European region.

- Historically, when Iraq invaded Kuwait on 2 August 1990, the invasion caused Brent crude oil to surge 77% and the S&P 500 index fell to a low of minus 15% over 70 days (10 October 1990). Oil prices then started to drop as oil production starts to come in while the index started to stage its recovery which picked up pace when the US-led coalition started its assault on Iraq troops. The S&P 500 rose by 25% by the time a ceasefire was called end February 1991. In another event, crude oil prices jumped on 43% between 8 November 2002 to 12 March 2003 when UN Security Council approved Iraq a "a final opportunity to comply with its disarmament obligations" which allowed US to invade Iraq on 20 March 2003. The S&P 500 fell 10% in the initial period but staged a multi years recovery even prior to the actual invasion.

Strategy

- Our strategy is premised on no physical confrontation between NATO and Russia and the global bodies would only impose sanctions against Russia. Despite the new uncertainties, central banks are likely to retain their stance to raise interest rates in view of existing inflationary pressures. However, should escalation of energy prices threaten economic growth, we may see the Fed dial down their hawkishness.

Equity

- Global equity markets were immediately sold down on the news, but many of them (excluding European markets) bounced back just as fast. A knee jerk reaction of any sell down may have provided selective opportunities to accumulate stocks on weakness as past experiences has showed that markets recover after the impact of the war is digested.

- We remain positive on the ASEAN and Malaysian markets and continue to maintain our current equity range. We have reduced our equity weights in the recent market run-ups and are now looking add weights in reopening plays like banks and consumer stocks in addition to selected commodity stocks on price weakness. On the other hand, we are more cautious with the European markets due to the potential direct impact. Nevertheless, the event is developing and we are monitoring them closely.

Fixed Income

- The conflict is expected to be confined to Europe and is not likely to derail the economic recovery in Asia or globally ex-Europe. We expect interest rates to still rise but the US Federal Reserve may tread more carefully on the quantum. Inflation may stay relatively high globally as crude oil prices spike.

- Overall, we still retaining our core strategy which remain constructive on the 5-to-10-year yield curve as sufficient rate hike buffer has already priced in. We are still constructive on corporate bonds in Malaysia as they do not have significant exposure to the conflict regions. The geopolitical tension has a direct impact on commodity prices (oil and natural gas) and this could benefit Malaysia's fiscal balance as oil price was assumed to be $67/barrel (compared to $100/barrel now) in the Budget 2022. Higher sustained oil price should reduce fiscal deficit which is a plus point to the bond market.

- Also, should the tension escalate to threaten world growth/recovery, we may tactically allocate higher weight to government securities as central banks will likely keep policy rates low for longer.

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