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Over the past fortnight we have seen the Russian invasion of Ukraine escalate to unexpected levels, where Russia is now at war with Ukraine and innocent civilians are being killed. This is heartbreaking to watch, especially as negotiated ceasefires are being reneged on. We think one of the main underestimations across the globe is the level to which Russia, or more specifically Putin, has been prepared to go.

In our last communication, we commented on how sanctions are typically a blunt tool for influencing behaviour as they take time to have an impact. What has been remarkable to witness is the unified response by America, Europe, the UK and parts of the rest of the world. We are seeing an unprecedented response, where the sanctions have been extensive. In addition, Germany has for the first time since World War II agreed to supply military arms to another country. This is a clear indication of how severe the situation has become.

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The sanctions

The list of sanctions is fluid but let us look at some of those that are already in place. On 25 February we knew that a sanction of SWIFT was being considered, and we have since seen Russian banks removed from the SWIFT messaging system. The end result of this is an increase in manual intervention for payments resulting in a delay of payments reaching Russia.

A measure not anticipated by the world is the freezing of Russia's central bank's assets, which has hampered Russia's ability to try insulate its currency from an aggressive devaluing.

Russian oligarchs have also not been spared, as the Russian elite are viewed as aiding Putin's war with Ukraine. Western governments have identified and imposed sanctions on these wealthy individuals, where their assets held in the US, UK, EU and Canada have been frozen. We expect the list of sanctioned individuals to continue to grow as more individuals are identified, thereby tightening the noose on Putin's financial flexibility. Trade of certain goods with Russia have been blocked, where any good that has a military use being limited in trade.

The most recent development where the US and UK has embargoed oil is a substantial escalation in the Western response. US leaders have repeatedly communicated that they will spare the US consumer as far as possible when implementing sanctions. This is evident by the sanction only coming into effect by the end of the year, thereby allowing American oil producers time to ramp up their output.

Russia has responded by banning trades by foreigners on their markets as well as any interest payments due to foreigners. Russia is also considering halting exports of fertilizers – given the large dominance of Russia and Ukraine in the fertilizer market, this is expected to negatively impact food production and prices.

What is particularly noteworthy is that the Western sanctions have no specified end, which potentially further enhances their effectiveness as the pain for Russia could far exceed their invasion of Ukraine. Even if Putin were to withdraw his troops from Ukraine, the world is unlikely to forgive and forget easily. As mentioned by a colleague, this could turn into Putin's worst own goal yet.

Markets response

Given the increased uncertainty, it is not surprising that volatility has increased rapidly. Markets are jittery as Putin's actions have exceeded many of our expectations. With every added sanction, there is a response by the opposite party(ies) – this is a tit for tat game with extremely high stakes. The risk is as the conflict escalates, an orderly exit seems less and less likely.

Markets remain an effective discounting mechanism, with the changing environment being priced into asset prices very efficiently. With the high oil prices (and commodities in general), inflation is expected to be higher than anticipated. This will curb growth, and the general global health has deteriorated.

What to do

In times of crisis, it is always important to go back to the basics and be governed by the advice and investment processes – these should be your guide during times of high uncertainty and low information.

There is currently a lot of emotion influencing markets. Markets across the globe (including the Russian market) appear to have been surprised by the invasion. A natural human response is to want to have no exposure, clearly to Russia, but possibly even to emerging markets in general. In times of risk there is no need for quick triggers, where investors should rather consider each allocation on its merits. Remaining diligent in making informed decisions will enable investors to avoid making emotional decisions (which can detrimentally impact their long-term investment outcomes).

At the same time, it is also important to recognize that things can potentially get worse. This risk was well summarized by one of our macro-economic research providers, TS Lombard, where they believe the severe Russian economic weakness and the botched invasion is likely to make President Putin more dangerous.

Fortunately, we get to close off this note with a glimmer of hope. Ukraine has indicated that they are open to Russia's demand of neutrality on Wednesday. We have seen markets bounce on this news, with the German DAX leading the pack up almost 8%. This doesn't necessarily indicate the beginning or end to anything but shows some positive sentiment. This news is very encouraging, as first and foremost we need a peaceful resolution for the citizens of Ukraine. That said, uncertainty remains high, and while we hope for a speedy resolution, this could still take some time and encounter a few detours enroute. As mentioned previously, we continue to monitor the crisis, as well as the secondary impacts across the globe.

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