CIO OFFICE MORNING MARKET WRAP – Tuesday March 1, 2022. ALSO AVAILABLE ON ALEXA

The month of February ended on a volatile note. Safe havens were sought after but damage on risk assets was limited. Monday's session ended with a modest -0.1% retreat for stocks in developed markets, and a slightly positive return in emerging regions. Safe bonds rallied sharply, with interest rates falling across the curve in a "bull steepening" pattern. The US 10-year treasury yield lost 14 basis points to close at 1.83%, while the 5 and 30 year maturities lost respectively 15 basis points to 1.72% and 11 basis points to 2.16%. The price of Brent crude oil gained 3% to close just below $101.

The war in Ukraine keeps center stage, and a simple reading from yesterday's market action for the big investment picture could be as follows: the energy market balance is threatened, economic growth should slow, but major stock markets look more or less priced for it. This is obviously just an instant picture, and we have no doubt that volatility will remain high, sustained by the military, diplomatic and economic developments of the crisis. Uncertainty is high and everywhere, including on the battlefield, but not in the fact that the Western sanctions against Russia have a considerable impact. At an institutional level, a growing number of countries are joining and enforcing sanctions, including some with a historically neutral position such as Switzerland or Sweden. Boris Johnson announced imminent further measures, and banned Russian ships from their ports. Japan decided to freeze the Russian central bank's assets. Canada plans to ban crude oil imports, and the UN General Assembly meeting on the crisis continues, in an unusually broad format to circumvent the veto power of Russia as a permanent member of the security council. At a corporate level, it's an exodus: after BP announcing yesterday that it would exit it's 20% stake in Rosneft, Shell follows with its joint-venture with Gazprom, and the list grows every hour, from GM and Harley Davidson halting deliveries to Disney pausing releases of new films. The pressure is mounting, especially on social media, on all global firms active in the country. On the diplomatic front, yesterday's negotiations between Russian and Ukrainian officials on the Belarus border ended with little progress, but both parties agreed to continue their talks. Ukraine demands an immediate withdrawal of troops while Russia wants the independence of the Eastern regions, claiming that the 2014 and 2015 Minsk agreements had never been respected and implemented. After Russia's central bank sharply raised interest rates to 20% yesterday, the government banned Russian residents from transferring hard currencies abroad. This may be one of the reasons why Bitcoin and several other crypto currencies rally, in an unusual disconnection with the overall risk appetite in conventional assets.

Markets may be quieter, but the crisis is far from being over. The invasion is aggressive, and so are the responses from governments and companies. They are making Russia a pariah state, which may be a dangerous game to play with one of the world's leading energy and military superpower. Russia is not North Korea. We keep on believing in a favorable scenario of de-escalation but the risks of a long war, or even of an outright escalation do not have a neglectable probability. Under our central scenario, global growth shouldn't be derailed. Both Russia and Ukraine are small economies and the financial systemic risk is contained, even if the exclusion of some banks from SWIFT will create turbulence. Both countries are however heavyweights on the commodity side, should it be energy or grains, and the impact of a war on consumer and business sentiment is obviously material. As a result, we expect global growth to be temporarily slowed, with rising inflation from higher energy prices and additional disruptions in global supply chains. According to our analysis, there is medium term upside potential on major stock markets under this scenario, which is why we bought at last week's trough and are now slightly overweight. Needless to say that we do not advise to invest in Russian assets, regardless of their extremely low valuation. They may anyway be kicked out of major investment benchmarks – another extreme measure. Whatever happens in the short term, long term consequences will be significant for the world order and the investment landscape, which may become more binary between the West and the East. We are in the middle, we hope for the best but will continue to closely watch the situation with a cold mind, which is not simple as the quality of information from both sides is low. The best possible news would of course be a ceasefire, and the worse would be an intensification of military power as well as a weaponization of energy supply from Russia which would take a major toll on Europe's economic outlook.

In other news, let's not forget that the virus situation has sharply improved in most of the world, except for some Asian areas such as Hong-Kong, which is considering a full lockdown. China's leading indicators were just out this morning and they were good. Both manufacturing and non manufacturing PMIs were above the median forecast in February, and both were slightly above the 50 level which marks the threshold between contraction and expansion. The nation set a lower than expected reference rate for the yuan, confirming a stance towards economic support from policymakers. Markets in Asia are relatively quiet as we write this morning. Stocks are overall well oriented, led by Japan gaining +1.4%, followed by Korea at +0.8% while China and Hong-Kong are close to unchanged. Government bonds give back some of their gains from yesterday, with the US 10 year hovering around 1.86%, and Gold is marginally down. Bitcoin continues to rally, now above $43,000 as the geopolitical crisis and its consequences in terms of capital constraints are of course beneficial to a decentralized, digital, and relatively anonymous store of value and mean of payment.

Today will be rich in terms of economic data, with PMI and ISM manufacturing indices for February being released for several major countries. The US ISM gauge is expected to reach 58, a very healthy level which would show an acceleration compared to the 57.6 of January, with a much improved virus situation as a backdrop. All eyes will of course remain on the war in Ukraine, its consequences and counter consequences, as well as how President Biden addresses the topic in his State of the Union speech today. The other elephant in the room is obviously the Fed, which will meet in two weeks to decide the first rate hike; in the meantime, Fed Chair Powell will testify to US Congress Wednesday and Thursday. The OPEC+ will also meet tomorrow. Stay safe.

MAURICE GRAVIER
Chief Investment Officer

Wealth Management
Emirates NBD

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