



## **CIO OFFICE MORNING MARKET WRAP – 2<sup>nd</sup> March, 2022. ALSO AVAILABLE ON ALEXA.**

The war in Ukraine intensifies, with reports of devastating fire, including the bombing of residential areas. More combat units from Russia and potentially Belarus are expected to reinforce the assault against major cities in particular. It is a human tragedy for Ukraine, and a challenge to the global economy. Financial markets thus saw rising risk aversion on Tuesday. Developed market stocks fell -1% on average with the US closing down -1.6% and Europe -2.3%. Interest rates were sharply down in a clear flight to safety. The US 10-year Treasury yield lost -10 basis points to 1.73%. The 5 and 30 year maturities lost respectively -12 basis points to 1.59% and -6 basis points to 2.10%. Gold was sought after, approaching the \$1950 mark. Oil prices kept on climbing, with the Brent crude barrel closing up 6%, above \$107, the highest in 8 years. This explains why stocks in our region keep on outperforming – and we are overweight there. The MSCI GCC is up +13% so far in 2022, and the Dubai DFM up +6% after a 1.3% gain yesterday. Major cryptocurrencies confirmed their decoupling from the overall risk sentiment: Bitcoin gained almost +20% since the invasion started. Cryptos may now be used for what they were designed for: a mean of payment and store of value independent from any centralized organization.

Economic data released yesterday confirmed that the global economy was accelerating before the war started. The US ISM manufacturing index came out at a very strong 58.6, above the median forecast of 58 and January's 57.6. The comparable flash PMI for the Eurozone was also good at 58.2, and so was the UK gauge at 58. These are strong numbers, but it was before. Looking forward, higher energy prices, sanctions, damaged sentiment and heightened uncertainty will take a toll on the outlook, especially for Europe – with accelerating inflation being the main transmission channel to weigh on growth. The US is certainly more immune, apart from the impact of higher energy prices, which should be dealt with thanks to robust balance sheets for consumers and corporates, as well as a strong job market. But let's face it: the outlook is clouded by the war, and the impact will only grow with the length and intensification of the crisis. Investment implications include primarily more volatility ahead, but we keep on thinking that under our central scenario of a de-escalation in the weeks to come, the sharp drop in equity multiples leaves some upside potential for the medium-term. This is why we went overweight on DM stocks last week. We do not expect this change to deliver in the short-term, which is more unpredictable than ever, but the entry point looked compelling to us. The key catalyst to change our view on the downside would be a dramatic escalation, should it be restrictions of energy deliveries from Russia to Europe or points of no return being reached on the battlefield.

Let's keep hope. Talks are not interrupted between Moscow and Kyiv, and they will resume tomorrow. Importantly, China is entering the diplomatic arena. China's foreign minister Wang Yi had a call with his Ukrainian counterpart and expressed a deep concern about the harm to civilians. State owned television channels talked about the conversation which raises the possibility of China to become a mediator in the war. This could be a game-changer as China is a trusted friend to Russia and its most important trading partner by far – even more so with the sanctions from the West. Officials from China have always been balanced about the Ukraine crisis, carefully avoiding to express an outright support, including their abstention to last week's UN Security Council vote.

Staying in Asia, markets there are reflecting the "risk-off" mood which hit the West yesterday. Most importantly, Brent oil touched \$110 a barrel, with a spike when President Biden, in his State of the Union speech, called President Putin a "dictator" – but there was nothing new on the topic in this speech, which was centred around domestic priorities. Asian stock indices are overall down, with Japan underperforming, down -1.8%, while China and Hong-Kong fall by -1%. Korea is modestly up. Interest rates are marginally higher, with the US 10-year at 1.75%. Cryptocurrencies are steady, and future contracts on Western stock indices are holding yesterday's cash closing levels.

Today, Fed Chair Powell will start his 2-day testimony to the US Congress. It is obviously important, as the war and the sanctions raise the risk of an economic slowdown but also of persistent inflation. Market participants will look for any hint on how the Fed will deal with such a dilemma. There may be none, as there are divergent views within the monetary policy committee itself. On a close topic, the OPEC+ will meet today and we will get the consumer price index for the Eurozone.

Stay safe.

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