CIO OFFICE MORNING MARKET WRAP – Monday February 28, 2022. ALSO AVAILABLE ON ALEXA

Russia shocked the world last week with a broadly unexpected full-scale invasion of Ukraine. Global markets had a sharp reaction, with the most significant being a surge in energy and commodity prices. All other asset classes were in the red over the week. Within emerging markets, stocks fell -4.8% while bonds lost -2%. Within developed markets, the MSCI World ended the week on a modest -0.1%, thanks to a sharp +3% rally on Friday led by Europe and the US. The entire fixed income asset class was in the red, and so were hedge funds. Volatility was extreme, with an initial shock followed by a sharp rebound in Western stocks in particular.

We said it repeatedly: 2022 should reward reactivity over proactivity, in a highly uncertain world with virtually no visibility, which is the title of our global investment outlook. Along those lines, our tactical asset allocation had pre-approved a couple of moves conditioned to market levels being reached. Earlier in February, we had reduced our underweight in government bonds from developed markets when the US 10-year Treasury yield surpassed the 2% level. Last week, we added to stocks from Developed Markets across profiles, as the S&P 500 fell way below the 4,300 threshold we had set. As a result, we added respectively 1%, 1.5% and 2% to DM stocks in our Cautious, Moderate and Aggressive allocations, funded by cash. This is actually slightly less than what we had sold earlier in January, at much higher prices, when we cut our large overweight to stocks to prepare to react to the “Year of low visibility”.

Coming back to Russia’s invasion of Ukraine. We are not geopolitical experts and can only hope for a quick resolution of the conflicts. With regards to investment consequences, we simplify our assessment of the short and medium term economic impact: it’s about energy. The supply disruption will raise inflation and slow growth from now on and into the next quarter. The longer term, if we exclude an outright world war, will also be about energy policies, especially for Europe, and a more polarized world between two blocks gravitating around two superpowers, the US on one hand and China on the other. The latest developments show no relief, with a sharp escalation in economic sanctions from the West. Apart from the now usual freezing of assets from oligarchs, two measures are of particular importance: some Russian banks are now excluded from the SWIFT international payment system, and the country’s central bank will be banned from transactions, in a move aiming at preventing them blunting sanctions by using their foreign reserves. These are very serious steps, and the Ruble sinks -30% this morning. Other measures from the West include providing weapons to Ukraine military as well as closing European airspace to Russian aircrafts and ban state-owned Russian media. The UN Security Council will hold an emergency session of the General Assembly today, which hadn’t happened in decades.

The situation is without a doubt terrible for the world and volatile for markets, especially after President Putin asked its nuclear forces to stand on higher alert, and as the financial consequences of seeing some Russian banks not being able to deal with their counterparts are unknown. But there are also sighs of hope. First, officials from Ukraine and Russia will hold talks at the Belarus border – both sides seem to have low expectations, but it’s a start. Second, China’s position looks ambiguous. Beijing abstained form a vote on a UN Security Council draft resolution condemning the invasion. This is not the outright support that a veto would have expressed. Finally, but crucially, the world needs oil and gas. Interestingly, Gasprom bank doesn’t seem to be on the list of the lenders excluded from SWIFT. Production from Iran could come back in the coming months, and the OPEC+ could decide to increase further the output, but there is no way Russian supply could be replaced in months. Indeed, energy supply was already struggling to meet demand before the invasion and the latest sanctions, which was certainly a key element in the decision of Russia. On one hand, the strength of the sanctions and the lack of support from China could push Russia to the negotiation table while on the other, the need for energy could help the

West looking for a compromise, especially as elections are happening in the coming months in the West, with voters being highly sensitive to inflation and energy prices in particular. Russia definitely looks unpredictable, however the multiple costs of occupying Ukraine seem way too stellar, which supports the idea of some de-escalation in the coming weeks.

From now on, we obviously expect considerable volatility ahead, around both military and diplomatic developments. However, if history is a guide, the crisis should de-escalate, and both the drag on global growth and the heightened risk premium could have been already reflected in stock prices, especially in the US. Even after going overweight there, our level of risk remains lower than most of our international competitors and so far we deliver on our objective to protect capital better in difficult times. We hope for the best but do not speculate on an imminent positive outcome: factually and fundamentally, apart from an Armageddon scenario, global growth should remain robust and provide positive expectable returns in the medium term.

As we write this morning, risk aversion is back on Asian markets. Regional stocks are falling rather than crashing, from -0.3% in Japan to -1.5% in Hong-Kong. However, future contracts on Western stock markets are deeply in the red, giving back a significant part of Friday's gains: contracts are down -2.5% on the S&P500 and -4% on the Eurostoxx 50. Oil prices are sharply up with the barrel of Brent trading up 4%, close to $102. Gold is above $1900, and the US 10-year Treasury yield is down 7 basis points to 1.89%.

The week ahead will of course be dominated by the developments of the war in Ukraine. President Biden will deliver his "State of the Union" speech on Tuesday, before Fed Chair Powell testifies to Congress the following two days. The OPEC+ will meet on Wednesday, and the week will end with the US monthly unemployment report. Stay safe.

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