GVC Gaesco Gestión

Invest in times of the Russian invasion of Ukraine

Russia's invasion of Ukraine began on February 24th and is undoubtedly generating a massive humanitarian drama. As far as the stock markets are concerned, from the day prior to that date, the North American Standard & Poors 500 index rose +0.87%, the Nikkei-225 Japanese has fallen by -6.3%, and the Eurostoxx-50, the most affected, has fallen by -11.8%. What should the investor do in this context?

I. In the first place, the investor must ask himself how the stock markets behave in the context of war.

The general rule of investment before wars is to buy just when they start, at first cannon shot. Of course, it is known that all wars have an end and that, once after the war, the only thing that remains are the prices at which the investor has been able to buy excellent companies. If a company was already good before, the only thing offered by the wars is the opportunity to buy them cheaper.

This general rule is based on experience. If we take into account what happened in 5 of the last great wars, the Vietnam War (1964), the Gulf War (1991), the War of Afghanistan (2001), the Iraq War (2003) and the Russian invasion of Crimea (2014), we obtain the following average profitability of that investor who invests just the first day that the fight begins:

1 month	2 months	3 months	4 months	5 months	6 months	9 months	12 months
+4.1%	+6.2%	+9.4%	+6.8%	+9.6%	+10.5%	+11.1%	+8.9%

This evolution is based on the evolution of the Standard & Poors 500. The strategy of buying as soon as the contest begins seems to be endorsed.

II. Secondly, the investor must ask himself about the particularities of this contest.

We like to have as much first-hand information as possible about all events. We intend to try to understand the motivations that may have led Putin to wage this war.

Certainly, the NATO issue is often cited as one of the main causes, according to the which Russia would not want to have a member of the Atlantic Alliance so close to its borders. According to this theory, the Russian bear would have been put so much between the ropes, that it would have given a claw. The theoretical cause of a certain longing on the part of Putin for the former Soviet Union.

However, our investigations lead us to a very different motivation. In recent years Ukraine had not only taken a clear stand for Westernization but had also gone well from 2015 to 2020 the GDP per capita in Ukraine had increased by 70%. During the same period in Russia rose only 6%. In other words, Ukraine, which does not have the level economy of the Russians, was prospering well. Where is the problem, if it turns out that other surrounding countries that have also looked to the

West have also prospered? The problem lies in the kinship relations between Russians and Ukrainians. It is estimated that up to a third of Russians have relatives in Ukraine. Some Ukrainian relatives letting the Russians know that they are prospering and that with the western turn it is good. Media may be censored communication and social networks in that part of the world, but not communication between family members. So, we understand that Putin is actually trying to save his worldview from him. Then it is a more defensive conflict than it may seem. If this is so the conflict is merely local, between Russia and Ukraine, and is not global, even though in the background everything may be Western values, and that the Western world should help Ukraine. This makes it easy to understand one of the issues that Putin most dislikes, which is the use of gas pipelines that pass through Ukrainian territory, which not only provide an income to Ukraine, but also give you additional advantages in your own gas consumption.

Additionally, although it is true that Russia is the largest country in the world, it is also true that it is only the twelfth world economy of the same magnitude as South Korea, whose territory is 170 times lower than the Russian. So the Russian-Ukrainian conflict cannot have the same effect as the which would have, for example, a supposed Chinese-Taiwanese conflict.

III. Thirdly, the investor must ask himself about the impact of the dispute on the price of the raw Materials.

Of course, the war generates tensions in those raw materials exported by Russia, in especially oil and gas, of which Europe in general, and Northern Europe in particular, has a great dependency. Their prices have risen sharply since the war began, for fear of restrictions either on the part of the seller or on the part of the buyer.

Additionally, there are other raw materials, of which Ukraine is an exporter, that can be affected and whose price has skyrocketed. Ukraine exports 16% of the world's corn, 12% of the world wheat, and 50% of world sunflower oil. If we add the Russian export to the Ukrainian these figures are 18%, 29% and 78% respectively. So, fearing for the supplies the prices of these raw materials, both in terms of their production and its distribution, have soared. Alternatives are sought that, in the case of corn, go through countries such as the United States or Brazil, and in the case of wheat by countries such as France or Romania.

In any case, greater upward pressure on the price of raw materials is to be expected. The CRB index, which reflects all commodities, was at the 400 level just before the virus, in February 2020, had risen to 606, just before the invasion, and is currently at 625. Raw materials have become 56% more expensive since, since before the virus, and the Russian war Ukrainian has given them an additional push.

IV. Fourth, the investor must ask himself about the impact of the increase in the price of the raw materials in the economy.

Unequivocally, it increases the already existing inflationary pressures. inflation rates were already fired before the conflict, with 7.5% from the United States, 5.1% from the Euro Zone, or 5.5% of the United Kingdom. They were also beginning to notice the second wave of the inflation, caused by services. The first wave of inflation was due to goods, and the second is probably led by the services, with covid restrictions that have the days are numbered, and a demand that will be released. There will be higher inflation and higher need to raise interest rates to tackle it, probably the most effective instrument that exist to curb inflation. The US FED has already declared that the war is not going to prevent raising interest rates, which is expected to start this very month of March. You there are seven Fed meetings left before the end of the year, and it could well raise rates all seven times in a row. With regard to the European Central Bank, which at last in February had shown itself willing to raising interest rates this year, now seems more likely to make further delays, which affects the rise of the dollar against the euro and has just made raw materials even more expensive for the euro zone. We expect the ECB to rectify and end up raising interest rates this year, at least twice.

The most important question is regarding whether the increase in the price of raw materials is going or not harm global economic growth. Let's see it in the case of the price of oil. The producing countries are satisfied with an oil price between 80 and 90 dollars per barrel. By On the one hand, it allows them to obtain important benefits, and on the other hand, it does not harm the world growth. According to our calculations, the price of oil starts to hurt internationally if exceeds 107 dollars per barrel. It has recently overcome them, but the important thing is not the punctual price but the average price. So far this year, the average price is $94 per barrel. Therefore, everything will depend on the duration of the high prices of the Brent.

Regarding the other raw materials mentioned, it will be very important to know, for example, in the case of corn and sunflower, if they are going to be able to be planted this year in Ukraine, which is happening between months of April and May, preferably.

V. Finally, the investor must decide.

In our case, the final investment decisions are both:

1) Take the opportunity to buy all possible companies while the contest lasts

2) Focus purchases on those sectors that are favored by the rise in interest rates.

Among them are, of course, sectors such as banking or insurance, and also cyclical sectors such as industrials or raw materials. The Tourism Sector deserves a special comment, probably one of the clearest today. It will benefit, in one side of the progressive decline in covid restrictions worldwide, and on the other hand, the strong consumer desire. The indications that we have for this coming summer, in in terms of bookings, purchase of slots at airports, etc., they are those of a 2022 euphoric summer.

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