WESTERN PACIFIC
WEALTH MANAGEMENT

Client Update
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War in Ukraine

On Thursday morning, Russia began a full-scale invasion of Ukraine. The invasion marks the largest military conflict in Europe since World War II. Initial reports indicate it was launched from both Russia and Belarus. The most likely (although far from certain) scenario appears to be that Russia will control the country within a few days. The invasion is a tragedy for the citizens of Ukraine and the region.

Global financial markets initially sold off on the news, before rallying later in the day. The invasion was widely expected, and markets had fallen substantially prior to the invasion.

Ukraine was once considered the breadbasket of Europe and remains an important agricultural producer. Overall, its economy is not huge; if Ukraine were a US state it would rank 35th in GDP, with an economy about the size of Nebraska. Its population of 45 million is roughly the same as California.

The geopolitical and military implications are profound. The Russian occupation will place Russian fighter jets, armor, artillery, and infantry troops much closer to the NATO military alliance. This invasion will require NATO to place additional troops in the area. The invasion will also disrupt global energy markets.

We don't have a crystal ball, but it seems unlikely that Russia will advance past Ukraine. The next group of countries to the west are all NATO members, and an attack on any of them would trigger an automatic, massive response from the West. That said, Russia's invasion has changed the dynamics of its relationship with its neighbors in ways that will reverberate through the region for years.

From an investment standpoint, there are some important considerations:

Energy prices have risen dramatically in recent weeks and are likely to remain high. The increase is not only due to the war but also a result of the continued economic recovery around the world as Covid cases slow. Rising energy prices will put increased pressure on inflation.

Emerging markets are helped by energy prices and high commodity prices generally. Indonesia, Malaysia, Mexico, Brazil, and others benefit from high oil prices. This could be a period where emerging markets start to outperform developed ones.

Inflation Rotation. In a previous letter we talked about how the causes of inflation had migrated from transitory ones last spring to supply chain related causes more recently. With the rise in energy and other commodities prices, inflation may have a new driver in 2022.

The Fed may be slower to raise rates during a geopolitical crisis, which could be a mild positive for equities. While the Fed looks to tighten this year, **China** is pursuing a stimulative monetary policy in 2022 which could lead to a rebound in its equity market. This will likely benefit the rest of the southeast Asian region as well.

As we've pointed out in previous letters, many asset classes have been in significant corrections since early 2021.

Growth stocks, especially the most speculative ones, are among the groups which have been declining. Many of them are down 50% or more from their peaks. Some of these are reaching pre pandemic levels and are becoming attractive again.

Phil Fisher (who along with Benjamin Graham were the two biggest influencers of Warren Buffett) wrote a book in 1958 called Common Stocks and Uncommon Profits. In chapters eight and nine he outlines several "Don'ts" for investors. One of them is "*Don't be afraid to buy on a war scare*." While this sounds counterintuitive, history has shown that financial markets tend to overreact to major news events such as the start of a war. In recent years, this was seen at the beginning of the wars in Iraq and Kuwait. In both cases markets fell in anticipation of the war and then rallied once the war started. Of course, the overall context of the market matters, and the valuation of the stock market remains relatively high which could make this time an exception. That said, it is times like this which can set up great buying opportunities for investors who are comfortable with volatility and have a long-term outlook.

Please feel free to call Roger or me if you would like to address this commentary or any market related topic.

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