Event update

Market impact - Russia's invasion of Ukraine

25 February 2022

Summary

Equity markets tend to overreact to adverse geopolitical events due to the uncertainty factor and fear of contagion risks.

Contagion effect from conflicts such as these, manifests itself through spike in commodity prices and not through economic or financial mode

Event brief

- Conflict between Russia and Ukraine has taken an ugly turn with Russia invading Ukraine and launching a multi-pronged attack in the territory.
- Russia has stated that it has formally recognized the independence of two regions in East Ukraine viz Donetsk and Lugansk.
- This meant that intense rounds of diplomacy and imposition of western sanctions has failed to deter Russian leadership to avoid a conflict.
- In response to Russia's military actions, Germany has halted the approval of the Nord Stream 2 pipeline, which was anticipated to be approved in CY2022 and ease tight gas markets in EU.
- UK and US have imposed certain financial sanctions and are in the process of rolling out further sanctions. Ministers in the EU have also approved financial sanctions to target the ability of Russia to access EU's capital and financial markets.

Impact on equity markets

Global equity markets and risk assets have turned extremely volatile and witnessed correction due to the uncertainty related to the extent of the conflict and fears of it turning into a full blown war. The volatility (since 11 Feb 2022) has accentuated after the invasion with key global indices seeing sharp correction on 24 Feb 2022. Commodity prices, especially global crude prices have spiked (Brent has crossed USD 100 / barrel first time since mid-2014) and will remain sensitive to the developments related to the conflict. US equity markets rebounded during intraday trade on 24 Feb 2022, as NATO has so far ruled out sending forces to Ukraine, thus opening up the possibility to avoid a full scale conflict in the region.

Indices	Since 11 Feb 2022	CYTD 2022	Indices	Since 11 Feb 2022	CYTD 2022
Domestic			International (in USD)		
S&P BSE Sensex	-6.2%	-6.4%	MSCI World	-4.4%	-10.1%
Nifty 50	-6.5%	-6.4%	Dow Jones	-4.4%	-8.6%
S&P BSE 200	-7.0%	-7.3%	S&P 500	-2.9%	-10.0%
S&P BSE 500	-7.5%	-8.0%	MSCI EM	-6.9%	-6.3%
S&P BSE Midcap	-8.2%	-10.9%	MSCI Europe	-8.7%	-11.2%
S&P BSE Smallcap	-11.5%	-13.8%	MSCI UK	-7.9%	3.3%
MSCI India INR	-6.7%	-7.8%	MSCI Japan	-5.5%	-7.9%
INR - USD	0.4%	1.8%	MSCI China	-7.5%	-7.1%
Crude Oil	4.9%	27.4%	MSCI Brazil	1.1%	16.3%

Source: Bloomberg, data as on 24 Feb 2022

HSBC Asset Management

Equity markets tend to overreact to adverse geopolitical events due to the uncertainty factor and fear of contagion risks. In this case, the situation may drag on and could be a source of negative headlines for some more time. That said, the **contagion effect from conflicts such as these, manifests itself through spike in commodity prices and not through economic or financial mode**. The region is one of the largest commodity exporters. Russia accounts for about 10% of global oil production, 41% of European gas imports, 15% of global coal producer and a major supplier of fertilizers, palladium, nickel, potash & aluminum as well as certain agricultural commodities (including wheat). So this conflict will have some impact on the already burning issue of global inflation and a lingering effect of the crisis, could push up the inflation further in the interim.
Predicting and assessing the impact of geopolitical events can be tricky, however history suggests that the impact of such events on equity markets have been temporary and with limited impact on growth. The following table shows the trend of how S&P 500 index behaved during periods of geopolitical crises, terrorist attacks etc.

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S&P 500 index performance	Date of Event	1 month^	6 month^
Iranian Gen killed in airstrike	3-Jan-20	2%	-3%
Saudi Armaco drone strike	12-Sep-19	1%	-2%
N. Korea Missile crisis	28-Jul-17	-1%	15%
Syria Bombing	7-Apr-17	2%	8%
Boston Marathon Bombing	15-Apr-13	7%	10%
London Subway Bombing	5-Jul-05	4%	6%
WTC attacks	10-Sep-01	-4%	3%
Iraq War 1	2-Aug-90	-9%	-5%
Reagan Shooting	30-Mar-81	-1%	-14%
Munich Olympics	5-Sep-72	-2%	3%
Six Day War	5-Jun-67	0%	5%

Source: Macquarie, ^ performance is taken from 10 days before event to 1month, 6 months after, absolute returns%

Closer home, the Nifty index has also behaved in a similar fashion to geopolitical risks, even including a conflict where India was involved (Kargil war).

	Nifty50 index Price Performance (%)		
Geopolitical events	**1 month (as on Event Date)**	**1 month later^**	**12 month later^**
World Trade Centre Bombing (26-Feb-93)	8%	-17%	61%
Kargil War (3-May-99)	-9%	16%	37%
9/11 (Sep-01)	-3%	-12%	-4%
Iraq War 2 (20-Mar-03)	-3%	-8%	68%
Average	**-2%**	**-5%**	**41%**

Source: DAM Capital Research, Absolute returns%, ^1 month / 12 months later from the Geopolitical event date

Investment view and Portfolio action

In the near term, the market may remain focused on the risks emanating from the conflict. **However, as we have seen historically, regional conflicts have had little lasting impact on global growth, suggesting that while the current event will drive volatility, and exacerbate energy issues for a time, but not change underlying trends.**

We remain focused on the fundamentals of our investee companies and especially the earnings growth trajectory. Geopolitical events such as these will not alter the **fundamental drivers of the investee companies**, even as prices undergo some short term correction, only to recover later. **So our portfolio strategy remains unchanged**.

Looking ahead, we see liquidity withdrawal (US Fed taper) and rate hikes in the US to dominate investor discussion for most part of 2022, as the US Fed plays catch-up against the backdrop of strong growth and high inflation. The market is expecting at least 6 hikes spread across 7 policy meetings scheduled for this year (cumulative hikes of about 160-170 bps). However, slowdown in demand and the geopolitical tensions, may force Fed to rethink the course of the rate hike cycle including the start of the cycle and quantum of hikes during the year.

Source: Bloomberg, HSBC Asset Management, India (HSBC AMC), Data as at 24 Feb '22 unless otherwise given.

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