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# The implications of the escalation in Ukraine

Following weeks of rising tension between Russian and US/European leaders as a result of Russia building up forces on the border of Ukraine, Russian troops have now crossed the border into Ukraine. This is a significant escalation of the crisis – and it does have implications for markets in the short term.

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Russian forces launched a major military assault on Ukraine late on Wednesday, with reports of missile strikes and explosions near major cities including Kyiv. This has continued overnight into Friday with reports that Russian troops have advanced near Kyiv from the north and of increasing casualties on both sides.

## Market reactions

Market reactions have been swift and sharp. The S&P 500 dropped in afternoon trading on Wednesday, finishing the session 1.8% lower before falling another 2.5% in overnight trading in the futures market. There was some recovery in the US trading session, however, with the continuing escalation, particularly on Kyiv, those gains have again been eroded. In the UK, the FTSE100 was down 3.9%, led by financials, and EuroStoxx 50 was down 3.6%. More positive price action is evident, however, in the European markets this morning.

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Oil prices jumped over 5% with Brent crude futures, the global benchmark oil price, trading above $100 a barrel for the first time since 2014 and have since settled around this level over the last day. So far in 2022, oil prices have risen over 30% for a number of reasons including as a result of the crisis in the Ukraine.

Russia is a powerful player in the energy market and there are concerns that it will continue to use gas supplies into Europe as a weapon against any new sanctions. Europe is highly reliant on Russian gas, and any disruption of energy supplies could boost energy prices further in the continent and elsewhere. Sanctions are also likely to impact international trade and payments to and from Russia.

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## Broader war still unlikely

Although serious, at this stage it seems likely that the conflict will remain contained in Ukraine and, as such, investors will adjust to the uncertainty and potentially see some price recovery. Given the news flow, it seems likely that the main aim of Russian leader Vladimir Putin is to secure regime-change in Kyiv and promote a Ukraine government that aligns to Russia's influence around economic ties and political leadership, rather than to NATO and the West.

In a pre-dawn TV statement, after troops had crossed the border, Mr Putin said Russia did not plan to "occupy" Ukraine as he demanded that the country's military lay down their arms. The Russian leader says he is not seeking to impose Russian military rule.

## Implications of further sanctions

US President Joe Biden and NATO have confirmed that they will not undertake any direct military response to this attack on an independent country – even though it is near the borders of NATO countries. There will, instead, be an intensification of sanctions. The sanctions imposed by the West are unlikely to deter any action in the short term. Russia has built-up significant currency reserves and has secured arrangements with China to provide access to funds in return for energy.

We can expect to see volatility in markets over the next couple of weeks as the responses and actions unfold and markets deal with the uncertainty. The situation is very fluid, and we are looking at potential scenarios that can escalate market concerns further.

As the situation clarifies, however, then markets tend to look through the short-term conflict and focus on other factors. Our house view is that central bank activity will dominate the market performance over the next 12 months as they adjust policy settings to deal with inflation. They will, however, take into account the escalating conflict when they deliberate these policy decisions.

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## A long-term view

The situation remains fluid and uncertain, and drawing accurate conclusions about how this will develop simply isn't possible. Clearly, from a human perspective the crisis in Ukraine is a tragedy, and it will inevitably bring further suffering and casualties, as well as concerns arising from neighbouring countries. However, from an investment perspective, it is important to focus on the long-term outcomes and not to react to the panic in the short-term. Similar events in history, if they remain contained, have shown that markets tend to recover from these initial periods of weakness. Of course, we will continue to closely monitor the situation with regard to sanction responses and ongoing developments and keep you informed of any significant changes to our central view.

If you have any questions, then please feel free to send them through to your usual Charles Stanley representative.