



## The effect of the Russian invasion of Ukraine on your portfolios

### Background and our view

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On 24 February, Russian President Vladimir Putin ordered the invasion of neighbouring Ukraine. The invasion followed weeks and months of provocations to the Northern Atlantic Treaty Organisation (NATO) and Putin's recognition of two separatist territories in eastern Ukraine as independent. There has been a collective response from Europe, the United Kingdom, the US and other Western allies, as they imposed a series of severe sanctions against Russia targeting oil refineries, military exports and financial institutions.

If we use the Russian annexation of Crimea in 2014 and the American invasion of Iraq in 2003 as our signposts, the effect of Russia's invasion of Ukraine on financial markets is likely to be marginal and temporary. However, it will naturally be associated with higher levels of market volatility if there is uncertainty about how events will ultimately unfold.

Our basic premise is that if the war between Russia and Ukraine remains a regional conflict that does not escalate into a global destabilising event, it should fade as a meaningful driving force for financial markets beyond the short term.

In the interim, risk-off sentiment will likely be prevailing at times of tension escalation, with risky asset classes like equities experiencing some short and shallow drawdowns, and safe-haven asset classes like the

US dollar and gold (and maybe US bonds) rallying during these periods of conflict escalation.

In our view, geopolitical events like these are likely to only be secondary factors to the more primary fundamental driver for financial markets this year, namely the major global policy transition from the massive monetary and fiscal stimulus of 2020 and 2021 to eventual policy tightening in 2022. How financial markets react to this policy pivot will be much more crucial for the relative returns from the different asset classes than what happens in Russia and Ukraine. At most, the situation in Ukraine reinforces our view that the global policy pivot in 2022 should culminate in a less conducive backdrop for asset class returns and could lead to periodic drawdowns in riskier asset classes this year.

Geopolitical events like these again highlight to investors the advantages of having a diversified investment portfolio. While some asset classes in an investment portfolio could experience short-term drawdowns when risk-off sentiment prevails (think of risky asset classes like global equities), other factors like a parallel weakening rand would soften the return effect for rand-based investors, for example. Similarly, while there could be near-term pressure on South African (SA) bonds from global risk-off sentiment and a weaker rand, some SA equity sectors will benefit from higher commodity prices and a weaker rand.

## Direct exposures to Russian asset classes

From a multi-asset-class perspective, our direct exposure to Russian assets is predominantly captured in our passive or enhanced passive emerging market equity exposures and, to a lesser extent, in our global bond exposure managed by Amundi.

Emerging markets, proxied by the MSCI Emerging Markets Equity Index, represent about 11% of the MSCI All Country World Index, which is our preferred benchmark for global equities.

Russia represented about 3.5% of the MSCI Emerging Markets Index before recent developments but following a severe sell off in the Russian equity market, that reduced to about 2 % of index weighting.

Russia therefore represented about 0.39% of global listed equity markets, which is a number that would have halved a few days into the conflict.

While some of our multi-asset-class portfolios would have captured this exposure in passive strategies others execute within an enhanced-index strategy managed by Robeco.

The Robeco enhanced passive emerging market fund maintained an underweight exposure to Russia, even before the crisis, at roughly half benchmark weighting, or about 1.75%, further lessening the overall portfolio exposure.

By virtue of the diversified equity exposures across the range, coupled with the weighting of Russian equities in the strategies mentioned above, the effective exposure of Russian equities is significantly reduced and can be considered immaterial on overall portfolio level.

**Across our Factor Series Range of portfolios, the direct exposure to Russian equities and bonds ranges from 0.05% to 0.10% on a total portfolio level.**

## Indirect exposures to Russian securities

There is, however, the possibility that some of the locally listed shares may experience some effect or have exposure by virtue of their operations and earnings related to Russia. Based on our view of the market, these include, but are not limited to, well-known shares such as Prosus, British American Tobacco, Mondi, Barloworld and Richemont.

These may not be the only shares affected by the crisis. We believe they may experience some effect in the weeks and months ahead, some only marginally, but the extent across the board is still relatively unknown and not easy to quantify. These shares represent about 12% of the FTSE/JSE Capped Shareholder Weighted Index, as detailed below.

There are some potential benefits and tailwinds to the crisis, as it relates to resource shares listed on the JSE. As Russia represents a significant producer of a range of industrial and precious metals, ongoing sanctions and disruption of supply may stand to benefit other producers globally, including those with operations and listings in South Africa.

It is further possible that diversified miners are likely to gain, as Russia has potentially triggered a faster energy transition towards green energy. This includes the use of battery power and other clean energy that is dependent on copper, aluminum, palladium and a range of industrial metals, thereby increasing demand and company earnings.

Share name	Benchmark weighting (%)
Compagnie Financiere Richemont SA	2.77%
Barloworld Ltd	0.50%
British American Tobacco PLC	2.56%
Mondi PLC	0.93%
Prosus NV	5.79%

## Conclusions

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The situation remains extremely volatile in the war-torn areas affected by this tragedy and the world financial markets. While we do not expect a near-term solution through diplomacy alone, the prospect of increased military action is real and concerning. Our solutions continue to favour asset classes and strategies that have fundamental value and differentiated risk characteristics.

We continue to monitor developments and will react and reposition our solutions, within their respective mandates, as required.

**Sonja Saunderson**  
Chief Investment Officer

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