CURRENT MARKET NEWS

Russia Rattles Markets . . . and Rattles NATO, too

Yung-Yu Ma, Ph.D., Chief Investment Officer, BMO Wealth Management - U.S.

Wednesday, February 23, 2022

Russia has both recognized as independent and sent "peace keeping" troops into the two Ukrainian break-away provinces of Donetsk and Luhansk. While troubling in its own right, the bigger geopolitical concern is that these actions represent the first step of a Russian campaign to invade Ukraine. It is unclear whether Putin's intentions – and resolve to endure increasingly stiff economic sanctions – go that far or whether viable diplomatic alternatives remain that satisfy Russia's purported desire to constrict NATO's influence near its borders.

Following the Russia-Ukraine news, the S&P 500 index fell just over 1% on the day. That relatively modest decline, however, was already following a poor performance the prior week driven by the anticipation of such an event. The U.S. oil benchmark, West Texas Intermediate (WTI), closed over 1% on the day to above $92/barrel, and the international benchmark, Brent Crude Oil, closed nearly 2% to greater than $97/barrel. Natural gas prices in Europe saw an even bigger increase as Russia is a major exporter of the commodity to Europe.

The US, UK, and EU are all responding with economic sanctions on Russia. So far, the most biting of these is from the EU which include halting certification of the Nord Stream 2 natural gas pipeline from Russia to Germany. Additionally, the EU is reportedly preparing broad-ranging sanctions on Russian parliament members and restrictions on Russia's access to financial services and capital markets in Europe. Overall, NATO unity looks significant.

In economic terms, the largest risk from further escalation is concentrated in Europe which could experience even stiffer energy prices at a time when inflation is already uncomfortably high. Rising prices in global commodity and energy markets would also have an inflationary effect in the U.S. and around the globe.

In extreme scenarios, increased inflation pressures could lead the Fed to an even greater degree of policy tightening. Certain emerging markets such as China are also highly dependent on energy imports which could add to the country's existing headwinds. Our recommended equity exposure that is overweight U.S. markets and underweight international markets still looks best positioned. Within the U.S., our recommended overweight to small caps reflects the considerably better valuation in that space which we continue to believe will play out favorably over time. Real estate could also provide a hedge to other equity positions if inflation stays high, but interest rate expectations do not increase substantially.

The Russia-Ukraine crisis is unlikely to resolve in short order. Whatever the next step, Putin's hand is likely strengthened by steadily moving more troops into the Russia-backed regions of Eastern Ukraine. Perhaps only then will diplomatic negotiations begin in earnest. The U.S. and Europe still have very stiff economic sanctions available such as cutting off Russia from the SWIFT international payment system and imposing harsh export controls and financial market restrictions. Russia is certainly not a pushover or a stranger to hardships, but our belief is that the extreme outcome of a full-scale Russian invasion of Ukraine is still not the most likely scenario considering the painful economic measures that would loom.

Repositioning around geopolitical developments is especially challenging when the desired end state – in this case for Russia – is unclear. Lasting, globally damaging economic and market scenarios are likely confined to the most extreme outcomes of the Russia-Ukraine crisis. While uncertainty is high, we still believe the primary drivers of equity markets for the year will be the Fed, inflation, and earnings growth.

Disclosure

"BMO Wealth Management" is a brand delivering investment management services, trust, deposit and loan products and services through BMO Bank N.A., a national bank with trust powers; family office services and investment advisory services through BMO Family Office, LLC, an SEC-registered investment adviser; investment advisory services through Stoker Ostler Wealth Advisors, Inc., an SEC-registered investment adviser; digital investment advisory and financial planning services through BMO Direct Invest Inc., an SEC-registered investment adviser; and trust and investment management services through BMO Delaware Trust Company, a Delaware limited purpose trust company. These entities are all affiliates and owned by BMO Financial Corp., a wholly owned subsidiary of the Bank of Montreal. BMO Delaware Trust Company does not offer depository, financing, or other banking products, and is not FDIC insured. You must be an existing customer of BMO Bank N.A. and enrolled in BMO Digital Banking to qualify for services from BMO Direct Invest Inc. Not all products and services are available in every state and/or location. Family Office Services are not fiduciary services and are not subject to the Investment Advisers Act of 1940 or the rules promulgated thereunder. Investment products and services: A**RE NOT A DEPOSIT - NOT INSURED BY THE FDIC OR ANY FEDERAL GOVERNMENT AGENCY - NOT GUARANTEED BY ANY BANK - MAY LOSE VALUE.** Capital Advisory Services are offered by a division of BMO Bank N.A.

BMO Private Bank is a brand name used in the United States by BMO Bank N.A. Member FDIC. Not all products and services are available in every state and/or location.

BMO Bank N.A. and its affiliates do not provide legal advice or tax advice. You should review your particular circumstances with your independent legal advisors and tax advisors.

This report contains our opinion as of the date of the report. It is for general information purposes only and is not intended to predict or guarantee the future performance of any investment, investment manager, market sector, or the markets generally. We will not update this report or advise you if there is any change in this report or our opinion. The information, ratings, and opinions in this report are based on numerous sources believed to be reliable, such as investment managers, custodians, mutual fund companies, and third-party data and service providers. We do not represent or warrant that the report is accurate or complete.

Any forward-looking statements in this report involve known and unknown risks, uncertainties and other factors that may cause the actual performance of future markets to differ materially from the projections depicted in the report. Past performance is not indicative of future results and current performance may be higher or lower than that shown in the report. There can be no certainty as to the extent or depth of any market downturn, nor any assurance regarding the nature, extent or timing of markets rebounding. When evaluating the report, you are cautioned not to place undue reliance on these forward-looking statements, which reflect judgments only as of the date of the report. Investment returns fluctuate, and investments when redeemed, may be worth more or less than the original investment.

Forward-looking statements in this report involve risks, uncertainties and other factors that may cause actual performance to differ materially from the projections and opinions contained in the report. Do not place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of the report. The words "may," "could," "should," "would," "suspect," "believe," "expect," "intend," "forecast," and similar expressions identify forward-looking statements. Forward-looking statements are not guarantees of future performance or events. Forward-looking statements involve risks and uncertainties about general economic factors. It is possible that predictions, projections, and other forward-looking statements will not be achieved. General factors that could cause our predications or projections to change include general economic, political and market factors; interest and foreign exchange rates; global equity and capital markets; commodities markets; business competition; technological changes; changes in laws and regulations; judicial or regulatory judgments; legal proceedings; and catastrophic events.

Any discussions of specific securities, investment managers, or strategies are for informational purposes only and should not be considered investment advice. The report does not constitute an offer to sell or a solicitation to buy any security or investment product. Any offer to sell or solicitation to buy an interest in any private security, investment product or fund may only be made by receiving a confidential private offering memorandum, prospectus, investment advisory agreement or similar documents from the investment manager, which describes the material terms and various considerations and risks relating to such security, investment product or fund.

This report is not intended to be a client-specific suitability analysis or recommendation, an offer to participate in any investment, a recommendation to buy, hold or sell securities, or a recommendation of any investment manager or investment strategy. Do not use this report as the sole basis for your investment decisions. Do not select an asset class, investment product, or investment manager based on performance alone. Consider all relevant information, including your existing portfolio, investment objectives, risk tolerance, liquidity needs and investment time horizon.

Our affiliates may provide oral or written statements that contradict this report. These same persons may make investment decisions that are inconsistent with this report. We and our affiliates will from time to time have long or short positions in, act as principal in, and buy or sell, the securities referred to in this report. We and our affiliates may have positions in the securities mentioned that are inconsistent with the views expressed by this report.

We are not licensed or registered with any financial services' regulatory authority outside of the United States. Non-U.S. residents who maintain U.S.-based financial services accounts with us may not be afforded certain protections conferred by legislation and regulations in their country of residence with respect to any investments, investment solicitations, investment transactions or communications made with us.

You may not copy this report or distribute or disclose the information contained in the report to any third party, except with our express written consent or as required by law or any regulatory authority.

Corporate Office:
320 S. Canal Street, Floor 12, Chicago, IL 60606