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Market Insight:
Investment Implications of Ukrainian/ Russian Turmoil

It is the second time this year that turmoil in an Emerging country is rocking the global markets. Previously it was economic/currency instability, now it is a serious political conflict that clouds the markets with uncertainty. As of this writing, Russia has invaded Ukraine and has issued a *’surrender or face military action’* ultimatum. How this plays out, no one knows, but if it escalates, the current Ukrainian crisis might have profound economic consequences, not only for the Ukraine and Russian, but also for Europe, North Africa and the US.

As an investor, it is important to consider the potential consequences to the global economy and financial markets. Below are some of the key points to consider when viewing this situation. *(notes from AtonRa Partners, Research)*

Brief history of the Ukraine/Russia Divide:
Ukraine is divided east and west by the Dnieper River, with pro-Russians on the east side and pro-Europeans on the west side. Around 25% of its population is of Russian ethnicity. The country is geopolitically extremely important for Russia, as the south (Crimea) has an access to the Black Sea, and the town of Sebastopol is home to a significant portion of Russia’s naval fleet. (see map- Red circle denotes Ukraine)

Ukraine's Holocaust never forgotten. In only two years during Stalin's reign (1932-1933), an estimated 2.5-7 million Ukrainians died from starvation (mainly on the west side of the country), while during the Second World War, another 8 million people died. The Ukraine holocaust was a direct consequence of Ukrainian nationalism, which saw the country declaring its independence in 1917. In 1922, the country was once again annexed by Russia. These events are still well anchored in Ukrainians' minds and are seen as the main explanation for today's divide between pro-Russians and pro-Europeans.

Ukraine is world's second largest exporter of grain. According to the USDA, by the end of 2013/2014, Ukraine will be the second largest grain exporter in the world market after the United States. Much of the wheat and maize are exported in North African (roughly 25% of total exports) and Asian (50% of its exports) countries as food wheat, and in Europe (20% of total exports) as feed wheat. Thus, the current escalation might have repercussions in many of the soft commodities' markets, as grain shipments through the Russian seaports might be obstructed, notably impacting shipments to Asia and North Africa. This is the single biggest risk for Ukrainian grain's exports. As most of the North African countries rely on cheaper Ukrainian grains, and any disruption might have direct consequences to those countries, which could add to further instability in the entire region.

Ukrainian situation could put intense pressure on European/Russian trade, and Russia's economy. The EU is the first trading partner of Russia. Most of the exports to the EU from Russia are in the form of energy (mainly gas, as 34% of European gas imports comes from Russia), and represent almost all of the Russian gas exports. If trade were to halt between Russia and Europe, it would have significant economic impact to both countries but more so on Russia. Their currency would fall dramatically causing rampant inflation and economic upheaval.

Potential US benefit: At the same time Europe would need to find other sources of energy with the fall out potentially benefiting US natural gas producers. With the ongoing North American unconventional gas revolution and the resulting global access to liquefied natural gas (LNG), the US has a great card to play with Europe as on one side, it would allow Europe to divorce from Russian gas dependence, and on the other side, it would open up a new market for the US., has to find other ways of energy diversification

Stock Market Impact: Whether the situation in Ukraine has any lasting downside effects on stock markets remains to be seen. If it turns out that the conflict remains isolated to the Crimean peninsula, any negative U.S. stock market reaction is likely to be fleeting. Even if the situation spreads to some of the regions in eastern Ukraine that are more heavily populated by Russians, the U.S. stock market is still likely to take things generally in stride with some understandable volatility along the way.

However close attention is warranted in the days ahead. If the crisis starts to drag out or violence starts to spread beyond heavily Russian populated regions in the Ukraine, the reaction by the U.S. stock market is likely to quickly become far more severe. Moreover, if the crisis begins to spread beyond Ukrainian borders, it becomes an entirely different ball game and would prompt a re-assessment of the global investment climate.

Investment Strategy: In early February, risk was further diversified through reallocating some assets away from purely 'directional' risk to more event specific risk. This means the portfolios will be less affected by sharp directional moves but will still have opportunity to generate return, even in choppy markets. Exposure to Emerging markets is minimal and stock concentration remains mostly in the US and to a small degree in Europe. At the same time, the portfolios are generating income from High Yield bonds and floating rate notes, both of which are performing well.

Please contact me with any questions or concerns.

Kind Regards

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