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BULLETIN: Russian Invasion of Ukraine

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GLOBAL ENERGY CHESS MATCH

It has often been said that if you can't fully understand or explain someone's actions, then simply follow the money. This situation appears to be no different.

Much has been made of Vladimir Putin's desire to reconstitute the former USSR, but it is not entirely clear that this is truly a politically driven event. This makes much more sense in the context of the world's richest man wanting to control his gas pipelines and wants the spheres of influence to ensure access to his markets.

In fact - while his troops are advancing rapidly on Kiev today, he is simultaneously negotiating a gas supply agreement with Pakistan. Last month, he negotiated a 30-year gas supply agreement with China. He is diversifying his client base in anticipation of sanctions and reduced/sanctioned demand from Europe. Russia has a very strong national balance sheet and plenty of reserves to shape the chessboard to its long-term favor, including supplying Europe again once the dust settles from today's headlines.

In our year-end letter, we wrote about Russia and said that we fully expected military action in the Ukraine. In our opinion, diplomacy was never going to work because Russia stood to gain too much leverage by waging a war against the Ukraine – and they were clearly not concerned about sanctions that it knew would be imposed. The world has to take Russia quite seriously again which will have an enduring impact in how we engage with them going forward.

Regarding the current action - there is an old military saying that you have to "crack walnuts with a sledgehammer" – and this is exactly what they are trying to do at the moment in the Ukraine. Russia realizes that it is in everyone's best interest that this action conclude as quickly as possible – which means a very aggressive action. Putin will likely install a pro-Russian government, permanently degrade Ukraine's military capabilities, and ensure that they never join the NATO alliance.

Putin will also gain full control over the pipeline system that runs through the Ukraine – and can perhaps use that as leverage to force a certification and opening of the Nord Stream 2 pipeline which he greatly wants. These actions will empower Russia to control all of the pipelines to their end clients, and not have to pay the transmission fees to the Ukraine either.

At this time, it is hard to see what more Russia could possibly gain by starting a wider war with NATO. It is simply not necessary to achieve all of his stated, and implied goals.

LONG-TERM IMPLICATIONS

There is no doubt that this recent action will increase the need for more diversified sources of energy for Europe and will create a renewed sense of urgency for ensuring a strong NATO alliance to keep the balance of power on the continent.

It also speaks to the enviable position that the US enjoys in terms of energy independence, a comparative advantage relative to other industrialized countries, and its waterfall effects through our economy – not to mention our national security.

GLOBAL MARKET REACTION

We also advised at year-end that the markets were fully valued, and that we expected a more volatile market environment in the new year with a correction very likely. That process started in January and has continued with the expected action in the Ukraine. The S&P 500 and the international markets are now officially in correction territory – down over 10%. We believe that the correction that started in January was healthy, and that while the overall markets are down, there are pockets that have attractive risk and reward opportunities going forward.

Although the markets have sold off on the news of the crisis in the Ukraine – they have not sold off nearly as much as in prior geopolitical events. And the 10-year Treasury is holding steady at 1.91%. This is signaling that there is an expectation by the markets that this action will be a sharp, short and contained event. This may set the market up for "relief rally" once the actions are completed in the coming days as is typical with these kinds of events.

That being said, there is no doubt that the global economic situation, still hobbled by global supply chain issues from C-19 and rising inflation, will face more challenges than before on the path to normalization. This includes that it may be difficult for the Federal Reserve Bank to continue to raise rates as aggressively as they wanted to before this action.

As you may recall, we made adjustments over the last several months anticipating a more challenging environment. With slower growth and higher inflation, our investment committee is considering some incremental adjustments, but no significant changes to the current positionings due to this event.

KEY TAKE AWAY

As we often counsel, it is impossible to time the markets. The only way to win as an investor is to ensure that you have a properly diversified portfolio, and to stay the course during periods of market volatility.

We have enjoyed an unusual period of low volatility and a market that has floated up substantially for the past two years, and the road ahead will be more volatile. However, staying invested through difficult market periods like this can also offer opportunities to add high quality assets to your portfolios at more favorable valuations.

We continue to monitor the situation very closely, and will provide additional updates if we see a continued escalation of events.

Please do not hesitate to call us with any questions.

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