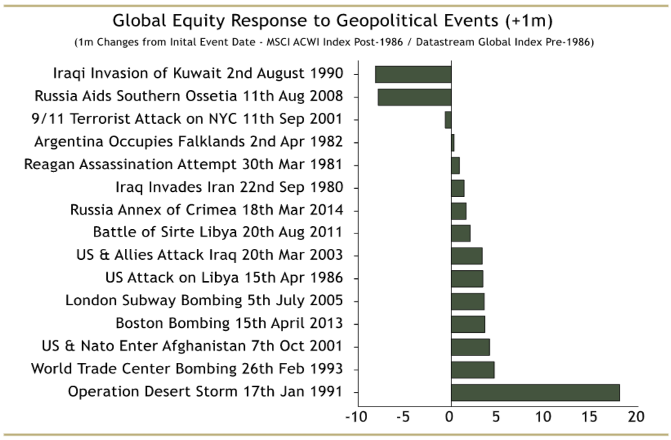
-Global Thematic Investors' Diary

Iain Little 25th February 2021

Where do Ukrainian economics matter, or is it "matter" that matters?

Economics is a dismal science. It has no feelings. Especially in horrible days of wartime like today. On the face of it, neither Russia (number 11 in the world, smaller than both Canada and Italy) nor Ukraine (number 60) are big enough as economies to affect the global post Covid economic and monetary settlement. After all, the world prospered mightily through 70 years of Cold War and Soviet era isolation. The table below shows that almost all equity returns turn positive 1 month after political shocks (though, ominously, pessimists might cite Russian "aid" to S Ossetia as an exception). Pearl Harbour preceded by a few months a 130% bull market in the USA only killed off by monetary tightening after the war was won and 85 million had died, the largest single cohorts being Russian, Chinese and Jewish civilians. Ghastly to say, wars can be good for stock markets, even for the losing side; infrastructure and nations get rebuilt in the longer term.

Chart 1: Global Equity (ACWI) and Geopolitical Events



Source: ASR Ltd. / MSCI / Refinitiv Datastream

In the longer term, economic *trends* -call them "weighing machines"- matter most. But political *events* –call them "voting machines"- matter more in the shorter term.

The proximate global economic effect will be on commodity supply (the complacent West taking much of the blame). Much has been made of Ukraine and Russia as the largest (30%) breadbasket in the world and the Russian Nord Stream 2 gas pipeline dilemma facing the EU/ Germany. But few would have predicted this week's announcement by a Democrat President to expand domestic mining in strategic metals (lithium, graphite, rare earths, cobalt, rhodium, nickel, zinc etc). This points to a supply chain challenge where ESG objections now take 2nd place. The USA is dependent on Russia for much of its strategic supply chain: C4F6 gas and neon for chips, palladium for sensors, plating material and computer memory (MRAM), titanium for engines, fans, fighter jet disks, missiles, satellites. Russia needs high end chips, where the USA has edge, but where Russia is said to be able to obstruct the USA's chip supply chain. These squeezes, offsets and stand-offs occur at a time when inflation is already above 5% for major economies.

What are the immediate investment actions from this Triple Hit (higher inflation + over-stimulated post Covid recovery + supply chain squeeze)? No bonds of any kind. Quality equities with a barbell: efficiency (value tech, healthcare, FMCG, consumer) *and* scarcity (energy, gold, metals, agriculture). Physical gold. New money into commodity/ scarcity areas. Some meaningful cash raising -don't fiddle- for those unable to endure what might be a longish wait, with Mr Putin holding the stopwatch. *More later when developments are clearer.*
