



Market Commentary: Financial Implications of the Russian Invasion of Ukraine February 2022

First, our hearts go out to the 40 million plus citizens of Ukraine. It is impossible to imagine or feel the fear, stress, and danger while going about our lives in the US – a country blessed with incredibly wide borders (oceans) to the East and West and friendly, materially weaker countries (Canada / Mexico) to the North and South.

The US is also blessed with its own natural reservoirs of oil and gas, and a large breadbasket smack in the middle of our country (meaning even more protected) that can feed our nation. These qualities will limit expected inflationary concerns relative to the rest of the world.

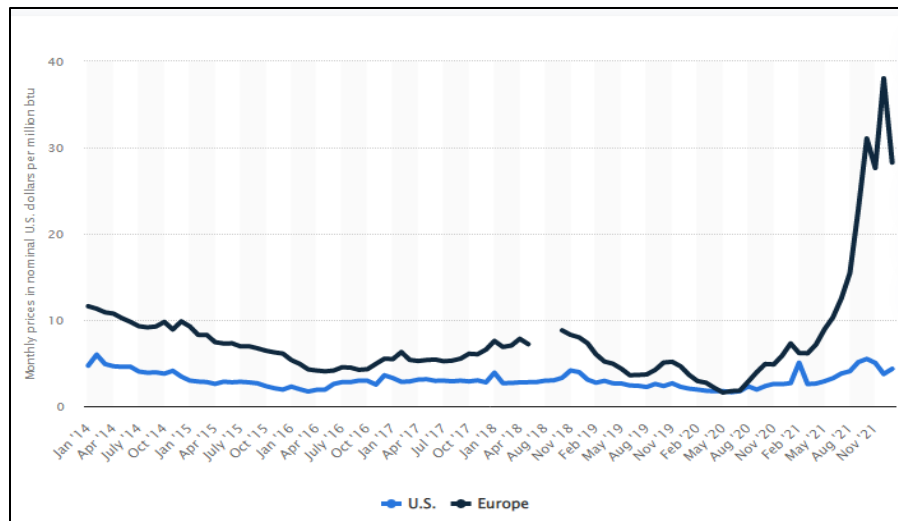
With all that stated, the US has benefited dramatically from the world order created post WWII with ensuing globalization and, especially over the '90s and early 2000s, an historically tame global political landscape. This is at risk of changing. Following is our attempt to make sense of some of the shorter- and longer-term potential consequences related to the Russian invasion of Ukraine.

Energy / Grain

Energy resources were already tight going into the conflict. So far, Russia and the West have been careful to carve out energy from the battle – Russia needs the money and Europe needs the resource. Given how quickly the Russian economy showed signs of cracking along with the larger than expected financial sanctions imposed by the West, it would be a really hard decision for Russia to shut off oil – it simply would hurt their capabilities almost immediately to fund their nation along with a further wallop to both their economy and currency. The same goes for Europe, and therefore the West, given their over-reliance on Russian energy.

Short term, there are not many solutions to Europe's energy need. Longer term, we are already seeing action within Germany, which is already a green energy consumption world leader, pledging to be 100% reliant on alternative energies by 2035,¹ while exploring other shorter term energy alternatives like resuscitating their nuclear energy program in the short term², and France re-upping their reliance on nuclear energy.

America is more protected as our energy output matches our consumption. The chart to the right highlights this fact through the massive difference in natural gas prices in the US vs Europe.



Monthly Natural Gas: US vs Europe, Jan 2014 – Jan 2022³

¹ [Germany aims to get 100% of energy from renewable sources by 2035 | Reuters](#)

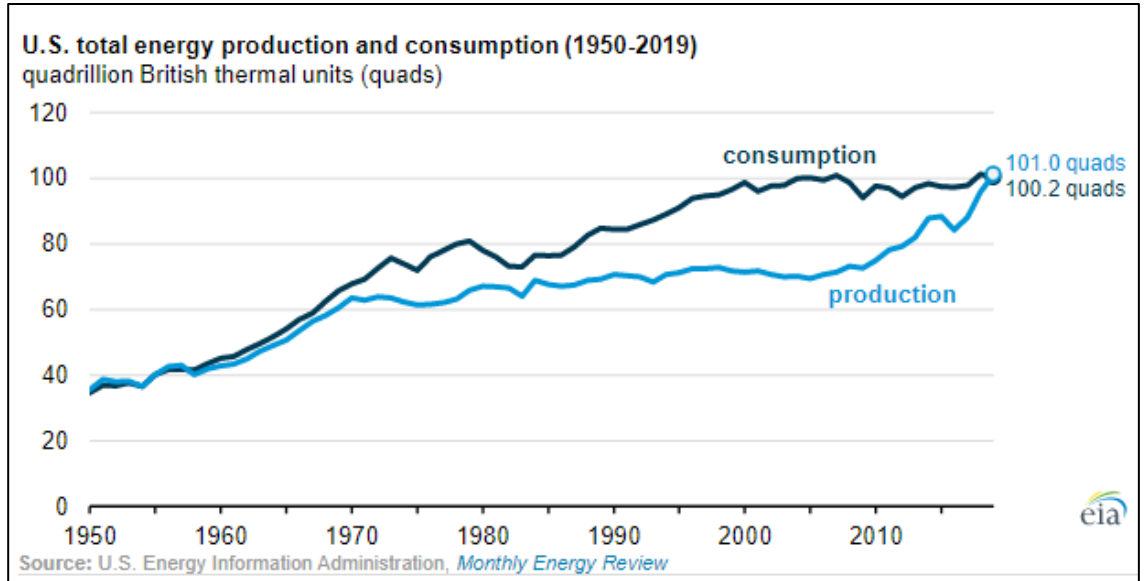
² [Germany mulls extending nuclear plants' life-span - economy minister | Reuters](#)

³ [Monthly natural gas prices United States and Europe 2022 | Statista](#)



US Energy Consumption = Production as of 2019⁴

Grain is another area that may become stressed due to this war. Like energy, grain has been excluded from the financial sanctions placed on Russia. This is another area where the US is relatively protected compared to the rest of the world given our own grain production. Unfortunately, though, a number of emerging markets can greatly suffer if there are worldwide shortages that create further upheaval and volatility in the world.

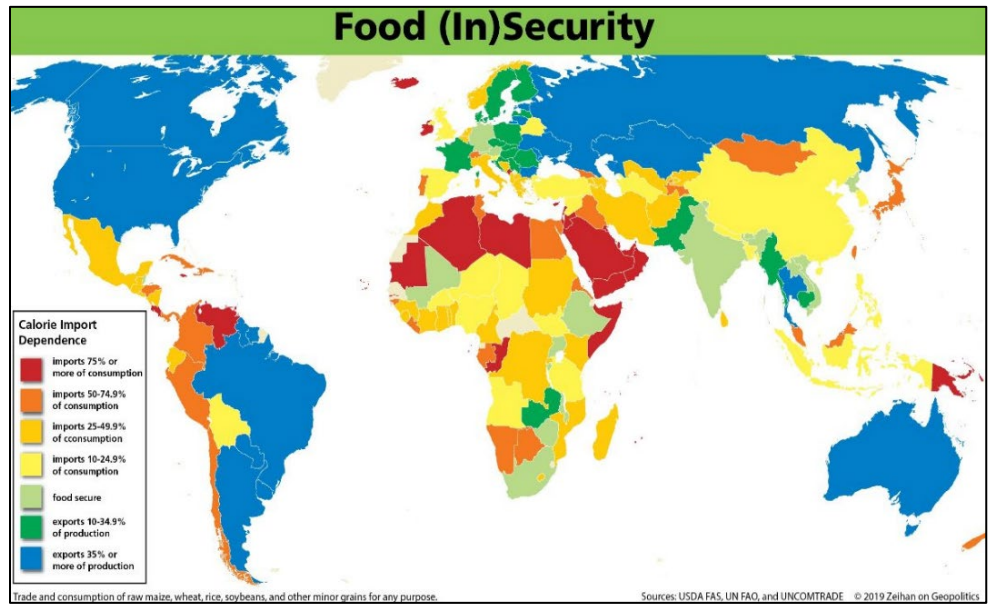


China

China is also controlled by a strong man that seems to be at odds with the West. However, there is a rational limit of how much China aligns with Russia given the realities of China’s goals for economic growth and a viable middle class. In 2019, China exported roughly \$1 trillion of goods to NATO countries, as compared to \$50 billion worth of goods to Russia⁵. While China can root for Russia, they are so intermingled with the West from a trade standpoint that it is hard to see them do much more.

While China has made amazing strides over the decades in becoming an economic superpower, they are still very reliant on the West and, we believe at least, have other economic initiatives ahead of them which would point to a more careful trading into a too-aggressive stance toward Taiwan – a fear many have as the next likely aggressive move on the global landscape.

You want to live in Blue or Green Regions:

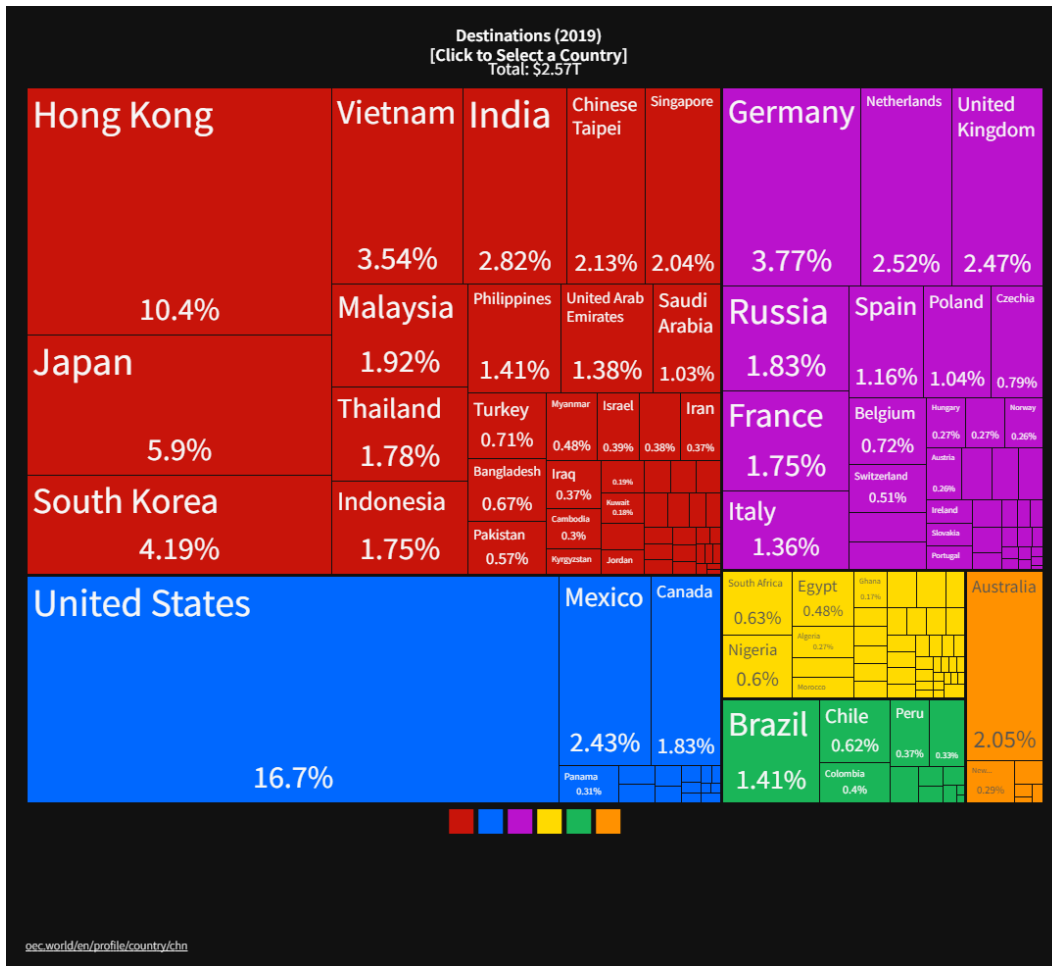


⁴ [In 2019, U.S. energy production exceeded consumption for the first time in 62 years - Today in Energy - U.S. Energy Information Administration \(EIA\)](#) – This is true for 2020 and, to our understanding, in 2021 as well. However, there is mismatch in that we produce more natural gas than needed, but less oil.

⁵ [China \(CHN\) Exports, Imports, and Trade Partners | OEC - The Observatory of Economic Complexity](#)



China Export Destinations 2019⁶



Russia - Putin

From what we can tell, the war does not seem to be going favorably for Putin with respect to the swiftness of the campaign or the sanctions meted out by the West. Furthermore, the vast majority of Ukrainians seem to have no interest in being governed by Russia. In short, this was never a winnable war for Putin given population opposition⁷. To be clear, the Russian's can take the entire territory if they would like (at least based on conventional wisdom) but the vast majority of Ukrainians have no interest in being governed by Russia which will create the quagmire seen countless times over history that eventually results in a retreat by the larger power and a loss. While it seems like we are in the very beginning portion of this new stage of the war (Russia has been in Ukraine for almost a decade now), the speed and severity of Western sanctions and the perceived lack of success so far in this newest campaign to take more of Ukraine results in a volatile position for two important Russian cohorts:

- **Putin:** What is his next step given the aggression of the West and potential weakness back home? This is a true wildcard.
- **Russian Middle Class:** Who will they ultimately blame for the incredibly quick and anticipated continued decline of quality of life? Putin or the West?

⁶ [China \(CHN\) Exports, Imports, and Trade Partners | OEC - The Observatory of Economic Complexity](#)

⁷ [Unpopular Russia Still Looms Large Over Ukraine Elections \(gallup.com\)](#) – slightly dated but to our understanding still accurate.



Inflation

The war is inflationary. As can already be seen, energy prices and grain prices have increased. While the US is somewhat protected, we are still part of a global economy where stresses on the general global system will affect us. The only positive here is that Russia needs to sell energy and grain as much as the rest of the world needs to buy it which means it would be an incredibly risky move for Russia to move to limit its energy sales⁸. If Russia simply moves its sales to China or other participants then there are surpluses in other parts of the world that should flow back to Europe.

Summary

While we are in the very early stages of this conflict, we believe it will have dramatic implications on globalization, energy, and global policing:

- **Globalization:** Given increased tensions with China, the realities of supply chain risks brought to the forefront by Covid, and general improvements in technology (the last being a positive), we believe there will be a quicker move away from globalization to regionalization – that means a further reliance by the US on Canada and Mexico and closer, stronger allies.
- **Energy:** The move to renewables will expand dramatically from both a defensive standpoint as well as a cost / value perspective (e.g., if oil / natural gas prices are relatively high it becomes more economical to go green)
- **Global policing / defense:** America will continue to move away from its position as police of the global waterways, resulting in additional shipping costs for countries not aligned with US interests. The US will also likely move more sensitive operations (e.g., semiconductors) onshore in order to limit our risks and sensitivities to distant countries / locales (e.g., Taiwan, China).

The US continues to be very well positioned given its natural resources, wealth, and geographic location. We continue to closely follow and analyze this conflict in light of the major investing implications, both short and long term.

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⁸ It would also be very risky for the rest of the world to include oil and energy in the sanctions since there are no great alternative and immediately available sources so we do not anticipate it but this would result in a large negative risk on the world.

