

# What rising geopolitical risks mean for markets

## UBS House View - Daily Europe

Mark Haefele, Chief Investment Officer Global Wealth Management, UBS AG  
Tilmann Kolb, Analyst, UBS Switzerland AG  
Vincent Heaney, Strategist, UBS AG London Branch  
Christopher Swann, Strategist, UBS Switzerland AG  
Patricia Lui, Strategist, UBS AG Singapore Branch

Tensions around Ukraine have escalated in recent weeks, with increased troop movements on the Russia-Ukraine border. Aside from the potential human and political consequences, this is an important issue for markets because of Russia's key role in global energy markets. Russia supplies around 40% of Europe's natural gas, and prices have already risen sharply. A disruption of supply—whether through sanctions, an active Russian decision, or an accident—could cause a commodity price shock. This would trigger both slower growth and higher inflation, adding to investor concerns about recession and higher interest rates.

In our view, a full-scale invasion of Ukraine by Russian forces remains a tail-risk event. The parties involved have strong incentives to avoid such an outcome. For Russia, sanctions could impair the standard of living of its population; for the West, a disruption in commodity markets could have deep economic repercussions. Such calculations should lead both sides to stop short of direct military action.

Instead, our base case is for diplomatic efforts to continue, allowing the situation to stabilize and the tensions to eventually ease. But this may take months, during which flare-ups are possible, for example due to actions taken by separatists in Ukraine or by Russian special forces, or due to cyberattacks.

Against this uncertain backdrop, we advise investors to:

1. **Ensure portfolios are well diversified.** Overexposure to individual regions increases political risks in portfolios. We have seen this recently with the roughly 30% fall in Russian equities since October. But the principle applies wherever you invest—this is why we always recommend a global approach to investing.
2. **Adopt a long-term perspective on political risk.** Historically, geopolitical shocks have only relatively briefly rattled financial markets, including the periods around the Iran-Iraq War (1979), the Gulf War (1990–91), the Venezuelan general strike (2002–03), the Libyan civil war (2011), and North Korea's missile tests. Rather than the event itself, it has been investors' overreaction that has posed the biggest risk to portfolios.

### Market update

**Nikkei 225 –3%, MSCI Asia ex-Japan –1.6%** on FOMC signals.

**S&P futures –1.7% as S&P 500** reversed earlier gains to end –0.15% on Powell's comments.

**10-year US Treasury yield –2bps to 1.84%** after +10bps to 1.86% Wed.

**2-year Treasury +3bps to 1.18%** after jumping 13bps Wed.

**Brent crude oil –1%**, to USD 89.1/bbl.

### What to watch: 27 January 2022

- US jobless claims
- US durable goods orders
- German GfK consumer climate

- 3. Consider adding to sectors that would outperform in the event of an escalation.** For example, investors looking to hedge can think about adding tactical exposure to [energy companies](#), which should benefit in the event of higher commodity prices. We also see this sector as attractively valued. By our calculations, the energy sector is priced for Brent crude oil around USD 60–65/bbl, rather than the current USD 89/bbl. In addition, companies involved in cybersecurity could get a boost in the event of a conflict where cyberwarfare plays a role. This market segment is also benefiting from [structural growth](#).

So, we suggest investors take a vigilant but calm approach to the recent tensions. For more on our view of the conflict, see our latest *Global Risk Radar* publication, "[What do geopolitical tensions in Eastern Europe mean for global markets?](#)"

### Caught our attention

- **Fed ready to start rate hikes.** Wednesday's FOMC statement strongly hinted that the Fed will hike rates at the next meeting on 16 March. It also stated that the tapering of asset purchases will proceed in line with its previous statement, wrapping up in March. While this was in line with market expectations, Federal Reserve Chair Jerome Powell used more hawkish language in his news conference, triggering a strong market reaction. His description of labor market conditions as tremendously strong suggests that the Fed believes it can raise rates at a faster pace than in the previous cycle without endangering its mandate on maximum employment. At the same time, Powell said that in his personal view, the outlook for inflation was the same or somewhat worse than in December, noting the lack of progress in solving supply chain issues. He therefore sees both the Fed mandates as requiring the removal of monetary accommodation. When asked about the possibility of a 50-basis-point rate hike, Powell did not rule it out. As for the balance sheet, Powell reiterated that the federal funds target rate would be the primary means of adjusting policy, and that the Fed wants assets to roll off the balance sheet in a predictable manner. He said that the FOMC would use the next couple of meetings to decide on the details of the process. *Our base case remains that the Fed will raise rates by 25 basis points in March, with additional hikes in June and September. However, as Powell made clear, the Fed is highly data dependent. If there are signs that high inflation is becoming entrenched, the Fed may raise rates at a more rapid pace. In our view, beyond the inflation data itself, wage growth and inflation expectations will be critical. Powell also noted that, while the omicron variant is having an impact, experts were predicting that case counts would decline. In our view, the pandemic is one factor that could force the Fed to slow down.*

## Appendix

UBS Chief Investment Office's ("CIO") investment views are prepared and published by the Global Wealth Management business of UBS Switzerland AG (regulated by FINMA in Switzerland) or its affiliates ("UBS").

The investment views have been prepared in accordance with legal requirements designed to promote the **independence of investment research**.

### **Generic investment research – Risk information:**

This publication is **for your information only** and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. The analysis contained herein does not constitute a personal recommendation or take into account the particular investment objectives, investment strategies, financial situation and needs of any specific recipient. It is based on numerous assumptions. Different assumptions could result in materially different results. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness (other than disclosures relating to UBS). All information and opinions as well as any forecasts, estimates and market prices indicated are current as of the date of this report, and are subject to change without notice. Opinions expressed herein may differ or be contrary to those expressed by other business areas or divisions of UBS as a result of using different assumptions and/or criteria.

In no circumstances may this document or any of the information (including any forecast, value, index or other calculated amount ("Values")) be used for any of the following purposes (i) valuation or accounting purposes; (ii) to determine the amounts due or payable, the price or the value of any financial instrument or financial contract; or (iii) to measure the performance of any financial instrument including, without limitation, for the purpose of tracking the return or performance of any Value or of defining the asset allocation of portfolio or of computing performance fees. By receiving this document and the information you will be deemed to represent and warrant to UBS that you will not use this document or otherwise rely on any of the information for any of the above purposes. UBS and any of its directors or employees may be entitled at any time to hold long or short positions in investment instruments referred to herein, carry out transactions involving relevant investment instruments in the capacity of principal or agent, or provide any other services or have officers, who serve as directors, either to/for the issuer, the investment instrument itself or to/for any company commercially or financially affiliated to such issuers. At any time, investment decisions (including whether to buy, sell or hold securities) made by UBS and its employees may differ from or be contrary to the opinions expressed in UBS research publications. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, divisions or affiliates of UBS. Futures and options trading is not suitable for every investor as there is a substantial risk of loss, and losses in excess of an initial investment may occur. Past performance of an investment is no guarantee for its future performance. Additional information will be made available upon request. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information.

Tax treatment depends on the individual circumstances and may be subject to change in the future. UBS does not provide legal or tax advice and makes no representations as to the tax treatment of assets or the investment returns thereon both in general or with reference to specific client's circumstances and needs. We are of necessity unable to take into account the particular investment objectives, financial situation and needs of our individual clients and we would recommend that you take financial and/or tax advice as to the implications (including tax) of investing in any of the products mentioned herein.

This material may not be reproduced or copies circulated without prior authority of UBS. Unless otherwise agreed in writing UBS expressly prohibits the distribution and transfer of this material to third parties for any reason. UBS accepts no liability whatsoever for any claims or lawsuits from any third parties arising from the use or distribution of this material. This report is for distribution only under such circumstances as may be permitted by applicable law. For information on the ways in which CIO manages conflicts and maintains independence of its investment views and publication offering, and research and rating methodologies, please visit [www.ubs.com/research](http://www.ubs.com/research). Additional information on the relevant authors of this publication and other CIO publication(s) referenced in this report; and copies of any past reports on this topic; are available upon request from your client advisor.

Options and futures are not suitable for all investors, and trading in these instruments is considered risky and may be appropriate only for sophisticated investors. Prior to buying or selling an option, and for the complete risks relating to options, you must receive a copy of "Characteristics and Risks of Standardized Options". You may read the document at <https://www.theocc.com/about/publications/character-risks.jsp> or ask your financial advisor for a copy.

Investing in structured investments involves significant risks. For a detailed discussion of the risks involved in investing in any particular structured investment, you must read the relevant offering materials for that investment. Structured investments are unsecured obligations of a particular issuer with returns linked to the performance of an underlying asset. Depending on the terms of the investment, investors could lose all or a substantial portion of their investment based on the performance of the underlying asset. Investors could also lose their entire investment if the issuer becomes insolvent. UBS Financial Services Inc. does not guarantee in any way the obligations or the financial condition of any issuer or the accuracy of any financial information provided by any issuer. Structured investments are not traditional investments and investing in a structured investment is not equivalent to investing directly in the underlying asset. Structured investments may have limited or no liquidity, and investors should be prepared to hold their investment to maturity. The return of structured investments may be limited by a maximum gain, participation rate or other feature. Structured investments may include call features and, if a structured investment is called early, investors would not earn any further return and may not be able to reinvest in similar investments with similar terms. Structured investments include costs and fees which are generally embedded in the price of the investment. The tax treatment of a structured investment may be complex and may differ from a direct

investment in the underlying asset. UBS Financial Services Inc. and its employees do not provide tax advice. Investors should consult their own tax advisor about their own tax situation before investing in any securities.

**Important Information About Sustainable Investing Strategies:** Sustainable investing strategies aim to consider and incorporate environmental, social and governance (ESG) factors into investment process and portfolio construction. Strategies across geographies and styles approach ESG analysis and incorporate the findings in a variety of ways. Incorporating ESG factors or Sustainable Investing considerations may inhibit the portfolio manager's ability to participate in certain investment opportunities that otherwise would be consistent with its investment objective and other principal investment strategies. The returns on a portfolio consisting primarily of sustainable investments may be lower or higher than portfolios where ESG factors, exclusions, or other sustainability issues are not considered by the portfolio manager, and the investment opportunities available to such portfolios may differ. Companies may not necessarily meet high performance standards on all aspects of ESG or sustainable investing issues; there is also no guarantee that any company will meet expectations in connection with corporate responsibility, sustainability, and/or impact performance.

**External Asset Managers / External Financial Consultants:** In case this research or publication is provided to an External Asset Manager or an External Financial Consultant, UBS expressly prohibits that it is redistributed by the External Asset Manager or the External Financial Consultant and is made available to their clients and/or third parties.

**USA:** This document is not intended for distribution into the US and / or to US persons.

For country information, please visit [ubs.com/cio-country-disclaimer-gr](https://ubs.com/cio-country-disclaimer-gr) or ask your client advisor for the full disclaimer.

Version A/2022. CIO82652744

© UBS 2022. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.