



# Russia attacks Ukraine: Questions and answers.

February 2022

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- The most important actions investors can take to help ensure peace of mind is to confirm that their long-term strategic portfolio allocations are aligned with their investment objectives and tolerance for risk.
- At a high level, our strategies do not have significant direct exposure to Russia.

Events have accelerated in Eastern Europe with Russian forces moving aggressively into eastern Ukraine and reports of explosions in parts of western Ukraine.

The Russia-Ukraine conflict is not new, but it has erupted into overt military aggression in recent days. Russia's commencement of direct attacks against Ukraine follows its unilateral recognition of the independence of Ukraine's two easternmost regions, Luhansk and Donetsk (known together as the Donbas). These actions raise the likelihood of sustained military conflict between the two nations.

Many Western countries have responded by ratcheting up sanctions on Russia, including Nord Stream 2 AG and high-profile Russian individuals. This raises key questions about the global economy and financial markets.

## How likely is a continued escalation of the conflict?

The current state of affairs in Ukraine is almost certainly not Russia's desired endgame and there may well be more deterioration to come. The situation is fluid and could go on for months.

Perhaps the most extreme scenario would see the conflict extend to the Baltic countries of Estonia, Latvia and Lithuania as they are members of the EU, euro area and NATO. Fortunately, this appears to be a remote risk at present. Nevertheless, because it would represent a game-changing escalation, we should not discount this as a possibility.

## What impacts could escalation within Ukraine—and subsequent additional sanctions from the West—have on commodity prices? At what point would higher prices start to dent global business activity and consumer demand?

This is a critical risk, but global economic activity has remained strong as the scope of lockdowns and other pandemic measures continue to recede. We don't think the world economy is at risk of recession in the near term.

While high commodity prices are favorable to Russia, its economy is heavily dependent on external trading relationships. Energy price pressures could also hasten negotiations with Iran to bring its oil production back onto global markets.

Furthermore, both OPEC (that is, the Organization of the Petroleum Exporting Countries) and non-OPEC oil production remains below pre-pandemic levels, which means there's spare capacity that could help offset high prices.

## What would the combined effects of an energy price shock be on inflation, interest rates and the expected trajectory of central bank policies?

Central banks were already in a difficult situation given that both ongoing supply bottlenecks and robust demand pressures were causing inflation to run hot. While adding a high-profile geopolitical conflict to the mix could further complicate central bankers' jobs, this was already a well-established concern.

## Would a relatively successful incursion or invasion by Russia embolden China with regard to Taiwan, raising the risk of military conflict in Asia?

First, let's define a successful invasion from Russia's perspective as one that neither invites a coordinated military response nor cripples the Russian economy via sanctions. While this could impact the strategic calculus for China, this was already a well-established risk.

## At what point might Western sanctions begin to undermine confidence and activity in emerging markets more broadly?

This is a valid concern, but emerging-market assets have been lagging developed-market counterparts for some time. Most risk assets are likely exposed to further escalation of the conflict, but in the case of emerging markets, risk premia are already fairly wide (and have widened further in the case of Russian and Ukrainian assets).

### SEI's view

There is a wide range of risks and ever-present uncertainties associated with the conflict in Eastern Europe. While there are no simple answers, investors should keep in mind that geopolitical conflicts occur with a fair amount of regularity.

Russia's aggression toward Ukraine will not be the last geopolitical conflict with the potential to impact markets and portfolios. These situations are just one of the many risks that call for sound portfolio diversification and disciplined rebalancing.

As bleak as the news about Russia and Ukraine may appear, the most important actions investors can take to help ensure peace of mind is to confirm that their long-term strategic portfolio allocations are aligned with their investment objectives and tolerance for risk.

### Our strategies<sup>1</sup>

At a high level, our strategies do not have significant direct exposure to Russia:

- **Dynamic Asset Allocation** has a commodities position that could be expected to benefit from higher commodity prices. However, EAFE and equal-weight S&P 500 equity positions could detract in the risk-off environment.
- **Emerging Markets Equity** has a neutral position to Russia compared to its benchmark.
- **International Equity** has negligible exposure to Russia.
- **Core Fixed Income** has a small exposure to Russian local-currency debt and ruble (RUB).
- **Multi-Asset Income** has a small exposure to Russian local-currency debt and RUB. The fund also has a small exposure to Ukraine.
- **Emerging Markets Debt** has a neutral weight relative to the benchmark on both RUB and the Ukraine hryvnia (UAH). The fund is slightly underweight Russian hard-currency debt and overweight Ukrainian hard-currency debt.

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<sup>1</sup> Investment strategy positioning information is sourced from BlackRock and FactSet as of January 31, 2022. Information on fund holdings is available at [holdings.sei.com/holdings](https://www.sei.com/holdings).

## Glossary of Financial Terms

**Hard-currency debt:** Hard-currency debt is debt issued in the currency of the largest industrialized nations and is mostly composed of U.S. dollar, euro, sterling or Japanese yen.

**Local currency debt:** Local currency debt refers to assets denominated in local currencies.

**Risk premium/premia:** A risk premium refers to the additional potential return available to investors in assets that are perceived to be riskier. This additional potential return can serve as compensation for the additional risk being taken.

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