M&G Investments

COMMENT ON

Russia-Ukraine Conflict

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We are very concerned about the Russian invasion of Ukraine and its tragic consequences for the Ukrainian people, as well as its potential to destabilise the post-Cold War European political order. In our view, these are serious developments and we are concerned about the apparent market complacency reflected in current asset prices: the range of possible outcomes is extremely wide and investors seem to be unsure how to reflect the risks involved. No one knows what the extent, duration or severity of the conflict, or of the related sanctions, will ultimately be.

Impact on Financial Markets thus far

We initially saw a broadly negative global market reaction as global equities and bonds weakened amid higher risk-off investor sentiment, with South African bonds selling off 20-30bps across the curve and the rand depreciating against the major global currencies. However, the SA weakness has been nowhere near the magnitude seen during previous crises like Coronavirus or the Global Financial Crisis, and further, global markets have already recovered much of their losses from last week. A traditional risk bellwether – the US government bond market – also witnessed muted moves.

Meanwhile, global precious metal prices, including gold and platinum group metals (PGMs), as well as oil and gas prices, jumped on the back of supply uncertainties, given that the severity and types of some of the sanctions still to be imposed, and their longevity, remain unclear. If sustained, these could ultimately feed through into higher headline inflation rates, but it is far too early to make such a call.

As for South African equities, the market is marginally higher, though sector divergences have occurred - financials are relatively flat, industrials are marginally weaker, and resources have experienced good gains, led by gold, energy and PGM stocks.

M&G Portfolio exposure

Our client portfolios have extremely small exposure to Russian equities and debt instruments: For example, 0.06% equity exposure and 0.03% bond exposure in the M&G Balanced Fund unit trust, and 0.03% each for Russian equity and bond exposure in the M&G Inflation Plus Fund unit trust as of 28 February 2022.

For M&G Investments, the changes in market valuations and risks haven't been significant enough within the context of our portfolios for us to change our portfolio positioning in specific securities, or our asset allocation views. We continue to believe valuations on SA assets are priced favourably in light of their medium- to longer-term fundamentals. Also note that from a valuation perspective, we would anticipate that the relative attractiveness of our local asset valuations (both equities and bonds) could provide some downside buffer over the medium-term.

South Africa hasn't been able to escape the shorter-term impact on global investor risk appetite, nor will it avoid the possible future ramifications of extended high oil prices, but for now we believe it is too early to determine what the longer-term impact might be on company earnings, or on global and local growth and inflation.

The Russian economy represents only 2% of the global economy, but does have an outsize influence on global commodity markets, particularly oil and gas. If Russian oil and/or gas supplies are excluded from the global supply chain on a protracted basis, as part of further sanctions for example, then we could see a further spike in global energy prices and a larger impact on inflation than previously forecast. This, in our view, is the primary risk to the global economy and financial markets. However, as yet there have been no suggestions that this option is part of the menu of sanctions foreign governments are considering, and in our view would be very difficult to implement given that some 40% of European gas and 25% of their oil comes from Russia.

Going forward we will be keeping an extremely close eye on developments for signs of lasting effects and, as active managers, will seek to take advantage of any opportunities that might emerge to add value to our client portfolios, and to protect client portfolios from any new or rising risks. We are in regular discussions with our colleagues in London and debating any new facts as they manifest.

Our risk-conscious, valuation-based process is driving our investment process and fund positioning, as it has been for the past 25 years. Our various funds are well diversified to provide a level of protection against global geopolitical risks such as we're experiencing now.