Truist Advisory Services, Inc.

Global Perspective from the Investment Advisory Group

Our take on Russia-Ukraine developments and a potential silver lining

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Key highlights

- A full-scale invasion of Ukraine cannot be ruled out, but our take is the probability of such an event has lessened;
- Markets tend to eventually rebound from geopolitical events unless the event pushes the economy into recession;
- Higher energy and agriculture prices could disproportionately hit vulnerable members of emerging and European economies;
- From a contrarian standpoint, the ongoing carousel of concerns has resulted in very depressed investor expectations. Similar readings historically have been followed by positive S&P 500 returns more than 90% of the time on a 3- to 12-month time horizon.

What happened

The President of the Russian Federation, Vladimir Putin, signed executive orders to recognize two republics in the Donbas region of Ukraine, Donetsk and Luhansk. This official recognition has provided the pre-text for Russia to order troops into that region of Ukraine. The increased geopolitical risk is weighing on global markets. U.S. markets were closed for the President's Day holiday, but markets in Europe and Asia were down around 2% yesterday. The damage in sentiment was more visible in the Russian markets where stocks lost over 10% and the Russian currency declined more than 3%.

Our take

Technically, The Donbas region has been Russian-controlled since 2014

Since the Russian invasion of Crimea in 2014, the Russian-speaking Donbas region of Ukraine has been controlled via heavy Russian influence and military stationing. Now, with Russia's official recognition of the breakaway republics, an agreement signed between the parties which claimed to be based on friendship, cooperation, and mutual aid, allows Russian troops to officially be based in these two regions.

A full-scale invasion of Ukraine cannot be ruled out but our take is the probability of such an outcome has lessened

As mentioned in previous publications, Russia appears not to be intent on a full-scale invasion of Ukraine. The current situation is akin to Russia's invasion of breakaway republics in Georgia in 2008 and Crimea in 2014. And while Russia has amassed over a hundred thousand troops around Ukraine, military experts note that the current build-up is not enough to take and keep control of all of Ukraine. The current standing is a good enough win for local politics in Russia, and de-escalation could begin from this tipping point.

Types of sanctions will show the West's hand

The U.S. and its allies in Europe are working on a list of sanctions to be announced shortly. Sanctions could limit investments in these newly recognized republics and on certain people operating there as well as parts of greater Russia.

The global economic fallout could be contained if subsequent sanctions on traded goods and services from Russia stay limited. Russia is a major exporter of energy and industrial metals like platinum, palladium, titanium, nickel, and aluminum, as well as grains. However, any sanctions on these commodities and products would likely lead to upward inflationary pressure in markets, where inflation is already at multi-decade highs.

Higher energy and agriculture prices could disproportionately hit vulnerable members of emerging and European economies relying on commodities and energy sourced from Russia. The U.S., with its energy mostly sourced locally, is less vulnerable to supply shocks than in the past. This is one of the reasons we remain overweight domestic equities relative to international markets.

Market implications

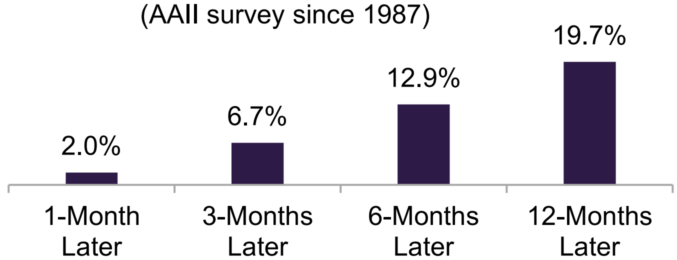
From a market perspective, we would be careful not to overreact to the recent rise in geopolitical events. While uncertainties remain, our work shows that historically **military/crisis events tend to inject volatility into markets and often cause a short-term dip, but stocks tend to eventually rebound** unless the event pushes the economy into recession. We still view near-term U.S. recession risk as low, especially given dramatically improving COVID-19 trends.

Investor sentiment also suggests the bar for positive surprises is low

From a contrarian perspective, one of the most favorable aspects of today's market is low investor expectations. Indeed, given ongoing geopolitical tensions, and concerns around inflation and monetary policy, the most recent survey from the American Association of Investors (AAII) showed **that the percentage of bulls dropped to just 19.2%, the lowest since mid-2016.** This is only the 32nd time since the survey's 1987 inception it has dipped below 20%.

While markets often remained choppy near term after similar past readings, the S&P 500 was higher three months later 94% of the time with an average gain of 6.7%. Stocks also rose 30 out of 31 times, or 97% of the time, on both a six- and 12-month forward basis, with average gains of 12.7% and 19.7%, respectively. The one major negative outlier where stocks fell was following the January 2008 signal when the economy was already in recession, unlike the current period or our expectations for this year.

Average S&P 500 returns after % of bullish investors dropped below 20%
(AAII survey since 1987)



	1-Month Later	3-Months Later	6-Months Later	12-Months Later
% of periods positive	**68%**	**94%**	**97%**	**97%**

Data Source: Truist IAG, FactSet, AAII. Past performance does not guarantee future

We see two potential offsets. The first is that the valuation for **the S&P 500 has now pulled back to 19.1x, down from 21.5x** at the end of 2021. While still not cheap, this is the lowest level since April 2020. Second, **the 10-year U.S. Treasury yield, which had been rapidly rising and causing investor angst, has eased somewhat.** Consequently, the equity risk premium, which measures the attractiveness of stocks relative to bonds, is within a range where the S&P 500 has tended to outperform bonds by double-digits, on average, over a 12-month forward basis.

Bottom line

We expect markets to remain choppy over the coming weeks as investors continue to digest these geopolitical events as well as the Fed's next steps. We also continue to expect more normal and frequent corrections this year. That said, the weight of the evidence still suggests that the primary market trend over the next 12 months remains higher and with low investor expectations, a little bit of good news could go a long way.

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