Truist Advisory Services, Inc.

Global Perspective from the Investment Advisory Group

What Russian sanctions mean for the global economy and markets

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Key highlights

- The new list of constraints placed on Russia is expected to have an effect not only on the Russian economy but also on the global economy, consumer sentiment, and broader financial conditions.
- This complicates the outlook and markets will remain very headline- driven and volatile near term. The repercussions will be long lasting as countries across the world rethink their relationship with Russia.
- The range of outcomes widens, but risks appear greater to international markets, such as Europe, that are more intertwined with Russia. Thus, the recent actions also serve to reinforce our U.S. equity overweight.
- While the news flow remains negative, we are encouraged that buyers stepped in to support the U.S. market at the first key fundamental support level. At this point, domestic economic growth is likely to be a notch lower, but we still see recession risk as relatively low.

What happened

On late Saturday, major global economic powers, including the U.S., UK, Canada, France, Germany, Italy, and the European Commission announced a new list of sanctions that would prevent Russia's central bank from using its **international reserves to undermine broader sanctions that were announced earlier in the week**. The new list of sanctions will place Russia, especially from the U.S. point of view, on par with countries like Iran, North Korea, and Venezuela. Excluding some Russian institutions from the global banking messaging system called SWIFT is one thing and still manageable from Russia's point of view but targeting the Russian central bank's foreign reserves took the economic side of the crisis to another level.

Coupled with previously announced sanctions, the new list of constraints placed on the Russian economy is expected to have an effect not only on the Russian economy but also on the global economy, consumer sentiment, and broader financial conditions.

Our take

Our heart goes out to the people of Ukraine

With the Russian army deep in Ukraine and continuing its military operation, there are much more significant concerns than the economic fallout of the crisis. The events and the scenes unfolding can be described as the worst crisis in Europe since the second world war. The human cost is a tragedy, with the loss of countless lives and the forceful immigration of millions. Our heart goes out to the people in Ukraine who are going through an ordeal hard to describe and bear.

Risk of Russia being removed from global bond and equity indices moved higher

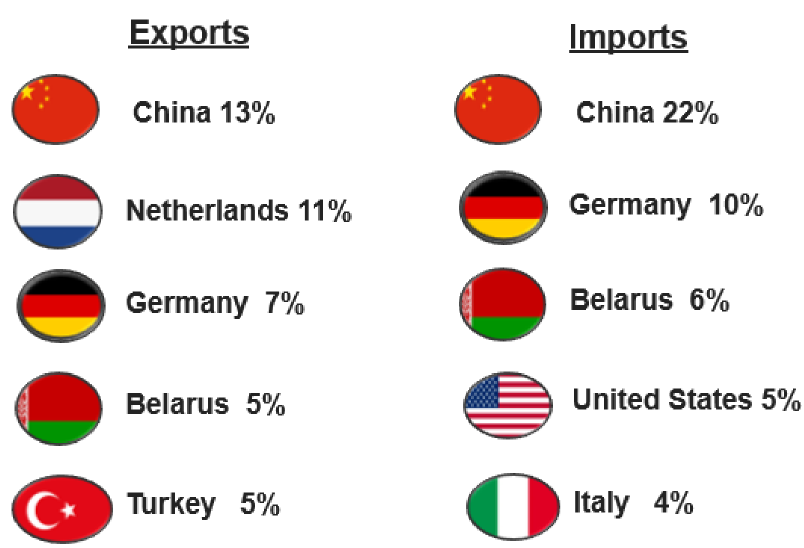
Global wealth funds started to announce limits on Russian investments, with Norway's sovereign wealth fund leading the charge. British Petroleum (BP) announced that it is planning to sell its shares in Russia's oil giant, Rosneft. Subsequently, Russia announced that it would temporarily ban foreigners from selling securities in local markets in Russia. This announcement could put Russia on a watch list by major equity and bond index providers, leading to the eventual removal of the country from major global indices. Rating agencies downgraded Russian debt to junk status with sanctions creating havoc in Russian financial markets and the economy.

Reverberations of the Russian currency crisis will be felt in neighboring regions

Like it did during the Crimean crisis, the Russian central bank raised interest rates, this time to 20% from 9.5%, to stop capital outflows. The Russian stock market was ordered to be closed on Monday to dampen the fallout. Nevertheless, the Ruble dropped another 20%, experiencing the steepest one-day drop of the current crisis.

There is no doubt that the epicenter of the economic crisis will be Russia, but neighboring countries that trade with Russia will also be affected. Russia is a top trading partner for many former Soviet Union nations and nearby countries. Tourism revenue of the nearby countries could be negatively affected with Russian tourists' purchasing power diminished significantly, and the restrictions on travel could last much longer than the crisis itself. The Russian economy is deeply intertwined with major European economies, especially for Europe's energy needs. Supply disruptions of energy to Europe could significantly impact the global economy.

Russia's top trading countries as a share of total imports and exports (%)



Data Source: Truist IAG, World Bank

It's not just energy; Russia is also a major commodity producer

In our earlier notes, we have mentioned that the global economic fallout could be contained if subsequent sanctions on traded goods and services from Russia stayed limited. With recent sanctions, it is evident that's no longer the case. Russia is a major exporter of energy and industrial metals; any sanctions on commodities for final products would likely lead to upward inflationary pressure in markets, where inflation is already at multi-decade highs.

Russia's export ranking in major energy and commodities

Mining/Producer	World Ranking
Natural Gas	1
Platinum	2
Palladium	2
Oil	2
Cobalt	2
Gold	3
Aluminum	3
Nickel	3
Phosphate	4
Silver	4
Iron Ore	5
Lead	6
Uranium	6
Boron	7
Gypsum	8

Data Source: Truist IAG, USGS

With Russian troops on the ground, Ukraine's exports are halted as well. Ukraine is a major exporter of agricultural products and some commodities. A prolonged halt on Ukraine's exports could significantly affect global food inflation.

Ukraine's export ranking in major agriculture and commodities

Mining/Producer	World Ranking
Sunflower seed	1
Potatoes	3
Pumpkins	3
Buckwheat	3
Dry Pees	4
Carrots	5
Titanium	6
Iron Ore	7
Graphite	7
Manganese	8
Uranium	9

Data Source: Truist IAG, USGS

Global economic implications

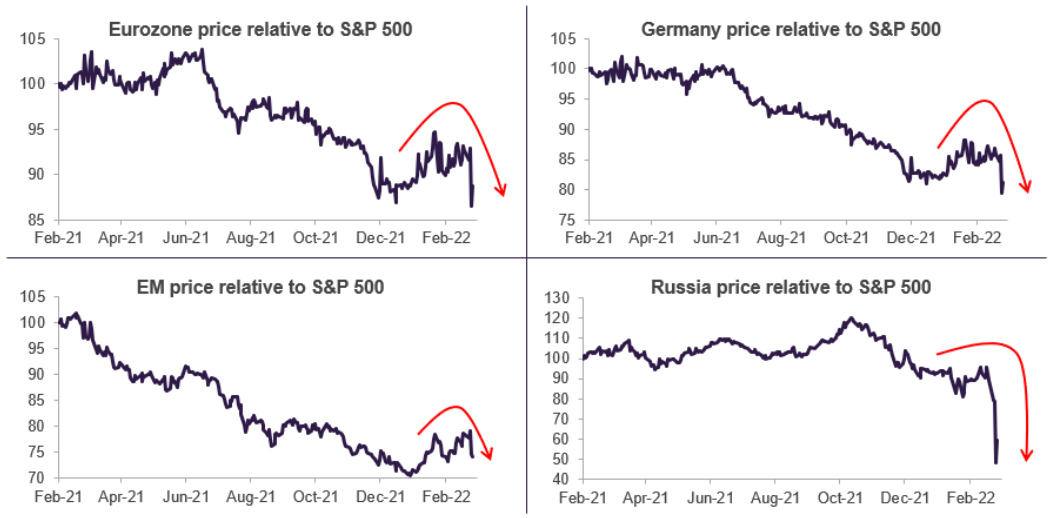
Russian nuclear forces were put on high alert, which seemed to respond to the turmoil in the Russian markets and economy. The economic isolation of Iran, North Korea, and Venezuela worked relatively well as these economies were not as intertwined with the global economy as Russia; more importantly, these economies didn't have much to fight with economically and militarily.

Russia, on the other hand, is a different story. Russia is one of the leading energy and commodity exporters in the world. In terms of proven oil reserves, Venezuela is the top country globally, Iran is number three, and both countries are already living under severe Western sanctions. Sanctioning another major energy producer could create supply shortages.

Market implications

Given the sanctions, global markets are under pressure, though in the grand scheme of things they are holding up relatively well given the news. Among the hardest hit groups are European banks, which are trading down more than 6%, with financial companies tied to Russia down much more.

The latest actions serve to reinforce our U.S. equity overweight. While the response has been more severe this time, the global markets are following the 2014 Crimea script, where the U.S markets held up much better on a relative basis to international markets. That said, investors should also recognize any progress towards a solution could also lead to a sharp snapback in some of these overseas markets.



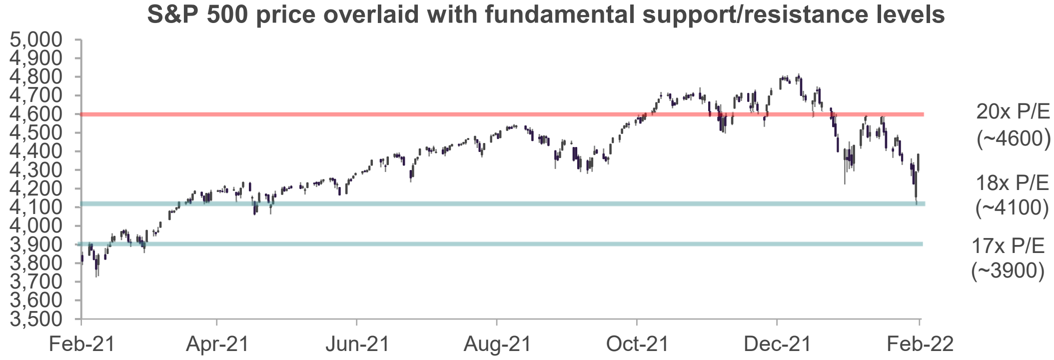
Data Source: Truist IAG, FactSet; Data as of 2/25/22. Past performance does not guarantee future results

Importantly, despite the negative news last week, U.S. markets—where we remain overweight—managed to close the week “up” and remain well above Thursday’s lows.

Notably, buyers stepped up last week with force just above the 4100 level on the S&P 500. This level coincides with a forward P/E of 18x and suggests that investors saw value at these levels. Greed and fear are a two-way street.

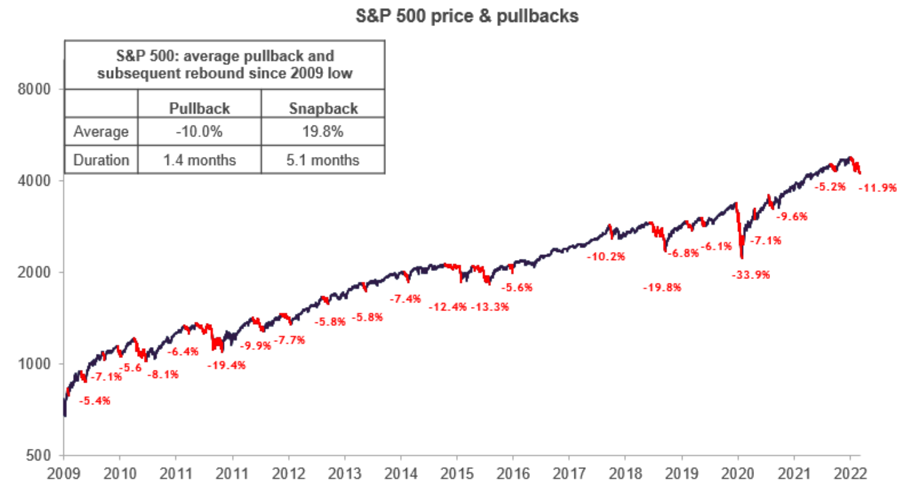
If conditions worsen, our base case continues to be that downside market risk will likely be contained in the 3800-3900 area. The 3,900 level coincides with a forward P/E of 17x; there is additional technical price support just above the 3800 level. Conversely, near-term market upside is likely to be capped around the 4,600 area. This level coincides with a 20x forward P/E multiple and technical price resistance.

S&P 500 price overlaid with fundamental support/resistance levels



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

As we discussed last week, it's also important to keep this in perspective. This is the 25th pullback of more than 5% that we have seen since the March 2009 low. Each setback came with bad news. Still, the S&P 500 has risen more than 500% since the March 2009 low. Importantly, snapbacks from these corrections have been sharp—**once stocks found their low, the average rebound over the next five months was 19.8**%.



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

Bottom line

The range of outcomes is wide and the ripple effects from the severe sanctions on Russia will have further consequences for the global economy, markets, and inflation. It complicates the outlook and markets will remain very headline driven and volatile near term. The repercussions will be long lasting as the world rethinks the relationship they have with Russia.

The risks appear greater to international markets, such as Europe, that are more intertwined with Russia. Thus, the recent actions also serve to reinforce our U.S. equity overweight. Even though the U.S. will not be immune to the global challenges, its economy is more insular. And while the news flow remains negative, we are encouraged that buyers stepped in to support the U.S. market at the first key fundamental support level. At this point, domestic economic growth is likely to be a notch lower, but we still see recession risk as relatively low.

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