Update on the conflict and its impact on the markets and our positioning

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As of the end of last week, the MSCI World Islamic index was down some 5.5% YTD. The S&P was down some 8%, while the Nasdaq was down 12.5%. Our strategies have generally outperformed their benchmarks YTD, with the Navigator fund down 2.6% while its benchmark is down 5.4%. The Global strategy is down around 0.9%. So significant relative performance.

The fall in the markets was initially driven by the expectations over tightening and higher rates. The markets are now pricing in the Russian and Ukrainian conflict. While markets corrected sharply on the announcement of the invasion, they rallied on Friday on the expectations that the Fed was under less pressure to tighten. Only to fall dramatically, as I write on Monday just before US market open.

We are relatively well positioned for the current uncertainty in the markets - we are overweight healthcare which is generally very defensive. In Navigator we are overweight Gold, which should provide a decent hedge. Also, our underweight in equities and sukuk has also helped. We are also overweight cash, relative to the benchmarks.

While we have a marginally overweight in energy stocks, we do have some exposure to Russia, either directly or through holdings such as BP. These have come under pressure, but they are relatively small positions.

Our expectation is that it could be a volatile few weeks. Oil is likely to be higher, unless of course the various leadership is able to find some common ground and negotiate their way out of this conflict. Right now, it's a very uncertain environment. Let's hope they can find some common ground and halt the conflict.

Generally, though, we feel our positioning is suitable for the environment and don't want to be too reactive to the environment, given how quickly the market dynamic can change.

Some further thoughts:

- If the crisis lingers, oil flirting with $150 should not be ruled out, further complicating the already-high inflation situation. If however, a peace deal is worked out it could fall off. So, at this stage we are holding back from adding.
- European equity markets appear vulnerable, due to exposure to Russian gas supply, US equities aren't entirely insulated from the crisis. We are underweight EU equities.
- Asian equity markets could be defensive but markedly inflation would create challenges. We remain overweight China at this stage.

As the war rages, investors should not make the mistake of interpreting the recent asset market performance as accurately reflecting the risks from the crisis. Everything appears fluid at the moment as governments and central bankers globally react with alacrity to developments in Ukraine. For example, there was a 'relief' rally in equity markets when investors saw the initial sanctions on Russia as 'watered down' and largely ineffective. When the invasion began, there was widespread belief that a closing-off of access to the SWIFT system for Russian banks was politically impossible. As of this moment, some Russian banks appear set to lose access to SWIFT, NATO countries have ratcheted up sanctions, and the Russian central bank will fear a run on the rouble with few levers to pull to stop the rout. Indeed, the Ruble is already down some 30% as at the time of writing

Looking back at the start of the conflict, commentators were almost united in their unspoken assumption that Ukraine would roll over quickly, leaving a Russia-imposed puppet government in charge. Everyone would calm down eventually, and financial markets would revert to familiar themes. Most commentators now see a starkly different reality.

Current indications are that this could be a long-drawn-out conflict. Political pressure will build for NATO countries to institute further punitive policies that impact Russia. We note that several countries are now openly talking about supplying offensive and defensive weapons to Ukraine.

Sadly, the Ukraine crisis is at risk of becoming the proxy between Russia and NATO. Should this unfold, it would be very negative for Russia and a continuation of the conflict would push oil prices up significantly.

While equity markets rallied Friday, we believe the risk of higher inflation and lower growth has increased materially.

Risk of higher inflation emanates from oil prices likely persisting at levels far higher than previously envisaged. Various forecasters suggest that oil could spike to maybe as high as $150. JPMorgan estimates that a $150 oil price would decrease global growth by an annualised 3% and boost inflation by 4%.

The risk of oil vaulting to $150 would be even more likely if Russia were to cut its supplies to Europe. Oil markets are already in a state of short supply, low inventories, and robust demand. OPEC's latest forecasts released last week envisage an oil market with less supply and lower stocks than previously forecast. OPEC meets on March 2nd and is expected to endorse its previous target of increasing oil supplies by 400,000 b/d in the coming months. However, recent OPEC output has been running at around 1m b/d below even its current target.

We believe that gold remains a good investment in current conditions. Some commentators suggest that gold has not performed, but that is simply incorrect. Gold has risen from $1800 to $1900 in February alone.

Equity markets remain vulnerable. At the epicentre of the crisis, European markets are probably the most vulnerable, even though they are not that expensive. Investors will be concerned that the region will suffer heavily from higher energy prices and as the fallout from Ukraine unnerves consumers and industrialists affecting post-COVID economic growth.

North Asian equity markets are having a more torrid time. The Hang Seng index fell 6.4% last week with a further government crackdown on tech stocks. Chinese stocks, which had started to show some resilience on hopes of greater support from the Chinese central bank (PBOC), have largely lost their momentum.

The US equity market falls into two camps; the positive is that the US is a long way from Ukraine, so US investors could simply discount the crisis as a European problem. However, it is more complicated than that. The Ukraine crisis is rapidly becoming a proxy conflict between Russia and NATO. The possibility of much higher energy prices would hurt the US economy. But, more importantly, the US equity market remains an expensive market that needs low interest rates and consistent good growth to maintain its poise.

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