Market Strategy
by STRATEGAS A BAIRD COMPANY

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With Russian troops officially entering Ukraine from nearly all directions, it is clear a major geopolitical event is at our doorsteps. We take a look at some potential next steps, likely sanctions, and longer-term implications of the action.

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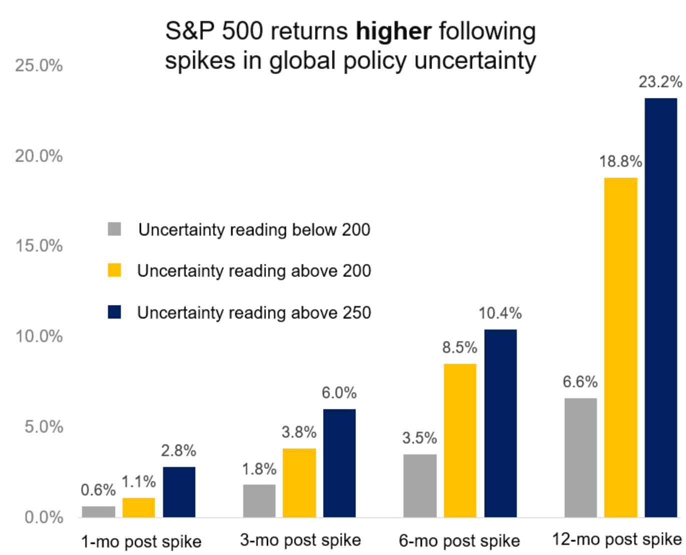
ON THE RUSSIA-UKRAINE TENSIONS

Swift Russian Victory or Protracted Resistance? If Russia's actions simply ended recognizing two breakaway areas, the impact could be similar to Crimea in 2014: limited sanctions, limited economic fallout. The impact for financial markets would be small, with more pain in Russia than the US. However, Russia has larger intentions and has now entered Ukraine. There are really two paths from here: **1)** A swift Russian takeover of the country with a new government installed. This event would be similar to Operation Desert Shield in 2003 with the lead up to the military event having a larger impact on financial markets than the event itself. Investors will be able to put book ends around potential outcomes; or **2)** Ukrainian resistance is stronger than Russia anticipates and the conflict will last longer. Energy and commodity prices are likely to stay elevated, adding inflation pressure and making the Federal Reserve's job even more difficult.

Sanctions Limited, But More To Come. After a relatively weak first round of western sanctions, the invasion into Ukraine will raise the stakes. We expect the US will impose export restrictions on critical technology and could possibly cut off US dollar access to Russian companies. Restricting Russian securities are also being discussed. Russia has already priced in these sanctions and are unlikely to stop or slow the invasion. Sanctions just make the action more costly.

Energy & Commodities Are Critical. Western countries are trying to hold back on energy sanctions due to rising prices at home and the adverse political ramifications of continued higher inflation. Thus far, no major Russian energy companies have been sanctioned, nor has there been serious talk of reducing imports of energy products from Russia (Russia is the world's third-largest producer of oil and second-largest producer of natural gas, with Europe being a key consumer). Russia's actions could have the effect of the US reaching an Iran Nuclear deal to get roughly 1.3 million new barrels of oil into the market. Russia is also a large exporter of other critical commodities.

Investment ramifications. These tensions are decidedly risk-off and should see money flow towards oil and traditional safe havens (e.g. the dollar, US Treasurys, gold) near-term, while weighing on equities and other risk assets. Upward pressure on oil and gas prices could cause a supply shock in oil and further cut into consumer discretionary income, greatly complicating the Fed's ability to tighten monetary policy. Longer-term, a bit more optimism. Forward returns from periods of elevated uncertainty are actually quite strong (see chart), while returns following other significant historical events have been more mixed. For instance, stocks were up double-digits both one year after Iraq invaded Kuwait and one year after the US-Iraq War began. While geopolitical events can cause uncertainty to spike and sentiment to plummet near-term, they haven't often resulted in longer-term economic or market pain (though the margin for potential outcomes is wide). In the end, as uncertainty grows, so does the impetus to focus on diversification, financial planning, and long-term outcomes. **Talk to your Baird Advisor today.**



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