

Equity Research; Russia/ Ukraine- Part 3



COLLINS SARRI STATHAM
INVESTMENTS

Research Report

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Key Risks to Price Target

Not applicable

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Sanctions v Russia, will they work?

Western government sanctions against Russia coupled with vast private sector sanctions are unprecedented. The sanctions are targeting the Russian Achilles heel, its pygmy economy, (amounting to the size of Netherlands + Belgium in GDP terms) that sells energy only and is highly import dependent.

The list below gives a snapshot of private sector closures just 2 weeks after the war started.

| AUTOMOBILES | CONSUMER | AVIATION | CONSULTATION | ENERGY | ENTERTAINMENT | FINANCE | NEWS/MEDIA | MANUFACTURE | SPORT | TECHNOLOGY | |
|--|---|---|--|---|---|--|---|--|---|---|--|
| Aston Martin Bentley Canadian Tire Daimler Ferrari Ford GM Harley Davidson Honda Hyundai Jaguar Mazda Mercedes-Benz Michelin Tire Nissan Nokian Tyres Renault Rolls-Royce Saddi Stellantis Subaru Toyota Volvo | Amazon Anheuser-Busch Asda Asos Bohoss Group British American Tobacco Brown-Forman Budvar Burberry Canada Goose Carlsberg Chanel Clorox Coca-Cola Croci Danone Diageo eddy Euse Lauder Farfetch Facer H&M Henkel Herbol Hermes Ikea Imperial Brands Indtess J Sainsbury Jysk Kilgob Kering Kimberly-Clark Kraft Heinz Lego Levi Strauss L'Oréal L'Oréal Knights Frank | AerCap Airbus Alaska Airlines American Airlines Boeing Bombardier Delta Korean Airlines United Airlines | Accenture Allen & Overy Bain & Company Baker McKenzie BCG CSIS Chippierfield Cleary Gottlieb Clifford Chance Deloitte Dentons Ernst & Young Fieldfisher Freshfields Grant Thornton Hines Kearney Knight Frank | 3m BP Eni Equinor Exxon GE Kinnos Cold Monroe Energy Norsk Hydro Oxy Pacifi Pram Shell Siemens Energy TotalEnergies Uniper Valero Energy Vitol Energy Waha Mango | Activision Blizzard Airbnb Booking Holdings Carnival DirectTV Disney Eurovision Expedia Hilton Hyatt Live Nation Entertainment Netflix Nintendo Norwegian Cruise Lines Oceania Cruises Paramount Regent Seven Seas Cruises Roku Take-Two Interactive T3 Mass Unilever Valio Walton Whirlpool YODK Yum Brands | Alliant American Express Adan Infrastructure Investment Bank Bank of China BlackRock BNP Paribas Citibank Credit Suisse Discover Fitch Goldman Sachs HSBC ICBC ING Intercontinental Exchange JP Morgan London Stock Exchange Group Mastercard New Development Bank Paycom Payroll Rabobank Remity Global Societe Generale Trafipura Vias Wise World Federation Of Exchanges | BBC Bloomberg Dow Radio Free Europe The New York Times The Washington Post | Aacorn Alcoa Atlas Copco BASF Caterpillar Dewes GlobalFoundries Hitachi Construction Honeywell JCB Komatsu Merco Outotec Rockwell Automation Sandvik Trimble Thermo Fisher TSMC WSP | Adidas FFA Formula One International Bobsled Federation International Cat Federation International Cycling Union International Hockey Federation International Skating Union International Tennis Federation International Weightlifting Federation IOC NHL NBA Puma S&P UEFA Under Armour Women's Tennis Association World Athletics Council World Boxing Association | Alphabet Adobe Akamai Amazon IT Group AHD Apple Assicurazioni Generali Autodesk Audi Bolt Bumble Cisco Cogent Communications Coursera Dell Deser EMC Technology Electronic Arts EPM Epicsson Etil Fortinet Grammarly HP IBM Intel NVEC Lightech Lumen Technologies Meta Microsoft Nokia Nvidia OneWeb Oracle Panasonic Raytheon Sabre Samsung SAP Siemens Snap Sony Spotify S&P Tata Twitter Uber Upwork VMware YouTube | World Boxing Council World Rowing Organization World Rowing Federation World Rugby Union WWE |

- Just McDonalds' closure in Russia, amounts to 62k jobs lost. Judging from online youtube commentary many Russians are not expecting these companies to return soon. Some have bravely voiced concerns over the sourcing of components, aircraft spare parts, software patches and the 'brain drain' to Israel, UAE and Turkey.
- More recent exits, Johnson & Johnson, Nestle, Munich Re, the world's largest companies in their respective sectors will deprive Russia of vital goods and services. The Russian economy is forecast to shrink 10% in 2022 (EBRD). That may prove conservative.
- The last Cold War (1947-1991) is described by wikipedia as a 'period of geopolitical tension between NATO and the Warsaw Pact....based around the ideological and geopolitical struggle for global influence'. A

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new Cold War has begun that will involve sanctions for a lengthy period. However the world is far more closely integrated in 2022 and as C-19 proved, economies can be very sensitive to external impacts.

- In terms of Asia, only Japan has heeded the message that ethical issues outweigh others. India is hell bent on circumventing sanctions with a misguided PM focused on cheap Russian oil and Rupee / Rouble convertibility. China has hamstrung itself by refusing to criticize Russia's approach. China cannot afford global economic alienation, but its dictatorial preferences require an ideological tilt towards Russia's attempt to annex its "wayward province". The bigger question is whether India or China can take such a morally corrupt stance given global public opinion.
- Russia's disruptive behaviour over many years, its needless cyberattacks, interference in democratic elections, bullying/ invading its neighbours, its support for Donbas resistance, domestic and overseas assassinations, airspace provocations, refusal to accept responsibility (for example MH17) has destroyed all vestige of trust in Russia under Vladimir Putin. The global Ukraine response has not happened in isolation.

The goals of global sanctions appear to be :-

- i) to end Russia's invasion of Ukraine
- ii) NATO achieving closer military containment of Russia given Ukraine's de facto client status
- iii) to create significant economic pain / Russian economic collapse / Russian public unrest / to ultimately achieve Russian regime change
- iv) to create a bargaining tool and means of holding Russia accountable for the cost of rebuilding Ukraine

Recent events remind me of 2002, when it became clear that Iraqi regime change was the true objective of the Bush Administration, not weapons inspections or Iraqi military containment or UN sanctions. I suspect the same is true today of the Biden Administration. However Biden realizes the US approach cannot involve the US military directly.

The United States recognizes that Ukraine's duly elected government should have the right to decide, (preferably with popular consent) if it wants to join NATO or the European Union, or any other international club, regardless of Russia's viewpoint. This was the view at the 2008 NATO Summit and it remains the case today. The Ukraine government's freedom of choice is the point of principle. Whether or not Ukraine is actually admitted to NATO or the EU or in what timeframe is another question, but that is almost beside the point.

Since February 24th 2022 it has become apparent that Russia has taken a course of action that, left unchecked and unopposed would create serious upending of the world order, create c.10m-20m refugees and encourage further Russian annexation / seizure of countries in its 'backyard'. At the same

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time confidence has grown in Ukraine's ability to resist occupation and mount a sufficient counter offensive that will stop Putin's acquisition plans. It is possible that the Russian armed forces will be defeated in the Ukraine which will destabilize Moscow.

It is also likely post the Bucha massacre, that further global sanctions and prohibitions, trade measures will be taken to block Russian oil, gas, steel, coal. But historical evidence suggests sanctions are a very blunt instrument that are far more likely to fail than succeed :-

| Country | Sanctions | Duration | Regime Change | Comment |
|--------------|--|-------------------------------------|---------------|---|
| Afghanistan | EU/ UK arms sanctions/ US seized \$7bn of bank reserves | 1999-present | Yes/ No | Poor outcome; US exit in 2021 post 20YR occupation. Taliban back in power. |
| Cuba | US embargo | 1960-2011 | No | Poor outcome Castro's rule 1959-2021 |
| Iran | US sanctions on financial sector, arms, nuclear tech | 1979-1981 1995-2020 2020 (US) | No | Complicated by US withdrawal from Iran nuclear deal 2018 |
| North Korea | Arms, materials investment restrictions | 1950s (USA) 2006-present (RoW) | No | Poor outcome, NK still testing nuclear launch capabilities |
| South Africa | Oil & Trade sanctions | 1987-1992 | Yes | Collapse of apartheid regime achieved/ elections in 1994 |
| Venezuela | Oil/ Banking/ foreign govt assets/ govt persons | 2015-present | No | Venezuela GDP-87% since 2012 (IMF), sanctions hurt the wrong people |
| Russia | Businesses/ Individuals As above | 2014- 2022 | No | Sanctions removal possible if Moscow fulfills 2015 Minsk II deal & leaves Ukraine |

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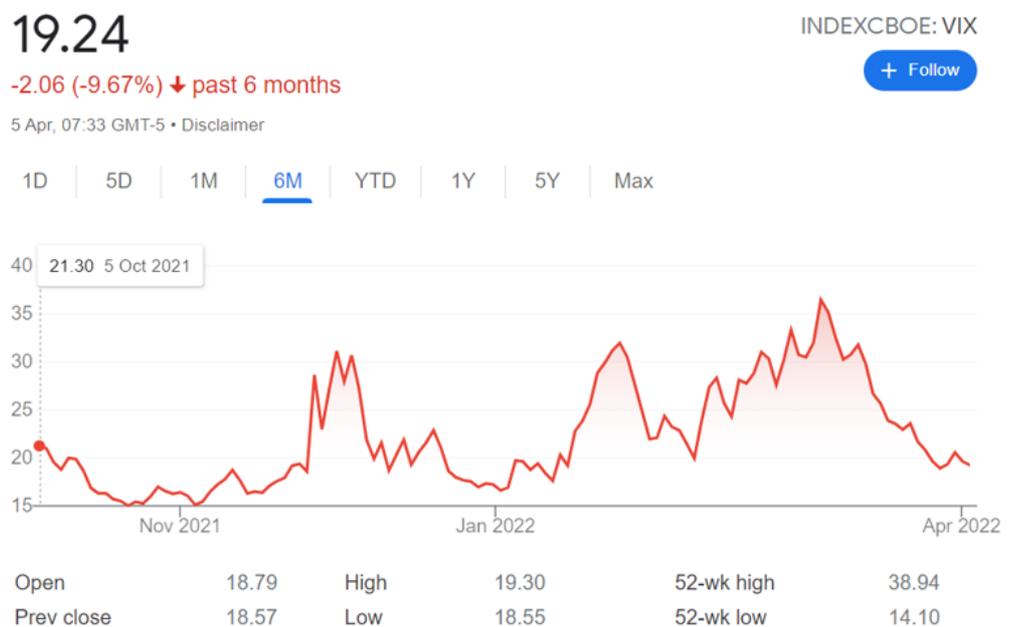
I am not saying sanctions are the wrong approach, they must be applied. However their track record is poor regardless of the circumstances. But against Russia, sanctions have been far more extensive and will hurt. The global response and quick alienation of the Russian economy has been so extensive that the continued operation of a failing military campaign seems like a bad option. However Putin is unlikely to be swayed by sanctions and could seek to escalate tensions via a number of nasty military options.

A great deal depends on continued Ukrainian military advances, and its access to US spy satellite data, Turkish drones and French surface to air missile supplies. So far, Ukraine’s military efforts have greatly surpassed expectations. But there must be far greater Russian public unrest than so far to sway Putin. How long will Russians tolerate economic hardship and 20% mortgage rates? Some dictators have survived sanctions for years, with public support, the Castro’s for example.

Conclusion; Q1 geopolitics reigned, Q2 market forces are re-asserting themselves

There has been normalization in the last month with UK blue chips trending upwards recouping their losses, despite the geopolitical context, higher interest rates and a cost of living problem. It is tempting to say the geopolitical problem is well understood and priced in. The move in the VIX (the US volatility index) is a telling sign of a calming down process in US assets, as well. This is normally positive for US blue chips.

Market Summary > VIX



Source: www.google.com

In my first article on this subject, I said the risk of conflict was 50:50 – the aim of investment research is not to predict warfare (I do not suggest a military

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expertise) it is hopefully to say yes there is a high risk of conflict, which was highlighted. Geopolitical risks remain high but their impact is increasingly localised. German blue chips for example have remained weak, and have not recouped their losses, due to recession risks being more elevated from energy disruptions.

Market Summary > Vanguard Germany All Cap UCITS ETF

20.97 GBP

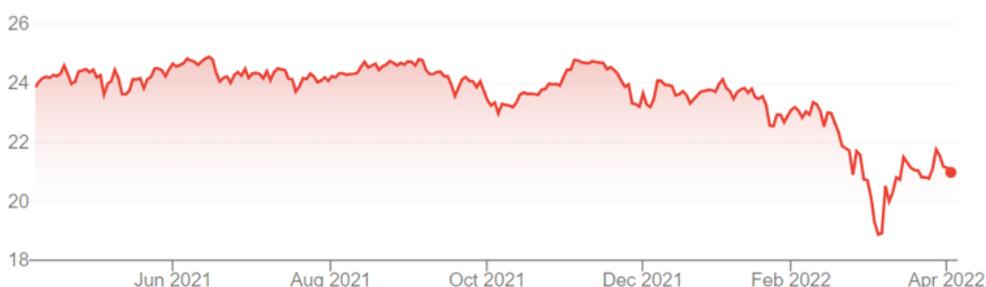
-2.89 (-12.12%) ↓ past year

LON: VGER

+ Follow

5 Apr, 13:59 BST • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



| | | | | | |
|------|-------|-----------|---|------------|-------|
| Open | 21.08 | Mkt cap | - | 52-wk high | 24.98 |
| High | 21.26 | P/E ratio | - | 52-wk low | 18.83 |
| Low | 20.97 | Div yield | - | | |

source: www.google.com

Overall I am more confident of improving equity market fundamentals over Q2 with a view to adding the laggards.

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