Market Update

With each passing day it seems that the violence in Ukraine is getting worse, and that the prospects for any durable, near-term and peaceful resolution are vanishing. We are not going to opine on the geopolitical significance of this conflict. Nor are we going to comment on the humanitarian aspects other than to say that the stories and images we all have seen are horrible. We will keep this commentary brief and focused on markets. In attempting to destroy the lives of Ukrainians, Vladimir Putin is causing severe collateral damage to the global economy.

We wrote last week that we do not believe that markets are on the verge of a Covid-like March 2020 meltdown. While we still believe that to be the case, we wanted to differentiate one aspect of this crisis from the market dislocation at the outset of Covid. A combination of technology and money got the economy through the Covid crisis and proved to be a tailwind for financial markets. Technology allowed many to seamlessly work remotely and led to the rapid development of vaccines and antiviral drugs. Fiscal relief and supportive monetary policy helped cushion Covid's blow to the economy. In the case of Russia's invasion of Ukraine, neither technology nor financial support can help insulate the economy from the impact of commodity shortages.

Russia and Ukraine are key producers of resources ranging from energy to food to industrial metals. Russia's rapid isolation from global trade and Ukraine's doubtful ability to supply global markets during a horrific conflict are causing a substantial repricing of critical commodities. Following sharp increases last year, commodity prices have further skyrocketed this year (and particularly in the last ten days) due to concerns over severe resource constraints (see the below graphic from Bloomberg with year-to-date changes in the far-right column).[1]

Commodity	2Day	Price	Norm Chg	%Chg	Time	%YTD
1) Energy						
2) NYM WTI Crude		125.96	+10.28	+8.89%	23:47	+67.48%
3) ICE Brent Crude		130.40	+12.29	+10.41%	23:47	+67.65%
4) ICE ARA Gasoil		1,330.75	+146.50	+12.37%	23:46	+99.51%
5) NYM NYH Gasoline		382.15	+27.75	+7.83%	23:46	+71.48%
6) NYM NYH Heating Oil		411.92	+34.29	+9.08%	23:46	+76.78%
7) NYM HH Nat Gas		5.05	+0.03	+0.60%	23:47	+35.28%
8) ICE NBP Nat Gas		460.27	+76.22	+19.85%	03/04/22	+169.73%
9) Metals						
10) LME Aluminum		3,849.00	+132.50	+3.57%	03/04/22	+37.10%
11) LME Copper		10,674.00	+323.00	+3.12%	03/04/22	+9.81%
12) Spot Gold		1,989.66	+18.96	+0.96%	23:57	+8.77%
13) DCE Iron Ore		836.50	+24.00	+2.95%	22:30	+20.18%
14) LME Nickel		28,919.00	+2,022.00	+7.52%	03/04/22	+39.32%
15) Spot Silver		25.90	+0.20	+0.78%	23:57	+11.12%
16) SHF Steel Rebar		5,046.00	+165.00	+3.38%	22:30	+11.92%
17) Agriculture						
18) CME Live Cattle		135.77	-2.58	-1.86%	03/04/22	-2.25%
19) ICE Coffee		224.25	+1.35	+0.61%	03/04/22	-0.86%
20) CBT Corn		775.25	+21.00	+2.78%	23:46	+31.35%
21) ICE Cotton		117.64	+1.22	+1.05%	23:47	+6.75%
22) CBT Soybeans		1,684.50	+24.00	+1.45%	23:47	+28.41%
23) ICE Sugar		19.35	+0.42	+2.22%	03/04/22	+2.49%
24) CBT SRW Wheat		1,294.00	+85.00	+7.03%	23:31	+74.89%

There is no easy technological or financial solution to resource disruptions. We can't simply print more oil, copper or wheat like we could money to help families and businesses get through the Covid crisis. Typically, new oil fields and mines take years to come online. Without a quick resolution to the current conflict that somehow results in Russia coming back into the global economic fold and Ukraine export capabilities returning, the world risks running low on key products for some time. The risk for the global economy is that resource shortages and price spikes exacerbate inflation while slowing growth – this is known as stagflation. It is not an ideal state.

Higher commodity prices threaten to result in higher prices for just about everything. From transportation, to heating, to electricity, to the food we eat and the goods we buy (think of the higher shipping costs in a world of $150 oil). The more that consumer and business spending shifts from things and services that are nice to have, to things that we need to have (like food and energy), the more money that will be directed toward resources and away from many of the goods and services we consume. We hate to say it, but this is potentially recessionary.

Barring a near-term resolution to the conflict, we think there are two likely pathways forward. Commodity prices this high are simply not sustainable in the medium to long term. If prices remain elevated, eventually new production will come online and additional supplies will meet demand, driving down prices. What may happen sooner is that high prices are in a way self-correcting in that they result in demand destruction, as fewer consumers and businesses can afford to maintain current levels of demand.

In any event, we do not expect elevated prices for commodities to persist indefinitely – or even longer than perhaps a few years at worst. But in the near term, there are no quick fixes to the amount of production that has come offline either due to the conflict or sanctions. Fortunately, North America is blessed with abundant natural resources and is far better positioned to weather this storm than many other parts of the world. Still, the near term disruption to the global economy are severe and markets will likely be turbulent.

Our advice doesn't differ much from last week in terms of how to position your portfolio. But we think it's worth advising (as we have in the past) to consider whether your portfolio structure and volatility exposure are in sync with your horizon and risk tolerance. The shorter the horizon you have, the more defensive you may want to position your holdings. The same goes for those less tolerant of risk and volatility. For investors with longer horizons who can stomach increased volatility, the current market gyrations are background noise – albeit incredibly tragic noise from a human perspective. Any material selloff could prove a good opportunity to add quality holdings with durable business models.

Additionally, we would also consider more exposure to geopolitically important industries. Quoting from last week now:

As we have written about in the past year, the world has underinvested in and undervalued stuff we need (like natural resources) relative to stuff we simply want (like technology). The energy shock Europe might experience due to the Ukraine fallout is a reminder that commodities make the world go round. Additionally, defense contractors will likely benefit from European nations increasing their military expenditures from far below 1% of GDP to levels closer to the US (2-3% of GDP). Other geopolitically important industries include semiconductors, artificial intelligence – particularly cybersecurity firms – and perhaps even life sciences firms.

Please reach out with any questions or concerns. This is a challenging market environment, changing on a daily basis and we are here to help you navigate through it.

Sincerely,

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Citations and Disclosures

[1] Bloomberg (as of 10:58pm CT March 6, 2022).

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