



**Philequity Corner (February 28, 2022)**

**By Wilson Sy**

### **Russian invasion**

True to Biden's warnings of an invasion and speculation that it would start after the Beijing Olympics, Russia began a special military operation to demilitarize Ukraine. A barrage of missiles rained down on Kiev and Kharkiv. Air strikes decimated Ukraine's military facilities including airfields, command posts, radar stations, and anti-aircraft missile systems. Ukraine's Foreign Minister Dmytro Kuleba stated that Russia had "launched a full-scale invasion of Ukraine."

### **"Peacekeeping" forces usher war**

The start of the war was signaled when Russian President Vladimir Putin announced that Russia recognizes Donetsk and Luhansk as independent republics. These are two areas in Eastern Ukraine that are controlled by pro-Russian separatist rebels who are funded and aided by Russia itself. Putin capitalized on the armed conflict between Ukraine and the separatists as he marched Russian troops into Donbas under the guise of peacekeeping forces. Putin claimed that he will protect Russians in the region against attacks from the Ukrainian government.

### **Understanding Putin**

In order to comprehend the rationale behind the Russian invasion, it is crucial to understand Putin's personal background. Putin started his career as a foreign intelligence officer in KGB, the Soviet Union's main security agency and the equivalent of the US Central Intelligence Agency (CIA). He was stationed in Dresden, Germany to gather intelligence on Western enemies. Because of his military background, Putin has always been patriotic while being extremely skeptical of Western powers. Putin is a judo black belt and practiced Russian sambo growing up. He is often photographed riding horses without a shirt to bolster his tough image. People describe the Russian leader as calculating, cunning, ruthless, determined, strong-willed, and fiercely nationalistic.

### **Restoring Soviet supremacy**

Putin was stationed in East Germany and witnessed the collapse of the Berlin wall. This was an incredible shock to him. He likewise saw the dissolution of the Union of Soviet Socialist Republics (USSR) which he referred to as the "greatest geopolitical catastrophe of the century." Considering his KGB background, aggressive temperament, and authoritarian tendencies, Putin is determined to restore Russia's status as a global superpower, similar to the position it held during the Soviet Union era. The USSR was a federal union of 15 national republics with a centralized government and economy led by Russia. The USSR was a global superpower due to its geographic size and the combined economies of its members. However, it was ultimately dissolved in 1991 when Soviet Union President Mikhail Gorbachev failed to revive the stagnating Soviet economy.

### **Putin roils against NATO expansion**

In 1990, the US and Russia verbally agreed that the North Atlantic Treaty Organization (NATO) would not expand beyond East Germany. However, NATO adopted an open-door policy and accepted applications from various European countries including former Soviet republics Estonia, Latvia, and Lithuania in 2004.

Since then, NATO military forces have been deployed in Poland, Estonia, Latvia, and Lithuania – countries that all share a common border with Russia.

Putin considers NATO's eastward expansion as an affront to Russia. He angrily remarked that NATO is "coming with its missiles to our doorstep." Ukraine and Georgia, also former Soviet countries that share a border with Russia, are both aspiring for NATO membership. If Ukraine and Georgia join NATO, Russia would be surrounded by NATO forces even more. Putin has drawn a red line with Ukraine because of its proximity and shared history with Russia. He has repeatedly stated that Ukraine's membership in NATO is unacceptable to Russia.

### **Sanctions from the West – can they stop Putin?**

The West has imposed sanctions on Russia targeting major banks, technology and aerospace companies, as well as Putin himself and his circle of oligarchs. The US spared Russia's energy exports from sanctions to avoid stoking higher energy prices. Brent oil reached a high of \$105.74/bbl when Russia attacked but settled at \$98.40/bbl after the US announcement last Friday. Another potential major sanction is cutting-off Russia from Swift, a secure messaging system that is widely used by banks around the world. Western leaders are promising to impose harsher sanctions that will cripple the Russian economy.

### **Russia invades, stocks rally**

Markets had corrected sharply in the days leading-up to the Russian invasion of Ukraine. However, equities staged a stunning reversal that bewildered investors when Russia actually invaded Ukraine. The Dow was down 859 points intraday and the S&P fell as low as 2.6%, but both benchmarks recouped their losses and closed positive for the day. This was followed by an 835-point advance of the Dow and a 2.2% gain for the S&P last Friday. It appears that investors took the opportunity to buy stocks while there is blood in the streets. This is a classic case of "sell on anticipation, buy on fact." Moreover, markets rallied and oil prices came down from their highs after Russia's energy exports were spared from sanctions and Biden's announcement of the release of US strategic oil reserves.

Though the market has bounced from oversold levels, there are still major risks emanating from the Russia-Ukraine war. What complicates the situation is Russia's status as a big producer of energy and commodities. Moreover, the invasion comes amid a global energy crunch and at a time when US inflation is at multi-decade highs. A prolonged strife between Russia and Ukraine would stoke even higher inflation and energy prices which can hamper growth. This may force central banks to hike interest rates much faster but at the expense of slowing down the economy. Investors are wary of the risk of stagflation that may be caused by high energy prices, elevated inflation, a fast climb in interest rates, and slowing economic growth. While markets have staged a dramatic rally, the situation bears watching due to the economic risks posed by the Russian invasion.

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