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Russia And Geopolitics Throw Another Curveball At Investors



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Markets

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Ukrainian President Volodymyr Zelensky (L) and Russian President Vladimir Putin (R) meeting in Paris ... [+] POOL/AFP VIA GETTY IMAGES

Russia’s invasion of Ukraine, in addition to the pain and devastation it has caused, also added another roadblock to the global economy’s attempt to return to some kind of “normal” after the pandemic. In addition to pushing oil prices even higher, it’s also broadly raised the level of inflation. Inflation

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history by Memorial Day. Inflation is evident in many other places, too – cars, housing, tuition, wages, and even food, to name a few.

In an attempt to help Ukraine without going to war, nations around the world have responded to the invasion with a new round of sanctions aimed at Russia and the oligarchs surrounding Vladimir Putin. Moves by major central banks have severely limited the Russian Central Bank's ability to sell "hard" currencies to defend the ruble. Since Russian troops moved into Ukraine, there's been a massive devaluation (~40%) of the ruble and Russian government bonds (some indicated at 10 cents/\$). In response, the Russian Central Bank has more than doubled interest rates, from 9.5% to 20%, and the government has prohibited Russian nationals from sending money overseas.

Even the threat of sanctions triggered a dramatic sell-off in the stocks of Russian companies, like Lukoil and Gazprom. To prevent further collapse, the Russian stock market was closed on February 28, with no word on when it may re-open. That may stanch some of the internal financial bleeding, but there's nothing the Russian government can do to stem the exodus of international companies. Major corporations have announced they will no longer do business in Russia, leading to a dramatic halt in the ability of the Russian population to acquire goods, services, and currencies that were previously available.

Perhaps the biggest effects, both in Russia and around the world, will be from the major energy companies that have said they will be abandoning their Russian operations. Future earnings for BP, Shell, and Exxon Mobil, each with billions of dollars worth of assets in Russia likely to be written off, are bound to be affected.

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since more than 10,000 financial institutions use SWIFT system to execute international transactions. But the Russians set up their own much smaller network after the annexation of Crimea in 2014. China has its own financial telecommunications system, and there are almost as many financial institutions outside the SWIFT network as in it.

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Like all the sanctions, it remains to be seen whether the banishment from SWIFT or any of these other efforts will be enough to change the mind of Putin and the Russian leadership. A big part of the problem with making sanctions effective is that Europe is so dependent on Russian natural gas, which, so far, the EU has exempted from sanctions. Since energy sales are a major driver of the Russian economy, granting such an exception appears to take a lot of the teeth out of the bite. It's not the strongest response, but perhaps it's all that can be done at this time.

The Russia/Ukraine crisis is bound to further feed the ongoing inflation

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uncertainty going forward. Of course, the long-term impact of the Ukrainian conflict depends on how long it lasts and whether or not some peace accord can be reached. Certainly, a worst-case scenario would be for it to spread beyond the borders of the two countries currently involved. NATO members are supplying Ukraine with financial support, military equipment, and even intelligence against its giant nuclear-armed adversary but avoiding committing “boots on the ground.”



While the world hopes for a swift and speedy conclusion to the conflict, there's an exceedingly low probability that a rapid peace accord can be reached where Russia pulls out.

In addition to a terrible humanitarian crisis and horrific loss of life and property, we should expect continued pressure on the global supply chain for all kinds of commodities while the fighting continues and after that. This

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opportunities in precious metals, like gold and silver, as well as stocks issued by precious metals producers.

Because of the global economy's dependence on it, the price of oil is among the biggest financial concerns arising from the Ukrainian conflict. With the current rally, oil is now trading at ~\$130/barrel, but many analysts are calling for it to hit \$150 or more. If this proves true, there remain numerous opportunities for investment in energy producer stocks, several of which appear significantly undervalued. There's also massive demand for steel right now, reducing surplus inventories and putting pressure on producers. Domestic demand for steel was already growing exponentially as Biden's infrastructure plan was starting to be implemented. Several companies are positioned quite favorably to benefit from the trend with steel, but it is important to take the time to research their fundamentals before you buy their stocks.

And on the long side, some companies that were formerly distressed due to the oil market sell-off during the COVID crisis, even though they've rallied tremendously, still look inexpensive. Many of those are reporting better than expected quarterly results and now even returning capital to shareholders with special dividends and stock buybacks. It has almost become routine to hear their management teams on earnings calls state that "this was the best quarter we've ever had."

So, although there's tremendous uncertainty right now, there are some very interesting pockets of opportunity for professional investors who have the time, resources, and expertise to fundamentally analyze companies in this rapidly changing environment. A good strategy may be to invest long in commodity producers that have good clean balance sheets and stand to benefit from the increased demand and favorable pricing. At the same time

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turmoil. But in the meantime, investors should keep a watchful eye on their portfolios and be prepared for changes due to geopolitics. And be on the lookout for the opportunities that always present themselves during times of crisis. Remember the old saying, “buy when cannons are firing and sell when the trumpets are blowing.”



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