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Harman Wealth Market Bulletin

Extended Conflict In Ukraine Warrants Change To Equity Exposure

Sanctions, support, and trade disruption create both challenges and opportunities.

At least for the next few years, however, we discern three important changes within the global economy that support adjustments to equity positions...

A lot has changed in a month. Since Russian forces invaded Ukraine on February 24th, hope for a short-term conflict and minimal disruption has all but faded. In its wake, the world has realigned back to the East-West tensions of long ago.

New economic challenges are at hand as well. Looking forward, the world will face the innumerable second-order effects of this moment for years ahead. At least for the next few years, however, we discern three important changes within the global economy that support adjustments to our various portfolios.

1. **Trade disruption leads to broad, elevated prices across commodities.**
   As part of sanctions, the U.S. and other NATO members aim to reduce or eliminate trade from Russia but ending Russian imports also requires finding new trade suppliers. The process is inherently disruptive and leads to higher prices until new trade lines can be fully established and efficiencies returned.

2. **Europe will end its co-dependence on Russian oil and natural gas.**
   Obviously, European nations are far too dependent upon Russia's oil and natural gas to end trade abruptly. Approximately 40% - 45% of the European Union's gas imports and 25% of crude oil imports originate from Russia.[1] Instead, Europe will deliberately transition away from Russia to replacement partners over time. Fortunately, U.S. energy companies stand on solid footing to help the EU meet its long-term objectives. Already, the U.S. is Europe's largest supplier of liquified natural gas (LNG) and has the capacity to become a more prominent long-term solution.[2]

...portfolios received changes on March 7th to increase exposure to a diversified set of industries. These include energy producers, energy infrastructure, industrial metals, agriculture, natural resources, and aerospace and defense

3. NATO member nations, including the U.S., will dramatically increase defense budgets.

One reason for Ukraine's robust resistance has been the vast number of donated arms from other supportive countries. Consequently, depleted arsenals will need to get replaced. Moreover, countries that have neglected defense spending for years will likely recommit to higher defense budgets ahead. Already, in the last month, seven European countries (including Germany and Italy) moved to increase investments in security spending.[3]

Portfolio Adjustments

In response to the changing landscape, portfolios received changes on March 7th to increase exposure to a specific set of diversified industries. These include energy producers, energy infrastructure, industrial metals, agriculture, natural resources, and aerospace and defense – categories that have historically performed well under such conditions. These exposures were accomplished through diversified mutual funds and ETFs that hold public traded stocks. As appropriate, the net exposure varied by portfolio.

Remaining consistent with our investment process, our portfolios will continue to adapt to significant changes in the economy. While there is clear recognition the economy is facing challenges, investors must understand fundamental growth is still being realized. Likewise, investors must be mindful of emerging opportunities in the midst of unexpected change.

Sources:

1. www.weforum.org
2. EIA.gov
3. MacKenzie, Christina. "Seven European nations have increased defense budgets in one month. Who will be next?" Breaking Defense.com. March 22, 2022.

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