Russia's Invasion Of Ukraine: Risks And Opportunities

Description

BY PORTFOLIO ARMOR

Troops on the Donbass front in Ukraine. Photo via RWA Podcast.

What's Next In The War

Likely, the fall of Kiev. Our Russian correspondent Anatoly Karlin, who successfully predicted the invasion when most thought it was a bluff, recently suggested Kiev might fall this weekend.

Why U.S. Markets Bounced After The Invasion

In our February 16th post, we suggested investors hedge; ZeroHedge suggested on Friday that investors hedging beforehand led to the U.S. markets bounce after the war started. That may be part of the reason for the bounce, but we suspect another is what didn't happen, or at least hasn't happened yet.

Russia's invasion didn't lead to war with NATO, and the West hasn't so far resorted to nuclear-level sanctions against Russia, such as removing it from SWIFT or boycotting its energy exports. In fact, as Javier Blas reported on Thursday, Europe was set to buy **Russian gas piped through Ukraine** on Friday.

The Risks That Remain

The risks that remain are big though, so we suggest investors take advantage of the bounce and add downside protection if they haven't already. The biggest risk is that the current war escalates to one between NATO and Russia. One possible way that could happen is if Russian aircraft inadvertently violate NATO airspace.

Another possibility is hawks in the U.S. succeed in getting NATO to implement a no-fly zone over Ukraine.

Recall that the West has implemented no-fly zones in the past against Libya and Iraq, but these were third world countries with negligible air forces or air defense capabilities. Russia, in contrast, has a well-equipped air force and air defense artillery.

Another risk that remains is that sanctions imposed against Russia become more severe, leading to reciprocal sanctions and metastasizing economic disruptions. We saw a small taste of that this past week, when Russia responded the UK's ban on Aeroflot flights landing there by banning British airlines from flying over Russia, closing them off from profitable great circle routes to Asia.

Similarly, if calls to exclude Russia from SWIFT succeed, that could lead to unintended consequences, such as Russia partnering with China on a competing system, which might lead to a weakening of U.S. dollar hegemony.

> The best case scenario for investors (and, more importantly, for limiting human suffering) remains a quick end to the war, but on Friday, the U.S. State Department opposed ceasefire negotiations between Russia and Ukraine.

Possible Opportunities

There are potential opportunities in some beaten-down Russian stocks now. In our personal account, we bought shares of two of them on Thursday and Friday: Yandex (YNDX) and Gazprom (OGZPY). Just to clarify: neither of those stocks were Portfolio Armor picks. For an idea of the sort of names Portfolio Armor has picked recently, these were its top ten names last month:

Screen capture via Portfolio Armor on 1/27/2022.

And here’s how they’ve done since, versus the SPDR S&P 500 ETF (SPY):

Portfolio Armor tends to pick stocks that have been going up recently, such as the current winner from the January 27th cohort, the oil E&P Antero Resources Corp (AR); Yandex and Gazprom both dropped significantly (along with the rest of the Russian market) after the invasion started. But while investors in U.S. stocks may be underrating the risks of the war, investors in Russian stocks may have overrated them. Yandex is essentially the Google (GOOG) of Russia, with 92% of its revenues coming from inside Russia.

As such, foreign sanctions would seem to have limited impact on it.
Gazprom of course sells plenty of gas to Western Europe, so it could be vulnerable to sanctions more severe than those that the West has currently imposed. But Germany's dependence or Russian gas makes those sanctions unlikely.

And as of Friday's close, contra data you'll find on some popular financial sites, Gazprom's forward dividend yield was about 22%.

One additional risk there, however, is that a Russian politician has mooted freezing dividends for residents of countries sanctioning Russia.

His proposal only mentioned bank stocks, but it's possible if that were implemented it could be extended to non-financial stocks such as Gazprom.