PMK
WEALTH & ADVISORY

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Impact of the Russian/Ukrainian conflict on the PMK Prescient FoFs Portfolios

We at PMK have continued to monitor the impact of geopolitical events on all our funds. This note confirms the limited direct exposure to the region.

It has is now almost 3 weeks since Russia launched their invasion in Ukraine, yet the conflict continues to heighten uncertainty in the global markets and outlook for economic growth. Even though both Russia and Ukraine have a limited contribution to the global economy, widespread sanctions against Russia, as well as the risk that the conflict may spill over to other politically volatile regions, are perceived by the media as significant.

Ukraine and Russia limited in indices

Before the escalation of the conflict, Russia's equity market constituted 0.4% of the MSCI ACWI index and 3.4% of the MSCI Emerging Market index1. These exposures have since significantly reduced on the back of the sell-off in Russian-listed assets. The Ukrainian stock market has not formed part of either of these indices since August 2015.

Sanctions against Russia by Western countries have drastically increased. This has caused a massive sell-off in Russian shares and the global trade in the country's shares and bonds have all but completely ceased. Currently, it is almost impossible to exit any position in the Russian market, which will restrict asset managers from exiting any Russian positions held prior to the escalation in conflict, There is currently also no active price discovery in the Russian market with no changes in the observable prices of Russian shares. This could result in stale prices being published by Russian Stock Exchanges and most likely do not reflect the true impact of the conflict, and more importantly, the effect of the sanctions.

Market reactions

Surprisingly, the global markets, and especially the South African market, have been very resilient during the initial days of the crisis. Unlike most global socio-economic crises, we did not see a significant flight from risky markets and asset classes. The PGM (Platinum Group of Metals) has been well supported by the current sanctions on Russia, a significant exporter of PGMs. The South African market has been well supported by this jump in PGM prices, as well as the increase in the gold price. The rand, as well as the bond market, also held its ground surprisingly well.

A week after the invasion we started to see significant volatility in local and global markets, especially driven by shares that have direct operations in Russia or Ukraine. However, energy shares, gold and PGM shares are continuing to support local and global markets. Following from Herman van Papendorp (Head of Research and Insights at Momentum Investments) and Sanisha Packirisamy's (Economist at Momentum Investments) Cover Magazine podcast that discussed the current Russian and Ukrainian conflict, we have started to see many of the risks that they had highlighted start to materialise. As an example, the oil and gas prices have increased significantly since the invasion.

Looking forward

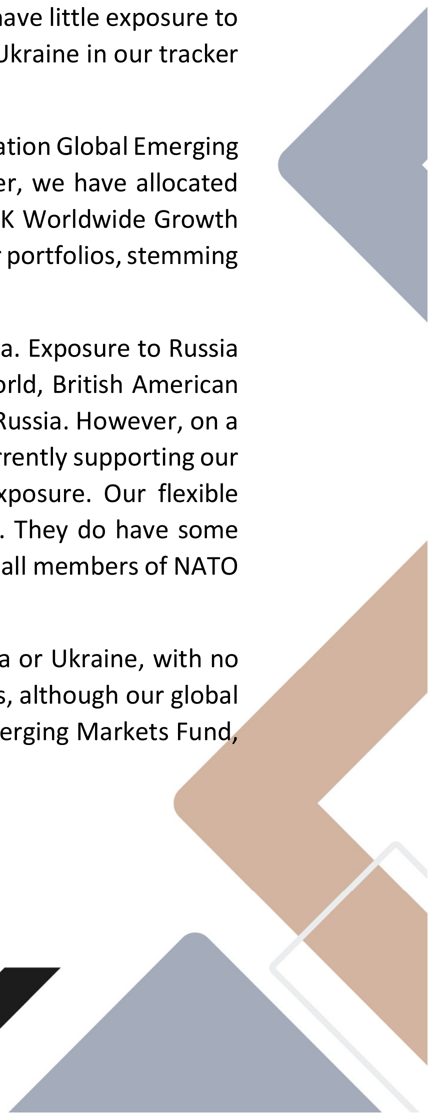
Our expectation is that this conflict will further exacerbate the global inflation risks, which could result in more aggressive interest rate increases. Inflation in the US is already well ahead of long-term normal trends and bond yields already started to rise significantly prior to the escalation in the conflict. We still believe the normalisation of global monetary policies is the biggest risk to global markets in the short to medium-term and the conflict may well exacerbate this risk. Central banks may also approach interest rate increases with a lot more caution, given the heightened risks to the global growth outlook.

It is also important to consider the second order effects in the markets. Typically, in stressed market conditions, one would expect gold to perform well as is currently being observed. Higher gold prices and PGM prices are to a large extent supporting the South African market.

Our Exposure

In our portfolios, we are currently marginally overweight local equities and bonds and marginally underweight global bonds. We are comfortable to maintain these positions from an asset allocation perspective. We have also been engaging with our local and global equity and property managers around their direct and indirect positioning and exposure to Russia:

As mentioned, the MSCI ACWI Index and the MSCI Emerging Market index also have little exposure to Russia and Ukraine and subsequently, we have limited exposure to Russia and Ukraine in our tracker fund CoreShares.



The fund in our portfolios with the highest direct exposure to Russia is the Coronation Global Emerging Markets Flexible (ZAR) fund, with approximately 10% direct exposure. However, we have allocated prudently to this fund, with our highest allocation to the fund being in the PMK Worldwide Growth Prescient FoF portfolio at 2.0%. Therefore, the effective exposure to Russia in our portfolios, stemming from this fund, is at most 0.2%.

The local equity managers in our portfolios have very limited exposure to Russia. Exposure to Russia is mainly indirect through locally listed companies such as Richemont, Barloworld, British American Tobacco, Mondi, Prosus and Glencore. These companies all have operations in Russia. However, on a look-through basis, we have a healthy exposure to gold and PGMs, which are currently supporting our local equity carve-out's relative performance against this indirect Russian exposure. Our flexible property manager, Catalyst, has no direct exposure to Russia nor the Ukraine. They do have some exposure to Eastern European countries like Poland and Romania, but these are all members of NATO and the manager does not foresee a spillover of the conflict to these regions.

The PMK Global offshore funds also have very limited direct exposure to Russia or Ukraine, with no standalone allocations to Russian or Eastern European equity or bond strategies, although our global managers had some relatively small exposure (the largest being the Fidelity Emerging Markets Fund, with exposure of 7.3% across 5 Russian stocks).

On a look-through basis our Funds had the following exposures to Russia before the conflict:

- PMK Income Prescient FoF – 0.0%
- PMK Stable Prescient FoF – 0.3%
- PMK Balanced Prescient FoF – 0.8%
- PMK Managed Prescient FoF – 0.7%
- PMK Worldwide Growth Prescient FoF – 0.7%
- PMK Global Flexible Prescient FoF - 0.5%
- PMK Global Cautious Fund IC Ltd - 0.7%
- PMK Global Growth Fund IC Ltd - 0.8%

Conclusion

At PMK, we pride ourselves in managing capital to optimize risk adjusted returns over the appropriate time horizon. It is therefore important, in these turbulent times, to stay with the financial plan we have developed with you. There will always be periods of stress in financial markets, but these same periods of stress also create investment opportunities. In March 2020, we saw one of the most significant sell-offs in financial markets off the back of the COVID-19 pandemic. One of the worst decisions we could have made at this time was to de-risk portfolios due to fears and poor market sentiment. Not only would investors have realised their losses, but they would have also missed out on the phenomenal recovery we have seen in the markets since then. This would have severely impacted the likelihood of achieving your financial goals.

We remain disciplined and steadfast in our approach of avoiding unacceptable losses in our portfolios over 12 months while optimising the likelihood of achieving the stated benchmark, given each portfolio's stated risk objectives and measurement periods.

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