Letter from the Global Chief Investment Officer

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I would like to open our extraordinary commentary on financial markets by expressing sympathy for and solidarity with all those who are suffering as a direct consequence of this terrible situation. Financial markets were not discounting the worst scenario, that of a conflict between Russia and Ukraine. The current volatility is therefore a reaction to the unexpected. Looking back at past instances of war, we can confidently say that it will take a few months before financial markets stabilize to levels where the consequences of the conflict on the real economy will be factored in. History also tells us that after a war-related stock market crash, investors who did not panic and, on the contrary, had the courage to invest, were rewarded with double-digit returns in the long run.

Most NATO countries are in the process of adopting sanctions against Russia and it is difficult at this point to even quantify the likely impact of any Russian retaliation on the European economy. The only prediction we can make at this time is that Europe will likely have to go through a period of lower-than-expected economic growth and higher and more persistent energy-driven inflation. The increased level of uncertainty now hanging over the European economy should prompt the European Central Bank to adopt a more cautious monetary policy approach. In particular, the decision to start removing monetary stimulus and raising rates could be postponed – if this proves to be the case, we could end up at the end of the year with European government bond yields at very low levels, most likely below the rate of inflation, and at the same time, with very attractive equity risk premiums.

The combination of negative real rates and high equity risk premiums would again reaffirm our preference for equities over bonds. The Federal Reserve may also decide to take a more cautious approach to raising rates, which could eventually reach a level below what markets currently expect. If so, even the more expensive U.S. stock market could show attractive risk premiums when conflict gives way to diplomacy and political leaders return to talking to each other to find a compromise that is acceptable to the three major powers that dominate the new world order: the United States, China, and Russia.

In fact, the increasing geopolitical instability that the world has experienced in the last twenty years, could be – in part – explained by the transition from a bipolar balance linked to the Cold War between the US and the Soviet Union, to a tripolar balance yet to be achieved, where the military superpowers are the US, China and Russia. In this tripolar world, for Europe to continue to play an important role, a further push toward fiscal union is likely to become a necessary condition, especially if the current 'energy crisis' strengthens Europe's determination to accelerate the transition to clean energy and greater diversification of its natural gas and oil supplies.

Therefore, in the medium to long term, we are even more convinced than before that it is necessary to invest in the companies that will make this transition happen. The lesson we have learned through many past crises is that, in order to build resilient portfolios that recover losses faster and generate positive returns ahead of market indices, we need to focus on long-term trends, investing in companies that have strong balance sheets and are major players in bringing said trends to fruition. Our portfolios obey these principles.

We cannot anticipate now how and if we will change our portfolios in the short term, but we can assure you that we are examining each company in them to assess the strength of its balance sheet and pricing power. As in previous economic crises, we will rely on our disciplined investment process, based on the core pillars of diversification and quality, because experience has taught us that when you have the right level of focus on both, you can weather any storm.