Crisis in the Ukraine: What Investors Need to Know

The most significant standoff between Russia and the West since the Cold War era is leaving investors with more questions than answers.

Russia supplies about one-third of the oil and gas imported into the European Union, a dependency that complicates its efforts to team with the United States on economic sanctions.

What started in March with Russia's annexation of the Ukrainian region of Crimea continues to evolve as tensions mount with no resolution in sight. In mid-April, Russian, Ukrainian, American, and EU leaders struck an agreement in Geneva, Switzerland, that was intended to defuse the crisis, but the deal unraveled quickly, leaving the United States and Moscow pointing fingers at each other as violence between government forces and pro-Russian militants escalated.

In response, the Obama Administration levied new sanctions against Russia, concentrating on the substantial holdings -- including 17 banks, energy companies, investment accounts and other firms -- of four billionaires viewed as part of President Vladimir Putin's financial circle.[1]

Speaking to reporters, President Obama said the goal of the targeted approach was to "encourage [Mr. Putin] to actually walk the walk and not just talk the talk when it comes to diplomatically resolving the crisis in Ukraine."[2]

As the weeks turn into months, anxious investors are left to wonder what comes next -- and what that might mean for them.

Reaction Thus Far

Investors across the globe are keeping a watchful eye on the crisis in eastern Europe and its potential impact on investment performance. The MSCI World and MSCI Emerging Markets indices have experienced heightened volatility since mid-March, when the situation began to unfold.

Adding negative fuel to investor concerns, on April 25, Standard & Poor's Financial Services downgraded Russia's long- and short-term foreign currency sovereign rating to BBB- status -- one step above junk. S&P said the decision to downgrade was based on the recent, large capital flows out of Russia, which had the potential to further undermine the economy's already weakening growth prospects.[3]

Indeed, according to a Reuters' analysis of Lipper mutual fund data, more than three-quarters of asset managers cut their Russian allocations in the first quarter of 2014. Year-to-date (as of May 7) the ruble-denominated MICEX index is off 13% while the dollar-denominated RTS has declined 21%.[4]

Deeper Western Sanctions

The current sanctions imposed by the West have focused on freezing the personal assets of influential Russians close to President Putin. If these measures prove unproductive, the next step may be for the United States to begin sanctioning companies in sectors such as energy and finance, which are vital to the Russian economy. Experts say this would undoubtedly get the attention of Russian leaders, forcing them to either break the diplomatic stalemate and negotiate, or retaliate by imposing their own counter-sanctions -- such as cutting energy supplies to western Europe.

Russian gas exporter Gazprom provides one-third of Europe's gas needs and about 50% of that is piped through the Ukraine.[5] While possible, most analysts do not see Russia shutting down energy exports -- which account for 70% of the country's exports.

Still, if tensions continue to mount and the parties involved cannot agree to negotiate a solution, analysts predict negative repercussions for the global economy.

Europe's Vulnerable Position

While the United States enjoys relative independence (it recently surpassed Russia to become the world's largest natural gas producer), Europe is another story.[6] Russia supplies about one-third of the oil and gas imported into the European Union, a dependency that complicates its efforts to team with the United States on economic sanctions. Further, the EU's exports to Russia are valued at $170 billion a year, with Germany standing alone as Russia's largest trading partner in Europe.[5]

With its economic destiny so closely tied to Russia, the EU is in a precarious position when it comes to taking its place at the global negotiating table while also struggling to emerge from its own protracted recession.

Takeaways for Investors

As this East-West drama continues to play out in the daily news, consider some "tried and true" strategies for coping with the bouts of market volatility it is likely to produce.

Don't panic. Don't sell into a rapidly declining market and don't buy into a rapidly rising market. You'll just be following the herd and locking in losses. Panic sellers also run the risk of missing the market's best-performing days.

Watch your asset allocation. During volatile times, more risky asset classes such as stocks tend to fluctuate more, while lower-risk assets such as bonds or cash tend to be more stable. By allocating -- and monitoring -- your investments among these different asset classes, you can help smooth out the short-term ups and downs.

Consider dollar cost averaging. A systematic purchasing plan, this can help in volatile times, as it provides for regular purchases over a period of time, taking the guesswork out of specific timing of purchases.

Sources:

[1]*The New York Times*, "U.S. Expands Sanctions, Adding Holdings of Russians in Putin's Financial Circle," April 28, 2014.

[2]The White House, Office of the Press Secretary, April 28, 2014.

[3]*Pensions & Investments*, "Ukraine crisis begins to hit pension coffers," May 12, 2014.

[4]Reuters, "RPT- Some investors hold fast in Russian markets, unfazed by big retreat," May 12, 2014.

[5]*CNN Money*, " 3 risks from the Ukraine crisis," April 28, 2014.

[6]*The New York Times*, "U.S. Hopes Boom in Natural Gas Can Curb Putin," March 5, 2014.