Commentary

March 2014

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Escalating Turmoil in Ukraine

- The Russian-backed President of Ukraine has been ousted.
- Russia has significantly expanded its military presence in the Crimea region in southeastern Ukraine.
- SEI Funds have little direct exposure to Ukraine and modest exposure to Russia.

Economic and geopolitical turmoil in Ukraine have been making headlines for some time now, but recently these events have also begun to roil global financial markets. Tensions have been running high for weeks with civil unrest fueled by a desire from ethnic Ukrainians to join the European Union. A bloody confrontation eventually led to the ouster of Ukraine's Russian-backed President Viktor Yanukovych followed by a Russian troop deployment in the Crimea region in southeastern Ukraine. Western nations view this as military aggression, while Russia believes it is protecting its interests—a large population of ethnic Russians, naval base in the Black Sea city of Sevastopol and critical natural gas distribution infrastructure—in Crimea.

Markets in both Ukraine and Russia have tumbled, with Russia implementing an emergency rate hike in an attempt to stem capital outflows and prop up a ruble that has fallen about 10% in 2014. Global equity markets went into a turmoil-induced slide to start March as investors fretted over rising oil and natural gas prices. Europe relies on Russia as a key supplier of natural gas and to a lesser extent oil. Russia has in the past turned off the natural gas spigot for political gain.

Our View

From a regional perspective, the natural gas situation alone provides enough leverage to keep Russia's neighbors largely in check. More broadly, Russia's geographical proximity to Ukraine coupled with its military strength will keep western nations from making significant waves—there will be some tough talk and perhaps a few sanctions, but we don't envision any direct western military intervention at this point. In the end, Ukraine is far more important to Russia than to any western country.

Our Funds

SEI has no direct equity exposure to Ukraine and very limited fixed-income exposure—about 1% in focused emerging market debt funds (which is underweight the benchmark). SEI equity funds investing in emerging markets have exposure to Russia—roughly 7% for focused emerging markets funds and up to 1.5% for funds with more modest emerging markets exposure (many funds have little to no exposure). Equity exposures to Russia are generally in line to slightly overweight the benchmarks, while fixed income exposures are underweight.

The overall situation has resulted in elevated volatility, with contagion being the primary risk. Russia's stock market—which we did not view as a particularly favorable environment to being with—plummeted into correction territory (a greater than 10% drop) and world markets have also moved lower.

We have not made any significant adjustments to our portfolios in response to these events, preferring rather to monitor the situation for signs of further contagion and ride out what will likely be transient volatility. Our managers are taking a similar wait and see approach. Russia has surprised investors in the past, so those with exposure to the region are likely to remain cautions and those without exposure will see no reason to add any.

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