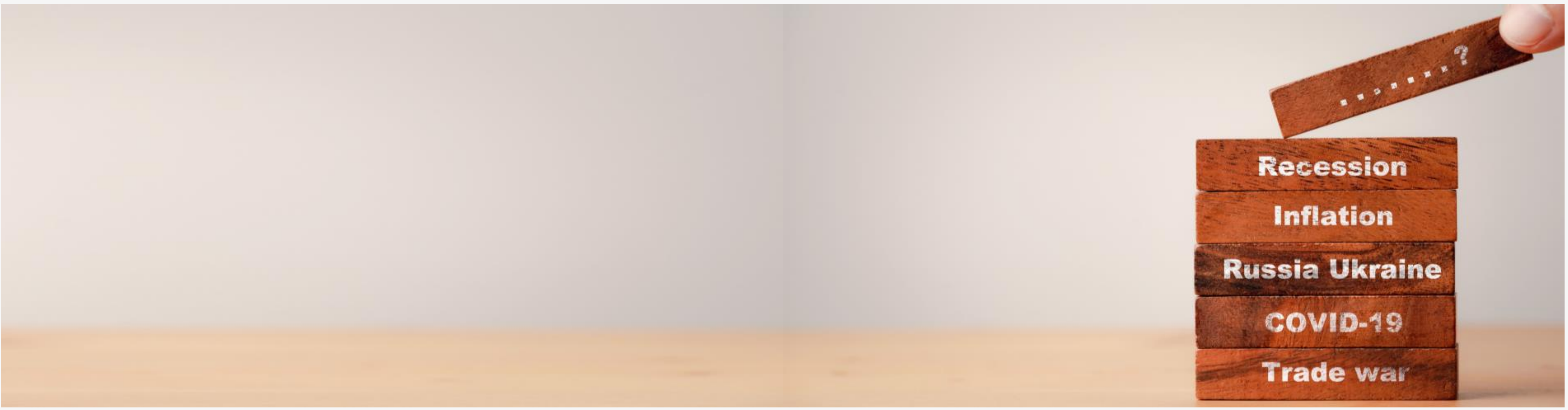
Special Report

How Conflicts and the Pandemic Reshaped Investment Strategies



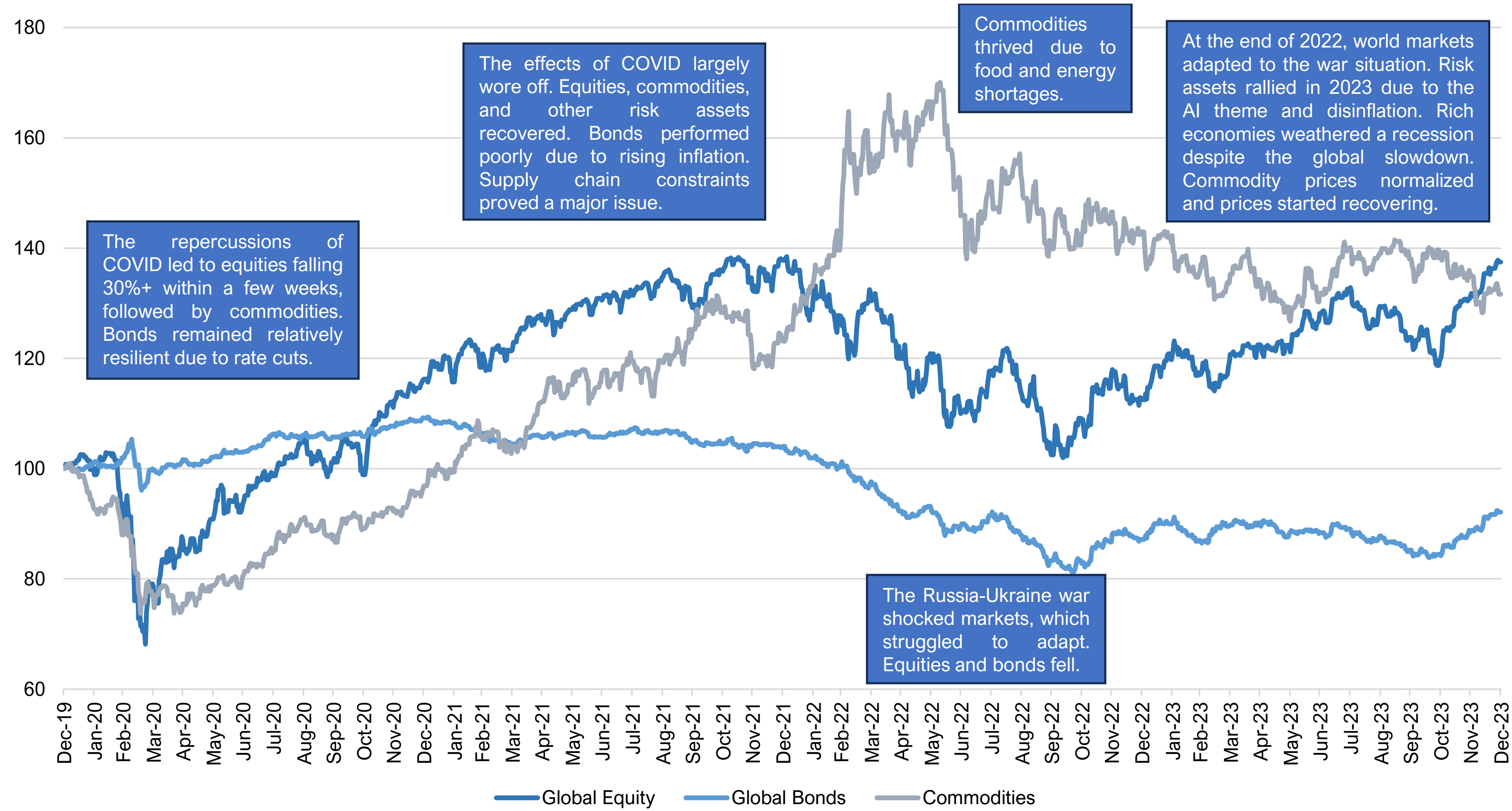
aranca

February 2024

Contents

Executive Summary

Broad summary of how pandemic and war impacted major asset classes



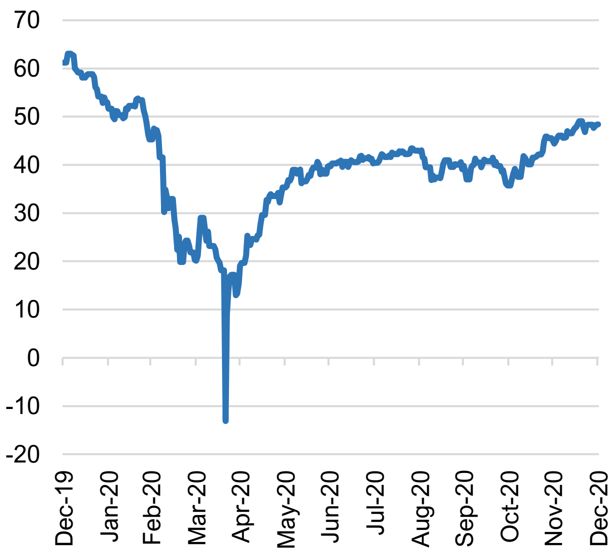
Source: *Bloomberg. Rebased: 31-Dec-2019 = 100. Global Equity: MSCI All Country World Total Return Index; Global Bonds: Bloomberg Global Aggregate Bond USD Total Return Ondex; Commodities: Bloomberg Commodities Total Return Index*

COVID-19 Pandemic – Impact (1/3)

Most asset prices fell while interest rates dropped to near-zero levels

WTI Crude Futures Price Negative

USD per barrel

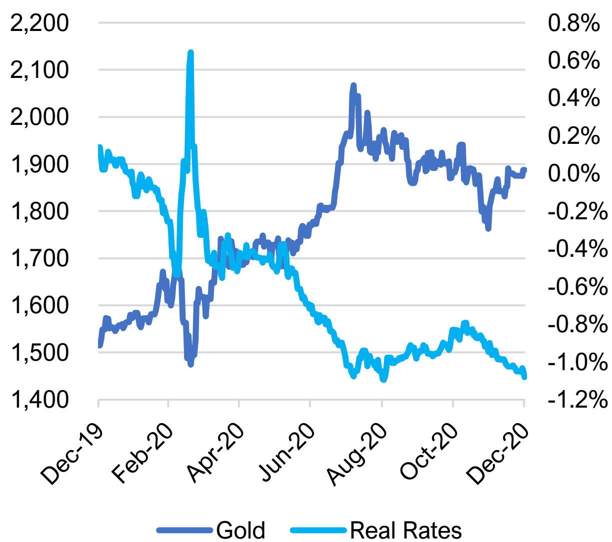


- Oil prices dropped considerably in March 2020 owing to oversupply concerns as demand weakened due to lockdown.
- WTI Crude Futures traded below $0 in April 2020. Futures contracts requiring buyers to take possession of oil in May were close to expiring, and few sought it because of the lack of storage.

Source: *Bloomberg*

Gold Price Rose

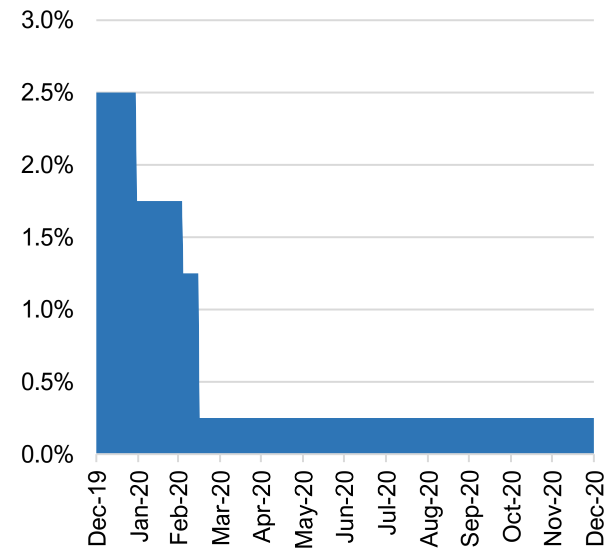
Price in USD / ounce. Real Rates: US 10-year TIPS Yield



- Gold prices rocketed, rising 34.9% from the start of 2019 to its peak in August 2020.
- Investors flocked to gold because of its safe-haven status. Moreover, gold prices are inversely proportional to real interest rates. The 10-year Treasury Inflation-Protected Security (TIPS) yield, a proxy for real rates, turned negative in 2020, which also supported the gold prices.

Interest Rate Cut

Fed Funds Target Rate



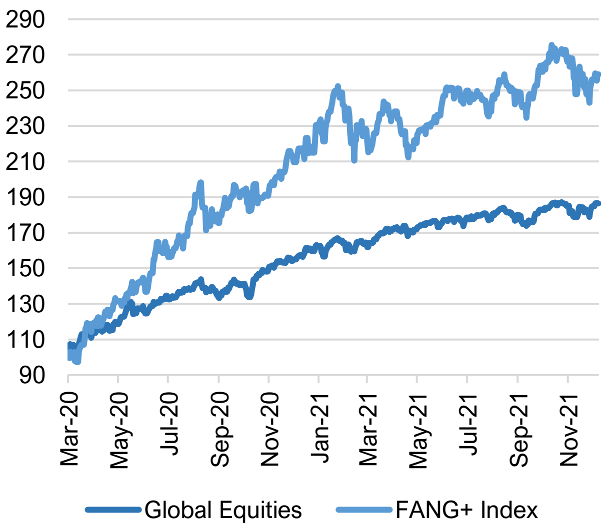
- COVID and the resulting lockdown caused widespread panic in financial markets, with global equities falling more than 30% within just weeks.
- To stabilize the markets, the US Fed initiated various measures to boost liquidity and investor confidence. It drastically reduced the Fed Funds Target Rate to 0.00–0.25%.

COVID-19 Pandemic – Aftermath (2/3)

Markets and consumer demand recovered, but inflation spiked

Rally in Equities

24-Mar-20 = 100; MSCI ACWI Total Return – Global Equities, NYSE FANG+ Index = FANG+ Index

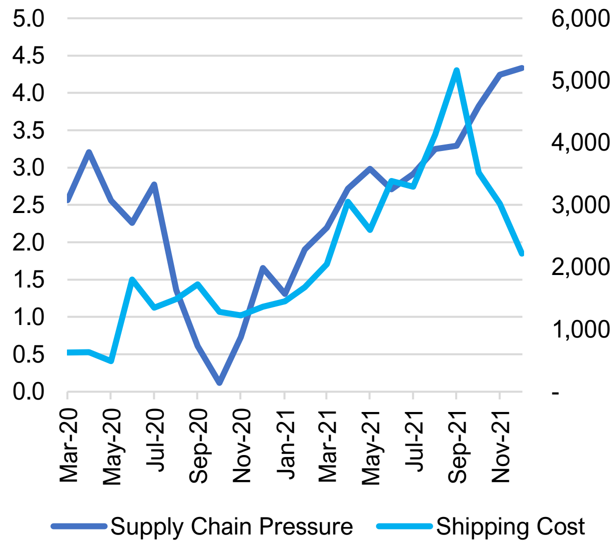


- Equities rallied after the Fed announced on March 24, 2020, that it plans to cut rates and buy agency mortgage-backed securities. This liquidity stimulus boosted investor confidence.
- Risk assets rallied. MSCI ACWI rose 86% between March 24, 2020, and 2021-end. The FANG+ Index, an index of high-growth tech stocks, outperformed the broader market.

Source: *Bloomberg, Investing.com*

Supply Chain Bottlenecks

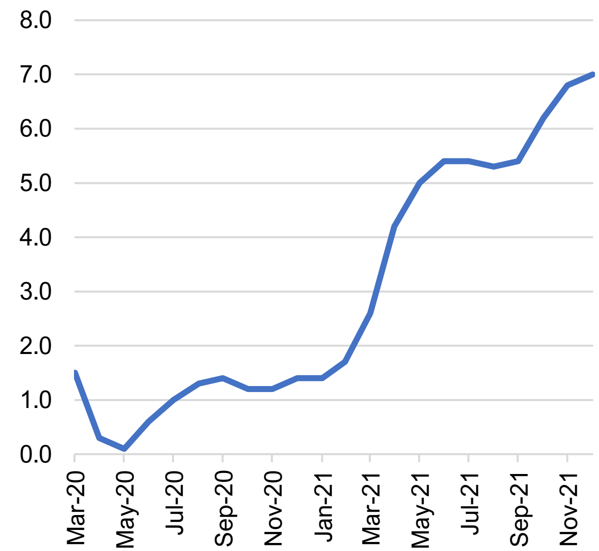
Shipping Cost as per Baltic Dry Index



- COVID triggered the Great Resignation, during where people quit jobs in large numbers. Most of these people worked in hospitality and healthcare, which increased job openings amid high demand.
- The lockdown led to lower factory output and hindered the flow of goods and services. This led to supply chain bottlenecks such as shortage of automotive semiconductor chips.

Inflation Skyrocketed

US CPI YoY Change, in %



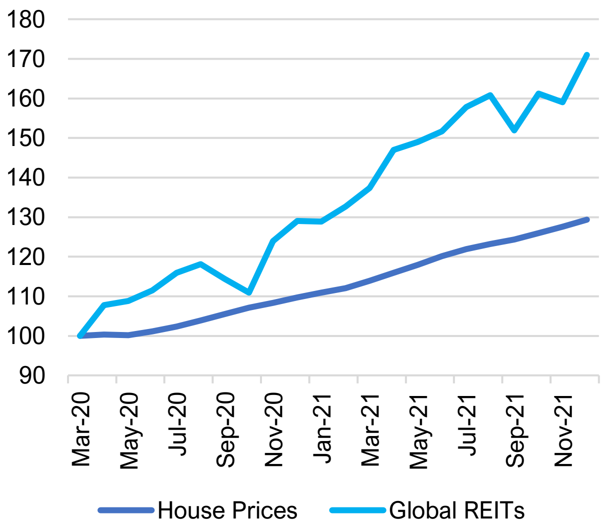
- The extraordinary fiscal and monetary stimulus granted during the pandemic, pent-up demand and supply chain bottlenecks led to rising inflation as demand outpaced supply.
- To control inflation, central banks globally started increasing rates, with EM banks leading the charge, and the era of near-zero rates came to an end.

COVID-19 Pandemic – Aftermath (3/3)

Home prices, commodities, and cryptocurrencies witnessed rally

Home Prices Rose

31-Mar-20 = 100; House Prices: FHFA House Price Index; Global REITs: S&P Global REIT Index TR USD Index

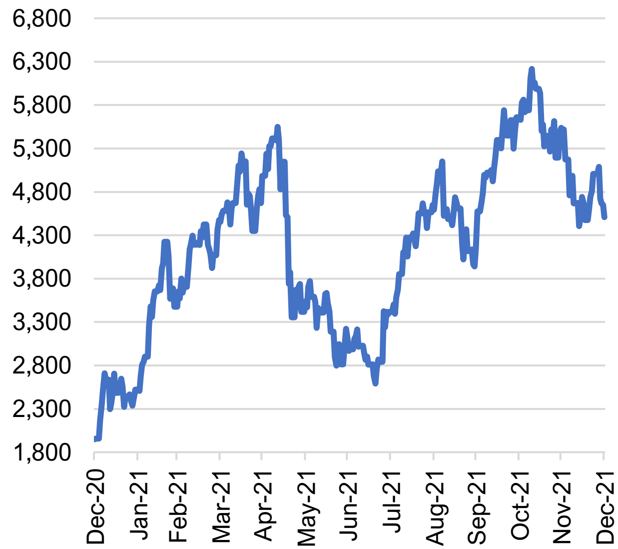


- Home prices rose in 2021 after the previous year's decline. Low mortgage rates allowed investors to buy houses and lock-in low, near-zero rates. Higher inflation also proved positive for real assets, such as real estate, which outperform during high inflation.
- REITs rallied after the pandemic on low mortgage rates and rising home prices.

Source: *Bloomberg*

Cryptocurrency Boom

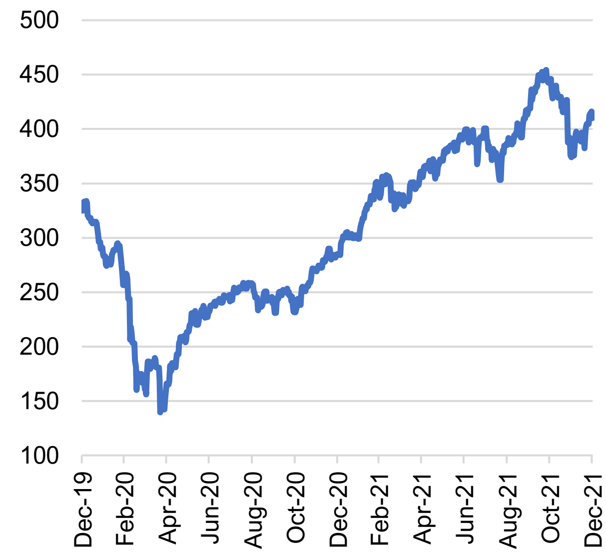
S&P Cryptocurrency Broad Digital Market Index



- Cheaply available money and accumulated excess savings led to a rally in cryptocurrencies and other related assets such as non-fungible tokens.
- The prices of many small cryptocurrencies like Dogecoin rose several times. Similarly, the stock prices of crypto-based firms also rose significantly, while smaller companies were funded by venture capital firms.

Commodity Supercycle

S&P GSCI Energy & Metals (Spot)



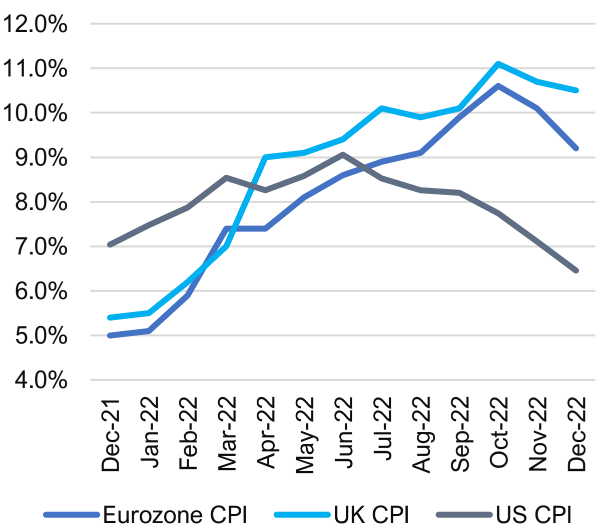
- As governments lifted lockdown and demand rose, industrial activity started recovering. The increased industrial activity led to rising prices of commodities such as energy and metals, both of which are used in industrial and production processes.
- This activity led investors to start expecting a supercycle in commodities, coupled with a period of high economic growth.

Russia-Ukraine War – Impact (1/3)

Global inflation rose largely due to high energy and food prices

Inflation Rose

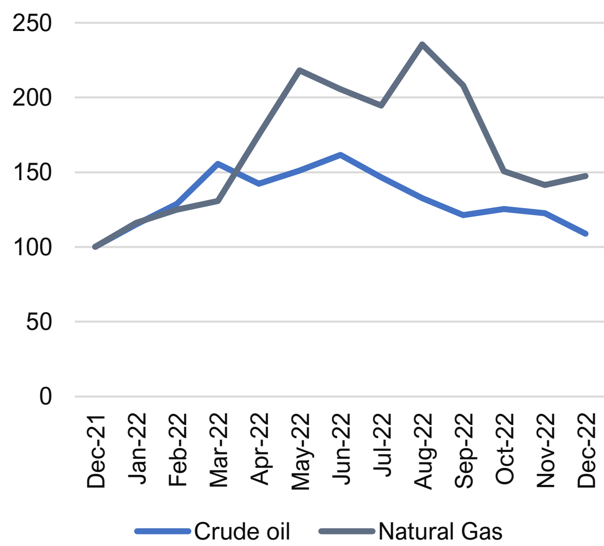
Consumer Price Inflation



- In early 2022, consumer goods prices rose due to COVID supply chain impacts. The Russia-Ukraine conflict and sanctions led to a notable surge in oil prices. Elevated fertilizer and transportation costs, together with Russia's blockage of grain exports from Ukraine, contributed to higher food prices.
- On average, food and fuel together accounted for over half of the 2022 inflation.

Energy Prices Spiked

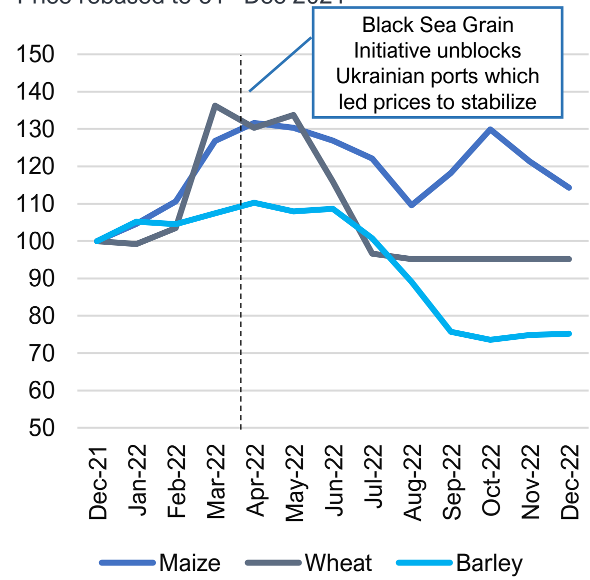
Price rebased to 31st Dec 2021.



- Sanctions on Russia and OPEC+ production cuts propelled Brent crude to US$120/bbl. The surge in gas prices was mainly caused by reduced Russian gas deliveries to Europe.
- Prices of electricity in Europe, fueled by natural gas, increased multifold as gas prices surged. However, gas prices stabilized in late 2022, driven by mild weather, better energy efficiency, and weak fuel demand in China.

Food prices Increased

Price rebased to 31st Dec 2021



- Ukraine is the world's third-largest barley producer, fourth-largest maize producer, and fifth-largest wheat producer. Russian military blocked Ukraine's ports, halting exports leading to an increase in food prices.
- Exports grew due to new transport routes and the Black Sea Grain Initiative, leading to a steady decline in food prices in 2022.

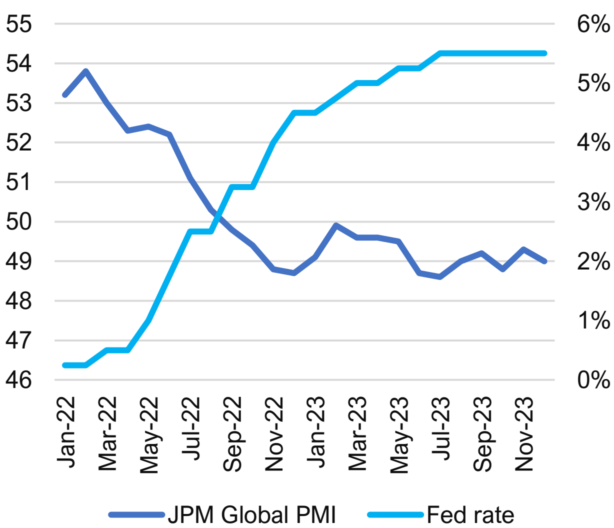
Source: *Bloomberg, Reuters*

Russia-Ukraine War – Aftermath (2/3)

Prices normalized but sticky inflation led to continued hawkish monetary policies

Global Economic Resilience

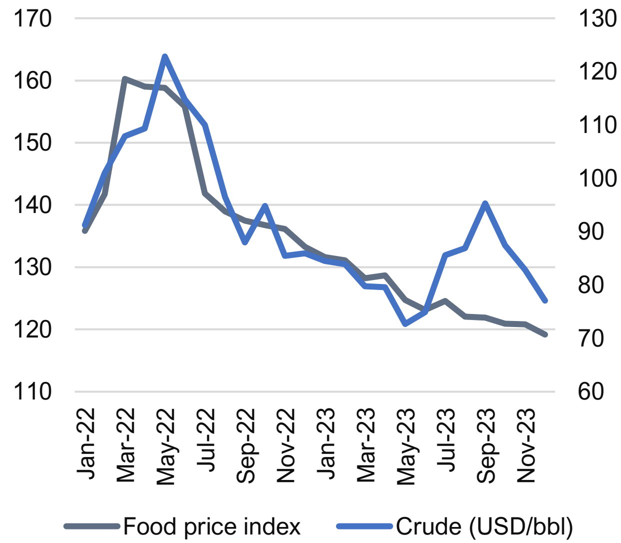
PMI > 50: Expansion; PMI < 50: Contraction



- The global economy slowed in 2022, and investors anticipated a global recession in 2023 due to energy crises and central banks' aggressive policies.
- However, in 2023, the US eased fiscal policy, and consumer spending in China rose due to relaxed pandemic rules. These growth areas offset the Eurozone's economic slowdown.

Commodity Prices Stabilize

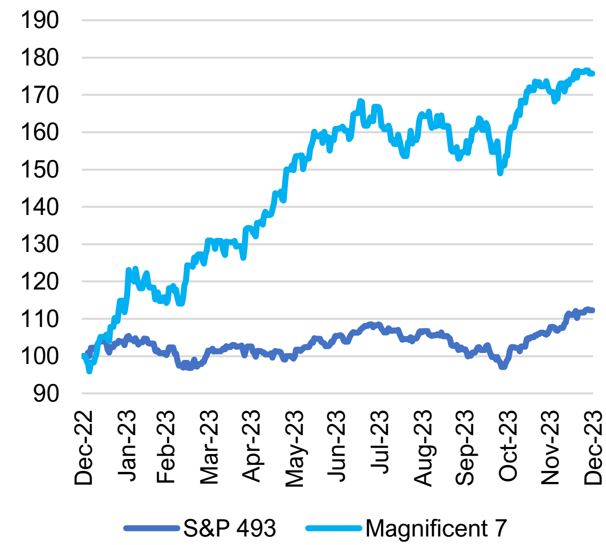
FAO Food Price Index



- Brent crude oil price declined in 2023, mainly due to global slowdown expectations.
- Average food prices reduced from 2022 highs. UN's FAO food price index fell 13.8% YoY, led by 32.7% decrease in the vegetable oil index. The dairy index fell by 17.3% and the cereals index by 15.4% YoY, the latter impacted by well-supplied global markets.

An Uneven Recovery in Equities

Rebased: 31-Dec-22 = 100



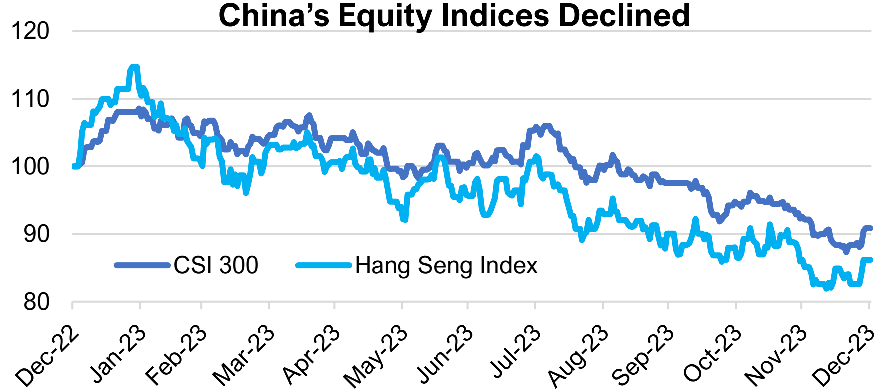
- Equities rallied in 2023; however, underneath, the rally was highly uneven. Mega-cap tech stocks, called the Magnificent Seven (M7 Stocks), drove the S&P 500 index return, significantly outperforming the rest of the index, named as the S&P 493.
- The rally in these stocks was driven by the AI theme as well as rate cut expectations.

Source: *Bloomberg. M7 Stocks include Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla*

Russia-Ukraine War – Aftermath and Israel-Hamas War (3/3)

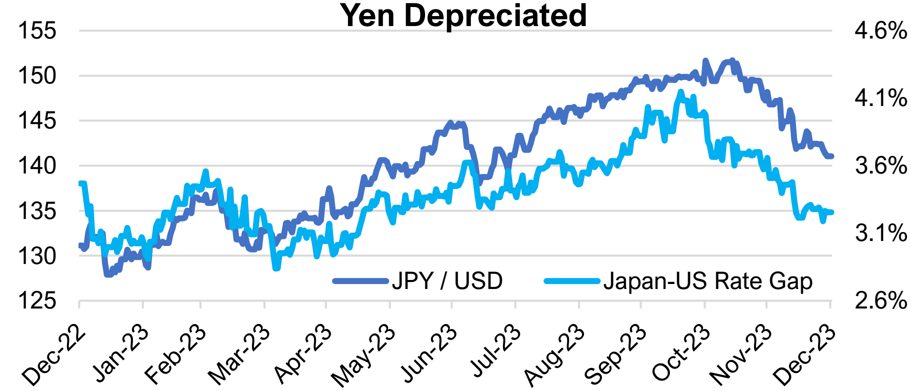
2023 saw outliers in China and Japan and a war between Israel and Hamas in Middle East

China's Equity Indices Declined



Even after dropping its zero-COVID policy in December 2022, China struggled to match the market's predicted growth rate. The sluggish economic recovery disappointed investors, resulting in negative returns.

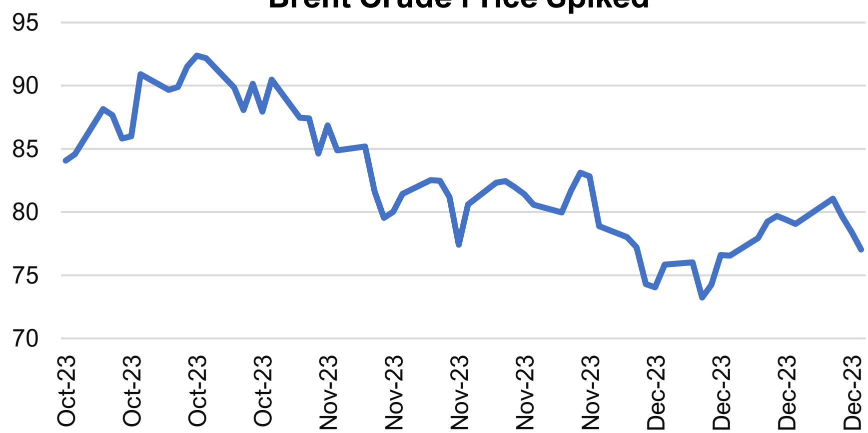
Yen Depreciated



Japan stood out amid the global trend of rising interest rates. The widening interest rate gap between USD (~4%) and JPY (~0.5%) caused the latter to decline as investors preferred exposure to the US dollar.

Israel-Hamas War

Brent Crude Price Spiked

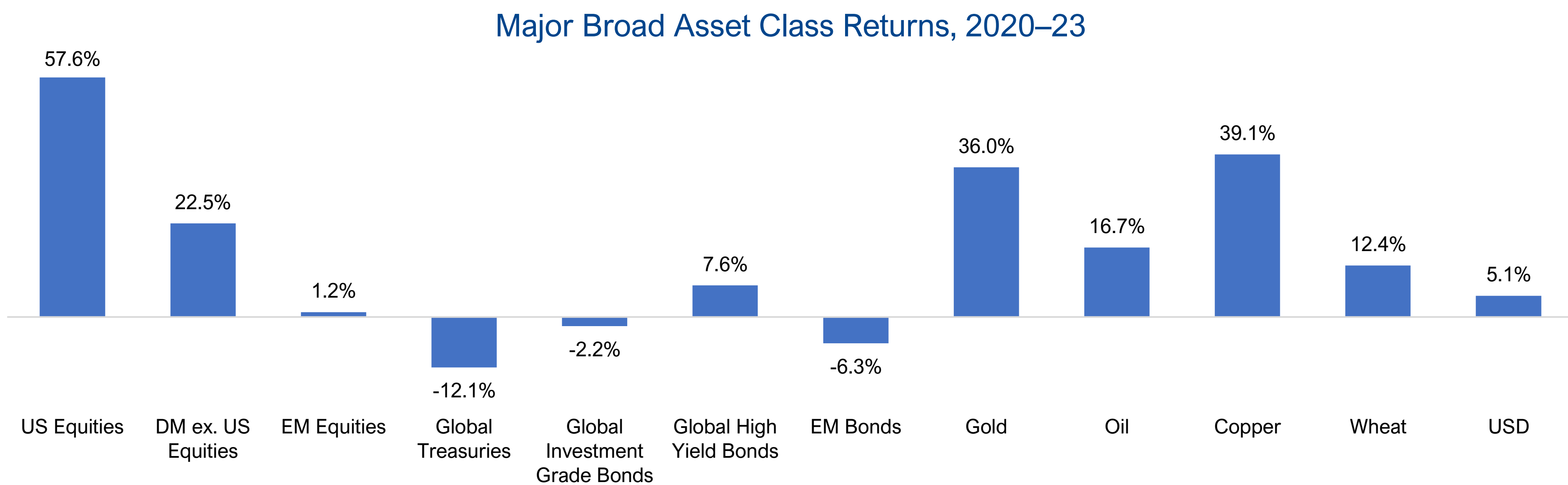


- The global commodity markets have shown limited impact from the Israel-Hamas conflict. Since the crisis began, oil prices have increased by approximately 9%, mainly due to concerns about the stability of oil supplies.
- Major oil & gas producers (including Saudi Arabia, the UAE, and Qatar) have maintained a passive stance, refraining from active involvement, thus constraining the impact on significant asset classes.

Source: *Bloomberg*

Conclusion

During 2020–23, equities rose, bonds largely declined, and major commodities gained



- The COVID pandemic and Russia-Ukraine war had an unprecedented impact on asset class returns.
- COVID: The pandemic-induced lockdown caused a free fall in asset classes. Major equity indices fell over 30% in a few weeks. The fall in bonds was more limited but highly uneven as safer investment-grade government bonds rose in value while riskier high-yield debt fell. The extraordinary fiscal and monetary stimulus led to increased demand as the lockdown was lifted and increased savings. The released pent-up demand, coupled with supply chain bottlenecks, caused inflation to rise, setting the stage for an end in the era of low rates.
- **Russia-Ukraine War:** The Russia-Ukraine war caused energy and food shortages, leading to increasing inflation and prompting central banks to further tighten their monetary policies. Major European countries were greatly affected as they scrambled for natural gas supplies.
- **Israel-Hamas War:** The Israel-Hamas war led to a temporary surge in oil prices. However, the impact was limited owing to the regional nature of the war.
- Between 2020 and 2023, US equities gained the most, followed by copper and gold. Global treasuries were the worst performers, followed by EM bonds; these were the only two major asset classes to have negative returns.

Source: *Bloomberg. Global Equity: MSCI All Country World Total Return Index; Global Bonds: Bloomberg Global Aggregate Bond USD Total Return Ondex; Commodities: Bloomberg Commodities Total Return Index*

2500+
Global clients

500+
Strong, professional team across multi-disciplinary domains

120+
Sectors and sub-sectors researched by our analysis

80+
Countries where we have delivered projects

ABOUT ARANCA

Growth Advisory & Procurement
CXOs in Strategy, SBUs, Sales, Marketing, CI/MI, Innovation

Valuation & Financial Advisory
CFOs in Start-ups, PE/VC Firms, Corporate M&A Teams, Mid-market Companies

Technology | IP Research & Advisory
R&D, Tech Scouting, Open Innovation, IP Teams, Product Development

Investment Research & Analytics
Brokerage, Hedge Funds, IRPs, I-Banks, AMCs, Investor Relations

Connect with our Team

Hasmit Ladhani

Analyst,
Investment Research

+91 223937 9999
hasmit.ladhani@aranca.com

Sumedh Pawse

Senior Analyst,
Investment Research

+91 223937 9999
sumedh.pawse@aranca.com

Anurag Bhagchandani

Assistant Manager,
Investment Research

+91 223937 9999
anurag.bhagchandani@aranca.com

Avinash Singh

EVP,
Investment Research

+91 124668 9999 (ext. 951)
avinashg.singh@aranca.com

For more details: *www.aranca.com* | *https://www.linkedin.com/company/aranca* | *https://www.aranca.com/knowledge-library*

Decide Fearlessly

From startups to the Fortune 500, private equity and global financial firms, Aranca is the trusted research and advisory partner for over 2500 companies

www.aranca.com

aranca