METROPOLE Gestion

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# Impact of the Russian war on our stock picking

The outbreak of war in Ukraine is a shock whose short-term and long-term economic consequences are difficult to evaluate at this stage. Whereas markets tend to react to events of a systemic nature with massive and largely undifferentiated movements, our approach is systematically to envisage the worst-case scenario for the stocks in our portfolio. The aim is to identify all the risks, even the most unlikely, to ensure that the companies in which we are invested have the capacity to weather the crisis, and to assess whether these risks have been correctly factored into their valuation. This method, which we invariably apply to our investment choices in times of great uncertainty, underpins the positioning of our portfolios during this latest crisis.

As a general rule, European companies have very little exposure to Russia, which accounts for only 1.6% of their turnover on average(1). This is equally true for the companies in our portfolio, whose average exposure does not exceed 2%(2). Among those stocks with the highest exposure, we find that the fall in bank stocks such as Unicredit, Société Générale or ING is disproportionate to the risk they face. Even were these banks to lose all their assets with exposure to Russia, i.e. defaults on loans and the loss of capital invested in any Russian subsidiaries they might have, they would still be left with levels of capital well in excess of regulatory requirements. ING offers one of the most striking examples. The stock has lost over 10 billion euros(3) from its market capitalisation, despite the bank declaring exposure of less than 5 billion euros in loans outstanding, equivalent to just one year's worth of net income for ING. Based on our analysis, the total loss of all these assets would have no impact on the capital adequacy of a bank that is already overcapitalised and only waiting for ECB approval to return the surplus to shareholders.

These three banks aside, our portfolio exposure to Russian risk is limited to the oil & gas groups BP and TotalEnergies, whose activities in Russia contribute no more than around 5% to their respective cash flows(4). In a similar manner, the total impairment of these assets with no compensation whatsoever would have no significant negative impact on their financial health, and, based on our analysis, the loss of this future revenue would be largely made up for by energy prices remaining at very high levels.

Despite the marked downturn in performances following the invasion of Ukraine, our portfolios carry very little exposure to Russian risk. Considerable market volatility nevertheless prompted us to make a number of changes within our portfolios in the days running up to the event. We reduced our exposure to the oil & gas sector by reducing TotalEnergies and Shell stocks, whose valuation now price in continuing high oil prices. We have also added to our holdings of pharmaceutical stocks (Sanofi and Grifols, a global specialist in plasma-derived products), which are significantly undervalued.

Looking to the longer term, the shock triggered by the conflict will undoubtedly add momentum to the economic upheavals already at work: an end to the globalisation of production systems and supply chains, which have proved to be fragile, along with the massive increase in investment spending as part of the large-scale industrial, digital and energy transformation, accompanied by the return of inflation. Our portfolios are positioned to make the most of this major economic regime change, a phenomenon we had already identified prior to this crisis.

*Sources:*

1. *Morgan Stanley research: "Sizing Up Further Escalation" February 23, 2022*
2. *Information obtained directly from companies (annual reports, direct contact)*
3. *Bloomberg, from 23 February 2022 (eve of the invasion to 1 March 2022)*
4. *Kepler Cheuvreux estimate for the year 2021*

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