

A Russian Winter

As a Russian winter bites a new cold war begins. With the crisis in Ukraine potentially tipping back into open warfare and the EU looking to escalate sanctions this is a short piece on the Russian economy and its population's ability to withstand the current sanctions and austerity measures to live in Mr Putin's newly coined "Mafia state".

I think many would agree much of the current sentiment in Russia goes back post world war 2 to historic global events such as the collapse of the Berlin Wall, the Cuban missile crisis and Mr Gorbachev watching Americans dive into makeshift nuclear bunkers to the tune of a rattling ICBM shaped sabre. It would appear in today's society the "us and them" sentiment is very much alive for many Russians and the present economic fracas going on between the Russian bear and the west finds its roots in this earlier era of political and military tension.

Recently Pro Putin intellectuals in Russia believe in the populations "ability to put up with economic hardship if they felt it helped Russia stand as a great power". A Levada centre poll in the country had Putin's overall approval rating within the population at 85%.

The western nations have managed to link arms (some more enthusiastically than others) under a cohesive banner of economic sanctions whilst the Kremlin's spin doctors have sought to open up old wounds by painting this as another story of western marginalisation to the point of economic warfare. Yesterday Ashton Carter the front runner for the new US defence secretary stated he was "inclined to support Kiev with heavy weapons". All of this has served to radicalise Putin's support base to rally behind the notion of economic austerity in return for Crimea and a rally to the cause.

Debatably a lot of this support for their Premier is a concoction of national pride mixed with fear and awe of the state. Putin's most stand out rhetoric post Crimea was to frame NATO as the enemy intent on chipping away at Russia's frontiers and shine a spotlight on political opposition with this quote -

"Information-related activity aimed at influencing the population, with the goal of undermining the historical, spiritual and patriotic traditions of defending the fatherland"

Bloomberg's Leonid Bershidsky concludes - "Political opposition is now classified as an activity worthy of a military response"

Worryingly this could be seen to clear the way for Putin to implement, execute and sustain any and all economic or military strategies in defence of Russia. Mix this with an 80% support base consisting of Russians who are ready for belt tightening austerity measures and the cocktail you get is a heady mix. This unified population looking for the Russian Premier to call the shots, we should deem a "Red Russian".

The Ukrainian premier recently stated in words echoing back to 1939 –

"No one should have any doubt that the ambitions and appetite of the aggressor exceed the boundaries of the Ukraine"

Economically Russia are certainly paying dearly to walk this line. This week we have seen Russia as an investable entity, downgraded to "junk" status, 417,000 foreigners opting to leave Russia. All a sobering thought for a super power (as Russians would still have us believe). Indeed combine a diverse array of sanctions from a unified west and introduce an unrelated and poorly timed crash in the global oil market and you can only have what can be described as the perfect storm for an oil exporting nation such as Russia.

What have we seen happening to the Russian economy as a result?

Instigating measures to ban travel and the odd, small, asset freezing of personal assets snowballed causing the USD/Rub to collapse down to 1/67Rub from roughly 1/33Rub this time last year. The Kremlin raised overnight interest rates from 10% to 17% to stave off further capital outflows that amounted to $151billion in 2014. This aggressive fiscal tightening served to bolster the falling currency for not much more than a fleeting moment. Global investors noted that even with an economy busting 17% interest rates the Kremlin couldn't stem the outflow deflating its own currency. The rating analysts at S&P who downgraded debt to "junk" status forecast a total contraction of -2.6% on Russian GDP in 2015 with analysts at the European Bank for Reconstruction and Development forecasting an even more bearish

-4.8% decline over the same period if the oil situation did not stabilise and the present sanctions remained in place.

In an attempt to feed the insolvent Banking sector and state owned oil industry the Kremlin's printing press has announced another $15Billion injection to bolster the countries gaunt balance sheet. These levels of continued bail outs can only go so far though (unless you are the ECB of course). The countries previously buoyant reserves dropped by $133 Billion last year leaving a balance of $379 Billion to see them through the present economic malaise. Analysts at S&P believe this level of economic decline could see Russian reserves totally spent by Q1 2017. What from there for the big bear?

Stark figures paint a black picture for 2015 for the Russian economy. In the light of the recent downgrade, global markets pushed the rouble down further and elevated projected capital outflows in 2015 up to $100 billion.

In the mind of a contrarian, and a brave one at that, this could be a buyers' market?

I would say for this to be the case we would need to need to see a retraction of military involvement in the Ukraine and a more buoyant oil market, as a starting point. This would however serve to contradict my entire observation of the Russian psyche of not backing down. The hundreds of pro-Russian troops labelled "Moscow-backed terrorists" now operating Russian made high tech weapons systems in Ukraine seems far from settled. With OPEC announcing no intention to taper output to protect the price of crude it could be argued that a contrarian buy strategy is folly. Whilst in the eyes of two of the major rating agencies Russian debt is still "investment grade" – but only just – it would on the face of it have as much attraction as investing in the Greek banking sector. As a cynic, what money on you might start to see a lot more Russian delegates in Greece over the coming months as Mr Tsipras could be Putin's "aide de combat" in preventing further EU sanctions?

If the Russian stance remains unchanged and the kremlin's staunch political agenda intact, the clock could well be counting down on how long we can expect to see Russian population accepting the Crimea and the Ukraine as a viable swap for seemingly permanent austerity measures.

Conclusion - TAM holds no emerging market or Eastern European exposure but continues to invest in European growth post Mario's announcement of a 1.1Trn fiscal package in the core Euro states. We continue to watch the situation in the Greek periphery and the headwind this might bring to a Eurozone recovery and the potential for a Greek/Russian build of relations.

We have remained underweight energy funds totally in 2014 but have recently added to exposure at higher risk end of our Growth and Adventurous portfolios.

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