

# Russia-Ukraine war looms over European equity markets

Published 4 March 2022

## Aneeka Gupta

Director, Macroeconomic Research, WisdomTree Europe

European equities are caught in the crosshairs of the war between Russia and Ukraine, down 12.6% Year to Date<sup>1</sup>. Equity risk premiums<sup>2</sup> in Europe have risen sharply owing to accelerating earnings yields despite the recent rise in bond yields. Europe is most at risk owing to its high dependence on Russia for energy and its proximity to the situation. While European equity performance has declined in lockstep with tightening financial conditions, we feel investors are discounting three important factors in their allocation to Europe (1) consensus earnings revisions re-accelerating for 2022 (2) continued fiscal support via the Resilience and Recovery Fund (3) monetary policy is likely to remain accommodative until de-escalation of the war.

*Source: Bloomberg, WisdomTree as of 28 February 2022. Please note – Goldman Sachs Financial Conditions Index (FCI) is defined as a weighted average of riskless interest rates, the exchange rate, equity valuations, and credit spreads, with weights that correspond to the direct impact of each variable on GDP.*

**Historical performance is not an indication of future performance, and any investments may go down in value.**

## ECB's remains hamstrung by new risk dimension

Russia is a major energy supplier to Europe. The war in Ukraine is fuelling concerns of disruption of gas supplies to Europe. Rising energy prices are passing through to headline inflation mechanically, as we saw this week. Eurozone headline inflation jumped to 5.8% in February, driven by higher energy costs, and this trend is likely to accelerate given the intensification of the conflict. The core inflation rate – excluding energy, food, alcohol and tobacco – also surged to 2.7%, reversing January's fall as both services inflation and non-energy industrial goods inflation accelerated. Rising energy prices could soon start to be a drag on consumer spending. However, some of the passthrough to retail would be limited in several European countries and those offering government offset schemes such as France and Italy. The complex combination of a war and severe sanctions are likely to prompt the European Central Bank (ECB) to ignore higher inflation and postpone the withdrawal of the stimulus for now. However, the war in Ukraine complicates the ECB's dilemma of tackling accelerating inflation that cannot be softened by monetary policy. Russia's invasion of Ukraine is adding to the long list of constraints and bottlenecks that are impacting global supply chains since the start of the pandemic. As a result, commodity prices are surging higher amidst concerns of supply disruptions and port closures.

## Navigating European equity exposure amidst a higher inflationary backdrop

Given the rise in inflationary readings, it would be prudent for investors to add exposure to stocks with high pricing power as they should see better relative earnings trends at this time. A consequence of higher real yields and a reduction in central bank liquidity should translate into increased valuation discipline by investors. We identify those stocks belonging to more value-oriented sectors such as financials, materials, utilities, and energy and benefiting from the current environment. These sectors also tend to have a lower duration (i.e., lower sensitivity to interest rates) and offer attractive dividend yields, which tend to outperform amidst a rate tightening environment. European banks have seen amongst the sharpest declines in recent weeks in tandem with their exposure to Russian banks such as – Austria's Raiffeisen (-50%), France's Société Générale (-32%) and Italy's UniCredit (-30%). Even amongst the most heavily exposed of these banks – Raiffeisen has measures in place to limit any impact from sanctioned customers. What's more, the latest data from the Bank for International Settlements for Q3 2021 shows that eurozone banks' outstanding claims on Russian residents were low. More importantly, the eurozone banking sector is much healthier than prior to the global financial crisis, which should help them weather this disruption.

Figure 2 shows comparative valuations and dividend yields of different strategies focused on high yielding European equity strategies: WisdomTree Europe Equity Income UCITS Index (Ticker: WTEHYTE Index), S&P Euro High Yield Dividend Aristocrats Net Total Return Index (Ticker: SPEUHDAN Index), the EuroStoxx Select Dividend 30 Index (Ticker: SD3E Index).

WisdomTree Europe equity income UCITS Index also offers high weight in value-oriented sectors such as financials (24.3%), materials (15.8%), utilities (15.4%), healthcare (13.8%) and energy (7.5%).

Fundamentals	WisdomTree Europe Equity Income UCITS Index	S&P Euro High Yield Dividend Aristocrats Net Total Return Index	The EURO STOXX Select Dividend 30 Index
Price to Earnings Ratio	14.7	15.0	14.3
Price to Book Ratio	1.8	1.5	0.8
Price to Sales	1.2	0.8	0.8
Price to Cash Flow	4.8	8.1	14.6
Net Dividend Yield (%)	5.2	3.8	5.2
Leverage (Net Debt to EBITDA)	3.3	2.2	3.4
Components	253.0	40.0	30.0

Source: Bloomberg, WisdomTree as of 3 March 2022

+Value's renaissance to persist

+ What's Hot: Do commodities offer an avenue to hedge against Russia-NATO tensions?

## Important Risks Related to this Article

### Important Information

**Marketing communications issued in the European Economic Area (“EEA”):** This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

**Marketing communications issued in jurisdictions outside of the EEA:** This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

**For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.**

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.