



Why markets haven't been spooked by instability

By Louisa Bojesen

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The biggest point the markets are making at the moment is that they aren't making a big point.

Given the increased tensions surrounding Russia and Ukraine after the downing of the Malaysia Airlines plane last week, we are closer to a war in Europe than what we have been for a long time. Simultaneously, the death toll in Gaza tragically keeps rising. Despite these dominating geopolitical events, involving harsh rhetoric -- and, in the case of Russia, sanctions -- from global leaders, markets aren't taking too much notice.

Apostolos Bantis, emerging markets credit strategist at Commerzbank says despite the significant negative developments following the MH17 plane crash, overall market reaction has been moderate. Investors seem to cautiously be taking a wait-and-see approach, especially given the strength seen in U.S. earnings so far. Bantis says there is not much evidence of a major sell-off on Russian assets, with little reaction on Russia's credit default swaps and bond yields.

According to Bantis, while the latest harsher US sanctions against Russia appear strong and have raised the headline risk, they are limited in scope. In particular, Bantis clarifies that the new sanctions don't allow U.S. entities and individuals to trade on new debt and equity instruments with a maturity longer than 90 days for four listed entities: Gazprombank, Vnesheconombank, Rosneft and Novatek. But, it is important to highlight that no assets are blocked, and all existing debt and equity instruments of the sanctioned entities, are not subject to any restrictions and may continue to be traded.

With David Cameron indicating before the House of Commons that he will be urging further sanctions against Russia at Tuesday's EU foreign affairs meeting in Brussels, Bantis says over the near-term, the sanctions will have a limited impact on the targeted banking and oil and gas companies.

Andrei Illarionov, a senior fellow at the Cato Institute's Center for Global Liberty and Prosperity and a former chief economic adviser to Russian President Vladimir Putin said he thought the West was missing the point. According to Illarionov, none of the sanctions put on Russia are important enough to stop Putin from trying to establish control over Ukraine, and not to let Ukraine choose to integrate with Europe.

Summer lull central bank strategies

When looking towards general markets, Justin Knight, Head of European Rates Strategy for UBS, highlights the difference in central bank strategies at the moment. Knight told me UBS has turned bearish on gilts, and they see a strong case for gilt yields starting to move higher in the next month or two.

UBS research states that while two- to 10-year yields likely will overshoot forwards over the next six months, analysts there are particularly bearish on the five-year part of the curve. Knight says that a positive outlook for long end gilts remain though. Regarding Europe, Knight doesn't think the European Central Bank will see the need to step in with full-blown quantitative easing to further support European markets.

Instead, Knight references UBS research pointing out their baseline scenario: the ECB's Targeted Long Term Refinancing Operation will be an attractively priced source of funding for banks, especially in the periphery, and that the initial round of funding will come with little conditionality attached.