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Brookfield expert says investors must keep an eye on their portfolios as Russia's war in Ukraine drags on

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Since Russia's invasion of Ukraine last month, much of the global community has responded with severe sanctions on Russia and meaningful support of Ukraine in the form of food, fuel and defensive munitions.

The impact of this conflict on global capital markets has been swift and profound. No doubt, a quick resolution would stoke a meaningful relief rally in stocks. Alternatively, if Russia decides to escalate the conflict by unleashing weapons of mass destruction in Ukraine or were to broaden the attack and involve a NATO country, expect a big market sell-off.

For long-term investors, hedging your bets for either outcome with a diversified portfolio is prudent. Here are the investment issues that rise to the top in the current market environment.

More inflation pressure

While Russia and Ukraine account for only 2% of global GDP, Russia is responsible for 12% of the world's oil exports, 17% of global natural gas exports, and the two countries together produce approximately 33% of the world's wheat supply. The disruption in supply of these important commodities has magnified the inflationary pressures already present due to the unprecedented expansion in the money supply, and certain supply chain problems, resulting from COVID19.

Accordingly, every investor should evaluate their portfolio's exposure to inflation-sensitive investments. Some of the most effective inflation hedges are commodities, treasury inflation-protected securities, and real estate.

A stronger dollar

As is typical in a 'flight to safety" environment, the U.S. dollar has strengthened slightly since the invasion.

Currently, over 80% of cross-border trade is conducted in U.S. dollars given its highly prized properties of safety and liquidity. However, its position as the world's favorite medium of exchange is declining. This was accelerated by the weaponization of the dollar against Russia, when Western governments agreed to "freeze" over $300 billion of Russia's hard currency reserves in response to its invasion of Ukraine.

The act of confiscating a sovereign government's central bank reserves is provocative and sends a clear message to all countries: Your U.S. dollars are not safe from confiscation if you get on the wrong side of a dispute with the U.S.

Assets such as gold, some non-U.S. currencies, and decentralized digital assets like bitcoin are gaining interest as central banks attempt to add diversification and flexibility to their reserves. Having exposure to these assets is increasingly attractive, albeit in small amounts.

Be ready to rebalance

U.S. stocks have moved slightly higher since Russia invaded Ukraine. This result is not altogether surprising given the amount of economic momentum and global liquidity enjoyed by the U.S. economy, and the small amount of global GDP directly impacted by this conflict.

Given the manner in which this conflict ends is very hard to predict, savvy long-term investors won't gamble on the outcome but instead use the opportunity provided by any large move up or down in stocks to rebalance their portfolio.

That means if the conflict ends reasonably quickly and the market stages a significant rally, take some of your profits out of stocks and reallocate these gains to other asset classes. If things in Ukraine escalate and stocks drop, take some money out of bonds or other assets and buy more stocks.

Federal Reserve actions

Despite high levels of inflation, Federal Reserve Chairman Jerome Powell announced a modest 0.25% increase to its base lending rate in mid-March. Prior to the war, expectations were for a 0.50% increase and the rhetoric from Powell reflected a "hawkish" stance. So it's fair to say, this conflict has caused the Fed to reduce the amount, or at least the timing, of monetary tightening previously planned.

Powell also announced the Fed's intention to begin reducing its nearly $9 trillion balance sheet. This means that soon the Fed will begin withdrawing some of the liquidity that has been propping up the U.S. capital markets. The combination of higher rates and less liquidity is designed to both slow economic activity and reduce inflationary pressures. It is also likely to lower the levels of the U.S. stock, bond and crypto markets.

Market volatility, regardless of its cause, serves as a reminder to long-term investors of the importance of building a diversified portfolio. A portfolio with complementary components functions to both withstand and thrive during periods of growth and recession, as well as asset price inflation and deflation. It also provides outstanding opportunities for rebalancing your portfolio to capture opportunistic share prices and reduce risk.

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