



### Market Comment – Russia’s Invasion of Ukraine

Historically, the appropriate investment response to geopolitical shocks has been to *buy* stocks during the immediate reaction to the event. For example, a recent review of 29 geopolitical surprises since WWII showed the *S&P 500 Index* was higher 83% of the time one year later.<sup>1</sup>

Our perspective on last night’s invasion of Ukraine is less bold than the historical data might warrant. While we do not intend to sell stocks aggressively in response to today’s developments – and we discourage others from doing so – we also caution against jumping into stocks right away.

Jan. 1, 1940 to Feb. 24, 2022

#### Stocks Usually Recover Quickly From Geopolitical Crisis

S&P 500 Performance After Geopolitical Events

| Event                            | Start Date   | 1-Week<br>Gain/Loss | 1-Month<br>Gain/Loss (%) | 3-Month<br>Gain/Loss (%) | 6-Month<br>Gain/Loss (%) | 1-Year<br>Gain/Loss (%) |
|----------------------------------|--------------|---------------------|--------------------------|--------------------------|--------------------------|-------------------------|
| Germany Invades France           | May-40       | -13.5               | -25.8                    | -16.1                    | -6.0                     | -22.0                   |
| Pearl Harbor                     | December-41  | -2.7                | 0.3                      | -9.0                     | -5.6                     | 3.7                     |
| Korean War                       | June-50      | -7.6                | -8.7                     | 1.2                      | 4.9                      | 11.2                    |
| Suez Canal Crisis                | October-56   | 1.6                 | -4.3                     | -4.1                     | -1.4                     | -11.5                   |
| Cuban Missile Crisis             | October-62   | -1.9                | 7.6                      | 17.2                     | 24.5                     | 32.0                    |
| JFK Assassinated                 | November-63  | 2.2                 | 3.1                      | 8.3                      | 12.7                     | 20.5                    |
| U.S. Bombs Cambodia              | April-70     | -2.9                | -6.4                     | -4.9                     | 2.0                      | 27.9                    |
| Kent State Shootings             | May-70       | -2.5                | -4.4                     | -4.1                     | 2.2                      | 26.8                    |
| Iranian Hostage Crisis           | November-79  | -1.0                | 3.2                      | 11.4                     | 3.0                      | 25.9                    |
| USSR in Afghanistan              | December-79  | 0.3                 | 5.4                      | -7.8                     | 6.4                      | 25.7                    |
| Falkland Islands War             | April-82     | 2.1                 | 2.7                      | -3.7                     | 5.8                      | 34.5                    |
| Beirut Bombing                   | October-83   | -1.6                | 0.1                      | 0.7                      | -5.5                     | 0.8                     |
| U.S. Invades Grenada             | October-83   | -1.5                | 0.6                      | -0.7                     | -5.5                     | 0.7                     |
| U.S. Bombs Libya                 | April-86     | 3.1                 | 0.1                      | 0.3                      | -0.6                     | 17.7                    |
| Invasion of Panama               | December-89  | -0.8                | -3.7                     | -3.4                     | 3.7                      | -6.9                    |
| Iraq Invades Kuwait              | August-90    | -3.3                | -8.1                     | -13.5                    | -2.1                     | 10.2                    |
| Gulf War                         | January-91   | 4.4                 | 16.7                     | 22.6                     | 20.6                     | 32.3                    |
| Gorbachev Coup                   | August-91    | 2.2                 | 0.1                      | 3.0                      | 7.0                      | 9.1                     |
| World Trade Center Bombing       | February-93  | 1.1                 | 1.9                      | 2.5                      | 4.2                      | 5.4                     |
| Oklahoma City Bombing            | April-95     | 1.3                 | 2.8                      | 11.3                     | 16.1                     | 27.0                    |
| U.S. Embassy Bombings - Africa   | August-98    | -1.4                | -6.1                     | 2.7                      | 14.6                     | 19.3                    |
| U.S.S. Cole Bombing - Yemen      | October-00   | -1.6                | 0.1                      | -4.7                     | -14.6                    | -19.6                   |
| WTC and Pentagon Attacks - 9/11  | September-01 | -4.9                | -1.1                     | 4.3                      | 6.9                      | -16.7                   |
| Bali Nightclub Bombing           | October-02   | 5.9                 | 4.9                      | 11.0                     | 3.9                      | 25.1                    |
| Iraq War                         | March-03     | -0.5                | 2.1                      | 15.7                     | 17.4                     | 28.4                    |
| Madrid Terror Attacks            | March-04     | 0.0                 | 1.9                      | 1.6                      | -0.7                     | 7.6                     |
| London Train Bombing             | July-05      | 2.4                 | 2.6                      | 1.6                      | 6.6                      | 6.6                     |
| India, Israel & Lebanon Bombings | July-06      | -2.8                | -0.1                     | 6.1                      | 11.0                     | 19.4                    |
| Russia Invades Ukraine (Crimea)  | February-14  | 0.8                 | 1.0                      | 2.6                      | 8.3                      | 14.7                    |
| Mean                             |              | -0.8                | -0.4                     | 1.8                      | 4.8                      | 12.3                    |
| Median                           |              | -0.8                | 0.3                      | 1.6                      | 4.2                      | 14.7                    |
| % Positive Return                |              | 41%                 | 66%                      | 62%                      | 69%                      | 83%                     |

Source: Glenview Trust; Reuters

<sup>1</sup> Source: Glenview Trust; Reuters

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## Very Unfortunate Timing for Energy Prices

Our caution stems primarily from the potential impact on energy prices from today's events. While a spike in the price of oil and natural gas is never helpful for the global economy, the timing of today's potential supply disruptions could not be worse, in our opinion.

At a minimum, higher oil and gas prices would apply further upward pressure on inflation at a time when price pressures are already problematic throughout most of the world. This was the condition *before* last night's invasion of Ukraine, but now the potential for supply disruptions seems even more threatening to the price of oil and the health of the global economy.

Unfortunately, we also believe there is a non-trivial possibility for a worst-case-scenario involving a short-term energy crisis, whereby global demand for oil might temporarily exceed the world's capacity to supply it. This has never happened before.

We believe the variable to watch for a possible super-spike in energy prices is production trends from OPEC and Russia. The consensus view is that global spare capacity for producing oil lies somewhere between 4-7 million barrels per day, or roughly 4% to 7% of global demand.<sup>2</sup> The vast majority of this spare production capacity is presumed to exist in three countries – Saudi Arabia, UAE, and Russia.

No one knows the right number for spare capacity because there are no global rules for reporting it. Some analysts question whether the current consensus estimates are too high, and they present various arguments to support this thesis. We believe the near-term response from OPEC and Russia might be telling on this front, particularly as it relates to Saudi Arabia and UAE. If these countries do not raise production to help alleviate crippling energy prices, investors will need to ponder whether it is because they are unwilling, or unable?

To be clear, we consider a super-spike in energy prices to be a tail risk at this point, rather than a baseline forecast. However, we believe the possibility is more than trivial, and therefore we factor it into our current investment thinking.

## Fed Policy

One modest silver lining might be a dial-back in monetary policy from the Federal Reserve (Fed). Before last night there was a view among many analysts that the Fed might raise interest rates by 50 basis points in March, rather than the customary 25 basis points. We suspect the turmoil in Ukraine may have eliminated the possibility of a larger rate hike in March, and it could potentially dial-down the trajectory of policy tightening more broadly.

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<sup>2</sup> Source: EIA; IEA; JP Morgan; Goldman Sachs

## **The “Growth Tax” and a Changing World Order**

We consider two more issues to be relevant to the current investment landscape – the notion of a “growth tax,” and signals of a changing world order. Both issues support a more patient response to the recent drop in global stocks, in our view.

The so called “growth tax” refers to an uncommon combination of simultaneous headwinds in the form of rising energy costs, higher interest rates, and a stronger U.S. dollar exchange rate. This confluence of factors serves as a tax on consumers and businesses that is not helpful for the global economic outlook.

As for a changing world order, it seems hard to ignore the increasing alignment of Russia and China to challenge the post-WWII dominance of the U.S. in the global world order. While we do not expect China to make a move on Taiwan in the near-term, we suspect the risk premium that investors choose to apply to this scenario may have stepped higher after last night.

### **In Summary...**

We believe the historical record of stock market behavior following geopolitical shocks is an important reminder to avoid panicking when these events occur. We do not encourage investors to act aggressively to de-risk their portfolios right now.

However, we would also caution against treating the recent decline as an aggressive buying opportunity. We find the potential ramifications for energy prices to be particularly troubling at this moment in history, and the risks associated with energy have potential knock-on effects for the health of the global economy. The possibility for a more lenient Fed tightening cycle is a potential offset on the positive side, while a re-think of geopolitical risk premiums related to China and Taiwan is an incremental negative, in our view.

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