Investing In Times Of War

With the ongoing situation in Ukraine, (now in its 53rd day, as I write) many of my clients have continued to ask what it means for their investment and pension portfolios.

Logically, they point out that regardless of the size and scope of the conflict, any declaration of war must have global repercussions.

Instability in one area of the world will cause a ripple effect reaching other areas of the world, regardless of the countries involved. Yes, this is likely to affect investments and pensions but the key point is not to worry. There are areas of opportunity in wartime and certain sectors have even outperformed.

- What is the history of investing in times of war, and what about the current conflict in Ukraine?
- What is the likely impact on stock market performance and the wider economy in the medium to long-term?

The Current Conflict in Ukraine

In the case of the current conflict between Russia and Ukraine, the heavy sanctions inflicted on Russia already have and will continue to heavily effect the global economy.

The sanctions are amongst the harshest ever imposed on a country, including preventing the Russian Government from accessing up to US$660 billion in foreign cash reserves, which they hold in foreign banks around the world.

Sanctions also ban Russia from SWIFT, so preventing Russians from using credit and debit cards to make payments and other banking services, and the freezing of the assets of Putin-connected Russian individuals around the world ranging from bank accounts, property, and even private yachts. (As of last week, some 17 vessels valued collectively at well over US$3trillion have been arrested).

Various multinational companies have also closed or reduced their operations in Russia. Apple have closed their Russian stores, Shell and BP have sold their stakes or abandoned their Russian operations, amongst a host of other global corporates.

Airlines, such as British Airways, Lufthansa and many others have stopped flights to Russia. Boeing and Airbus have suspended parts, maintenance and technical support for Russian airlines.

The conflict does not only impact the Russian economy

Many countries export products to Russia. If this is no longer possible, then they will see a reduction in profits, which will then go on to affect their balance sheet. Similarly, many countries in the world import products from Russia. Key in this case is energy in the form of oil, gas, and coal.

Although the supply of oil has not yet been cut, we saw huge rises in fuel prices in many countries throughout March and into April.

Other products, both Russian and Ukrainian, such grains, cooking oils and fertilisers are also impacted. Due to the decrease in supply, we are likely to see both shortages and a rise in price of these products.

However, it is very difficult to predict exactly what will happen in the short to medium term.

Previous Wars and Their Impact on Stock Market Performance

We can consider previous wars and the impact that they had on the stock market.

Civil wars and internal conflicts, like those in Sierra Leone (1991-2002) and the Central African Republic in 2013, caused severe issues for those countries' economies. But from a global perspective, these wars did not cause problems in the major global stock markets.

However, large-scale wars, like World Wars 1 and 2 did impact most markets, even the US market before the US had entered the fray.

Historically, global markets operated very differently from how they operate today. For example, prior to World War 1, every country operated independently, and were, to a large extent, isolated from global crises. Those doing global trade were seen as at 'gold standard' level, with London acting as main international market since inception in 1771.

By the end of World War 2, significant changes were made to the global financial system which increased interdependence between countries. The World Bank and the IMF (International Monetary Fund) were created, and from then on stocks reacted very differently when conflicts arose.

It's also important to consider the duration, and the popularity of the war on the home front.

The Vietnam War and the Gulf War saw very different stock market outcomes in the USA due to the different views of the wars amongst Americans. The Afghanistan War continued for almost two decades, during which the markets saw both highs and lows.

It seems the longer a war continues, the less reactive markets are to its influence. Sadly, war may start to be seen as 'Business as usual'.

Here's a Selection of Wars and its Effects on the Global Economy

World War 1

- Net importing nations lost gold reserves, negatively impacting their economies, because the slow economic conditions saw greater demand for exports.
- With the start of the war when Archduke Franz Ferdinand was assassinated, the stock market was barely effected.
- When Austria-Hungary declared war on Serbia in 1914, the Dow Jones dropped by 30% and the market had to close to maintain order and stability. When it opened a few months later, it shot up by 88% and continued to rise until late 1916

- When the US declared War on Germany in 1917, the stock market took a hit and continued trending downwards into 1918. It didn't recover fully until mid 1919, on the news that the war was over.

World War 2

- The US was just emerging from the Great Depression by 1939 when the war started. In the early days of the war the Dow Jones increased over 10%, suggesting that the geopolitical environment would end the tough economic times of the '30s. However, the war disrupted international trade so after this initial boost, the market started to fall.
- Governments policies around the world prevented it falling further, and from 1939 to the end of the war in 1945, the Dow Jones was up 50%. The gain was put down to the various international cooperation agreements helped grow the US economy.

Korean War

- The Dow Jones dropped around 5% on the first day. The war was a shock to most investors
- The recovery was fast, and when the war ended in 1953 the Dow Jones was up almost 60%.

Vietnam War

- The Dow Jones grew by 43% from the start to the end of the war (1965 to 1973), despite its low popularity.
- Government decisions on funding the war caused inflation, setting off a mild recession in 1970.

Gulf War

- The Gulf War lasted for 7 months, so short a time that it is difficult to separate the changes caused by the conflict from other world events. Oil prices increased, causing a brief recession, unusual in times of war.
- By the time of the Gulf War, the US economy had changed from processing natural resources and manufacturing capital goods to primarily producing information and services. This may have meant that the stock market reacted differently during this war compared to previous wars.

Afghanistan War

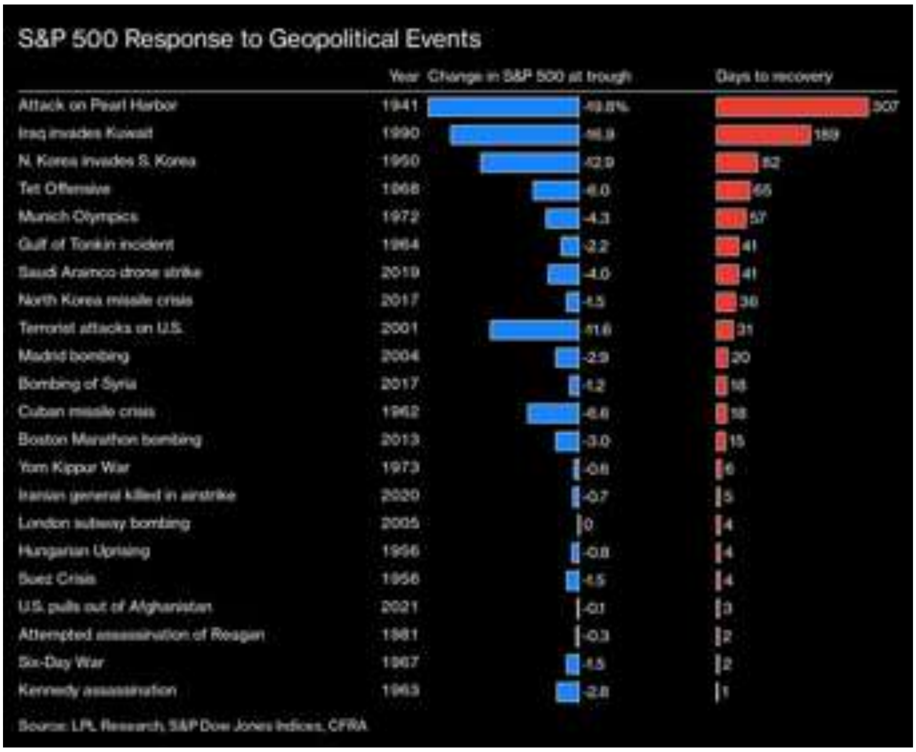
- The Afghanistan War lasted for almost 20 years, making it difficult to measure the impact of the war.
- There were two crashes (2008 Global Financial Crisis and 2020 Covid Pandemic) which were both followed by quick recoveries, however these were largely unrelated to the war.
- Industries such as Real Estate, Data Processing and Information Services and Computer Systems design and related services saw huge growth, suggesting that the war did not influence them. Shares in industry-leading defense contractors also profited

Are there any historical patterns?

There is often comfort to be drawn from assuming that ‘history repeats itself’, but for many there is still that element of doubt, so perhaps Mark Twain’s wry observation is more accurate;- “History Doesn't Repeat Itself, but It Often Rhymes”

Below is a table of events from 1941 to the present, and the subsequent negative impact on the S&P500, along with the time taken for the market to recover.

Whilst we can argue that history is not repeated on every occasion, there is perhaps ‘rhyme or a reason’ for the market to recover in every case.



So where are we now?

In the early days of a conflict, there is always volatility. For example, both the FTSE and the Dow Jones dipped in the week (25/02/22) Russia invaded Ukraine. However both indices recovered over the following month.

Logic dictates that this volatility is inevitable during times of war, but history has shown that this is not always the case.

At the beginning of a war (especially if there is no gradual escalation) stocks prices tend to decline due to shock and uncertainty. Once war begins, history has shown that the stock market goes up, as has been the case with the Dow Jones and the FTSE during March.

There is no need to panic

Panic-selling investments at the start of a war is likely to be a very bad move, considering that early sharp drops tend to be followed by steady gains.

Regardless of world events, investors should maintain proven strategies to protect and grow portfolios.

The best way in which you could do this is to speak with an expert, and have your investment portfolio professionally managed.