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THE FINANCIAL IMPACT OF GEOPOLITICAL EVENTS

Changes in capital markets can be significant

BY CHRIS KELLY

In my 20-plus years of advising affluent families, I have never had another advisor or money manager ask my opinion on what is happening in the markets and how they should position their clients. Well, this actually happened shortly after Russia invaded Ukraine earlier this year. There are a couple of thoughts that came to mind—first, I often refer to Harry Markowitz's *Modern Portfolio Theory*, which in layman's terms states that if you build a well-diversified portfolio across multiple asset classes with quality holdings, you should successfully weather most economic events. By the way, Markowitz's theory won the Nobel Prize in Economics, so it's proven and it works.

The second thought I shared was a look at the history of our markets during and after a significant geopolitical event. The most notable event I've personally experienced was the 9/11 terrorist attack on the World Trade Center and Pentagon. The markets were closed until September 17, and when the markets reopened, they were down sharply as investors went into a panic and sold their holdings. The S&P 500 dropped approximately 11 percent and took just over a month to fully recover. Another event that resonates in our history would be World War II. Depending on the dates you use to calculate market data, the S&P 500 dropped nearly 20 percent in 1941 and took just under one year to recoup the losses. These two events are probably the most notable we can relate too, although there have been many more: presidential assassinations and attempts, bombings throughout the world, and numerous invasions. All these events are reasons why the markets drop, and each time they have dropped. This is where the *but* comes in. On average, if you take all the major geopolitical events that have occurred since 1940, the S&P 500 has been positive after six months roughly 69 percent of the time and 80 percent after one year of the event. In my opinion, geopolitical events have little long-term effect on our markets, and rather that fundamentals drive markets.

In my opinion, Russia's invasion of Ukraine is a significant event. The world has come together unlike any other time in support of Ukraine and its people, with a few exceptions. But here in the United States, we have our own issues which are directly and indirectly related to the Russian invasion. The biggest increase we are seeing is in the commodity sector: fuel prices have increased by 29 percent, and the price of wheat has jumped by 56 percent.

With all this said, do not panic. I actually see this as a great opportunity to capitalize in these current market conditions. Back in May 2020, the price of oil dropped $55.90 a barrel in one day to settle at negative $37.63 a barrel. A lot of the big banks and investment firms were calling for the oil index to continue dropping, which it did not. Then recently we did a review and noticed the same banks were buying oil at $105 a barrel and telling the client it's going to $150 a barrel. That's panicking. We should be doing the complete opposite, selling high and buying low. I can provide many theories as to how to maneuver through these difficult times, but being an investor takes patience and discipline with little or no emotion.

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We provide advice for multi-generational purposes. This is a perfect time to meet with your advisor and review your investment policy statement. The IPS is essentially your business plan as to how you are managing your assets. If you do not have one, you should not be investing. The IPS will help you with portfolio construction, tax implications, time horizons, cash-flow requirements, risk tolerance and more. Most importantly, it will have instructions on what to do when the markets drop by certain percentages, such as if the market drops 10 percent, you make a predetermined adjustment, all the way to a point in which you move liquidity back into the market, maybe a 20 percent drop depending on your personal needs.

Remember my first thought and do not panic. Develop and implement a long-term portfolio using the nation's finest yet safest money managers. Follow your IPS and make adjustments when you reach certain limits. Take advantage of any anomalies you might see in the markets, and have a long-term outlook.

+ ABOUT THE AUTHOR
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