George Washington, Geopolitics, and Investing

Although it now celebrates all of our Presidents, what we now call "Presidents Day" in the United States was at first a commemoration of the remarkable life and the immense legacy of George Washington.

This Presidents Day, we are faced with a seemingly-imminent Russian invasion of Ukraine. As with any armed conflict, the situation is highly fluid and changes quickly with every development carrying potentially global ramifications. It seems timely and appropriate to convey my stance on the crisis of today through the words of Washington, our first President and a man who was certainly no stranger to geopolitical crises.

The moral, legal, tactical, and humanitarian implications of Russia's invasion plans are beyond the scope of this article, and of my expertise. Most of the questions that I have been receiving around this crisis pertain naturally to the impact to global capital markets and to market prices.

The price of oil will probably increase if Russia attacks Ukraine due to a reduction in global supply. This is true of any conflict involving an exporter of oil, but the effect here is likely to be deepened by United States and NATO sanctions and the closing of Russian pipelines following any aggression. As of this writing, Brent Crude opened at $94.29/barrel, an eight-year high but not an unusual price. (See my article "As Clear as…Oil?" [April 2020] for an explanation of Brent crude and oil price dynamics.)

Prices above $100/barrel are not historically unprecedented, nor are they correlated with economic downturn. As we have seen in recent years, neither is the price of crude oil a perfect indicator for the price of gasoline at the pump, which is has been determined predominantly by fluctuations in demand Crude oil prices have been advancing steadily for the past two years as the world reawakens fully from both winter and the pandemic lockdowns. We should expect to see the price of gasoline increase as seasonal and structural demand increases; whether we see long or lasting increases in the price of crude oil or natural gas depends on Russia and any NATO response, which is of course anyone's guess. For now, suffice it to say that $100/barrel Brent would likely have happened this year, Ukraine or not.

A conflict could also trigger increases in the prices of agricultural commodities (Ukraine is often referred to as Europe's "breadbasket" and exports corn, wheat, sunflower oil, and others) and metals (Russia is a leading exporter of iron ore, nickel, palladium, and aluminum). How much and when will ultimately be determined by unpredictable and fluid hypothetical scenarios and are again matters of raw speculation.

Price pressures on all of the above could quickly move in the opposite direction if the conflict is de-escalated or a diplomatic resolution is achieved. Such an outcome is also possible, although it is typically discounted by the media. History has shown that trading against positive outcomes – in this case "peace" - tends to be a losing proposition.

We should bear in mind that the situation is not binary, as in "Russia invades" or "Russia does not invade". Contrary to often oversimplified and overheated headlines, there is a wide and nuanced range of potential outcomes to the Ukraine scenario, with the eventual storyline ending up somewhere between the worst- and the best-case scenarios. (Indeed, if the outcomes could be reduced to either/or, market prices would likely increase as uncertainty would be low.) Therefore, market prices can also respond in a nuanced and wide-ranging way, making accurate price forecasts extremely difficult.

With this cloudy view of the present, what can we ascertain from relevant data, and what would George say?

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> **"We should not look back unless it is to derive useful lessons from past error, and for the purpose of profiting by dearly bought experience."**
>
> **– George Washington**

It is not necessary or helpful to speculate on particular outcomes, including those of the Ukrainian dilemma at hand. The real question is not "Will wheat prices increase?", but rather "What will be the likeliest long-term effect on my financial plan?". The most useful knowledge that we can apply is our historical perspective of past geopolitical crises, many of which seemed dire and existential in the moment but fade in retrospect.

Experienced investors already know how quickly and consistently that markets tend to rebound from sharp declines regardless of the cause, but it is interesting to narrow our lens to exclude natural disasters, banking and credit meltdowns, viral pandemics, speculative manias, etc. and to consider catastrophes of a specifically geopolitical nature.

Consider this table[i]:

Stocks Usually Take Geopolitical Events In Stride

S&P 500 Index And Geopolitical Events

		S&P 500 Returns		Days	
Market Shock Events	Event Date	One Day	Total Drawdown	Bottom	Recovery
U.S. Pulls Out of Afghanistan	8/30/2021	0.4%	-0.1%	1	3
Iranian General Killed In Airstrike	1/3/2020	-0.7%	-0.7%	1	5
Saudi Aramco Drone Strike	9/14/2019	-0.3%	-4.0%	19	41
North Korea Missile Crisis	7/28/2017	-0.1%	-1.5%	14	36
Bombing of Syria	4/7/2017	-0.1%	-1.2%	7	18
Boston Marathon Bombing	4/15/2013	-2.3%	-3.0%	4	15
London Subway Bombing	7/5/2005	0.9%	0.0%	1	4
Madrid Bombing	3/11/2004	-1.5%	-2.9%	14	20
U.S. Terrorist Attacks	9/11/2001	-4.9%	-11.6%	11	31
Iraq's Invasion of Kuwait	8/2/1990	-1.1%	-16.9%	71	189
Reagan Shooting	3/30/1981	-0.3%	-0.3%	1	2
Yom Kippur War	10/6/1973	0.3%	-0.6%	5	6
Munich Olympics	9/5/1972	-0.3%	-4.3%	42	57
Tet Offensive	1/30/1968	-0.5%	-6.0%	36	65
Six-Day War	6/5/1967	-1.5%	-1.5%	1	2
Gulf of Tonkin Incident	8/2/1964	-0.2%	-2.2%	25	41
Kennedy Assassination	11/22/1963	-2.8%	-2.8%	1	1
Cuban Missile Crisis	10/16/1962	-0.3%	-6.6%	8	18
Suez Crisis	10/29/1956	0.3%	-1.5%	3	4
Hungarian Uprising	10/23/1956	-0.2%	-0.8%	3	4
N. Korean Invades S. Korea	6/25/1950	-5.4%	-12.9%	23	82
Pearl Harbor Attack	12/7/1941	-3.8%	-19.8%	143	307
Average		**-1.1%**	**-4.6%**	**19.7**	**43.2**

We can see that the S&P 500 fell -4.6% on average in the major catastrophes of a specifically geopolitical nature since the attack on Pearl Harbor in 1941. Following those temporary drawdowns, the S&P 500 then fully recovered in just over six weeks on average. The absurdity of making costly changes to a long-term plan in anticipation of an event that, on average, is a literal blip is obvious.

This is absolutely not a forecast regarding the conflict in Ukraine or any other present or future crisis, nor is it a lamentation of past troubles. It is an invitation to rely on history as our guide and as the context for the present. What we have seen, and what we expect to see, is that capital markets process information efficiently and tend to quickly recover from geopolitical shocks.

> **"Happiness depends more upon the internal frame of a person's own mind, than on the externals in the world."**
>
> **– George Washington**

The media tends to warp reality through a catastrophist lens. Trivial matters are amplified into causes for worry, and significant matters combust into causes for panic, dismay, and hysteria. Constant fear is the interest that one pays for buying the media's narratives.

Markets, like people, are not only difficult to forecast, but utterly impossible to predict, in any way that is precise enough to profit from consistently. We have to accept that the future will constantly surprise us in negative and in positive ways – *and then plan accordingly*.

Therefore, your investments are comprised of carefully considered components, and are designed to support your long-term objectives, not today's needs. Parts of a diversified portfolio will benefit from any of the conflict-driven price movements noted in the first section; other parts would benefit in the event of other outcomes. Your plan is built to maximize your odds of success with the minimum risk, cost, and stress.

Often, situations like this create opportunities for investors. For example, if prices change, we may have an opportunity to rebalance your portfolio and shift your asset allocation. This means we might be able to simultaneously "buy low" and "sell high" as a way to get your portfolio back to a desired mix that is most appropriate for you.

Viewed in this way, it becomes easier to regard things less as the crises that they are made out to be, but as the opportunities that they are. The "shocks" that other investors dread become the fuel for long-term growth. Trepidation and distress become confidence and discipline.

> **"Perseverance and spirit have done wonders in all ages."**
>
> **–George Washington**

The armed conflict in Ukraine is only one among many factors that are influencing the market today. It is often the case that the visible headlines are relatively small inputs to the broader market; this is part of the reason that crises look so much smaller in the rear-view mirror than they did through the windshield. I think it is extremely important for an investor to remember how temporary these events actually are. That perspective is a powerful advantage, and is a key that unlocks investing success.

Be emotionally prepared for more volatility in the days to come. In today's financial markets, many trades are triggered automatically by algorithmically driven computers. Once certain technical levels are reached, these computers start selling (or buying) indiscriminately. Others are programmed to execute their orders based on the technical levels that result from the first group. This domino effect can lead to eye-popping volatility—both on the downside and upside.

In the short term, market movements can be heavily influenced by fear and computerized trading, while in the long term, they tend to reflect broader-based economic trends. The challenge is to not let the difficulties and temptations of the short term prevent us from reaping the potentially enormous benefits of long-term investing.

If you have specific questions about the developing situation in Ukraine and how it pertains to you and your plan, we are here to advise you. Thank you for your confidence in us.

At one point in his famously temperamental youth, George Washington was determined to go to sea as a midshipman, eager to find fortune and make his mark on the world. I will close with the following words, written by George Washington's uncle Joseph Ball about George. It is sage advice for any investor:

"Go on gently and with patience, as things will naturally go. This method… will carry a man more comfortably and surely through the world than going to sea."

Happy Presidents Day!

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[i] Source: https://www.marketwatch.com/amp/story/what-a-russian-invasion-of-ukraine-would-mean-for-markets-as-white-house-warns-attack-could-come-any-day-now-11644624056, LPL Research, S&P Dow Jones Indices, CFRA, 01/24/2021

The modern design of the S&P 500 Index was first launched in 1957. Performance before then incorporates the performance of its predecessor index, the S&P 90.