NAVIGATING GEOPOLITICAL EVENTS

EFFICIENT FINANCIAL

Ignore Geopolitical Events?

Russia's invasion of Ukraine is an important reminder that geopolitical risk is a part of investing in global markets.

Even when a geopolitical event is combined with an economic recession (the "perfect storm"), "investors were very likely to experience gains three, six, and 12 months later. Patience was rewarded."

As an investor, you should focus on things you can control (your asset allocation, costs, fees, tax deferral or avoidance), and ignore those you can't.

> ***"The important thing about an investment philosophy is that you have one you can stick with."***
> *- David Booth. Founder and Executive Chairman of Dimensional Fund Advisors.*

As the Russia-Ukraine crisis is unfolding, it is understandable that many are worried about the impact of the invasion on the rest of Europe and the global economy. The conflict has also caused increased volatility in global share markets which were already unsettled by fears of increasing interest rates and rising inflation.

This current wave of negative news may feel worse than what we have experienced in the past and many fear the situation may get worse. This feeling is coined the "recency bias" in behavioural psychology.

Recency bias is a cognitive bias that favours recent events over historic ones. As a memory bias, it gives "greater importance to the most recent event".
Yet, geopolitical events are not uncommon. Since World War 2 and the Pearl Harbour attack in 1941, there have been tens of similarly worrying events.

Back in 2017 we commented that terrorist attacks were then the cause of great concern in most of Europe, United States, Iraq and even Iran. The United Kingdom was rocked by Brexit vote. Brazil suffered from both economic woes and bribery scandals and South Korea just replaced its former president, who has since been officially indicted.
The Trump presidency appeared 'unstable' and no one disputed that the U.S. were in for a period of extended uncertainty.
Back then, the most concerning threat to the U.S. was North Korea, which appeared to be moving rapidly towards the development of a nuclear-armed intercontinental ballistic missile capable of reaching American shores. The then U.S. Defence Secretary Jim Mattis declared this prospect as posing a "clear and present danger" to the world.

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> *"Stop trying to predict the direction of the stock market, the economy, interest rates, or elections."*
> *- Warren Buffett*

Then and now it is no wonder the question a number of investors may ask is: "Should I pull out of the market, sit on the side lines and wait for things to 'settle down'?"

In times of uncertainty, it is useful to gain perspective from how the world coped and recovered from similar past events.

A good benchmark is the US S&P 500 index. In the table are listed major market shock events in the last 80 years and their impact on the day and during the length of the different crises. While there is some variation in the impact, the average drop in the S&P 500 index on the day of the event, was just over 1% and the average drop was just under 5% for the duration of the crises.

It is good to remind ourselves of this when we are going through uncertain times. So, whilst there is no denying that the current invasion of Ukraine by Russia is an horrific event and it is unclear what the resolution will be at this stage, our strong belief in the ability of the aggregate of all market participants to adapt to change, based on how we have adapted to historical events in the past, is a great comfort during uncertain times.

S&P 500 Returns				Days	
Stock Market Event	**Event Date**	**One Day**	**Total Drawdown**	**Bottom**	**Recovery**
US Pulls out of Afghanistan	30/08/2021	0.4%	-0.1%	1	3
Iranian General Killed in Airstrike	03/01/2020	-0.7%	-0.7%	1	5
Saudi Aramco Drone Strike	14/09/2019	-0.3%	-4.0%	19	41
North Korean Missile Crisis	28/07/2017	-0.1%	-1.5%	14	36
Bombing of Syria	07/04/2017	-0.1%	-1.2%	7	18
Boston Marathon Bombing	15/05/2013	-2.3%	-3.0%	4	15
London Subway Bombing	07/05/2005	0.9%	0.0%	1	4
Madrid Bombing	11/03/2004	-1.5%	-2.9%	14	20
US Terrorist Attacks	11/09/2001	-4.9%	-11.6%	11	31
Iraq's Invasion of Kuwait	2/08/1990	-1.1%	-16.9%	71	189
Reagan Shooting	30/03/1981	-0.3%	-0.3%	1	2
Yom Kippur War	06/10/1973	0.3%	-0.6%	5	6
Munich Olympics	5/09/1972	-0.3%	-4.3%	42	57
Tet Offensive	30/01/1968	-0.5%	-6.0%	36	65
Six Day War	06/05/1967	-1.5%	-1.5%	1	2
Gulf of Tonkin Incident	02/08/1964	-0.2%	-2.2%	25	41
Kennedy Assassination	22/11/1963	-2.8%	-2.8%	1	1
Cuban Missile Crisis	16/10/1962	-0.3%	-6.6%	8	18
Suez Crisis	29/10/1956	0.3%	-1.5%	3	4
Hungarian Uprising	23/10/1956	-0.2%	-0.8%	3	4
North Korea Invades South Korea	25/06/1950	-5.4%	-12.9%	23	82
Pearl Harbour Attack	07/12/1941	-3.8%	-19.8%	143	307
Average		**-1.1%**	**-4.6%**	**19.7**	**43.2**

Source: LPL Research, S&P Dow Jones Index, CFRA, 24/01/2021
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future returns.
The modern design of the S&P 500 Index was first launched in 1957. The performance before then incorporates the performance of its predecessor index, the S&P 90.

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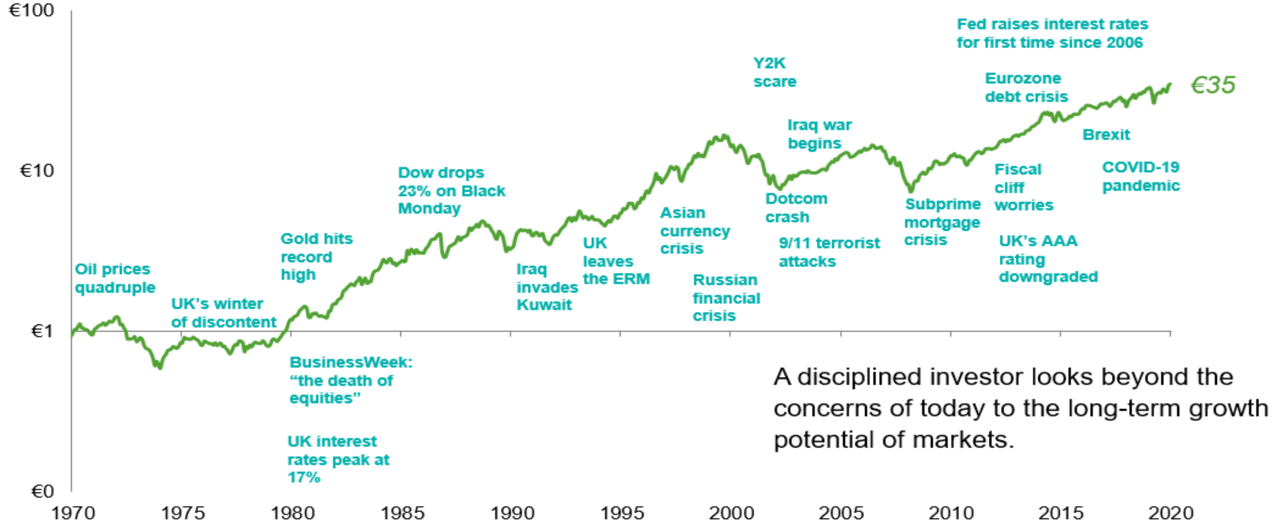
Markets Have Rewarded Discipline

Growth of a Euro—MSCI World Index (net div), 1970–2020



Data presented in the Growth of €1 chart is hypothetical and assumes reinvestment of income and no transaction costs or taxes. The chart is for illustrative purposes only and is not indicative of any investment. Past performance (including hypothetical past performance) does not guarantee future or actual results. Performance may increase or decrease as a result of currency fluctuations.

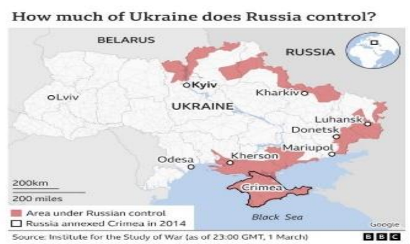
In EUR. These events are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news. MSCI data © MSCI 2021, all rights reserved. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

Another perspective which is helpful to calm the nerves is to look at the make-up of a typical globally diversified and market weighted portfolio. Our investment portfolios are widely diversified and our allocation to Russia and Ukraine is through Emerging Markets (as opposed to Developed Markets) funds. Depending on the overall risk allocation (from low risk to high risk), our portfolios' allocation to Russia ranges from 0.1% for low-risk portfolios to 0.3% for high growth or aggressive portfolios. Our Socially Responsible Investment portfolios only have 0.1% exposure to Russia across the different risk allocations. We have no direct exposure to Ukraine and Belarus.

Global Developments and Their Impact

Geopolitical events like military or economic conflicts can affect stock markets in many ways. These events are normally widely followed by investors.

We believe current market prices quickly incorporate expectations about the effects of these events on economies and companies. We believe that the most effective way to mitigate the risk of unexpected events is through broad diversification and a flexible investment process.



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This philosophy applies to other crises, like natural disasters, social unrest, and pandemics.

However, geopolitical events sometimes lead to restrictions on investors' ability to trade in specific stocks or on certain exchanges. One way is through government sanctions.
In recent days, the US and other Western governments have issued sweeping new sanctions directed at Russia. Fund Managers previously reduced the weight of Russia in their emerging markets and global equity portfolios after sanctions were imposed in 2014 after the annexation of Crimea. Most funds have very small exposure to the Russian market, if any at all.

In some cases, geopolitical events have led to temporary market closures, impacting all stocks in a certain market for a period of time.
For example, on June 27, 2015, Greece closed its stock market after defaulting on its government debt. The **Athens Stock Exchange** stayed closed until August 3 of that year.
During the Egyptian revolution of 2011, the **Egyptian Stock Exchange** closed after January 27 and remained closed for over a month.
Unplanned market closures are not limited to emerging markets.
In 2019, the **Tokyo Stock Exchange** closed for 10 days after Japanese Emperor Akihito abdicated the Chrysanthemum Throne.
In 2001, **the New York Stock Exchange** closed until September 17 after the September 11 attacks on the World Trade Centre.

These types of market disruptions are not new, and the form that they take can vary. We've seen other examples over the decades including currency repatriation restrictions in **Malaysia** in 1997, the introduction of capital controls in **Argentina** in 1999, and a successful coup d'état in **Thailand** that led to a market closure in 2006.

> ***"Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate". -*** *Warren Buffett*

The Value of Flexibility

Flexibility is valuable in managing portfolios through these events. No two events are the same, but common themes are uncertainty and rapid change. The diversified nature of our portfolios is important in allowing flexibility. If investing is halted in a market or in certain stocks, trading can continue across multiple other eligible countries and securities. Equity portfolios typically invest across thousands of stocks.

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Planning for the Unexpected

Investors in global equity portfolios inevitably face periods of geopolitical tensions. Sometimes these events lead to restrictions, sanctions, and other types of market disruptions. We cannot predict when these events will occur or exactly what form they will take. However, we can plan for them by managing diversified portfolios and building flexibility into our process.

Current events have shown once again the importance of being globally diversified. Whilst we can't eliminate market risk, having a low cost globally diversified portfolio and a risk allocation to match your risk tolerance and need to take risks to achieve your financial goals, is the best tool in our arsenal as independent financial advisers.

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