WAR… WHAT IS IT GOOD FOR?

“War...What is it good for?...Absolutely nothing, say it again, y'all...Absolutely nothing, listen to me. Oh war, I despise 'Cause it means destruction of innocent lives. War means tears to thousands of mothers' eyes. When their sons go off to fight and lose their lives’
Lyrics to ‘War’ song, written by Norman Whitfield, Barrett Strong, and Edwin Star

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Like many others, I have been horrified watching events unfold in Ukraine. We are feeling a multitude of emotions, e.g. sadness, anger, fear, etc. But news coverage of the war does allow us to also witness many instances of bravery and generosity. Suffice it to say that the humanitarian crisis occurring in Ukraine is deeply unsettling.

As bad as the news is regarding the Russian invasion of Ukraine, the impact of the war on diversified investment portfolios is relatively contained. In fact, the increase in interest rates we witnessed in the first seven weeks of 2022 had probably a greater negative impact on the markets.

Given all the existing uncertainty in the market, this is a good time to check in on what history teaches us. We cannot address every single issue contributing to the current uncertainty in the markets, but let us discuss a few of them.

The <u>Russian invasion of Ukraine</u> is definitely causing plenty of market angst. But historically, ‘acts of war’ have had a limited impact on financial markets. (S*ource: RBC GAM, Investor Insights, Perspective on the Russia-Ukraine crisis, March 4, 2022)* In looking back at eight decades of military events, we find that the month before the beginning of the event to be the worst, while the following three months usually see gains. *(Source: National Bank Investments, Quick Take, CIO Office, February 22, 2022)*And if measured from the market low reached during significant international events since 1950, the US stock market has reached a median return of 33.0% one year out, and 43.1% two years later. *(Source: Mackenzie Investments, Seeking Clarity in the Fog of War, February 25, 2022)* This is not to say that the market cannot go lower from here over the next few months but I would encourage investors to look out 12-24 months past this very difficult moment as opposed to being overly focused on what is happening today.

Another area of uncertainty is the <u>rise in interest rates</u>. Bond yields have actually been going up since last August. But the official US Federal Reserve Rate has been stable and very low since early March 2020. That is expected to change very soon. Should that be a great cause for concern? Our studies show that, on average, over the 18 Fed rate hike cycles since 1958 the markets have earned decent returns. In fact, following the first Fed rate hike, on a 12 months horizon, the U.S. S&P 500 stock market index and the Canadian TSX Composite delivered a median (average) return of 7.0% and 11.3%, with the returns being positive roughly 70% of the time. *(Source: RBC DS Portfolio Advisory Group, Equities: What happens around the start of the Fed rate hike cycles?, Nov. 9, 2021)* I would add that the Russian invasion of Ukraine is likely to make the central banks more hesitant about fast and extensive rate hikes. Monetary policy that is too restrictive (hawkish) could inadvertently cause a recession.

Another contributor to uncertainty is the fact that <u>the most important U.S. stock market index - the S&P 500 Index - was down 10%</u> on February 22nd relative to its all-time high. A decline of 10% or more in this index is officially called a ‘correction’. Should the U.S. stock market dropping down into ‘correction’ territory be a major cause for future concern? While there is no doubt a correction can cause anxiety amongst investors, our studies show that for the 12 corrections experienced since 1988, the medium return of the index over the next 365 days is 17.2%. (*Source: RBC GAM, Recent Volatility in Context, February 2022*) This is not to say that the market could not be lower in 12 months from now. But the sheer fact that the market is lower today relative to its recent all time high means that stocks are cheaper and expected future returns have most probably improved. And investors should also remember that pullbacks happen relatively often. Since 2000, more than half of the years have included a correction of 10% or more in the U.S. S&P 500 Index. *(Source: Special Edition, Global Insight, Risks become realities: Consequences of Russia’s strikes on Ukraine, February 24, 2022)*

<u>Pessimism</u> is at a relatively high level these days, further contributing to uncertainty. Bearish sentiment - measured by the weekly American Association of Individual Investors (AAII) survey - spiked in January as global equities sold off and again recently (to its highest since 2013) as geopolitical tensions erupted. Such pessimism has historically been consistent with stronger future gains for equities. (Source: Liz Ann Sonders and Kevin Gordon, Charles Schwab & Company Ltd., War: What is it Good For? Absolutely Nothing, March 4, 2022) Apparently there are currently fewer bulls (optimists) than bears (pessimists) in the equity market. The latest Investors Intelligence survey of newsletter writers shows those classified as bullish fell to 29.9% while the proportion of bears increased to 34.5%. It is the first time since April 2020 that the bull-bear ratio fell below 1. Similar readings have occurred six other times since 2010 -- all taking place near the bottom of a major market selloff. (Source: Bloomberg , Stock Gauge That Called Past Market Bottoms Flashes Buy Signs, Mar 3, 2022)

Not making the front page news yet are the <u>U.S. mid-term elections</u>. As we unfortunately all know, election campaigns regularly amplify negative messages, and candidates draw attention to the country’s problems. Consequently, in the first several months of the year with a midterm election, stocks tend to have lower average returns. And afterwards, above-average returns are typical for the full year following the election cycle. Since 1950, the average one-year return following a mid-term election is 15%. (Source: Capital Group, Can U.S. midterm elections move markets? 5 charts to watch, January 20, 2022) We should add that mid-term elections usually result in the president’s party losing ground in Congress. This would suggest that the government will be politically divided in 2023. In turn, a divided government might reduce the odds of future tax hikes and spending increases. (Source: Brian S. Wesbury - Chief Economist, First Trust Portfolios, February 28, 2022)

Hidden between all the ‘known’ negatives is the often overlooked positive that there is plenty of excess cash reserves held by individuals and companies out there. I am not implying that all of it is waiting and ready to be deployed in the markets. But some of it will, e.g. Goldman Sachs expects Corporate America to accelerate the pace of its share repurchases this year. Goldman has increased its 2022 S&P 500 buyback estimate to $1 trillion. (Source: Buyback dividend growth in 2022 could be stronger than expected, Reuters, March 7, 2022) This should provide some level of support for the markets.

From what has now been discussed, my belief is that many of the issues that might be viewed negatively today for the markets might actually be positives for the markets when looking out into the future. My final conclusion is that as long as an investor has a diversified portfolio and a medium-to-long-term time horizon, one should be able to successfully ride through the current storm.

Should you have any questions or concerns, please feel free to reach out. And as always, we encourage you to contact us if there has been an important change in your financial situation.

Wade Brown Wealth Management
March 11, 2022

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Insights/Opinions from Experts

In this section, as I often do, I would now like to offer a few very recent quotes/insights/observations from respected market experts that hopefully provide useful perspective during these very uncertain times.

"Fundstrat's Tom Lee sees stocks shaking off rough start and rallying nearly 20% by the end of 2022. Fundstrat Global Advisors' managing partner Tom Lee told CNBC on Thursday he remains positive on stocks for the remainder of 2022, even as Wall Street confronts a more aggressive Federal Reserve and geopolitical uncertainty in Eastern Europe." (P.S. my note: Tom tends to be bullish, but a few months ago, he did correctly predict 2022 would have a rough start)
CNBC PRO, March 10, 2022

"The bottom line is that this war between Russia and Ukraine is extremely serious…The situation is still quite fluid… we tend to view this as an opportunity for incrementally more investment risk-taking, as opposed to less."
RBC Global Asset Management, Macro Memo, March 1-14, 2022

"Although risks to capital markets have risen measurably over the past several months, a significant equity market adjustment has taken place, reducing valuation risk and improving expected returns."
RBC Global Asset Management, The Global Investment Outlook- Spring 2022 Release, February 28, 2022

"The Russia/Ukraine crisis will continue to produce market volatility, but the direct impact on corporate earnings should be small….the worst might be behind us..."
J.P. Morgan, The J.P. Morgan view, March 2, 2022

"...history shows that while geopolitical crises such as the one between Russian and Ukraine can temporarily roil markets, they don't typically have long-term consequences for investors…The impacts of the conflict are likely to vary depending on the geography…Diversification and professional management can help manage short-term risks while pursuing long-term rewards."
Fidelity, Fidelity Viewpoints, What does the Ukraine crisis mean for markets?, February 25, 2022

"…the history of recent decades shows that the impact of local and regional conflicts tends to have limited, short-lived impact on the global economy and financial markets. We think the ongoing market concerns regarding Ukraine and Russia will once again prove to be mainly impacting near-term investor sentiment once fear of a major escalation diminish...Canada (is) well positioned for robust U.S. outlook and rising oil prices. For Canada, $100 oil is good news (except when filling up at the gas tank) for both the economy and the TSX and largely explains why Canadian equities have outperformed most regional equity markets year-to-date ….For long-term investors, such geopolitical and market turmoil, while highly unpleasant, is part of the journey of investing. Despite the disheartening humanitarian impact being inflicted on local populations, we don't think investors should be overly concerned and alter their investment outlook based on recent developments. Because we think investor sentiment is excessively pessimistic regarding the geopolitical and economic outlook, we stand ready to buy equities on further dips over coming weeks. Although we expect investor sentiment to remain hesitant to bounce back on lack of near-term peace developments, we think we are nearing a bottom for sentiment. We expect anxiety over Ukraine to eventually diminish against a U.S. economy that's running at full employment."
BMO Asset Management, Russian Drums of War Spark Boxing-Day Stock Sales, February 2022