How Markets Respond to Geopolitical Crises

Investors are increasingly worried about geopolitical crises but very few have taken the time to understand how the markets typically react when these things go down. The reactions to wars, political malfeasance, or scandals are not always what you would think based on the headlines. In this piece I wrote for Bloomberg I look back on how the markets have reacted to prior periods of turmoil. The results may surprise you.

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According to a survey by the CFA Institute, more than two-thirds of global investment professionals expect the geopolitical climate to affect investment returns over the next three to five years. And a full 70 percent of respondents expect these changes to negatively affect market performance.

In the past nine months or so, the world has seen its share of upheaval, starting last June with the Brexit vote and continuing in November with the election of Donald Trump as president. On April 6, another geopolitical crisis erupted as Trump ordered Tomahawk missile strikes on a Syrian air base in response to a suspected chemical attack on civilians by the regime of President Bashar al-Assad.

No one knows if things will escalate or if this will turn out to be a one-off event, but investors should be aware how the markets have reacted to geopolitical events in the past.

In the six months following the onset of World War I in 1914, the Dow dropped more than 30 percent. That year, the stock market closed for six months, the longest it has ever been shut, because liquidity all but dried up. But in the following year, it rose more than 88 percent, which remains the highest annual return on record for the Dow Jones Industrial Average. In fact, from the start of the war in 1914 until it ended in late 1918, the Dow was up more than 43 percent in total, or around 8.7 percent annually.

Hitler invaded Poland on Sept. 1, 1939, which began World War II. When the market opened on Sept. 5, the Dow actually rose almost 10 percent in a single day. When the attack on the U.S. naval base at Pearl Harbor occurred in early December 1941, stocks opened up the following Monday down 2.9 percent, but it only took a month to regain those losses. From the start of WWII in 1939 until it ended in late 1945, the Dow was up a total of 50 percent, more than 7 percent per year.

The Korean War began in the summer of 1950 when North Korea invaded the South. That conflict ended in the summer of 1953. In that time, the Dow was up an annualized 16 percent, or almost 60 percent in total.

U.S. troops were sent to Vietnam in March of 1965. The Dow would finish the remainder of that year up almost 10 percent. By the time the last of the U.S. troops was pulled out of Vietnam in

1973, the stock market was up a total of almost 43 percent, or just under 5 percent per year.

The Cuban Missile Crisis had the world on the brink of nuclear war in October of 1962. The confrontation lasted 13 days from Oct. 16, 1962, to Oct. 28. In that two-week period the Dow remained surprisingly calm, losing just 1.2 percent. For the remainder of that year the Dow would gain more than 10 percent.

President John F. Kennedy was assassinated a little more than a year later in Dallas. The market opened up 4.5 percent the day after. Stocks finished up the following year, 1964, more than 15 percent.

Stocks dropped 13.3 percent in the three weeks following the Gulf War in the summer of 1990. From July of that year through October, the S&P 500 dropped 19.9 percent, but this also coincided with recession.

The attack on U.S. soil on Sept. 11, 2001, saw stocks fall sharply, down almost 15 percent in less than two weeks following the tragedy. The economy was already in the middle of a recession at that point and stocks were still falling from the technology bubble, but within a couple of months the stock market had made back all of its losses from Sept. 11.

The U.S. invaded Iraq in March 2003. Stocks rose 2.3 percent the following day and finished up the year with a gain of more than 30 percent from that point on, though this followed the end of a brutal bear market.

You can see that stocks have a mixed record when dealing with international conflicts. There's no road map to follow should things get out of hand anywhere in the coming years. Making financial decisions in the face of geopolitical uncertainty can be a scary proposition, so investors need to realize that there are certain things that are out of their control.

Predicting geopolitical events is no easy task. Predicting how markets should respond to those events may be even harder.

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