

The Ukraine Invasion—What Does It Mean for Investor Portfolios?

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Russia launched attacks on Ukraine last week, marking the start of the next phase in the Ukraine crisis. It makes sense that the markets are already reacting. Before the market opened, U.S. stock futures were down between 2 1/2 percent and 3 1/2 percent, while gold was up by roughly the same amount. The yield on 10-Year U.S. Treasury securities has also dropped sharply. International markets were down even more than the U.S. markets, as investors fled to the more comfortable haven of U.S. securities.

The Markets Are Being Hit Hard

News of the invasion is hitting the markets hard right now, but the real question is whether that hit will last. History shows the effects are likely to be limited over time. This event is neither the only time we've seen military action in recent years nor the only time we've seen aggression from Russia. In none of these cases were the effects long-lasting.

Historical and Current Events

Let's look back at the Russian invasions of Georgia and Crimea (which is part of Ukraine). In August 2008, Russia invaded the republic of Georgia and the U.S. markets dropped by about 5 percent, then rebounded. In February and March 2014, Russia invaded and annexed Crimea and the U.S. markets dropped about 6 percent on the invasion, then rallied. In both cases, an initial drop was erased quickly.

When we look at a wider range of events, we largely see the same pattern. The chart below shows market reactions to other acts of war, both with and without U.S. involvement. Historically, the data shows a short-term pullback followed by a bottom within a couple of weeks. Exceptions include the 9/11 terrorist attacks, the Iraqi invasion of Kuwait, and, looking further back, the Korean War and Pearl Harbor attack.

Event	Event Date	One Day Return	Total Draw Down	Days to Bottom	Days to Recovery
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%	13	26
North Korea Missile Crisis	7/28/2017	-0.1%	-0.2%	2	3
Bombing to Syria	4/7/2017	-0.1%	-1.2%	5	11
Boston Marathon Bombing	4/15/2013	-2.3%	-3.0%	4	11
Madrid Bombing	3/11/2004	-1.5%	-2.9%	10	14
US Terrorist Attacks	9/11/2001	-4.0%	-11.6%	8	19
Iraq Invasion of Kuwait	8/2/1990	-1.1%	-16.9%	50	131
Reagan Shooting	3/30/1981	-0.3%	-0.3%	1	2
Munich Olympics	9/5/1972	-0.3%	-4.3%	30	41
Tet Offensive	1/30/1968	-0.5%	-6.0%	24	45
Six Day War	6/5/1967	-1.5%	-1.5%	1	2
Gulf of Tonkin Incident	8/2/1964	-0.2%	-2.2%	4	29
Kennedy Assassination	11/22/1963	-2.8%	-2.8%	1	2
Cuban Missile Crisis	10/16/1962	-0.3%	-6.6%	6	14
Hungarian Uprising	10/23/1956	-0.2%	-0.8%	3	4
North Korea Invades South Korea	6/25/1950	-5.4%	-12.9%	13	57
Pearl Harbor Attack	12/7/1941	-3.8%	-19.8%	97	214
Average		-1.5%	-5.4%	15	35
Average Ex Recessions		-1.3%	-4.3%	13	30

Note: Red values occurred during recessions. White boxes indicate events that ultimately incited the US to send troops to war.

Source: Bloomberg Intelligence

Sources: The index referenced here is the S&P 500 Index.

Still, even with these exceptions, the market reaction was limited both on the day of the event and during the overall time to recovery. In fact, comparing the data provides useful context for today's events. As tragic as the invasion of Ukraine is, its overall effect will likely be much closer to that of the Russian invasion of Ukraine in 2014, when Russia annexed Crimea, than it will be to the aftermath of 9/11.

Surprising Wartime Market Results

But even with the short-term effects discounted, should we fear that somehow the war or its effects will derail the economy and markets? Here, too, the historical evidence is encouraging, as demonstrated by the chart below. Returns during wartime have historically been better than all returns, not worse. The war in Afghanistan, though not included in the chart, matches the pattern. During the first six months of that war, the Dow gained 13 percent and the S&P 500 gained 5.6 percent.

Capital Market Performance During Times of War							
	Large-Cap Stocks	Small-Cap Stocks	Long-Term Bonds	Five-Year Notes	Long-Term Credit	Cash	Inflation
1926-2013							
Return	10.0%	11.6%	5.6%	5.3%	5.9%	3.5%	3.0%
Risk	19.0%	27.2%	8.4%	4.4%	7.6%	0.9%	
All Wars							
Return	11.4%	13.8%	2.2%	3.7%	2.8%	3.3%	4.4%
Risk	12.8%	20.1%	6.4%	3.5%	5.5%	0.7%	
World War II							
Return	16.9%	32.8%	3.2%	1.8%	3.0%	0.3%	5.2%
Risk	13.8%	21.0%	1.9%	0.8%	1.1%	0.0%	
Korean War							
Return	18.7%	15.4%	-1.1%	0.7%	0.3%	1.5%	3.8%
Risk	11.1%	12.7%	3.0%	1.7%	3.2%	0.1%	
Vietnam War							
Return	6.4%	7.3%	1.9%	4.7%	2.7%	4.9%	4.1%
Risk	12.1%	21.1%	8.1%	4.4%	6.9%	0.3%	
Gulf War							
Return	11.7%	-1.2%	12.5%	12.5%	12.1%	7.0%	4.7%
Risk	19.4%	27.5%	8.4%	3.8%	6.7%	0.2%	

Source: Mark Armbruster, "What Happens to the Market if America Goes to War?" CFA Institute Blog, 2013

Sources: The indices used for each asset class are as follows: the S&P 500 Index for large-cap stocks; CRSP Deciles 6-10 for small-cap stocks; long-term US government bonds for long-term bonds; five-year US Treasury notes for five-year notes; long-term US corporate bonds for long-term credit; one-month Treasury bills for cash; and the Consumer Price Index for inflation. All index returns are total returns for that index.

Returns for a war-time period are calculated as the returns of the index four months before the war and during the entire war itself. Returns for "All Wars" are the annualized geometric return of the index over all "war-time periods." Risk is the annualized standard deviation of the index over the given period. Past performance is not indicative of future results.

Expect a Headwind

This data is not presented to say that today's attack won't bring real effects and hardship. Oil prices are up to levels not seen since 2014, which was the last time Russia invaded Ukraine. Higher oil and energy prices will hurt economic growth and drive inflation around the world and especially in Europe, as well as here in the U.S. This environment will be a headwind going forward.

Economic Momentum Going Forward

Will we see effects from the headwind caused by the Ukraine invasion? Very likely. Will they derail the economy? Not likely at all. During recent waves of Covid-19, the U.S. economy demonstrated substantial momentum, which should move us through the current headwind until markets normalize. We are already seeing U.S. production increase, which should help bring prices back down—as has happened before.

Despite very real concerns and risks the Ukraine invasion has created and current market turbulence, we should look to what history tells us. Past conflicts have not derailed either the economy or the markets over time. Historically, the U.S. has survived and even thrived during wars.

What This Means for Portfolios

Although current events have unique elements, they're really more of what we've seen in the past. Events like last week's invasion do come along regularly. Part of successful investing—sometimes the most difficult part—is not overreacting. If you're comfortable with the risks you're taking, you might not be making any changes—except perhaps to start looking for some stock bargains. If you're worried, consider whether your portfolio allocations are at a comfortable risk level. If they're not, talk to your advisor.

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