About Investing

Navigating the links between geopolitics and portfolio performance

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Advisers and investors have long paid close attention to the impacts of geopolitical events on investment markets and portfolios. But such impacts can be complex and even counterintuitive, requiring advisers to both guide investors and calm their nerves.

It's often the job of advisers to reassure investors that while stock markets can respond immediately to events, it's not always the case. Similarly, it's important to note that even when there is a reaction, its direction, scale and duration may not be what you might obviously expect, or necessarily reflect the magnitude of the related developments.

As an example it would have been natural to assume that markets would fall in response to the storming of the US Capitol building in January 2021, causing shockwaves around the world and temporarily delaying the ratification of Joe Biden as President-elect. In reality the crisis made no difference to short-term political or economic expectations. The S&P 500 Index continued rising and the Dow Jones Industrial Average Index closed at a record high.[1]

Lessons from recent history

During the Global Financial Crisis in 2008 the global economy slumped and investors sold out of equities in huge numbers in fear of a prolonged and damaging downturn. As we now know, however, those that resisted that temptation were rewarded with a bull market that started in March 2009 and only ended with the COVID-19 pandemic 11 years later.[2]

Markets were buffeted over that period by geopolitical turbulence including the US-China trade dispute, the European Union (EU) debt crisis, ongoing tensions in the Middle East, Brexit and Donald Trump's tenure in the White House. But while there were sharp corrections along the way, markets continued to move in a broadly upward direction with some hitting record highs. There were specific reasons for that resilience and for the highs still being reached even as economies continued to reel from the effects of the pandemic.

The most obvious is the effect of central bank policies, including low interest rates and quantitative easing, which had the effect of dampening volatility and incentivising investment in risky assets such as equities.[3] Whilst geopolitical events still have an impact on market sentiment, more sustained market momentum tends to be triggered by both fiscal, but more importantly monetary policy. During 2022, as inflation increased, central banks responded with interest rate rises. The resulting effects of the commencement of normalising monetary policy has seen bond values fall at the same time as shares have been repriced to accommodate a change in the economic outlook.[4]

Investment markets and the war in Ukraine

While we know that geopolitical events don't typically impact directly on investment markets, there are some exceptions. One is the war in Ukraine, which has driven up inflation and contributed significantly to uncertainty and volatility in global investment markets.

There are several factors in this. For instance, the impact on the supply of commodities such as wheat and oil has exacerbated the ongoing disruption that the COVID-19 pandemic caused to global supply chains. The International Monetary Fund (IMF) warned in July that the commodity price shock had increased the risk of recession[5] and downgraded its global growth forecasts for both 2022 and 2023 to 3.2% and 2.7% respectively.[6]

But while the war could affect markets over the short and medium-term, long-term investors can be reassured by the growth of stock markets through the conflicts that scarred the 20th century.[7]

Cutting through the noise

With technology and other resources increasingly enabling individual investors, it's easy for people to conclude that they have all they need to manage their own investments without the help of a professional adviser. But those resources mostly became available during that long bull market and many private investors will have little experience of dealing with downturns and prolonged volatility.

This is where advisers can really come into their own, acting almost as behaviour coaches, helping clients to block out the 24/7 'news noise' that can cloud decision making, calming anxious clients and

Investing can feel complex and overwhelming, but our educational insights can help you cut through the noise. Learn more about the Principles of Investing **here**.

introducing some long-term perspective. That might involve reminding clients of the fundamental principles of long-term investing, such as the value of diversifying by spreading their investments across a range of low correlation assets.

There's plenty of evidence that can be used to help convince clients of the benefits of sensible portfolio management. They include various studies demonstrating that asset allocation is the biggest single driver of portfolio returns over time (as opposed to market timing or stock picking, for instance).[8] Investors can also be reassured by data showing the value of regular, drip-feed investing and the benefits of both compounding and pound-cost averaging.

Bouncing back: Q2 2020

Between 19 February and 23 March 2020 the S&P 500 Index plunged by 34% as the unfolding pandemic triggered a panicked sell-off.[9] Yet by early June the Index had rallied by 44%.[10] Investors who continued to drip-feed money into their portfolios over that period would have stood to benefit from pound cost averaging, while those that sold out locked in their losses and missed out on the recovery that followed.

Understanding the technical factors

Investors can also benefit from being guided through some of the more technical factors that influence market movements. For instance, that stock markets very rarely mirror the performance of economies.

Taking the FTSE 100 as a case study, as a capital weighted index it can be dragged down by the underperformance of just a handful of some of its biggest constituents or a slump in one or two of the larger sectors. For example, while financials accounted for around 18% of the Index at the end of 2021, information technology (IT) companies made up less than 1.5%.[11]

That means the FTSE 100 didn't benefit from the strong 2020 performance of technology stocks, many of which gained on the back of the pandemic and so had a disproportionate impact on the performance of indices with much greater technology exposure, such as the S&P 500 Index.[12]

Similarly, the FTSE 100 Index performed better in the weeks following the 2016 European Union referendum than many investors had expected. That was mainly because around 70% of stocks on the FTSE 100 Index sourced the bulk of their earnings from outside the UK and so benefited from the weaker pound sterling.[13]

Asset Management

Looking to the long-term

We have seen in recent years how politics can defy predictions, but that, along with the current uneven outlook, simply underlines why it's so important for investors to seek out professionals that have the experience, skills and knowledge to help them navigate the months and years ahead.

Find out more

Learn more, visit our website here for more insights into financial markets.

[1] Market Watch, 6 January 2021
[2] CBS News, 12 March 2020
[3] Moneyweek, 10 August 2019
[4] CNBC, 18 October 2022
[5] International Monetary Fund, 26 July 2022
[6] International Monetary Fund, 31 October 2022
[7] Griffin Black, 24 February 2022
[8] Palisades Hudson, 1 July 1999
[9] Innovest, 23 July 2020
[10] Forbes, 8 June 2020
[11] Siblis Research, 31 December 2021
[12] Forbes, 7 June 2020
[13] Shares, 8 August 2019