IN FOCUS

Investment Insights into Current Events

DiMeo Schneider & Associates, L.L.C.

Market Performance Amid Geopolitical Crises

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North Korea. Afghanistan. Syria. With geopolitical crises dominating the news-cycle seemingly daily, we reviewed historical data to gain a better understanding of financial market performance during volatile periods in history. We link these historical observations to our portfolio construction process and discuss key implications.

Key Points:

- **Market performance in times of conflict:** History provides relevant context with respect to market performance in times of conflict. Since 1900, there have been 7 major geopolitical crises that have included armed conflict (WWI, WWII, Korean War, Vietnam War, First Gulf, September 11th, Second Gulf War). Market performance rose during more periods of conflict than they fell.[1]
    - WWI (1914-1918): The Dow was up more than 40% or close to 9% annualized.
    - WWII (1939-1945): The Dow was up 50% or more than 7% per year.
    - Korean War (summer 1950-1953): The Dow was up nearly 60% or approximately 16% annualized.
    - Vietnam War (March 1965-1973): The Dow was up about 43% overall which equates to approximately 5% annualized.
    - First Gulf War (summer 1990): The Dow dropped 13.3% in the three weeks following the inception of the war and finished the year down nearly 20% overall. Keep in mind this time period, summer of 1990, also coincided with a recession.
    - September 11th (2001): Stocks fell nearly 15% in less than two weeks following the attacks on the World Trade Center. Despite the attacks and the recessionary environment brought-on by the bursting of the Tech Bubble, stocks recovered all of the losses within about a two month time period.
    - Second Gulf War (March 2003-December 2003): The U.S. invaded Iraq in March, 2003. Stocks rose 2.3% the day following the initial invasion and finished 2003 with a gain of more than 30%.
- **We've been here before:** Perhaps the closest historical comparison to North Korea is the Cuban Missile Crisis. The confrontation between the U.S. and the U.S.S.R. lasted 13 days from October 16th to October 28th, 1962. During this period, the Dow was down only -1.2% and finished 1962 up nearly 10% overall.
- **We have a plan:** DiMeo Schneider's proprietary Frontier Engineer™ asset allocation algorithm simulates thousands of outcomes and accounts for possible "fat tail" events. This process helps right-size allocations to riskier asset classes and avoids "betting-the-farm" on any one asset class. The result is a broadly diversified portfolio among 10 – 15 distinct asset classes which tends to reduce overall volatility and hold up better when any one asset class is experiencing a period of stress. Should geopolitical events impact equity markets substantially, fixed income allocations provide a ballast and act as a source of liquidity used to rebalance assets into poorly performing asset classes at more attractive valuations (lower prices).

    It is easy to focus on the daily headlines. However, how your portfolio performs relative to *your* stated investment objectives over time is most important. Sticking to a plan and avoiding emotional reactions to headlines and day-to-day market gyrations remains the best way to ensure long-term investment success.

[1]Ben Carlson, CFA, "How markets reacted to geopolitical crises", *The Economic Times*, 4/13/2017, http://economictimes.indiatimes.com/markets/stocks/news/how-markets-reacted-to-geopolitical-crises/articleshow/58158842.cms