War... what is it good for?

Deep data dives provide guidance to investors when they are worried about the impact of geopolitical events.

Geopolitical events such as wars are commonplace, unfortunately, and they are something investors will need to constantly grapple with when setting their short- and long-term investment strategies.

Given the conflict in the Middle East, it may be worthwhile examining how markets have behaved during past geopolitical events.

Specifically, I have looked at the performance of the S&P 500 index – among the most liquid and traded markets globally – around key geopolitical events. The data suggests long-term investors should look through these events, as the downside, on average, is manageable. On a much shorter time horizon, there may be trading opportunities for investors who are inclined that way.

3 FUNDS TO WATCH

Global X Bloomberg Commodity ETF

The exchange traded fund, trading on the ASX under the code BCOM, provides exposure to a liquid, well-diversified basket of hard and soft commodities that are significant to the world economy and have low correlation with other major asset classes. It invests in a highly liquid, broad-based basket of commodities, including energy, grains, precious metals, industrial metals, softs and livestock.

Perennial Strategic Natural Resources Trust

The actively managed fund invests in listed and unlisted companies exposed to the resources industry. It can also invest in global shares (up to 20%) and unlisted shares (up to 20%), with most of the portfolio in Australian listed shares. It has exposure to commodities such as oil, gas, gold, uranium, lithium, rare earths and copper.

Betashares Australian Resources Sector ETF (ASX: QRE)

The fund aims to track the performance of an index comprising the largest ASX-listed companies in the resources sector, including BHP, Rio Tinto and Woodside Energy. However, investors should be aware that it has concentrated positions in some stocks.

How the sharemarket reacted

GEOPOLITICAL EVENT	DATE	S&P 1-DAY RETURN	S&P 500 TOTAL DRAWDOWN	S&P 500 DAYS TO BOTTOM	S&P 500 DAYS TO RECOVERY
Iranian general killed in air strike	3-1-2020	-0.7%	-0.7%	1	5
Saudi Aramco drone strike	14-9-2019	-0.3%	-4.0%	13	26
North Korean missile crisis	28-7-2017	-0.1%	-0.2%	2	3
Bombing of Syria	7-4-2017	-0.1%	-1.2%	5	11
Boston marathon bombing	15-4-2013	-2.3%	-3.0%	4	11
Madrid bombing	11-3-2004	-1.5%	-2.9%	10	14
US terrorist attacks*	11-9-2001	-4.9%	-11.6%	5	19
Iraqi invasion of Kuwait*	2-8-1990	-1.1%	-16.9%	50	131
Ronald Reagan shooting	30-3-1981	-0.3%	-0.3%	1	2
Munich Olympics	5-9-1972	-0.3%	-4.3%	30	41
Tet Offensive (Vietnam War)	5-9-1968	-0.5%	-6.0%	24	45
Six-Day War in the Middle East	5-6-1967	-1.5%	-1.5%	1	2
Gulf of Tonkin incident	2-3-1964	-0.2%	-2.2%	4	29
John F. Kennedy assassination	22-11-1963	-2.8%	-2.8%	1	2
Cuban missile crisis	16-10-1962	-0.3%	-6.6%	6	14
Hungarian uprising	23-10-1956	-0.2%	-0.8%	3	4
North Korea invades South Korea	25-6-1950	-5.4%	-12.9%	13	57
Pearl Harbor attack	7-12-1941	-3.8%	-19.8%	97	214
Average		-1.5%	-5.4%	15	35
Average excluding the two recession periods		-1.3%	-4.3%	13	30

Source: Bloomberg Intelligence * Took place during recessions.

How much do geopolitical events impact stocks? The short answer is, on average, not that much. Bloomberg collated data from 18 geopolitical events since 1940 that resulted in a decline in the S&P 500. On average, the drawdown from these events was 5.4% and it took about 15 days for the S&P 500 to bottom out.

The other key point to note from the data is that the biggest drawdowns in the S&P 500 took place in the US: terrorist attacks, the Iraqi invasion of Kuwait, the North Korean invasion of South Korea and the Pearl Harbor attack, all of which resulted in the US going to war.

With the US just coming out of the debacle that was Afghanistan, my view is that it does not have the appetite for another drawn-out war. In fact, most global economies, including the UK, Europe and China, do not currently have the economic strength to withstand a widespread conflict. Most developed economies are still battling high inflation and low economic growth.

Commodities as a hedge

More specifically, the data on major wars going back to 1800 suggests commodities provide a great hedge. Since 1800, there have been five major global wars: the War of 1812, the US Civil War, World War I, World War II and the peak of the Cold War in 1973-74.

According to a study conducted by the research consultancy Thunder Said Energy, during all of these major conflicts, 95% of commodities experienced higher prices. Further, it's no surprise that commodities that experienced the largest disruption in supply also experienced some of the largest price gains.

Fast-forward to today. While we appreciate that no two conflicts are likely to be identical, the supply of critical commodities will continue to attract a premium, and hence investors will again find them to be a good hedge against wars. Even without a war, governments have moved to shore up the supply of critical minerals that assist in their energy transition and are key inputs in technological innovation.

Underinvestment challenge

In recent years, there has been a material underinvestment in the new supply of some commodities, in part driven by the shift to renewables. This is especially true for fossil fuels such as oil and coal, which still power much of the global economy.

Hence further shocks, such as potential disruption from wars to existing supply could create challenges. For example, if tensions in the Middle East spread to a drawn-out conflict, then this could have a major impact on oil.

The Strait of Hormuz, which is between the Persian Gulf and the Gulf of Oman, is a key choke point for the supply of liquid natural gas and oil supply and accounts for a material percentage of global consumption. ■

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