

Your Knee-Jerk Reaction is Maybe Wrong

MARKET UPDATE
February 24, 2022

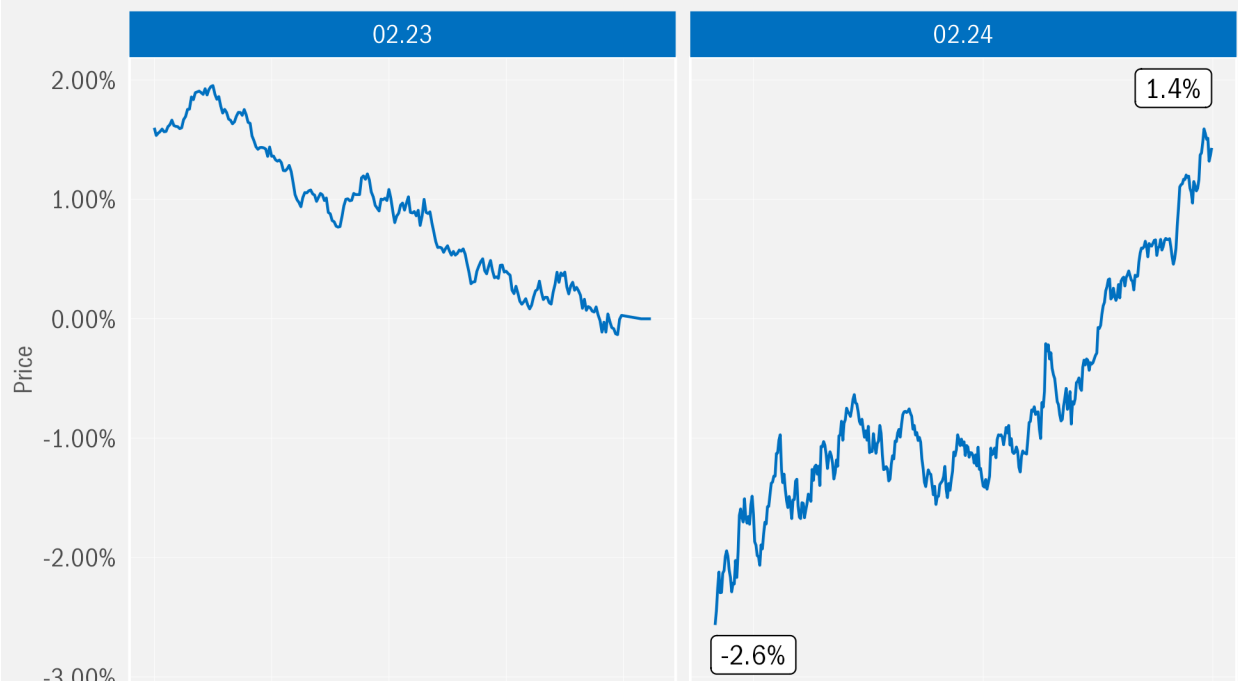
It's rare that market action provides such clarity of purpose to our recommendations that investors maintain a long-term orientation with investment plans, even as they regularly revisit their tolerance for market risk. After Russia launched an invasion of Ukraine in their early morning hours today, international markets opened to significant losses. Domestic stocks opened down as much as 2.5%. But by market close, U.S. stocks had regained every bit of ground lost today...and even some of prior day's drop. The stark change of fortune offers a fine reminder to investors wary of market tumult:

- Amidst market declines, the time to gauge tolerance for various levels of investment risk may have passed
- Sales of risky assets after substantial loss may do little more than lock in losses already experienced
- Investors should regularly revisit comfort with potential market risk in order to increase the likelihood of adhering to long-term investment plans when the inevitable market decline arrives

One Would Have Thought...

On Monday, February 21, the President of Russia, Vladimir Putin, announced his intention to recognize as independent two states in eastern Ukrainian region of Donbas and send in troops to those regions to maintain peace, in his words. Yesterday evening U.S. time, he then announced that he intended to launch a "special military operation" against the leadership in the country's capital Kyiv. Shortly thereafter, news reports suggested a much broader invasion of Ukraine was in process, with assaults commencing from the north, near Kyiv, from east outside of the disputed regions and from Crimea in the south. By Thursday morning, with European markets already seeing measurable losses, U.S. markets opened down as much as 2.5%. U.S. Treasuries absorbed those flight-to-quality dollars and yields sank as bond prices rose. Through the morning, though, stocks began to recover lost ground, a trend that hastened after President Biden discussed additional Russian sanctions. By market close, the S&P 500 had bounced more than 4% from the day's low to close up more than 1.4% on the day. Given the still well-uncertain nature of the events likely to unfold from here, we find the day's 4% rebound among the more surprising outcomes we've experienced in our investment careers.

Figure 1: Intraday Performance of the SPDR S&P 500 ETF Trust (SPY)



From 02.23.22 through 02.24.22. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. SOURCE: SRCM using data from Bloomberg

Minding Myriad Matters

In addition to the more obvious geopolitical implications, Putin's war in Ukraine could have a very chilling effect on the ongoing macroeconomic recovery from the COVID-19 pandemic. And if late-day financial news coverage is any indication, investors seem more keenly focused on that potential for a slowdown in growth. The ramifications of further upward pressure on energy prices were Russian supplies restrained or removed from global markets seem top-of-mind, too. Uncertainty regarding both matters has some wondering whether current expectations for monetary policy will remain in place.

Hypothesizing a bit, were the economic pressures to increase such that growth slows, policy normalization might be extended, with relatively more positive impacts to the bond markets and a perhaps more neutral impact on equities; greatly dependent, of course, on the nature and extent of the slowdown in growth. Conversely, faster inflation may require even more aggressive policy stances, regardless the war's impact on growth. That scenario raises the potential for negative impacts on both stocks and bonds.

But let's be clear: such simplistic hypotheses ignore the very unknowability of Putin's next actions, the economic and military responses to those actions, the macroeconomic implications of each of the above, and the eventual shifts in monetary policy to come as a result. Even more, we'll reiterate the fact—made quite obvious by today's market activity—that it's quite difficult in advance to determine how the stock and bonds markets will weigh the importance of and react to any change of events or trend. That's why we continue to believe it of utmost importance to coordinate a regular conversation regarding current and desirable exposure to market risk.

Likely More Swings to Come

Importantly, we do not believe that today's market action is indicative of what we are likely to experience as this new crisis in Europe evolves. As we are likely to reiterate in our regular commentary next week, though, we believe patience through such times of market declines and increased volatility tends to find reward in more positive outcomes over the long-term. That idea is supported by the fact that, except for the latest decline, the U.S. market has recovered from every major downturn it ever has experienced, no matter the drivers, depth or duration. Nonetheless, given what we expect will prove continued market volatility for some indeterminate time, readers may wish to revisit the implications for shorter-term goals. So, we welcome any discussions you may wish to have regarding our understanding of the events as they are evolving in the context of exposure to broad-market risk.

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