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WEALTH MANAGEMENT

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Monthly Insight

Global Events and Your Portfolio

The Russian invasion of Ukraine is an important reminder that geopolitical risk is a part of investing in global markets. Navigating geopolitical events requires expertise, flexibility, and—perhaps most important—discipline. A well-designed approach is vital and should be based on your individual long-term goals and risk tolerance. This is nowhere truer than when considering geopolitical events and their potential repercussions for markets.

Geopolitical events like military or economic conflicts can affect stock markets in many ways. Especially now, with our 24-hour news cycle and near-instantaneous access to new information, such events are generally widely followed by investors. As we watch the latest headlines or videos, however, it's important to remember that current market prices quickly incorporate expectations about the effects of these events on economies and companies. In fact, with today's computer-driven financial markets, this information is almost instantaneously "priced in" to trading activity. In other words, no individual investor can react to market-moving events as quickly as the market itself reacts. And no investor can predict with better than random accuracy the direction of the movement. What we can say with absolute certainty, however, is that for every seller there is a buyer: someone who believes that purchasing that asset at the agreed price represents an opportunity for gain.

For these reasons, a sound investment approach should emphasize positioning assets to benefit from the pricing action of evolving information. Most often, this approach calls for maintaining the predetermined balance of asset types, rebalancing when mandated by market movement, exercising appropriate harvesting of losses when called for, and remaining disciplined and patient. Put simply: investors should use the information available in current market prices rather than trying to outguess or anticipate future directions. As long as efficient markets continue to function normally, it is generally in the investor's long-term best interest to continue investing according to the established strategy.

Research also suggests that the most effective way to mitigate the risk of unexpected events is through broad diversification. This philosophy applies to most crises, including wars, natural disasters, social unrest, and even unprecedented global pandemics, as many investors learned during 2020 and 2021.

However, geopolitical events may sometimes lead to restrictions on investors' ability to trade in specific stocks or on certain exchanges. One way is through government sanctions. In recent days, the US and other Western governments have stated they would impose new sanctions on Russia in response to an invasion of Ukraine. The exact nature of these sanctions and extent to which they would impact listed securities are uncertain. If imposed, they would add to sanctions on Russia that have been in place for a number of years.

In another recent example, the US issued executive orders in 2020 and 2021 that prohibited US persons from investing in certain Chinese companies. Like the ongoing situation in Russia and Ukraine, this period was marked by uncertainty. For weeks and months after the original order took effect in November 2020, fund managers sought clarity on the scope of the restrictions and the exact list of sanctioned stocks.

In some cases, geopolitical events have led to market closures, impacting all stocks in a certain market for a period of time. For example, on June 27, 2015, Greece closed its stock market after defaulting on its government debt. The Athens Stock Exchange stayed closed until August 3 of that year. During the Egyptian revolution of 2011, the Egyptian Stock Exchange closed after January 27 and remained closed for over a month.

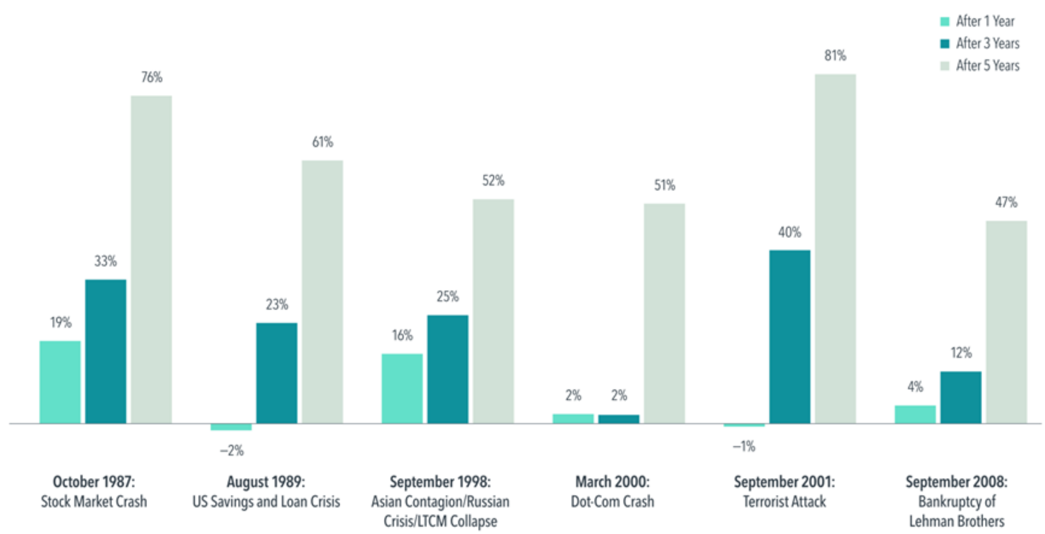
And, it must be said, unplanned market closures are not limited to emerging markets. In 2019, the Tokyo Stock Exchange closed for 10 days after Japanese Emperor Akihito abdicated the Chrysanthemum Throne. In 2001, the New York Stock Exchange closed until September 17 following the September 11 attacks on the World Trade Center. These types of market events are not new, and the form that they take can vary. We've seen other examples over the decades.

Diversification is valuable in managing portfolios through these events. No two events are the same, but common themes are uncertainty and rapid change. The diversified nature of our portfolios is important in navigating the uncertainty inherent in the financial markets. Proper diversification means that even if we encounter challenges in a particular market or in certain stocks, we can continue trading across multiple other eligible markets and securities that are less affected or even affected differently. By spreading our risks across hundreds or even thousands of stocks—as with a broadly diversified mutual fund—a well-diversified portfolio can allow us to anticipate that unexpected events—such as the invasion of Ukraine—are less likely to disrupt our long-term strategy.

It’s also worth remembering the demonstrated resilience of the financial markets, even in the face of various economic, financial, and geopolitical crises. The following chart illustrates the cumulative returns realized by an investment strategy consisting of 60% equities and 40% fixed-income. Notice how this strategy performed at intervals of one, three, and five years following some of the major crises of the last 35 years:

The Market's Response to Crisis

Performance of a Balanced Strategy: 60% Stocks, 40% Bonds (Cumulative Total Return)



SOURCE: Dimensional Fund Advisors. Past returns, including simulated returns, do not guarantee future results.

It might be of special interest to notice the returns achieved following the 9/11 terrorist attack: perhaps the most traumatizing geopolitical event in US history and one that resulted in the week-long closing of the New York Stock Exchange, as mentioned above. One year later, a 60-40 portfolio would have experienced a negative 1% growth rate. After three years, however, the portfolio would have grown by 40%, and that rate would have slightly more than doubled—to 81%—after five years.

Although a globally diversified, balanced portfolio strategy invested at the time of each of the circumstances shown above would have suffered losses immediately following most of these events, financial markets did recover, as can be seen by the three- and five-year cumulative returns shown in the exhibit. In advance of such periods of discomfort, having a long-term perspective, appropriate diversification, and an asset allocation that aligns with their risk tolerance and goals can help investors remain disciplined enough to ride out the storm.

Investors in global equity portfolios will inevitably face periods of geopolitical tensions. In addition to the tragic human consequences of such events, sometimes they also lead to restrictions, sanctions, and other types of market disruptions. We cannot predict when these events will occur or exactly what form they will take. However, from a financial perspective, we can plan for them by maintaining diversified portfolios and building discipline into our process.

At Empyrion Wealth Management, we utilize our expertise, research, and experience to help clients build diversified portfolios that are designed to help them achieve their most important financial goals while minimizing the effects of market volatility resulting from unforeseeable events. To find out more, click here to read our recent article, “War and the Casino.”

Stay Diversified, Stay YOUR Course!

SOCIAL MEDIA DIGEST

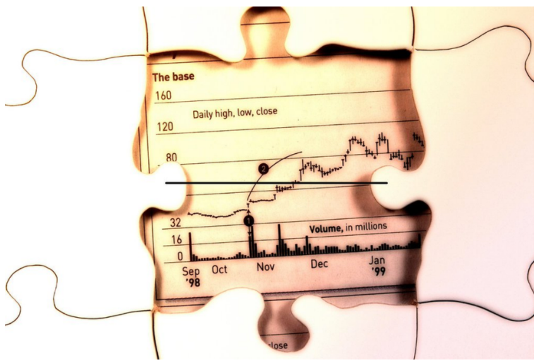
In case you missed them, here is a roundup of my latest posts on social media:

Today’s women are owning their success, commanding larger paychecks than those that came before them, and rising to the top of the ladder in their fields. Today's women are breaking the bias. Happy International Women's Day!

While illiquid assets like fine wines (no pun intended) and other collectibles probably should not form the bulk of your holdings, there is certainly a place for them in a well-diversified investment program.

Don't play the day, play the year. In

my latest Fox 40 clip, I discuss how international crises usually affect the market in the short term but not the long term.



Value stocks tend to outperform stocks in other categories, although no one can tell when the outperformance will happen. The only way to reliably capture the value premium is to commit to a long-term strategy.

KIMBERLY FOSS

President, CFP®, CPWA®, CFT-I™ Candidate

"We understand that every person we serve has distinct values and ambitions, and they

each need their own plan for wealth management."