

Special Market Update

Russia's Act of War Rattles Markets

Near and Longer-Term Implications

Following weeks of brewing tensions, on February 24, 2022, Russia acted on its threats to attack Ukraine, justifying its aggression by declaring independence for two pro-Moscow areas of Ukraine.

This attack on Ukrainian sovereignty, is unquestionably a tragedy, and while the human toll is still unknown, a protracted conflict could inflict unimaginable harm on the citizens at the heart of this battle.

It's important to note that the situation in Eastern Europe is complex and is continuing to evolve which means it's difficult to predict what will happen over the coming days, weeks, or months. But for now, below are some early insights about how markets are responding and what may potentially lie ahead.

Conflict Implications and Market Fallout

Outside of the human toll, which is of primary concern, global equity markets initially responded by selling off aggressively, most intensely in Europe. Markets abhor uncertainty and may have been somewhat dismissive of the risks ahead of this potential event. This in part is why we may have witnessed such an aggressive reaction where risk assets like stocks sold off dramatically, and gold and bonds that are considered less risky, rallied.

The Ukrainian military is well trained, and while certainly smaller than Russia's, this could lead to

a longer-term quagmire if the conflict becomes protracted with Ukraine putting up a strong defense. As a result, we could see continued uncertainty with the biggest implication being a prolonged slump for European economies going forward. These are early days, but expectations are that markets will trade in a very volatile fashion until some clarity emerges from the conflict, but the uncertainty may weigh on investor sentiment.

Impacts to the Outlook

In the past, outside of WWI and WWII, geopolitical conflicts have led to extreme volatility but did not materially impair longer term economic growth. For investors with a longer horizon, while this period may be very uncomfortable, with this year's returns potentially impacted, past episodes of military conflict have not significantly limited long-term investment returns. In short, extreme losses in a given period, often lead to more accretive returns in a following period.

In North America, while sentiment might currently be bleak, the impacts to the economy will likely be less severe than what Europe is experiencing. This environment is expected to add stress to an already tight commodity market. Russia is a major producer of oil, the primary supplier of natural gas to Europe

and supplies about 40% of Germany's natural gas. Russia is also one of the major suppliers of base metals across the world. These major commodities are up materially because of the conflict and on the realization of the potential for major supply chain impairments as sanctions imposed on Russia by the international community take their toll.

On the inflation front, certain goods that are driven off commodity prices may continue to experience elevated price pressures, as Russia is removed from the global trading system. Notwithstanding, the expected rate hike cycle from central banks should continue, but the pace of rates could be affected particularly if there are additional disruptions to the inflation and global economic outlook.

Asset Allocation During Market Volatility and Uncertainty

Diversification is key within multi-asset portfolios to withstand environments like the current one. While a balanced portfolio may experience declines along with the broader market, some exposure to lower risk asset classes could help to materially offset dramatic declines.

Equity markets have demonstrated the ability to weather conflicts in the past. The chart below highlights how the S&P 500 Index initially responded to major military conflicts, and its resiliency throughout the duration of the majority of the wars.

S&P 500 Index (US\$) Returns

Event	Start	End	1 Day Return	Period Return
Korean War	25-Jun-50	27-Jul-53	-5.38%	7.70%
Vietnam War (US)	8-Mar-65	30-Apr-75	-0.16%	0.05%
U.S. Invasion of Panama	20-Dec-89	31-Jan-90	0.57%	-4.01%
Operation Desert Shield	2-Aug-90	17-Jan-91	-1.88%	-6.69%
Operation Desert Storm	17-Jan-91	28-Feb-91	1.30%	11.92%
Bosnian War	6-Apr-92	14-Dec-95	-1.86%	12.04%
Somali Civil War	22-Aug-93	13-Oct-93	-0.20%	1.17%
Kosovo War	28-Feb-98	11-Jun-98	0.00%	4.31%
War in Afghanistan	7-Oct-01	30-Aug-21	-0.83%	7.51%
War in Iraq	20-Mar-03	15-Dec-11	2.30%	3.82%
Russo-Georgian War	1-Aug-08	12-Aug-08	0.00%	2.32%
Russo-Crimean War	20-Feb-14	26-Mar-14	-0.19%	0.69%

Period return is the return from the start date to the end date. Periods greater than 1 year are annualized.
Source: TDAM

Markets

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