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North Korea

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We're not going to pretend to be experts in geopolitics, but at the same time we must acknowledge that the recent escalation in tensions surrounding North Korea has us all a bit on edge and is something that mustn't be dismissed. Of course - most importantly - there is the very real fear of the human toll should those tensions spill over into conflict, but beyond that, we also must look to our portfolios to see how the issue is affecting the markets. As we know, financial markets and global conflicts don't get along too well, so this is an issue that needs to be addressed.

There are two things we know:

1. Neither China, Russia, nor the United States wants a world war
2. North Korea will not be allowed by the global community to possess nuclear weapons and the tools to deliver them

Of course we will only know in hindsight how this all plays out. Both the optimists and the pessimists have their share of valid arguments. But looking purely at the financial markets, maybe we can use the past as a guide to help us gauge investors' responses to past conflicts. From Bloomberg:

- The Korean War began in the summer of 1950 and ended in the summer of 1953. In that time the Dow was up an annualized 16 percent, or almost 60 percent in total
- US troops were introduced to the Vietnam conflict in March 1965 and by the time the last troops were withdrawn in 1973 the market was up a total of almost 43 percent, or just under five percent per year
- The Cuban Missile Crisis had the world on the brink of nuclear war for 13 days in October 1962 yet the Dow remained surprisingly calm, losing just 1.2 percent during that time. For the remainder of the year the Dow would gain more than 10 percent
- JFK was assassinated a little more than a year later in Dallas. The market opened up 4.5 percent the following day and finished the following year – 1964 – up more than 15 percent
- Stocks dropped 13.3 percent in the three weeks following the 1990 Gulf War, but this timing also coincided with recession
- The 9/11 attacks saw stocks fall sharply, down almost 15 percent in less than two weeks. The economy was already in the midst of recession and stocks were still falling from the 1999 tech bubble, but within two months the stock market had regained all of its 9/11 losses
- Stocks rose 2.3% the day after the US invaded Iraq in March 2003 and finished the year up more than 30 percent, although this timing followed the end of a three-year bear market

The takeaway is *not* that markets tend to ignore brutal geopolitical events. Rather it might be reasonable to conclude that *investors' reactions to fear and our reactions to reality are quite different*. As an example – the markets responded to the 2016 Brexit referendum with a strong selloff because of fears of widespread EU disintegration. The markets then rallied when those fears were determined to be unfounded. We also remember the pullback prior to the 2003 Iraq invasion on fears of military challenges from the Iraqi Republican Guard Forces, and we also remember how reality proved those fears overblown.

No one knows how this current escalation of events will unfold. We do however know that, over the long run, corporate earnings and economic growth will always be the real drivers of the financial markets, and those drivers today are in impressive shape. We remind our readers though that bull markets and economic expansions don't last forever and even the most robust bull markets have corrections from time to time. That we haven't experienced a pause of any magnitude in a year-and-a-half suggests that we're due, and whether the catalyst is borne of economic or geopolitical events, we should always be prepared and we should always remember to keep the long-term view in mind.

As always, we're here should you have questions or wish to discuss these thoughts or their applicability to your personal situation. Until then, we so very greatly appreciate your continued relationship and trust.