NOTTINGHILL INVESTMENT ADVISERS, LTD.

Perspective

Geopolitical Crises and U.S. Equities –
A Few Examples

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> *"Times of worldwide crisis initially can be unsettling, but the news typically proves to be of little consequence to the long-term investor."*
>
> -- *Dick Davis*

The American and North Korean sabers, of course, have been rattling all summer as our erstwhile Northeast Asia nemesis continues to move ahead with a nuclear/ICBM capability. We don't mean to dismiss the seriousness of this matter, and certainly are conscious of the potential scope of human suffering involved; but, when such geopolitical crises develop, we often are asked about their possible impact on U.S. equities. The short answer is that crises of this nature typically do not have a lasting impact unless there is a clear economic impact above and beyond the crisis itself. But, that is the $64,000 question, isn't it? Prior to or in the midst of a full-blown geopolitical crisis, how do we know for sure about the possible economic impact? We don't, but a look at a few past geopolitical crises and their impact in stock market terms is instructive.

The Fall of France

The ultimate Evil Empire had made peace with the Soviet Union; annexed the Rhineland, Austria, and Czechoslovakia; and, conquered Poland. However, Britain and France still were standing. Everyone knew that an attack was coming, and everyone thought it would come through Belgium as it had in 1914. Instead, as we know, the Germans attacked through the Ardennes. Then, Guderian's famous pivot north and the dash to the Channel. The British and the French, who had charged east into Belgium when the first cannon went off, were trapped, and May-June 1940 became a disaster of truly epic proportions. (The scope of the disaster is illustrated once again in this summer's "Dunkirk.") The French surrendered on June 22, 1940. On that date, the S&P 500 Index closed at 9.98. The following is Index performance (price only) over the next three- , six- , and nine-month periods:

Three Months	*+6.91%*
Six Months	*+4.51*
Nine Months	*-0.50*

Pearl Harbor

Sunday, December 7, 1941, "the date which will live in infamy." The ill-prepared, sleeping giant was awakened, and suddenly was headed into a war of unprecedented dimension against two very experienced, implacable enemies. From that date forward, nobody's life would be the same. The prior Friday, the S&P 500 Index closed at 9.38. Over the next three, six, and nine months, the Index did the following:

Three Months	*-13.01%*
Six Months	*-10.45*
Nine Months	*-8.10*

This disaster, also of truly epic proportions, of course, was followed by the dark pre-Midway days of 1942. Interestingly, by December 7, 1942, when we clearly were <u>not</u> out-of-the woods, all of the lost ground had been made up.

The Cuban Missile Crisis

Trouble clearly had been brewing for a few days – and most people knew it – but, JFK didn't address the nation until the evening of October 22, 1962. The address was memorable, and those late-October days in 1962 constituted his finest hour. We know this because we <u>now</u> know that a quarantine of Cuba was by far the least draconian of the many options put before him and, therefore, how close we actually came to Armageddon. On October 22, the S&P 500 closed at 54.96. The following is Index performance over the subsequent periods:

Three Months	*+19.07%*
Six Months	*+26.09*
Nine Months	*+23.54*

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General Westmoreland had decreed that there was light at the end of the tunnel; but, someone forgot to tell the Viet Cong and North Vietnamese regulars who launched a series of well-coordinated attacks throughout South Vietnam on January 30, 1968. The fighting in Hué and elsewhere took a terrible toll on the enemy, however, the political battle at home was lost irretrievably. In short order, erstwhile LBJ ally, Walter Cronkite, delivered his famous position-reversing editorial; LBJ announced that he would not run in the fall election; and, anti-war violence escalated across the country. The stock market seemingly took little notice that public support for the war had taken a major turn and that the tearing of the nation's fabric had moved to a new level. The subsequent market returns:

Three Months	*+5.06%*
Six Months	*+5.22*
Nine Months	*+11.42*

Persian Gulf War

In 1982, the Argentinians never thought that the British fleet would sail and attempt to re-take the Falklands. Big mistake, and likewise, Sadam Hussein apparently didn't believe that anyone would retaliate if and when he invaded the lost province of Kuwait. Someone – actually a lot of people – did retaliate in the wake of the August 2, 1990 invasion. Oil prices did spike, and that caused some stock market consternation; but, the war and the oil-related stock market problems were all over by early-1991. The details:

Three Months	*-11.28%*
Six Months	*-2.40*
Nine Months	*+8.26*

Here, for the first time in this brief review of geopolitical crises, we see one of them have a direct impact on worldwide and U.S. business activity. Would a Mideast oil supply problem have a similar impact in 2017? Probably not. U.S. shale production clearly has changed the ballgame.

September 11, 2001

One can argue that, horrific as these terrorist attacks were, they did not constitute a geopolitical crisis. And yet, they did spawn two protracted wars and countless military actions. The skies were blue and sunny that day as millions watched this string of tragedies unfold, and, like all Americans alive on the original Pearl Harbor Day, the lives of those 2001 millions (ourselves included) will never be the same. U.S. equities? The market did not open on that Tuesday, and remained closed the rest of the week. The following Monday, the market re-opened, and the S&P 500 Index sank 4.92% to 1038.77. Stocks then rallied into year-end before suffering through a difficult 2002. The three- , six- , and nine-month returns (from 1038.77) are the following:

Three Months	*+9.20%*
Six Months	*+12.26*
Nine Months	*-0.25*

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Again, as the war of words has escalated over the past several weeks, others and we have been asked to weigh in on the potential impact on U.S. equities. Of course, we often have said that divining the course of the overall stock market is beyond our capabilities (and those of anyone else) under any circumstances. And yet, history does teach us that geopolitical crises often do prompt knee-jerk selling, but that the impact of those crises on the market then is superseded on a longer-term basis by the usual, i.e., macro data, corporate earnings, etc. We believe that history is a good teacher in this case.

We hope that you and yours are having a good summer. As always, please contact us if you have any questions.

Best regards,

Doug, Jeff, and Lindsay