RBC Global Asset Management

INVESTOR INSIGHTS

Escalating tensions: How markets respond to acts of war

February 2022

Key take-aways

- Russia has further escalated tensions with Ukraine by entering two pro-Moscow areas of Ukraine controlled by separatists.
- Financial markets continue to express uncertainty around the impact of any further escalations.
- Historically, equity markets quickly look past acts of war.

After several weeks of escalating tensions, on February 21, 2022 Russia announced that it would recognize two pro-Moscow areas of Ukraine – Donetsk and Lukansk – as independent states. Russia then quickly moved troops into these two areas. Investors, understandably, may be wondering how markets could react to further military escalation.

Recent developments

Many countries have responded to Russia's recent actions with sanctions. Germany notably announced it would block the Nord Stream 2 pipeline, designed to deliver natural gas from Russia to the rest of Europe. The pipeline had been completed and was awaiting German approval to begin operating. Other NATO members – including Canada, the U.S. and the UK – announced financial restrictions.

Questions now remain around Russia's next moves and how countries will continue to respond. Putin's speech on February 21st suggested he's questioning Ukraine's sovereignty; however, uncertainty remains around whether he is planning a full-scale invasion or will stop at moving into these two regions that have close ties with Russia.

How markets respond to acts of war

While market uncertainty may persist for some time, there are two important messages investors should keep in mind:

- Acts of war rarely have large or lasting impacts on markets.
- Periods of heightened uncertainty are common during times of geopolitical tension.

A strong investment plan is designed to withstand periods of volatility so investors don't have to react. With that in mind, let's look at some evidence that shows how markets typically respond to acts of war. The chart on the next page looks at how U.S. equity markets have historically reacted in response to acts of war and terrorism.

Equity Market Response to Acts of War
Impact on Dow Jones Industrial Average Index (USD)

Event	Date	Median Experience: Decline Days	Decline %	Reaction Period* Days
ACTS OF WAR (all)		**5**	**-2.7**	**12**
U.S. Aggressor		**5**	**-2.2**	**12**
Atomic bombing of Hiroshima	Aug 6, 1945	2	-0.9	4
Bay of Pigs invasion announced (Cuba)	Apr 17, 1961	6	-3.0	22
Gulf of Tonkin Incident (Vietnam)	Aug 4, 1964	3	-2.0	11
U.S. bombs Cambodia	Apr 30, 1970	21	-14.1	67
Failed attempt to free hostages in Iran	Apr 28, 1980		No decline	
U.S. invades Grenada	Oct 25, 1983	10	-2.7	14
U.S. bombs Libya	Oct 25, 1986		No decline	
U.S. invades Panama	Dec 18, 1989	3	-1.9	10
Coalition bombing of Iraq	Jan 17, 1991		No decline	
Coalition invasion of Afghanistan	Oct 5, 2001	3	-0.1	5
Coalition invasion of Iraq	Mar 19, 2003	9	-2.5	13
U.S. Target		**2**	**-2.7**	**4**
Japan bombs Pearl Harbor	Dec 8, 1941	12	-8.2	240
Soviet Union shoots down U.S. spy plane	May 9, 1960	2	-0.5	4
Cuban Missile Crisis begins	Oct 23, 1962	1	-1.9	2
Terrorists kill U.S. marines in Lebanon	Oct 24, 1983	11	-2.7	15
China captures U.S. spy plane	Apr 2, 2001	2	-4.0	4
Other		**11**	**-7.1**	**35**
N.Korea invades S.Korea	Jun 26, 1950	14	-12.0	59
Soviet Union invades Afghanistan	Dec 26, 1979	7	-2.2	10
Iraq invades Kuwait	Aug 2, 1990	51	-18.4	138
Russia invades Georgia	Aug 7, 2008		No decline	
Russia invades Crimea, Ukraine	Feb 28, 2014	1	-0.9	2
Terrorism		**5**	**-4.1**	**15**
Seizure of American Embassy in Iran	Nov 5, 1979	3	-2.7	6
World Trade Centre (WTC) Bombing	Feb 26, 1993	2	-0.3	3
Oklahoma City Bombing	Apr 19, 1995		No decline	
U.S. Embassy Bombings in E. Africa	Sep 23, 1998	18	-11.8	62
Bombing of USS Cole	Oct 12, 2000	5	-4.2	12
WTC and Pentagon Attacks	Sep 11, 2001	5	-14.3	42
Madrid Train Bombings	Mar 10, 2004	11	-3.9	18
London Train Bombings	Jul 6, 2005		No decline	

*Reaction period: Number of days that the market declined in response to an act of war and then took to recover to its level prior to the event.
Source: RBC GAM, Ned Davis Research. An investment cannot be made directly into an index. The table does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns stated would be lower. Past performance is not a guarantee of future results.

What you'll notice is that market declines tend to be short. They typically last 5-11 days, depending on the situation. The actual change in the market is also relatively benign, and often more muted than what investors might think. In fact, historically they've been more muted than the decline U.S. equity markets experienced in January of this year.

Of course, no one can predict with certainty how financial markets will react during a war or other conflict. However, one thing is clear: having a long-term view is likely your best ally in times of crisis.

Publication date: February 23, 2022