Key Questions

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Should You Sell Out of Stocks as Russian Forces Move In?

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The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

Market gyrations likely will continue and will potentially unnerve short-term market participants. While we should acknowledge that the global world order may be changing, we continue to believe that long-term investors will be rewarded for their patience and optimism.

After weeks of increasingly contentious rhetoric, the situation in Ukraine has taken a decisive turn for the worse in the last week. Late Monday, Feb. 21, Russia deployed "peacekeeping" troops into pro-Russian areas of Ukraine, a veiled measure to "protect" Russian supporters. Less than 24 hours later, Russia raised the stakes by formally recognizing these areas as independent states, even though they clearly fall under the jurisdiction of the Ukrainian government.

A few hours later, the U.S. and several of its allies announced the imposition of a broad range of sanctions – with a threat of more to follow – for what President Joe Biden labeled "the beginning of a Russia invasion of Ukraine." This proved prescient as a full-scale invasion into Ukraine soon followed sadly marking the beginning of a major humanitarian tragedy and the possible realignment of the world order. In short, this development will likely have serious implications for years, perhaps generations, to come.

The Fog of War Complicates the Economic Outlook

The Ukraine/Russia relationship has been fraught with complexity for years, thus leaving political strategists to speculate about what will transpire. Attempting to formulate an investment thesis on random game theories would entail considerable conjecture. Likely such decisions would devolve into emotions outweighing tried-and-true principles such as ensuring your portfolio is well-diversified, maintaining a long-time horizon, and focusing on fundamentals, not fear.

Admittedly, the specter of a protracted, multi-national significant conflict complicates an already uncertain economic outlook. In the past several months, we have argued that the U.S. economy would be undergoing a meaningful transition in 2022 – one marked by abundant monetary and fiscal stimulus to one defined by higher interest rates and gradually restrictive economic support in order to stem rising inflationary pressures.

We further stated that markets had become "crowded," which, by itself, is not a good or a bad thing, but potentially an added source of volatility. For these reasons, we felt the year would be characterized by flattish returns for most traditional asset classes.

We also felt that a recession could be avoided, noting that strong pricing power and productivity gains could, in many instances, offset higher wages and other production costs, providing a continued boost to corporate earnings. We also noted that a robust housing market and strong wage gains boded well for consumer spending, helping propel a shift in consumers' buying habits from goods to services, especially as the economy continued to reopen. Lastly, we also observed that healthy balance sheets among corporate and financial institutions were clear positives.

A non-trivial risk to the outlook, however, was that inflationary pressures would prove too severe, forcing the Federal Reserve to raise interest rates too much and tip the economy into a recession. At the beginning of this month, that risk was on the rise.

Impact on Inflation and Stocks

Now, however, the Fed finds itself in an even less enviable situation as a likely outcome from a lengthy conflict involving Russia, Ukraine and its allies, and perhaps others, would be a stagflationary shock – a situation described by falling economic activity coinciding with rising inflation. This set of circumstances likely has caused the S&P 500 Index to fall slightly more than 10% from its recent high, commodities prices to surge, and bond prices (which already are quite high) to provide little support.

The Fed will formally meet in mid-March; as of now, the members likely will stay on course to reverse the support they injected into the economy two years ago during the height of the COVID-19 pandemic. A lot could change between now and then, and thus such a prognostication could also change.

Stocks, meanwhile, likely will remain volatile and may even experience greater downside risk in the days and possibly weeks ahead. Longer-term, however, history has demonstrated that those who remain patient will ultimately be rewarded.

For instance, Forbes recently looked at nearly 30 episodes of geopolitical conflict since World War II. The magazine found that one week following the outbreak of a conflict, stocks were higher only 41% of the time. One month later, however, stocks were higher nearly two-thirds of the time and one year after the onset of a conflict, stocks were higher 83% of the time.

Conclusion

No one knows how the Ukraine situation will evolve or how long it might last. Moreover, investment cycles pause or even end when economic expansions are maturing and are met by an exogenous shock (usually geopolitical in nature), that pushes energy prices higher. The odds of a recession have therefore risen as a result of this tragic turn of events.

Yet, at the same time, corporate fundamentals remain quite healthy. Yes, earnings growth this year will slow versus 2021. But in the quarter just ended, 77% of the companies reported earnings exceeded expectations, climbing nearly 30% year over year. Also worth noting: Net profit margins in the fourth quarter of 2021 were 12.5% versus 11% one year ago.

In sum, while markets are focused elsewhere, we believe stocks remain the preferred asset class of choice for growing and compounding one's wealth, and as such, we encourage investors to remain focused on fundamentals and remain invested for the long run.

For more information, please contact your advisor.

About the Author

As Chief Investment Officer, George Mateyo is responsible for establishing sound investment strategies for private and institutional clients, expanding internal and external research capabilities, and managing the delivery of solid risk-adjusted investment performance.

In previous roles, George spent more than 15 years in investment management and investment consulting, where he acquired firsthand knowledge and insights into the capital markets and the stewardship of investment portfolios for institutional and high net-worth investors.

George received his MBA from the Weatherhead School of Management at Case Western Reserve University and completed additional studies at the London School of Economics.

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