Don't be drawn into a Game of Russian Rublette

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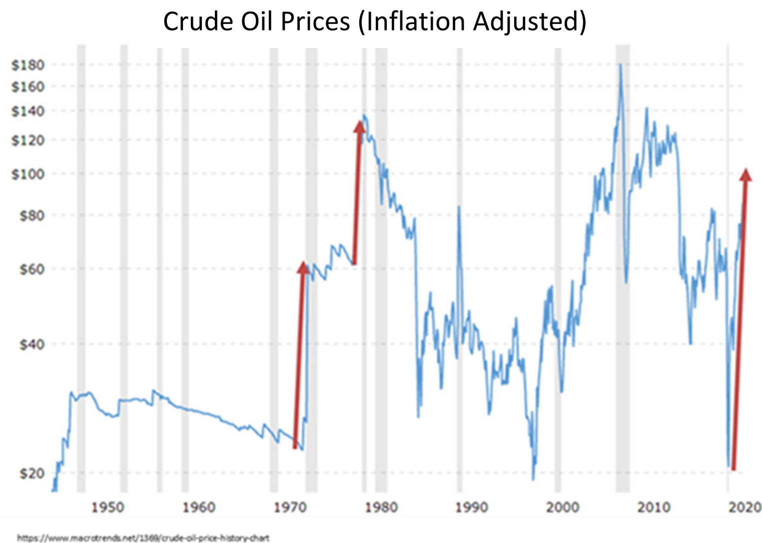
We have coined the term "Russian Rublette" as a cross between Russian Roulette and the impact on the Russian Ruble of Putin's ill-conceived invasion of Ukraine. Since Putin began the invasion of Ukraine, the Russian Ruble has fallen by 30% and the central bank has doubled short-term rates to 20% to defend its currency. Putin has shot himself in a Russian Roulette sort of way.

The Ukraine crisis is on track to produce the biggest war in Europe since 1945. Putin assumed that he would be able to quickly overwhelm the Ukrainian military, dismantle the government and install a puppet regime in Ukraine. Initial US Department of Defense estimates were that the Ukrainian government would fall in two days. Beyond the actual invasion Putin also aimed to achieve three strategic objectives: (a) counter NATO's expansion into Eastern Europe; (b) demonstrate Russian economic and military strength; and (c) highlight fractures within Western powers. So far, the opposite has occurred on all three fronts. The possibility that the conflict recedes into the background diminishes day by day while the likelihood of a long and bloody occupation increases. Putin needs to "save face" and the Ukrainian people show no signs of a pending surrender. Clearly, for investors, these are nail-biting times.

In normal times, markets ebb and flow on the latest economic statistics. During a war scare, by contrast, it's political news that moves the markets. Further, all kinds of prices have moved, sometimes by large amounts, in response to the mere utterances of the key actors in the geopolitical drama. The prices of gold, oil, bonds and equities have gyrated as traders have adjusted their assessment of the evolving war. The heartbreaking and visceral images from Ukraine add to the anxiety and fear.

The table from Deutsche Bank to the right shows the effects of modern wars on markets. On average, the S&P 500 declined by 6.5% following the outbreak of the war. Except for the first three conflicts, the losses were recouped in less than a month. So, at face value, it all seems relatively benign. However, this crisis is more like the first three as they are associated with significant oil price spikes (see the chart that follows). Unless Putin relents, this crisis may take some time for the markets to work through. As such, this crisis is most akin to the Oil Embargo in 1973 which resulted in the steepest loss and greatest duration to recovery (4 years). The Oil Embargo resulted in a sharp reduction in the supply of oil that curtailed economic growth and drove inflation. While the economy is less sensitive to the price of oil today than in the 1970s, western economies are still bereft of energy independence.

Event	Start of sell-off	Duration of sell-off (trading days)	Duration to recover to prior level (trading days)	Size of sell-off
Israel Arab war / oil embargo	29-Oct-73	27	1475	-17.1%
Shah of Iran exiled	26-Jan-79	9	34	-4.6%
Iranian hostage crisis	5-Oct-79	24	51	-10.2%
Soviet invasion of Afghanistan	17-Dec-79	12	6	-3.8%
Libya bombing	21-Apr-86	20	7	-4.9%
First Gulf War	1-Jan-91	6	8	-5.7%
Kosovo bombing	18-Mar-99	4	9	-4.1%
9/11 attacks	10-Sep-01	6	15	-11.6%
Iraq war	21-Mar-03	7	16	-5.3%
Arab spring (Egypt)	27-Jan-11	2	3	-1.8%
Ukraine conflict	7-Mar-14	6	13	-2.0%
Intervention in Syria	18-Sep-14	21	12	-7.4%
Average	**1973-2014**	**12**	**137**	**-6.5%**



With that as historical context, today we are faced with a two-headed monster caught in a feedback loop of almost mythological proportions:

a) Inflation: Investors face a paradigm shift in US economic policy. The huge monetary and fiscal stimulus prompted by COVID-19 is not just waning but is beginning to be curtailed. Fiscal and monetary stimulus combined with supply chain shortages have helped fuel inflation which the government now must combat.

b) The Russia-Ukraine conflict has resulted in geopolitical instability affecting corporate profits, debt default risks, and commodity prices ranging from energy to food.

What is worse is that one monster feeds the other. Sanctions on Russia continue to drive crude oil and commodity prices higher, driving inflation higher and putting pressure on the Fed to tighten more to curb inflation. However, while the oil price rise is inflationary, it is also contractionary like a tax as consumers have less to spend in the rest of the economy. If the Fed were to err in the direction of overtightening on top of the drag of high oil prices, the Fed risks a recession.

To say the least, the geopolitical events and market volatility is more than disconcerting, it is downright scary and can profoundly influence our emotions. So, we want to remind you of some key principles about how markets work and how we manage money on your behalf to keep you on track to attaining your goals.

1. **Don't play Russian Rublette with your wealth** by moving to cash to avoid end-of-the-world risk. The end-of-the-world happens only once. This time is not it. The financial media may tempt you to do otherwise, but the market timing road typically leads to higher costs, missed opportunities, and in many cases, greater losses. This behavior will typically create a drag on the performance you would have otherwise achieved over the long run had you stayed the course set out by your investment strategy and financial plan.

2. **You have to take risk to achieve your goals.** Markets compensate investors for taking risk, not sitting on cash. Stocks are riskier than bonds which are riskier cash. Accordingly, the long-term returns for stocks are higher than bonds, which in turn, have returns higher than cash. In the short-run, market returns are driven by shocks to the system, market participants' perceptions of and attitudes toward risk, but not the long-term return generating process of the economy and markets. If you are tempted to bet on predictions of changing perceptions, refer to #1 above.

3. **How you take risk matters**. Wealthcare offers alternative investment approaches for this reason. Using an investment strategy that matches your beliefs and gives you confidence that you will be successful in the long run is essential to staying the course during volatile times. We believe in goal-connected, risk-managed, cost-effective investment approaches which are highly diversified by country, sector and style.

4. **How you use risk matters.** Yes, you have to take risk to achieve your goals, and how you take risk in the markets matter. However, it is how you use risk to achieve your goals that is most central to how we serve you. This is captured in our patented Comfort Zone® which reflects the essence of goal-connected investing. Rather than reacting emotionally to a market sell-off, a goals-based approach allows us to take a look at how market movement may be affecting your goals and then allowing for intelligent adjustments to keep you and your life-financial plan in the Comfort Zone.

Large market moves, both down and up, will continue to be with us for a while, along with alarming headlines, pictures and forecasts. Buckle up. Recognize the markets are forward-looking and have already discounted significant negative expectations for the short-run. In the longer run, equities have recovered after large declines. How much equities you own should be driven by the investment horizon, your goals, and your tolerance for risk. One of the best ways to address the question of how much should own is to review the Comfort Zone with your advisor. Keep your eye on the prize: a life well-lived.

Investing involves risk, including potential loss of principal invested. Past performance is not a reliable indicator of future results.

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