CETERA® INVESTMENT MANAGEMENT

COMMENTARY

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Market Uncertainty Grows with Potential Russia/Ukraine Conflict

- U.S. stock markets fell on Thursday as investors retreated to safe-haven bonds.
- The impact on stock markets from war and other crisis events is hard to quantify.
- A Russian/Ukraine conflict could lead to more inflation.

Equity markets are falling as uncertainty grows around a potential Russian invasion of Ukraine. On Thursday, the U.S. ambassador to the U.N., Linda Thomas-Greenfield tweeted about an imminent invasion, while President Biden said we were at a "very high risk" of a Russian invasion and added he believed that Russia is engaged in a false flag operation to create an excuse to invade. Russia continues to downplay the possibility of an invasion but also expelled the deputy U.S. ambassador to Russia. With the rising tensions, investors poured money into bonds, sending bond prices up and bond yields down. The money for these bond purchases were sourced out of equities, so the S&P 500 dropped over 2% and the tech-heavy NASDAQ dipped nearly 3%.

Market reactions to war and crisis events can be tricky and hard to quantify. Each one is also different, happening under different market and economic conditions with different factors at play. If we look at past market reactions, you can see that returns on the S&P 500 differed by event but were largely unaffected. We do point out that the 9/11 attack also coincided with the dot-com bubble, so attributing the 1-year return solely to that event might be misleading.

Stock Market Reaction to War and Crisis Events

Event	Date	S&P 500 Return		
		1-Day	1-Month	1-Year
Kuwait Invaded by Iraq	8/2/1990	-1.1%	-8.9%	12.8%
1993 World Trade Center Bombing	2/26/1993	0.2%	1.4%	8.3%
Oklahoma City Bombing	4/19/1995	-0.1%	3.1%	30.8%
September 11th Terrorist Attack	9/11/2001	-4.9%	0.6%	-15.5%
Start of Iraq War (2003)	3/20/2003	0.2%	2.4%	29.2%
2004 Madrid Terrorist Attack	3/11/2004	-1.5%	1.5%	8.7%
Brexit Referendum	6/23/2016	-3.6%	3.1%	17.8%

Source: Cetera Investment Management, FactSet, Standard & Poor's. Returns shown are total returns, which include dividends.

Since each event does have different factors, let's dive deeper into what could potentially happen if a Russia/Ukraine conflict did escalate. Russia is a large energy-producing country, producing a lot of oil and natural gas for Europe. Potential sanctions on Russia could reduce this energy supply and cause oil and gas prices to rise, thus increasing inflation further. Europe is in a tough bind on this as they recently decommissioned nuclear energy plants, banned fracking and is coming off an extremely harsh winter a couple years ago, which diminished fuel inventories.

The wild card in this is central banks. In the U.S., the Federal Reserve is focused on raising rates and markets anticipate a 1.50% to 1.75% increase in rates (the equivalent of six to seven 0.25% hikes) this year. We currently believe that the market is overestimating the Fed's hawkishness, but a potential conflict could cause inflation to rise further, as we discussed. This would put the Fed in a tougher position. A conflict could also hurt growth which may cause the Fed to become more dovish as future inflation prospects may fall.

Meanwhile, China and Taiwan are both watching this conflict closely as China continues to declare its intention to reunify with Taiwan. U.S. debt to GDP is already at World War II levels after all the fiscal stimulus that was passed for COVID relief. One could argue the U.S. along with its NATO allies can't afford any type of military conflict right now. This could potentially limit the extent of any NATO interventions.

Trying to anticipate what may happen is extremely difficult. To further extrapolate the market impact is even harder. We reiterate that in 2022, our primary investment themes are slowing economic growth, a more hawkish Fed and an increase in market volatility. With market risks rising, we continue to anticipate more volatility in the near term. Any disruption to current expectations could be a headwind for stocks, and with high stock market valuations, this could amplify any volatility. Still lingering stimulus, a financially healthy consumer and the eventual abatement of supply chain issues suggest limited market downside. We maintain that diversification is the key in this market. In these times, your financial professional can help you stay focused on your long-term risk and return goals and help you with your personalized investment objectives.

This report is created by Cetera Investment Management LLC. For more insights and information from the team, follow @CeteraIM on Twitter.

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A diversified portfolio does not assure a profit or protect against loss in a declining market.

Glossary

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The **S&P 500** is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.