Conflicts & Investment Returns

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Introduction

The Russian invasion of the Ukraine started in February 2022 and the easy victory that Vladimir Putin anticipated has not materialised; this has led to the prospect of a protracted conflict that could last months or even years.

It has been over seventy years since a major conflict in Europe, and twenty-four-hour news continues to bring the horror of war into our living rooms. Most of those who fought through World War Two are no longer here to remind us of the human cost of global war and that we should do all that we can to avoid this turning into a wider war between NATO and Russia.

Whatever the outcome it seems clear that we are entering a period where geo-political tension and the risk of military "flash-points" will be here us for some time.

Whilst incomparable to the humanitarian problems, understanding the potential financial implications for economies and investment markets when conflicts occur is extremely important.

Over the last fifty years or so there have been numerous instances of unrest and conflicts fought by different nations; some of which were at the height of Cold War when tension between the East & West were just as fragile as they are today. The aim of this report is to look at the impact these conflicts had financially and whether we can learn anything from these events that could help us now and in the future.

Conflicts

We have available date back to 1973 and have decided to examine the following conflicts and flashpoints.

Conflict	Start Date	End Date
Soviet – Afghanistan War	Dec 1979	Feb 1982
Iran – Iraq War	Sep 1980	Aug 1988
Falklands War	Apr 1982	Jun 1982
First Gulf War (Western Coalition)	Aug 1990	Feb 1991
Bosnia	Apr 1992	Dec 1995
Kosovo	Feb 1998	Jun 1999
9/11 Terrorist Attacks	Sep 2001	Sep 2001
Afghanistan War (Western Coalition)	Oct 2001	Aug 2014
Iraq War (Western Coalition)	Mar 2003	Dec 2011
Russian Invasion of Georgia	Aug 2008	Aug 2008
Arab Spring	Dec 2011	Dec 2012
Russian Invasion of Crimea	Feb 2014	Mar 2014
Russian Invasion of Ukraine	Feb 2022	To Date

These are not exhaustive and there have been plenty more localised conflicts and civil wars around the World; those selected involved or potentially impacted major powers and Nations either directly or indirectly.

Indicators Analysed

For each of these events we will focus on the following indicators looking at the performance and trend in periods prior to and post each conflict.

- Bank of England Base Rate
- 10 Year UK Gilt Yield
- UK Retail Price Index
- Oil
- World Stocks
- UK Stocks
- UK Gilts
- UK Index linked Gilts
- Gold
- Broad Commodities

Economic Indicators

Whilst Gross Domestic Product (GDP) is the key measure of economic growth it is a lagging indicator; therefore, we have focused on interest rates, inflation, and the price of Oil as measures of the business cycle – as well as how they impact different asset classes.

- Five-year average prior to the conflict
- Level at start of conflict
- Level at end of conflict
- Five-year average post the conflict

Financial Assets

The focus of investments in this report is on the UK, where we are based and invest; however, this is extended to include the broad Global Stock Market, Gold, and Broad Commodities.

Within the report we will look at how they had been performing in the build up to the conflict as well as during and after; with equities we will also look at valuation metrics using Price Earnings Ratio, G&D Price Earnings Ratio and Dividend Yield[1].

- Return five-years prior to conflict
- Level at start of conflict
- Level at end of conflict
- Return during conflict
- Return next year after start of conflict
- Return next three years after start of conflict
- Return next five years after start of conflict
- Change in Price Ratios & Dividend Yields (equities only)

Analysis Objectives

The objective of this analysis will be to visualise the impact of the conflict on financial assets, identifying any trends or themes, to see if there is an appropriate response that could benefit investment portfolios.

[1] The Price Earnings Ratio (PE) is the price of the share divided by its earnings per share, the Graham & Dood Price Earnings Ratio uses a 10-year average of the earnings per share to iron out cyclicality. The dividend yield is the dividend per share divided by the share price.

Soviet - Afghanistan War

Background

The Soviet Union invaded Afghanistan in December 1979 to support the Communist Government in its fight against the anti-communist Mujahideen guerrillas. Over 100,000 Soviet troops controlled large towns and cities but failed to crush the insurgents despite bombing and depopulating rural areas to reduce civilian support. With US supplied air to surface missiles the Mujahideen reduced the effectiveness of Russia air power, and the war became a stalemate where over 15,000 Soviet troops died. In 1988 with the USSR already starting to disintegrate a withdrawal was agreed that was completed in February 1989.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	10.7%	NA	15.7%	259%
Level at Start	17.0%	NA	17.2%	$42.0
Level at End	12.9%	9.5%	7.8%	$16.4
5 Years Post	10.5%	9.5%	5.5%	-34.1%
Change	↓	↓	↓	↓

The Soviet invasion may have had little impact on the economic position of the UK; in the 1970's inflation had hit all-time highs, accentuated by Oil embargos. Interest rates were high in an effort to curb inflation – both would fall through the 1980's, improving conditions for equities and fixed interest securities.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	83.1%	289.2%
Level at Start	105.5	290.5
Level at End	466.6	1288.0
Return During	342.2%	343.4%
Next 1 Year	17.6%	24.2%
Next 3 Years	18.3%	59.7%
Next 5 Years	48.4%	147.0%
PE Start	8.9x	8.0x
PE End	21.2x	12.3x
G&D PE Start	NA	15.0X
G&D PE End	33.6x	22.9X
Yield Start	4.6%	6.3%
Yield End	1.9%	4.2%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	NA	NA
Level at Start	NA	NA
Level at End	102.86	NA
Return During	NA	NA
Next 1 Year	NA	NA
Next 3 Years	NA	NA
Next 5 Years	NA	NA

	Broad Commodities	Gold
5 Years Prior	37.9%	156.9%
Level at Start	680.1	$457.2
Level at End	1373.3	$382.0
Return During	101.9%	-16.5%
Next 1 Year	11.7%	25.9%
Next 3 Years	-4.5%	-4.8%
Next 5 Years	13.2%	-29.5%

Summary

At the start of the conflict the interest rates, inflation and Oil had all been near all-time highs and had the potential reverse direction eventually. World and UK Stocks valuation levels were still low and recovering from the deep declines of the 1970’s. Fixed Interest data is not available, Commodities continued to rise but Gold having previously prospered started to falter. The conflict seemed to have little impact on the recovery of stocks or the decline in Gold as inflation and interest rates started to fall through the decade. As the Soviet Union was economically isolationist; the main risk to the global economy and investing was if the West was drawn into to the conflict directly

Iran - Iraq War

Background

Iraq’s invasion of Iran in September 1980 was drive by territorial, religious and political disputes; these tensions had existed since Iraq’s establishment in 1921. The turning point was the Iranian revolution that removed the pro- Western Government and replaced it with a fundamentalist regime. In 1979 Saddam Hussein became President fearing Iranian expansion and seeking to reassert control over Shatt al-Arab that was Iraq’s only access point to the Persian Gulf invaded Iraq. Ultimately the conflict became locked in a stalemate that led to over half a million deaths and many more casualties.

Although the conflict remained localised, mindful of the effect on Oil prices that the embargos of the 1970's had, Western powers deployed warships to the Gulf to help regulate supply whilst North Sea Oil & Gas provided new sources of production. The War formally ended in August 1988.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	11.7%	NA	15.0%	192.2%
Level at Start	16.0%	12.9%	15.9%	$33.6
Level at End	10.9%	10.2%	5.7%	$15.6
5 Years Post	10.2%	9.87%	6.0%	-53.1%
Change	↓	↓	↓	↓

Whilst there may have been concerns that inflation could return as a result in a fall in production of Oil from Iran and Iraq the price had already risen by almost 200% in the previous five years. After an initial spike in the price to just over $40 per barrel by December 1980 the price of Crude would continue to fall over the rest of the decade.

	World Stocks	UK Stocks
5 Years Prior	76.4%	114.5%
Level at Start	124.4	362.1
Level at End	405.55	1135.4
Return During	226.0%	213.6%
Next 1 Year	-5.1%	-7.3%
Next 3 Years	20.3%	50.9%
Next 5 Years	45.6%	117.7%
PE Start	9.3x	8.0x
PE End	20.3x	12.0x
G&D PE Start	NA	16.7x
G&D PE End	30.5x	21.6X
Yield Start	4.3%	5.9%
Yield End	2.1%	4.5%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	NA	NA
Level at Start	82.63	NA
Level at End	101.8	NA
Return During	23.2%	NA
Next 1 Year	-12.5%	NA
Next 3 Years	17.3%	NA
Next 5 Years	14.1%	NA

	Broad Commodities	Gold
5 Years Prior	74.6%	350.8%
Level at Start	800.8	$669.5
Level at End	1194.2	$431.0
Return During	74.6%	-35.6%
Next 1 Year	-16.3%	-31.4%
Next 3 Years	-6.8%	-39.3%
Next 5 Years	-6.4%	-52.1%

Summary

Starting not long after the Soviet invasion of Afghanistan this conflict perhaps posed more risks to the global economy and financial assets given the impact it could have had on the price of oil. However, unlike the embargos of the 1970's the price of oil had already risen by almost 200% in the previous five years and would more than half in value over period of the war. The discovery of North Sea Oil & Gas also increased supply. After initially wavering in the year after the start of the conflict World and UK Stocks continued their upward trend through the 1980's as inflation was gradually tamed and interest rates started to fall. Conversely commodities and Gold in particular, would decline over the five years from the start of war.

Falklands War

Background

The Argentine invasion of the Falklands was a brief conflict that came about after General Galtieri ended negotiations with Britain who rejected Argentine claims of sovereignty (Britain had seized the islands in 1833). The decision was based more on political expediency as the ruling military Junta hoped to distract the population from years of economic mismanagement and human rights abuses.

Within just over six weeks Britain put together and landed a task force of the islands, which despite stubborn resistance from the Argentine forces was able to retake the islands by the middle of June – the total loss of life was relatively small at around 900 on both sides. The patriotic support in the UK for Margaret Thatcher's actions saw her win a landslide election the following year in 1983.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	12.3%	NA	13.1%	102.8%
Level at Start	13.3%	11.8%	9.4%	$29.3
Level at End	12.6%	10.0%	9.2%	$35.2
5 Years Post	12.4%	8.4%	4.9%	-37.0%
Change	→	↓	↓	↓

The brief nature of the conflict, the fact that it did not draw in other nations or alliances and that it didnt involve Oil producing regions helped insure there was little disruption economically. The UK was gradually reducing interest rates with Gilt Yields and inflation following.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	28.3%	79.0%
Level at Start	109.4	388.1
Level at End	106.5	414.8
Return During	-2.7%	6.9%
Next 1 Year	31.7%	39.3%
Next 3 Years	59.1%	99.6%
Next 5 Years	272.7%	205.1%
PE Start	9.2x	9.7x
PE End	9.1x	10.4x
G&D PE Start	NA	14.9x
G&D PE End	NA	15.6X
Yield Start	5.0%	6.2%
Yield End	5.1%	5.9%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	NA	NA
Level at Start	83.03	NA
Level at End	87.76	NA
Return During	5.7%	NA
Next 1 Year	19.9%	NA
Next 3 Years	11.9%	NA
Next 5 Years	26.7%	NA

	Broad Commodities	Gold
5 Years Prior	70.3%	140.8%
Level at Start	656.6	$363.3
Level at End	638.6	$315.5
Return During	-2.8%	-13.1%
Next 1 Year	6.8%	19.9%
Next 3 Years	20.7%	-8.3%
Next 5 Years	43.0%	22.2%

Summary

The Falklands War was brief and did not disrupt the UK economically with interest rates, yields and inflation already trending downwards. It would though strengthen the Conservative Government's position and allow them to continue a pro-business strategy that led to the privatisation of Government assets helped by the growth in revenues from North Sea Oil & Gas. Yields on Government debt were downtrend leading to price appreciation and this continued, providing a tailwind for UK stocks that hardly missed a beat during the conflict and soared by almost 100% by 1985 (World Stocks performed similarly). The move to a more deflationary environment saw Commodities and Gold make only modest progress in years following the conflict.

First Gulf War (Western Coalition)

Background

Iraq's invasion of Kuwait in August 1990 sparked the start of the first major crisis in the post-Cold War era. The aim of Saddam Hussein was to acquire Kuwait's oil reserves – to cancel a large debt Kuwait owed Iraq – and to expand power.

The UN Security Council moved quickly to ban trade with Iraq; this resolution importantly was backed by the Arab League. During this period the US had sent troops to the Gulf and their presence was supported by the Soviet Union. With Iraq seemingly poised to invade Saudia Arabia the West and Arab forces were invited by the Kingdom to deploy in the country.

Over the next few months, the US carried out its largest military deployment since WWII and the UN Security Council authorised the use of force for the first time since the Korean War to remove Iraq from Kuwait if they didn't leave by January 1991. Operations Desert Storm and Desert Sabre resulted in cease fire by the end of February 1991.

Importantly during their retreat Iraq's forces set fire to Oil storage facilities and 950 of Kuwait's Oil Wells. Whilst Saddam retained power Iraq was strategically isolated and failure to divest itself or co-operate with inspectors on the issue of weapons of mass destruction led to further conflict.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	11.5%	10.2%	5.6%	-26.0%
Level at Start	14.9%	11.8%	10.6%	$19.7
Level at End	13.4%	10.0%	8.9%	$20.1
5 Years Post	11.8%	8.4%	3.2%	-19.8%
Change	↓	↓	↓	↓

Initially Oil prices spiked sharply, doubling to almost $40 per barrel in October 1990. The boom of the 1980's was running out of steam in the UK as inflation had returned, and the country joined the Exchange Rate Mechanism to try to control it. However, this ended up devaluing sterling and interest rates were increased to defend the currency; this ultimately led to recession in 1991.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	138.9%	75.3%
Level at Start	442.4	1375.6
Level at End	458.3	1402.9
Return During	3.6%	2.0%
Next 1 Year	1.4%	16.5%
Next 3 Years	20.8%	41.9%
Next 5 Years	37.0%	63.1%
PE Start	18.1x	11.8x
PE End	18.1x	12.1x
G&D PE Start	28.4x	20.2x
G&D PE End	28.3x	19.5X
Yield Start	2.4%	5.1%
Yield End	2.4%	5.1%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	-4.8%	NA
Level at Start	89.6	NA
Level at End	101.2	NA
Return During	12.9%	NA
Next 1 Year	13.2%	NA
Next 3 Years	37.8%	NA

Next 5 Years	23.9%	NA
	Broad Commodities	**Gold**
5 Years Prior	199.0%	21.8%
Level at Start	2246.4	$403.0
Level at End	2183.5	$364.5
Return During	-2.8%	-9.6%
Next 1 Year	7.7%	-11.0%
Next 3 Years	3.9%	-8.5%
Next 5 Years	0.1%	-4.1%

Summary

The First Gulf War had broad support Globally, including the Arab League and Soviet Union meaning there was little chance of conflict between major powers. The risk of Iraq controlling 45% of the World's Oil reserve needed to be dealt with quickly; this risk was reflected in the initial doubling of the Oil price in Q3 1990. The rapid success of the coalition and isolation of Iraq meant there was little disruption to the Stock Market or a real flight to safe-haven assets (Gold consistently declined during and after). The UK was facing its own issues with a recession and high interest rates to defend its currency in 1991; however, this was short lived and as rates came down both Gilts and Stocks returned to positive territory.

Bosnian War

Background

In early 1992 Bosnia's Muslims and Croats voted for independence in a referendum boycotted by Serbs; after the EU recognised Bosnia's independence Serbs laid siege to Sarajevo with the aim of carving out a Serb republic. The UN imposed sanctions on Serbia and in January 1993 a UN peacekeeping force deployed. In 1995 Bosnian Serb troops continued to commit atrocities as they sought to conquer Srebrenica and prompted NATO Air Strikes. By the end of 1995 the Dayton Peace Accords were signed, and a 66,000 strong NATO peacekeeping force arrived in Bosnia.

Economic Indicators

	Bank Base	**10Y Yield**	**RPI**	**Oil**
5 Years Prior	11.9%	10.2%	6.4%	-2.2%
Level at Start	10.4%	9.1%	4.3%	$18.0
Level at End	6.4%	7.4%	3.2%	$18.2
5 Years Post	7.8%	6.1%	2.7%	-2.8%
Change	↓	↓	↓	↓

There appears to have been no major change to direction for interest rates, yields or inflation during this period as they continued a downward trend. Oil had been in decline prior to the conflict and continued that trend.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	6.8%	37.7%
Level at Start	435.6	1629.9
Level at End	637.6	2338.2
Return During	46.4%	43.5%
Next 1 Year	14.9%	11.6%
Next 3 Years	34.5%	27.2%
Next 5 Years	61.3%	71.5%
PE Start	20.1x	17.5x
PE End	19.4x	15.4x
G&D PE Start	25.1x	20.4x
G&D PE End	28.9x	22.4x
Yield Start	2.6%	4.8%
Yield End	2.0%	3.8%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	2.0%	NA
Level at Start	107.37	NA
Level at End	117.73	NA
Return During	9.6%	NA
Next 1 Year	8.5%	NA
Next 3 Years	2.9%	NA
Next 5 Years	9.0%	NA

	Broad Commodities	Gold
5 Years Prior	152.4%	-24.0%
Level at Start	2369.6	$337.4
Level at End	2551.6	$386.0
Return During	7.7%	14.4%
Next 1 Year	4.1%	0.2%
Next 3 Years	-6.4%	15.3%
Next 5 Years	38.8%	1.4%

Summary

Whilst this was primarily a UN and NATO mission, many of the World’s economic protagonists were involved. The history of the region as a flashpoint for the start of global conflicts may have concerned many, it was the atrocities and ethnic cleansing that triggered the reaction from the West.

There was very little impact on financial assets and all continued previous uptrends, except for Gold that reversed losses and gained in value modestly.

Kosovo War

Background

In 1989 ethnic Albanians in the Serb province of Kosovo started to protest against the ethnic Serbs and the Government of Yugoslavia. These protests had by 1996 led to the emergence of the Kosova Liberation Army and their attacks gradually increased until in 1998 it became an armed uprising.

Atrocities and ethnic cleansing by a ruthless Serb counteroffensive displaced thousands leading to a UN arms embargo. After negotiations broke down NATO begin air strikes against military targets as Serbs continued to drive Albanians out of the region.

In June 1999 NATO and Yugoslavia signed a peace accord allowing 1.5m Albanians to return under the protection of UN Peacekeepers and in 2008 Kosovo declared independence.

Economic Indicators

	Bank Base	**10Y Yield**	**RPI**	**Oil**
5 Years Prior	6.1%	7.6%	2.7%	-23.9%
Level at Start	7.3%	5.9%	3.4%	$14.1
Level at End	5.0%	4.9%	1.3%	$16.2
5 Years Post	6.3%	4.9%	2.3%	138.5%
Change	↓	↓	↓	↑

There was no major change to direction for interest rates, yields or inflation during this period as they continued a downward trend. Oil had been in decline prior to the conflict and rose modestly during but significantly in the following five years.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	87.8%	96.3%
Level at Start	844.1	3551.0
Level at End	1024.4	4126.0
Return During	21.4%	16.2%
Next 1 Year	12.0%	7.3%
Next 3 Years	21.8%	16.0%
Next 5 Years	-20.8%	-32.3%
PE Start	22.1x	19.7x
PE End	27.5x	24.9x
G&D PE Start	31.9x	28.49x
G&D PE End	35.7x	30.5X
Yield Start	1.7%	2.9%
Yield End	1.5%	2.5%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	13.6%	NA
Level at Start	130.9	100.9
Level at End	136.5	117.0
Return During	4.3%	16.0%
Next 1 Year	9.3%	14.7%
Next 3 Years	3.7%	22.5%
Next 5 Years	8.4%	37.4%

	Broad Commodities	Gold
5 Years Prior	20.7%	-9.0%
Level at Start	2903.2	$298.9
Level at End	2278.7	$259.8
Return During	-21.5%	-13.1%
Next 1 Year	-34.2%	-3.1%
Next 3 Years	36.7%	-13.5%
Next 5 Years	47.1%	17.5%

Summary

As with the Bosnian conflict, events in Kosovo did little to disrupt economies or financial assets that were already in strong uptrends. There were larger forces at play that would affect financial markets in the not too distant future as the Tech Bubble started to run out of steam and a new downward phase for equity markets would start.

9/11 Terrorist Attacks

Background

Whilst this is not a conflict it was a major terrorist event that would lead to a second Gulf War and twenty years of fighting in Afghanistan. The attack was carried out by Islamic extremists linked to Al Qaeda and killed almost 3,000 people. Osama Bin Laden's financing of Al Qaeda was in retaliation for US support of Israel and its presence in the Middle East. Within two months US forces removed the Taliban in Afghanistan – who harboured Bin Laden – as part of an international response -in Operation Enduring Freedom. Whilst the subsequent conflicts in Iraq and Afghanistan are covered in the next section; the impact on economics and financial markets in the three-month following the attacks is considered here.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	6.1%	5.7%	2.7%	32.5%
Level at Start	5.0%	4.8%	1.7%	$30.9
Level at End	4.0%	4.8%	0.7%	$19.6
5 Years Post	6.1%	4.6%	2.7%	93.4%
Change	→	→	↓	↑

There was little impact in the three months following the attack, other than Oil falling by -36% which was driven by a combination of a slowing economy and concerns about the impact that the attacks would have on global tourism and aviation.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	17.2%	22.5%
Level at Start	801.7	3179.7
Level at End	837.5	3391.4
Return During	4.5%	6.7%
Next 1 Year	-12.2%	-15.5%
Next 3 Years	19.7%	-1.7%
Next 5 Years	64.3%	30.9%
PE Start	19.4x	17.0x
PE End	21.5x	19.3x
G&D PE Start	24.5x	21.1x
G&D PE End	25.2x	22.3X
Yield Start	1.9%	3.3%
Yield End	1.8%	3.1%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	17.9%	NA
Level at Start	135.8	125.4
Level at End	135.8	125.7
Return During	0.0%	0.3%
Next 1 Year	2.4%	4.9%
Next 3 Years	-0.7%	18.5%
Next 5 Years	1.8%	36.5%

	Broad Commodities	Gold
5 Years Prior	16.6%	-25.1%
Level at Start	3767.1	$287.0
Level at End	2815.2	$277.6
Return During	-25.3%	-3.3%
Next 1 Year	-4.9%	10.9%
Next 3 Years	41.8%	41.0%
Next 5 Years	57.4%	100.8%

Summary

The initial impact of the attacks on Stock Markets was to accelerate their downtrend, but by December of 2001 there had been a recovery and stocks - although the real upward trend would not resume until after 2003. There was no rush to the safe havens of Fixed Interest Securities or Gold, and Commodities plunged by over 25%.

Afghanistan War (Western Coalition)

Background

This is an extremely long period of almost twenty years, encompassing the Great Financial Crisis. The Western Coalition toppled the Taliban within two months of invading in October 2001. The next phase from 2002 until 2008 was aimed at defeating the Taliban as a military force and rebuilding the Afghan State. However, from 2008 the Taliban adopted a classic counterinsurgency war that led to larger Western forces deploying to the region.

In 2011 the US military located and killed Osama Bin Laden and a timetable was set for the gradual withdrawal of forces with responsibility handed over to the Afghan military and police. The US and NATO combat missions formally ended in 2014 but it would be another seven years until full a full withdrawal was completed.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	6.1%	5.7%	2.6%	-17.3%
Level at Start	4.5%	4.8%	1.6%	$20.3
Level at End	0.5%	1.8%	1.6%	$37.7
5 Years Post	0.5%	1.3%	2.5%	187.6%
Change	↓	↓	→	↑

Interest rates were falling as recessions started in 2002/2003 and by the end of the conflict the Financial Crisis had pushed them close to 0%. It was a similar story for Gilt Yields as low inflation also helped to keep yields pinned down. Oil rose sharply into 2008 before plunging to new lows and recovering most of those losses by 2014.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	15.9%	27.0%
Level at Start.	812.57	3355.9
Level at End	1598.13	4573.3
Return During	96.7%	36.3%
Next 1 Year	-15.7%	-18.9%
Next 3 Years	19.4%	-5.5%
Next 5 Years	67.2%	30.0%
PE Start	19.6x	18.5x
PE End	16.8x	16.7x
G&D PE Start	24.7x	22.2x
G&D PE End	17.5x	13.9x
Yield Start	1.9%	3.1%
Yield End	2.6%	3.6%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	15.3%	NA
Level at Start	136.1	125.5
Level at End	184.4	313.8
Return During	35.5%	150.1%
Next 1 Year	0.9%	3.9%
Next 3 Years	0.5%	19.8%
Next 5 Years	1.0%	36.2%

	Broad Commodities	Gold
5 Years Prior	-9.1%	-26.0%
Level at Start	3047.7	$282.3
Level at End	2188.4	$1061.4
Return During	-28.2%	276.1%
Next 1 Year	18.4%	11.8%
Next 3 Years	105.4%	48.4%
Next 5 Years	90.3%	108.8%

Summary

During this period what was going on in the Economy and Financial Markets had much more of an impact than the conflict itself; the initial shock of 9/11 had little effect in the short term as the US was already heading towards recession. World and UK Stocks were already in decline from the peak of the Tech Bubble and performed well in the 3-5-year periods post the start of the War. The low interest rate environment that was created from 2002/2003 would create the conditions for the US Housing Bubble and Great Financial Crisis as Stocks and Commodities rose and fell significantly to the long-term benefit of Gold and Fixed Interest Securities. Interest rates temporarily rose before falling to record lows in the Financial Crisis pushing risk assets back up sharply.

Iraq War (Western Coalition)

Background

The second Gulf War consisted of two distinct phases; a conventional war (March-April 2003) that quickly defeated the Iraq military, followed by the coalition's occupation of Iraq and an insurgency war that began to decline in 2007 until the US withdrew in December 2011. The War had begun because of the ongoing failure of Iraq to co-operate with UN weapons inspection. The US believed Iraq held weapons of mass destruction – it was later proved they did not – and continued to pose a real threat to the US and the West. George W Bush, supported by British Prime Minister Tony Blair; declared an end to diplomacy in March 2003 and gave Saddam Hussein forty-eight hours to leave Iraq. When this didn't happen, US began air strikes followed by a ground invasion. Unlike the first Gulf War there was less united support France, Germany and Russia all objecting to the build up toward conflict.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	5.4%	5.0%	2.3%	143.9%
Level at Start	3.75%	4.3%	3.1%	$29.9
Level at End	0.5%	2.1%	4.8%	$105.5
5 Years Post	2.41%	2.0%	2.3%	267.8%
Change	↓	↓	↑	↑

Interest rates had already been falling as the US faced recession and a slowing economy after the Tech Bubble burst; both the Bank Base Rate and 10 Year Yield then fell in the period that encompassed the GFC. Oil would peak in 2008 before declining sharply in the deflationary period that followed.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	-26.2%	-35.5%
Level at Start	655.4	2388.7
Level at End	1188.4	3809.3
Return During	81.3%	59.5%
Next 1 Year	44.7%	27.8%
Next 3 Years	97.1%	76.4%
Next 5 Years	124.0%	68.6%
PE Start	16.4x	14.5x
PE End	11.9x	10.2x
G&D PE Start	18.6x	14.8x
G&D PE End	16.6x	13.8x
Yield Start	2.5%	4.3%
Yield End	3.0%	3.6%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	8.1%	36.8%
Level at Start	141.2	138.6
Level at End	175.3	268.3
Return During	24.2%	93.5%
Next 1 Year	-2.2%	4.8%
Next 3 Years	-0.3%	18.2%
Next 5 Years	-0.2%	41.2%

	Broad Commodities	Gold
5 Years Prior	53.9%	14.0%
Level at Start	4165.1	$336.3
Level at End	4683.1	$1570.5
Return During	12.4%	367.1%
Next 1 Year	18.5%	18.6%
Next 3 Years	51.9%	65.1%
Next 5 Years	109.8%	197.2%

Summary

As with the coalitions War in Afghanistan during this period what was going on in the Economy and Financial Markets appears to have had much more of an impact than the conflict itself. As stocks had been in decline to 2003 it was easier to understand why their fortunes reversed from a low level. Commodities then enjoyed a bull run driven by China's infrastructure spending; for Gold, after years in the doldrums the Financial Crisis and concerns regarding the Global Financial system would see its value soar.

Russian Invasion of Georgia

Background

Georgia had suffered a Civil War in the 1990's following its independence after the breakup of the Soviet Union; whilst there was a ceasefire in 1994 tension continued to simmer between the Ossetians and Abkhazians. After its independence Georgia became increasingly pro-western, including being part of the US Coalition in Iraq in 2002. Georgian president Sakaashvilli attempted to crack down on separatism and relations with Russian worsened in 2006 when four Russian Military Officers arrested on suspicion of espionage and accusation of Moscow support for separatists.

With Georgia on the verge of joining NATO, Russia built up its forces and after months of accusations too the opportunity to invade when Sakaashvilli ordered Georgian troops to take over the capital South Ossetia. With five days Russian Troops had moved to within 30 miles of the Georgian capital of Tbilisi; the war left 850 dead and 35,000 Georgians homeless. Although no other countries joined them, Russian declared South Ossetia and Abkhazi independent states.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	4.8%	4.7%	3.4%	275.1%
Level at Start	5.0%	4.6%	4.8%	$109.8
Level at End	3.0%	4.1%	3.0%	$51.1
5 Years Post	4.8%	2.9%	3.4%	3.4%
Change	↓	↓	↓	↓

The War only lasted five days and came at a time when economic conditions were worsening with the onset of the Financial Crisis. Over the three months following the invasion interest rates were being cut dramatically and deflationary forces were pushing down inflation whilst oil prices collapsed.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	70.3%	33.4%
Level at Start	1369.34	3862.33
Level at End	868.86	2904.89
Return During	-36.5%	-24.8%
Next 1 Year	-18.8%	-12.2%
Next 3 Years	-6.0%	-0.2%
Next 5 Years	12.0%	22.5%
PE Start	13.70	10.80
PE End	9.60	7.10
G&D PE Start	23.86	17.06
G&D PE End	14.78	12.57
Yield Start	2.8%	4.2%
Yield End	4.1%	5.9%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	0.0%	45.4%
Level at Start	137.99	205.51
Level at End	143.33	194.63
Return During	3.9%	-5.3%
Next 1 Year	8.1%	-1.5%
Next 3 Years	20.8%	17.3%
Next 5 Years	22.1%	32.4%

	Broad Commodities	Gold
5 Years Prior	105.4%	116.0%
Level at Start	8496.37	$786.5
Level at End	4780.97	$745.1
Return During	-43.7%	-5.3%
Next 1 Year	-50.4%	21.6%
Next 3 Years	-41.8%	121.3%
Next 5 Years	-41.7%	69.0%

Summary

This conflict was very short-lived and had little impact on the course of the economy or financial assets that were already feeling the deflationary forces of the Financial Crisis and in severe decline. Looking at this in hindsight it was the first of three Russian incursions in Eastern Europe that would follow a similar pattern and end with War in Ukraine.

The Arab Spring

Background

Whilst this was not a conflict fought between countries it led to significant unrest and civil war; that remains ongoing, most notably in Syria where General Assad continues to attempt to suppress unrest supported by Russia. The "Arab Spring" was a wave of pro-democracy protests and uprisings in the Middle East and North Africa, starting in Egypt and Tunisia where regimes were quickly toppled. Whilst conflicts continue the main period of the Arab Spring was December 2011-December 2012.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	2.4%	3.9%	3.5%	66.2%
Level at Start	0.5%	2.1%	4.8%	$105.5
Level at End	0.5%	1.9%	3.1%	$111.1
5 Years Post	1.4%	1.8%	2.3%	-51.3%
Change	→	↓	↓	↓

Although the uprisings in the region were unsettling, they did little to affect interest rates, inflation or importantly the oil price where there was only a marginal increase of 5.3% during the period before it then declined by over 50%.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	-18.6%	-14.9%
Level at Start	1188.4	3809.3
Level at End	1392.9	4280.8
Return During	17.2%	12.4%
Next 1 Year	17.2%	12.4%
Next 3 Years	37.2%	20.2%
Next 5 Years	41.8%	35.7%
PE Start	11.9x	10.2x
PE End	14.3x	12.5x
G&D PE Start	16.6x	13.8x
G&D PE End	18.0x	14.4x
Yield Start	3.0%	3.6%
Yield End	2.8%	3.5%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	27.8%	55.4%
Level at Start	175.3	268.2
Level at End	180.0	269.9
Return During	2.7%	0.6%
Next 1 Year	2.7%	0.6%
Next 3 Years	6.4%	19.0%
Next 5 Years	10.5%	32.6%

	Broad Commodities	Gold
5 Years Prior	-20.2%	151.8%
Level at Start	4683.1	$1570.5
Level at End	4817.5	$1696.7
Return During	2.9%	8.0%
Next 1 Year	2.9%	8.0%
Next 3 Years	-27.1%	-22.6%
Next 5 Years	-49.6%	-28.3%

Summary

The impact of the uprisings was insignificant on financial assets, even the price of Oil that hardly changed, despite the potential risks that the challenges to the authoritarian regimes in the Middle East posed.

Interest rates remained unchanged at ultra-low levels and Gilt yields continued to tighten, which was more the result of accommodative monetary policy as the Eurozone Crisis unfolded.

Equities performed well, probably due to a combination of lower interest rates and five years of negative returns that had left price ratios at low levels. Conversely commodities and gold that had enjoyed five years of double-digit returns performed poorly both during and subsequently.

Russian Invasion of Crimea

Background

Vladimir Putin always believed that Crimea should be part of Russia – reversing what he claimed as a historic injustice - and in the early part of 2014 there were pro-Russian demonstrations in Sevastopol. By the end of the month unmarked troops and gunmen occupied key infrastructure as Sergey Aksyonov was installed as Crimea's Prime Minister.

Links with Ukraine were cut, and Russian troops moved in to "protect Russian Citizens and Military assets". On 6th March the Crimean Parliament voted to join the Russian Federation and a public referendum was scheduled that returned a 97% majority to join Russia.

Over the following year there were continued skirmishes between militias and Ukrainian forces and there was more global attention as Malaysian Airlines flight 777 was shot down killing all 298 on board. In February 2015 a twelve-point peace plan was proposed, and heavy weaponry was withdrawn by both sides; however, there have been frequent violations of this agreement since its signing.

Economic Indicators

	Bank Base	10Y Yield	RPI	Oil
5 Years Prior	0.5%	2.9%	3.2%	152.4%
Level at Start	0.5%	2.8%	2.7%	$109.6
Level at End	0.5%	1.7%	1.0%	$59.9
5 Years Post	0.5%	1.3%	2.5%	-39.7%
Change	→	↓	↓	↓

The Bank of England Base Rate remained unchanged in the five years prior and post the annexations whilst Gilt yields continued their long term down trend. Inflation also continued to fall hitting 1% by the start of 2015 and remaining close to the Central Bank target of 2% for the five years after the conflict. Oil had risen significantly in the five years prior after it recovered from the lows of the Financial Crisis; however, over the period of the conflict the price fell in value by almost -40%.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	96.4%	70.3%
Level at Start	1645.3	4923.8
Level at End	1730.8	5068.6
Return During	5.2%	2.9%
Next 1 Year	5.2%	2.9%
Next 3 Years	8.1%	10.1%
Next 5 Years	19.5%	9.7%
PE Start	15.9x	15.0x
PE End	17.8x	17.1x
G&D PE Start	19.6x	15.6x
G&D PE End	19.5x	15.5x
Yield Start	2.5%	3.2%
Yield End	2.4%	3.2%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	12.5%	41.4%
Level at Start	169.7	272.8
Level at End	188.7	312.3
Return During	11.2%	14.5%
Next 1 Year	11.2%	14.5%
Next 3 Years	16.0%	35.8%
Next 5 Years	20.0%	40.3%

	Broad Commodities	Gold
5 Years Prior	44.2%	40.5%
Level at Start	4891.3	$1,316.7
Level at End	3219.7	$1,232.5
Return During	-34.2%	-6.4%
Next 1 Year	-34.2%	-6.4%
Next 3 Years	-50.8%	-6.8%
Next 5 Years	-49.4%	-0.1%

Summary

As with the invasion of Georgia the annexation of Crimea did little to interrupt the economic environment, with interest rates and yield pinned to the floor and risk assets continuing their upward trend. Deflationary pressures remained and commodities continued to fall and there was little interest in Gold as it retreated from the highs of the Financial Crisis.

Russian Invasion of Ukraine

Background

At the time of writing this conflict remains ongoing after Russia escalated the war that had been going on since 2014 by invading the Ukraine following a large military build-up in forces along the border in late 2021. Vladimir Putin has followed the same pattern as previous incursions, justifying the invasion as necessary to prevent the persecution of ethnic Russian minorities and the threat of expansion by NATO.

The result has been widespread condemnation from most of the rest of The World and the United Nations; harsh sanctions have been implemented on the Russian economy by the West, who are also providing significant military and humanitarian support to the Ukraine.

With Europe, and Germany in particular, a large importer of Russian energy the impact on costs has been significant. This could ultimately increase further given the importance of the Ukraine and Russia in providing Wheat and Grains to countries around the globe. The ramifications of sanctions could also have far reaching implications for supply chains, energy supply and the dollar.

Economic Indicators

	Bank Base	**10Y Yield**	**RPI**	**Oil**
5 Years Prior	0.4%	0.9%	3.2%	87.0%
Level at Start	0.5%	1.6%	8.2%	$101.4
Level Now	1.0%	1.9%	9.0%	$108.0
5 Years Post	NA	NA	NA	NA
Change	↑	↑	↑	↑

The Bank of England Base Rate has today (5th May 2022) been raised to 1% and Gilt Yields are also continuing to rise from their all-time lows. The objective is clearly to show that action is being taken to combat inflation that has been accentuated by the rising cost of energy that the conflict has brought. The price of Oil has so far increased only modestly – after an initial spike to $139pb - as the US released reserves.

Financial Assets

	World Stocks	UK Stocks
5 Years Prior	52.5%	5.0%
Level at Start	2710.4	5695.9
Level at End	2626.5	5659.5
Return During	-3.1%	-0.6%
Next 1 Year	NA	NA
Next 3 Years	NA	NA
Next 5 Years	NA	NA
PE Start	18.0x	15.7x
PE Now	17.4x	15.8x
G&D PE Start	25.7x	18.4x
G&D PE Now	24.7x	18.4x
Yield Start	2.0%	3.2%
Yield Now	2.1%	3.5%

	Nominal Gilt Index	Index Linked Gilts
5 Years Prior	0.3%	16.1%
Level at Start	197.5	430.2
Level at End	192.7	405.1
Return During	-2.5%	-5.8%
Next 1 Year	NA	NA
Next 3 Years	NA	NA
Next 5 Years	NA	NA

	Broad Commodities	Gold
5 Years Prior	32.8%	50.7%
Level at Start	3196.6	$1,849.2
Level at End	3923.4	$1,968.8
Return During	22.7%	6.5%
Next 1 Year	NA	NA
Next 3 Years	NA	NA
Next 5 Years	NA	NA

Summary

The impact of Russia’s actions on economies and financial assets will play out over the coming years; however, we can say it has come at a time when interest rates were at all time low, and equities were at (or near) multi-year highs and look ripe for a reversal. Commodities were already in an up-trend after years of underperformance and the energy crisis that the conflict has brought has speeded this up. The move toward sustainable energy sources, as an alternative to Russian supplies, will also now likely gather pace which will add to inflationary pressures. COVID had already highlighted the risk of extended supply chains and the reshoring of production and manufacturing back to more secure territories will gain further traction the longer the war continues – or worse expands.

Indicators Analysed

Comparing Performance

The chart below demonstrates that, except for Gilts, all assets that have been assessed have been volatile; we can categorically state that equities have been the best investment[2].

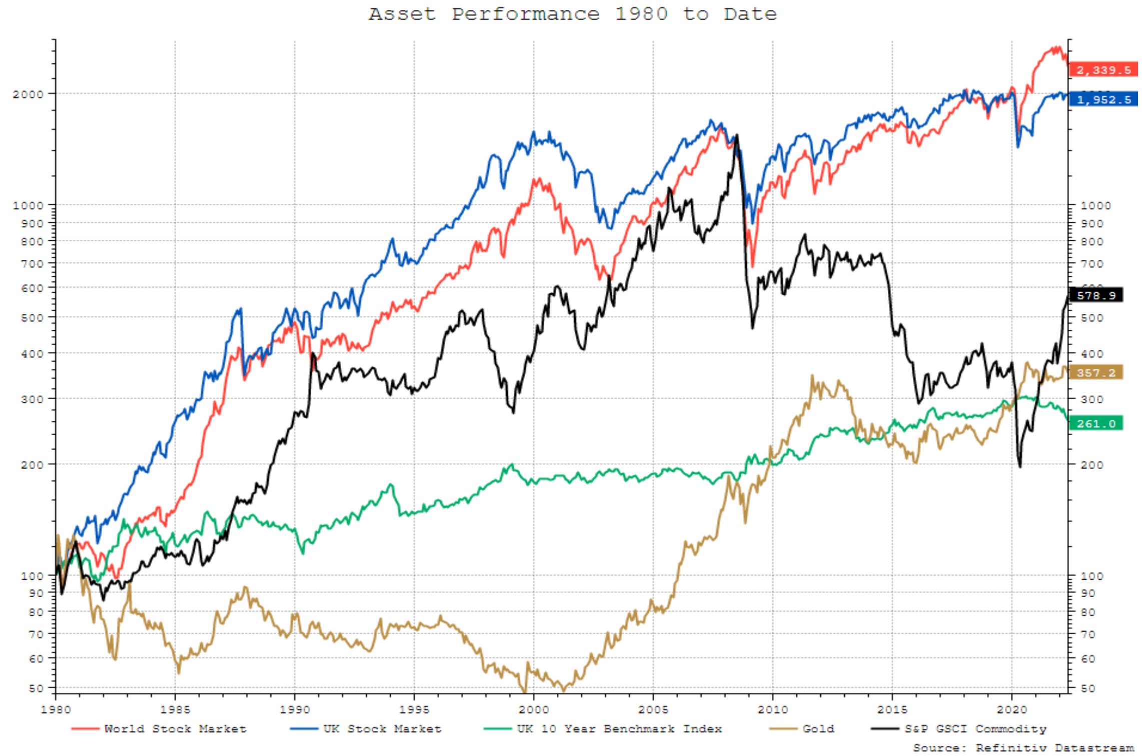

Figure 1.1 Asset Performance Rebased 1980 to date

In figures 1.2 and 1.3 over the page we can see how World Equities performed in each of the different conflicts; a maximum time frame of five years has been set for each graph. In most scenarios, the Stock Market was higher by the end of the conflict, although losses occurred of circa -10% to -15% in the initial phase. The losses in graph 1.3 (the Afghanistan War and the Russian invasion of Georgia) were driven more by the decline following the Tech Bubble of 2000 and the Great Financial Crisis of 2008.

[2] Index Linked Gilts have been excluded as they were not issued until 1988 and do not have a common start date.

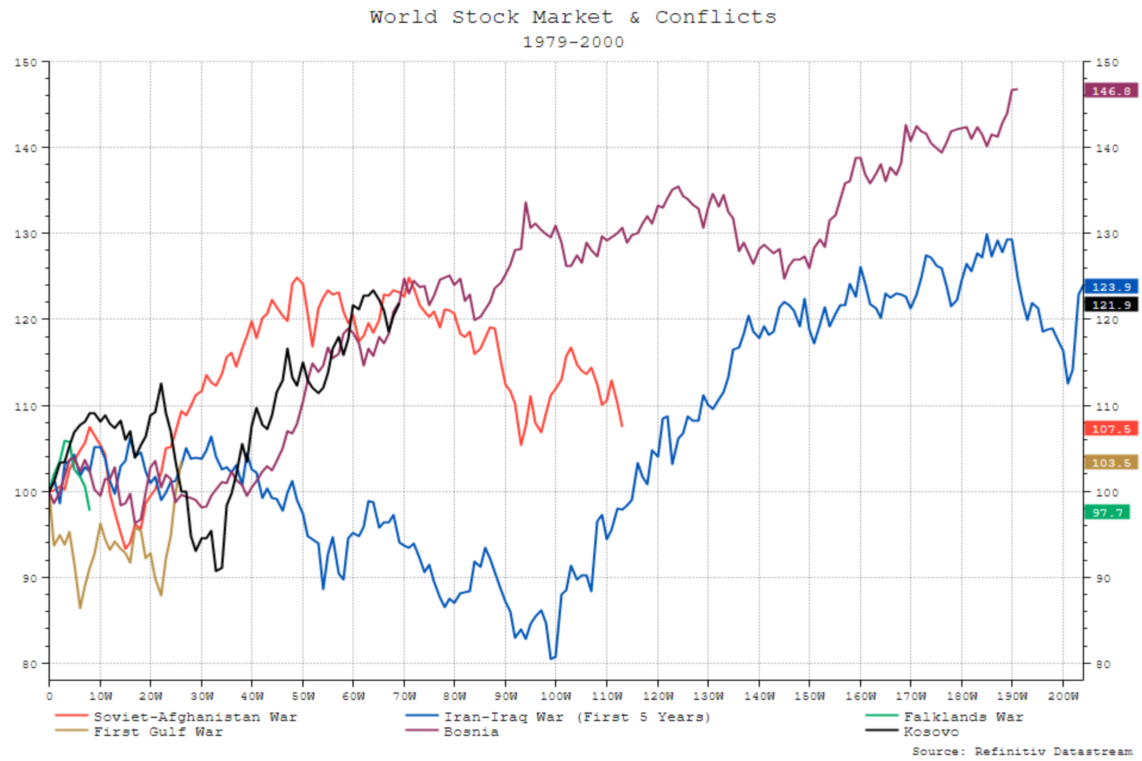

Figure 1.2 World Stock Markets & Conflicts 1979-2000

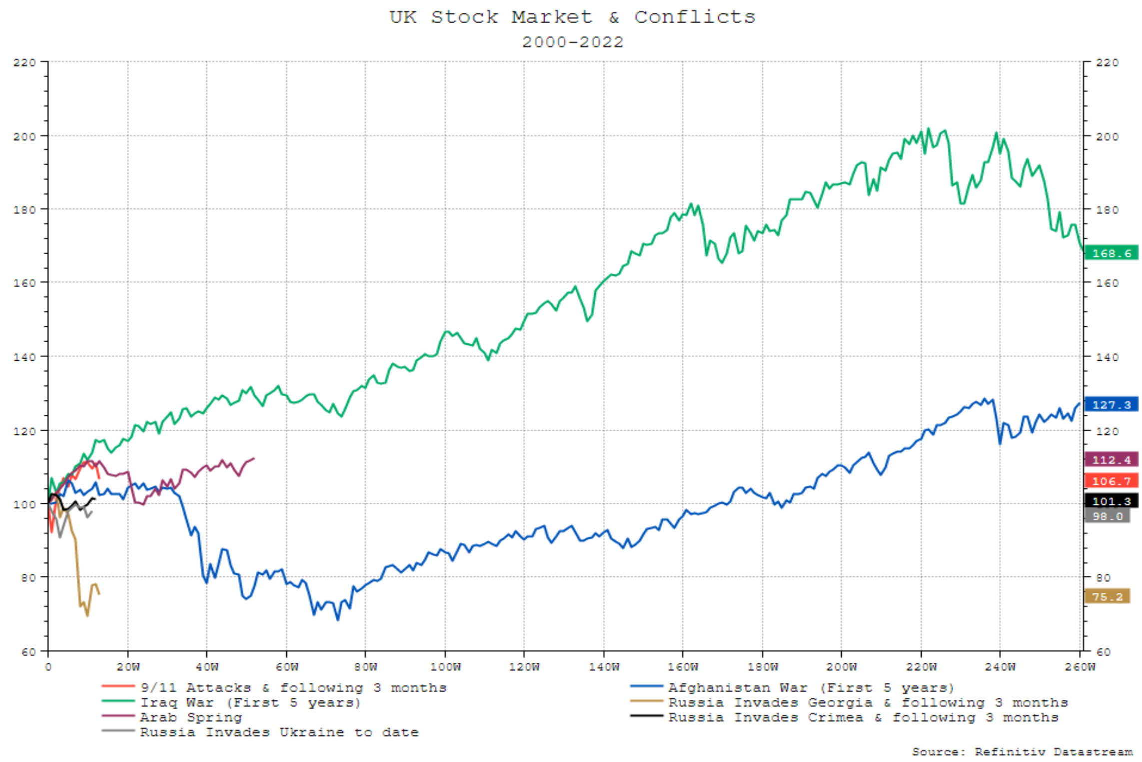

Figure 1.3 World Stock Markets & Conflicts 2000-2022

It has been a virtually identical story for the UK Stock Market.

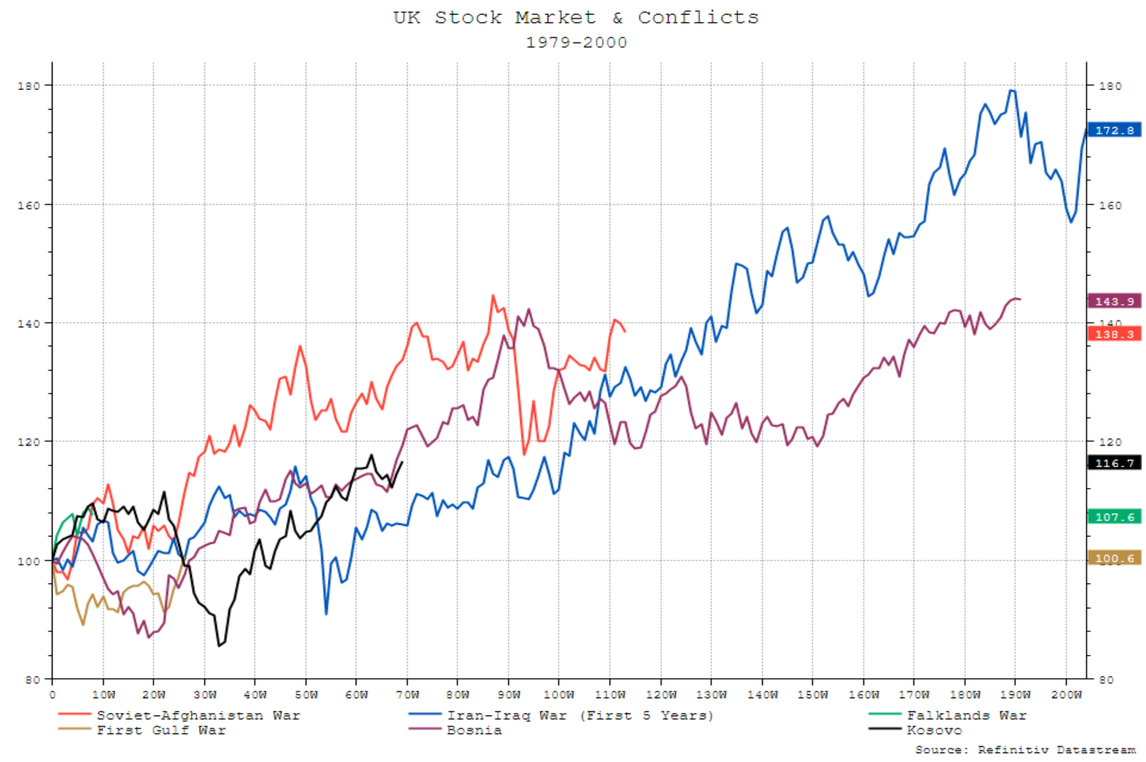

Figure 1.4 UK Stock Markets & Conflicts 1979-2000

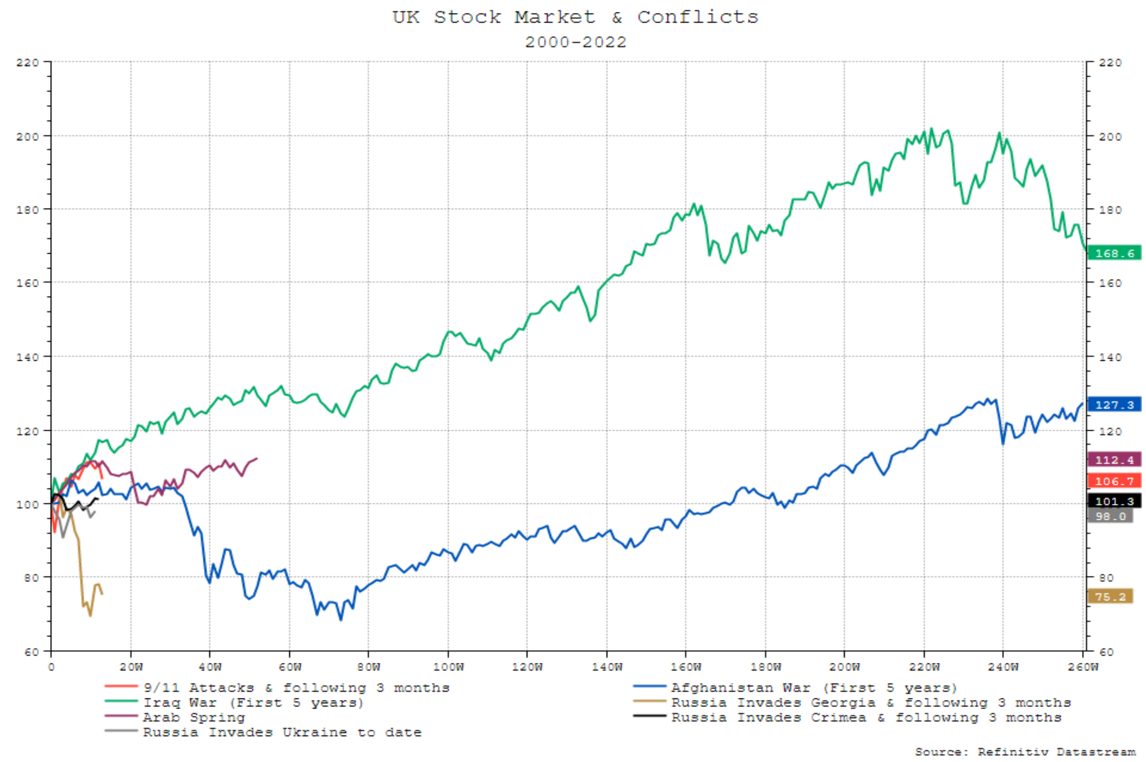

Figure 1.5 UK Stock Markets & Conflicts 2000-2022

The "safe haven" of Gilts overall have been positive in the early part of conflicts – but not always – and over the entire period returns have been flat.

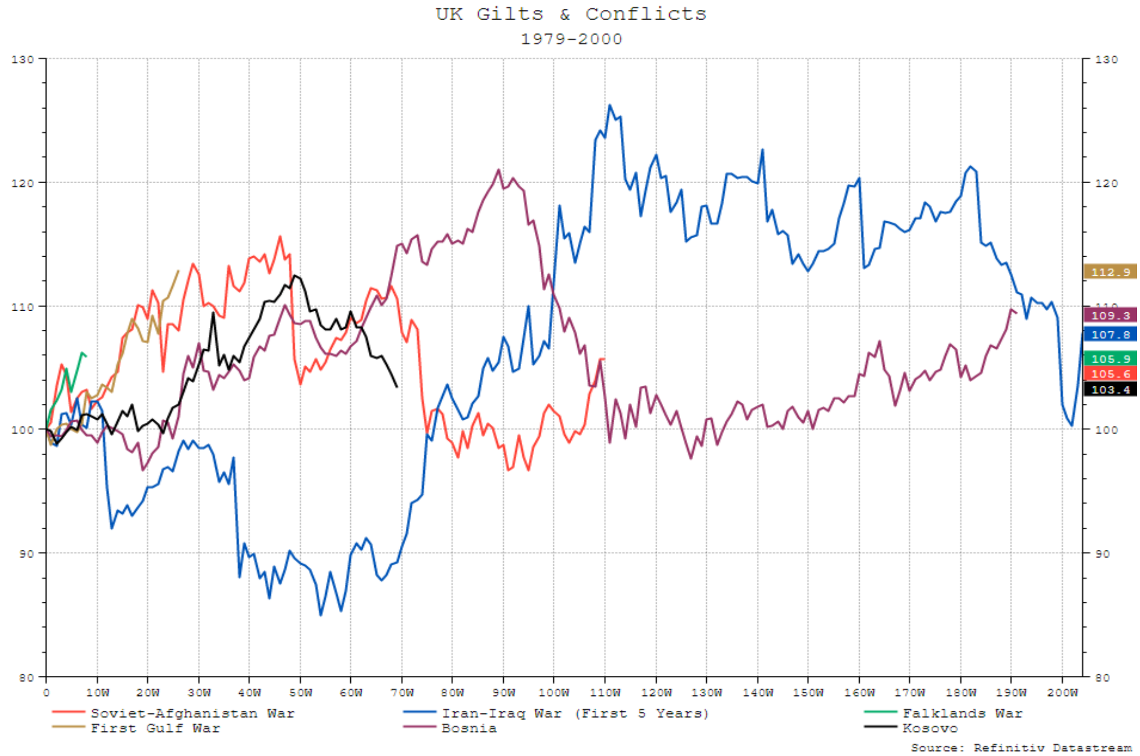

Figure 1.6 UK Gilts & Conflicts 1979-2000

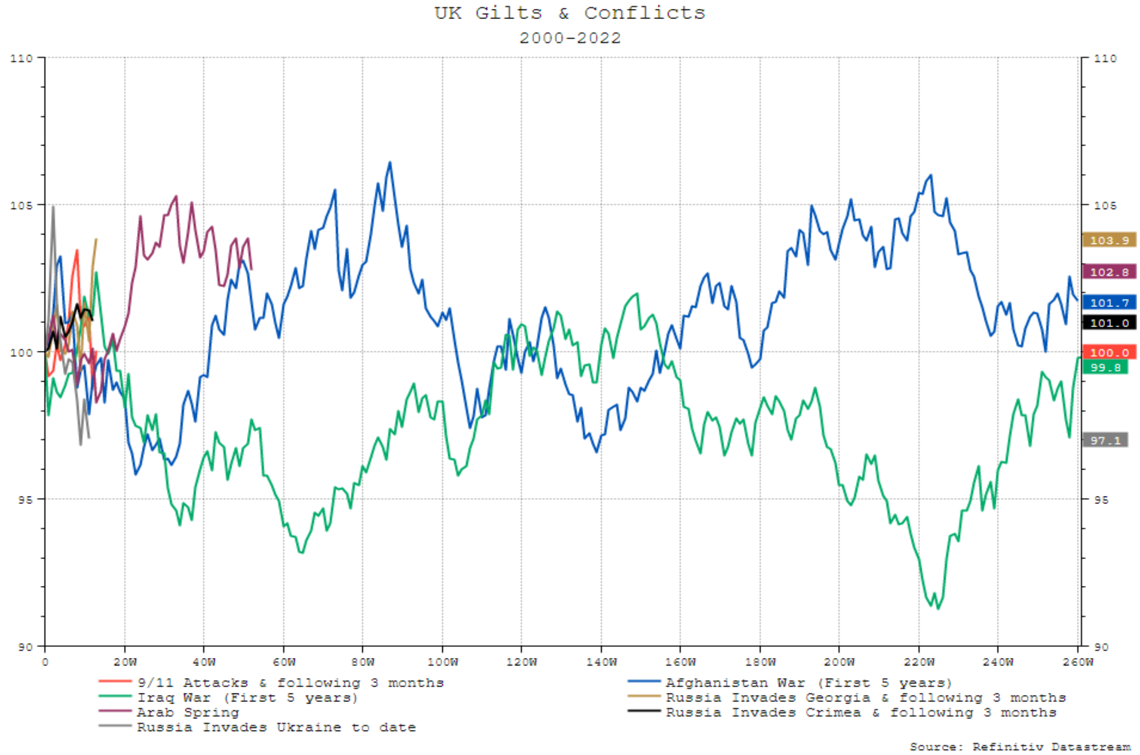

Figure 1.7 UK Gilts & Conflicts 2000-2022

Except for early 1980’s Gold up to 2000 fell during conflicts; whilst it has increased in value in the period since 2000.

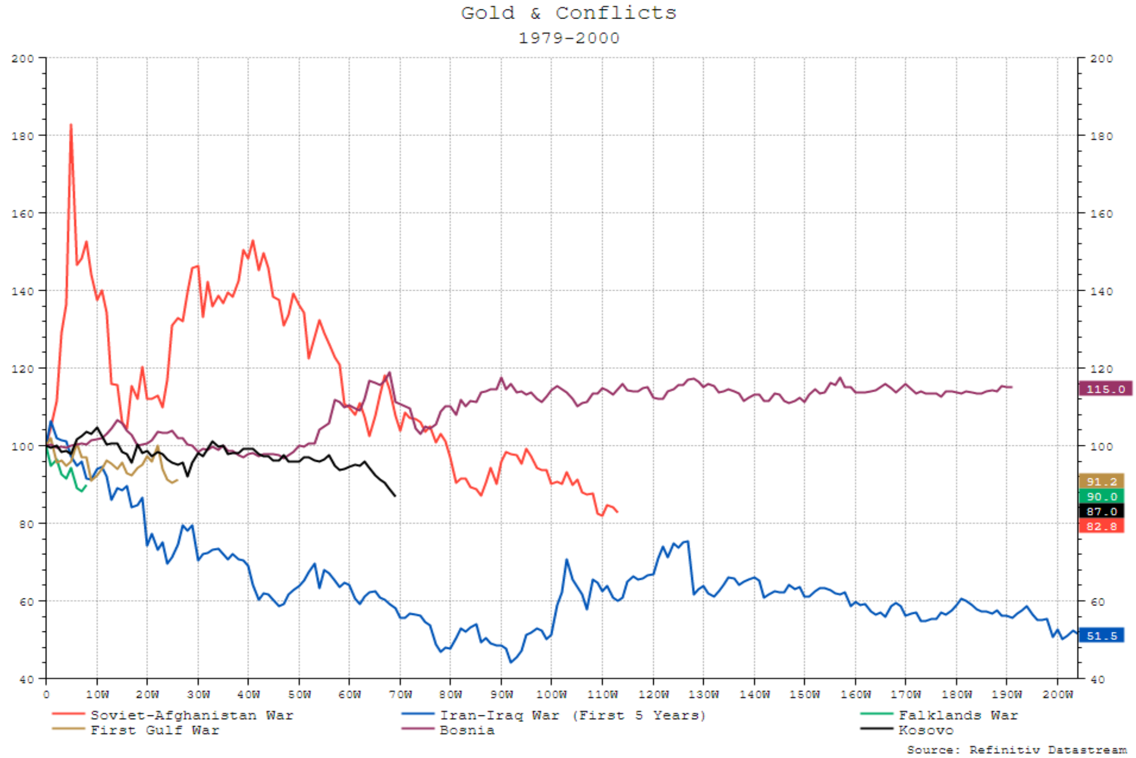

Figure 1.8 Gold & Conflicts 1979-2000

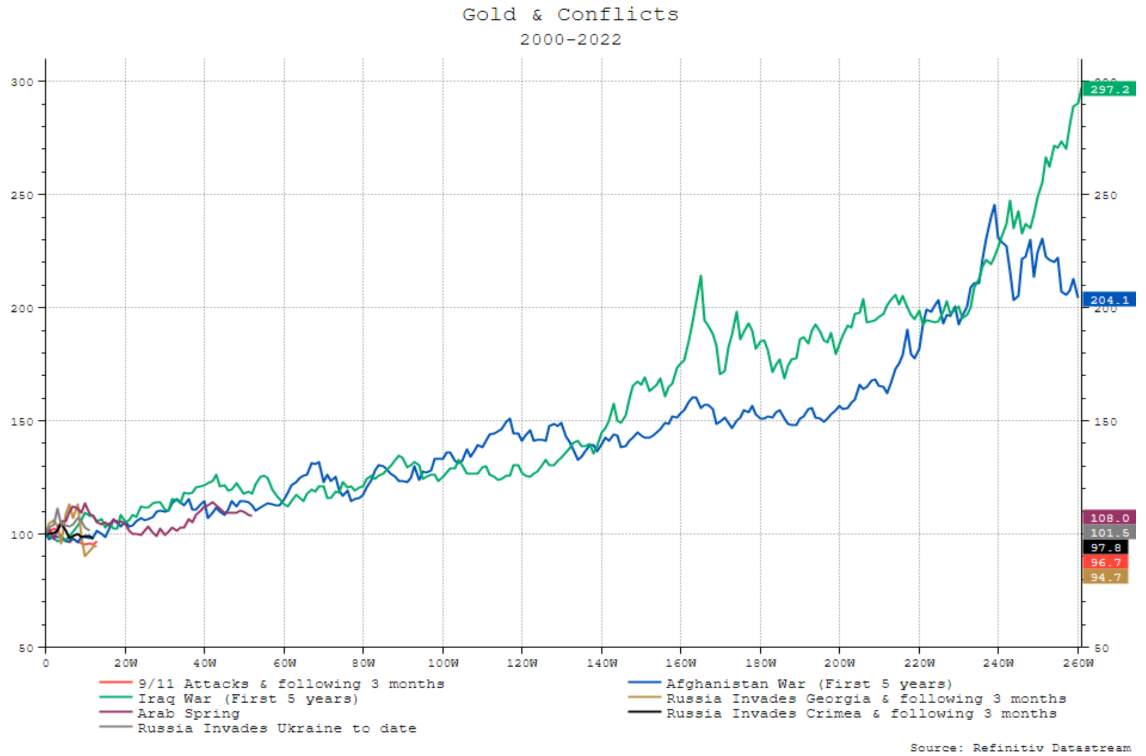

Figure 1.9 Gold & Conflicts 2000-2022

Pre-2000 commodities generally fell in value when conflicts started; after the Millenium there has been a mixed response.

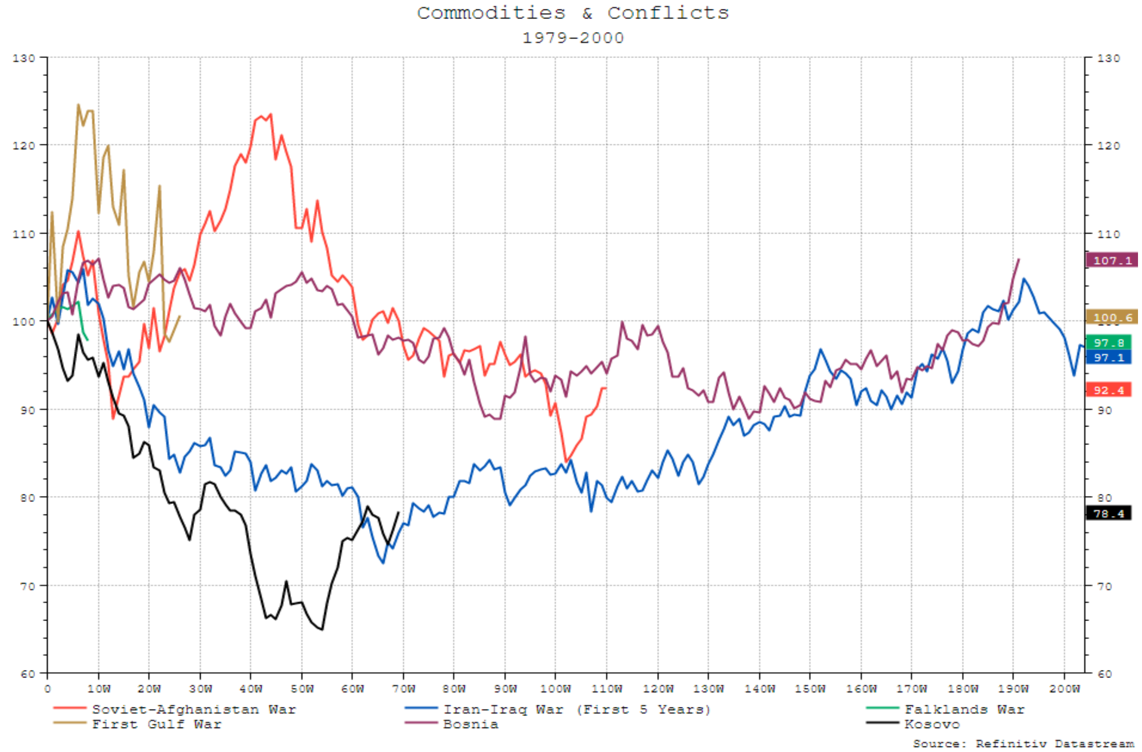

Figure 1.10 Commodities & Conflicts 1979-2000

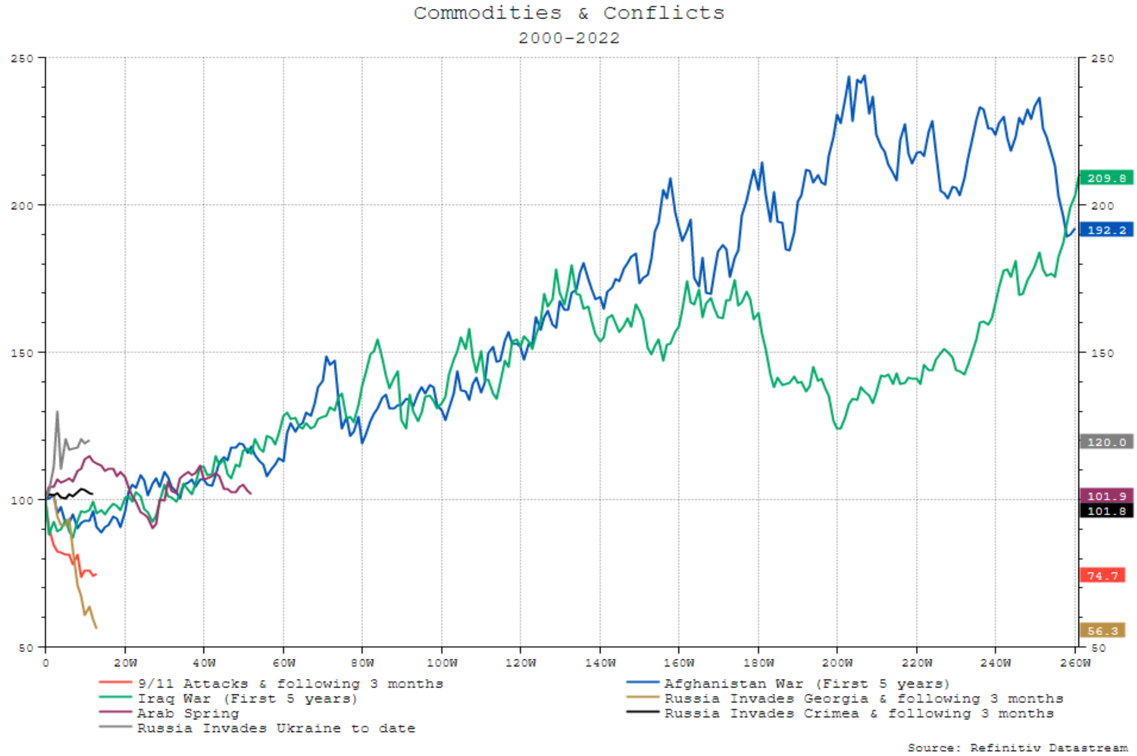

Figure 1.11 Commodities & Conflicts 2000-2022

Visualising Returns

Appendix One to Five shows the returns for separate asset classes prior, during and post each conflict; using the key below to visualise performance helps understand returns and performance.

Return	
<-15%	↓
-15% to -5%	↘
-5% to 5%	↔
5% to 15%	↗
>15%	↑

Figure 1.12 Key for Asset Return Tables

Reviewing these tables confirm that both World and UK Equities generated the greatest number of positive outcomes, and the returns were higher during the thirteen conflicts analysed.

Positive Outcomes	During Conflict	One Year After Start	Three Years After Start	Five Years After Start
World Equities	77%	67%	92%	92%
UK Equities	85%	67%	75%	92%
UK Gilts	92%	82%	82%	91%
Gold	31%	58%	42%	58%
Commodities	46%	50%	50%	67%

Average Return	During Conflict	One Year After Start	Three Years After Start	Five Years After Start
World Equities	61.7%	7.7%	29.2%	70.4%
UK Equities	55.2%	7.3%	32.9%	64.1%
UK Gilts	10.9%	5.6%	10.6%	12.5%
Gold	43.8%	3.5%	6.9%	30.5%
Commodities	4.9%	-5.8%	10.3%	21.1%

Points for Consideration

This evidence makes a compelling argument for equities compared to other asset classes when it comes to what assets to hold during a conflict; however, over the last twenty years the conflicts themselves appear to have had less and less impact economically and on financial assets. There could be any number of reasons for this trend and the thoughts below are not exhaustive; we can only speculate as to the impact that the conflicts considered have or have not had on investment returns.

The end of the Cold War and break-up of the Soviet Union meant that the risk of a Global conflict between major powers reduced significantly, and investors no longer considered it a possibility. The Western Powers – and NATO in particular – did not have any direct opponent of equivalent military strength and the larger conflicts such as the Gulf War enjoyed widespread support from a coalition of nations (including Russia).

Changes in the Global Economy and Financial system have had more of an impact on investment returns than any of the conflicts since 1980. Globalisation and interconnection with companies operating across The World has been deflationary as production of goods and provision of some services were moved to regions where cheaper labour existed. This reduced the risk of conflict as maintaining positive trading conditions with countries was more of a priority.

These deflationary trends and events in the financial world have led to falling interest rates, which in turn means the impact of conflicts and unrest have been offset by lower borrowing costs that are beneficial to risk assets. The suggestion is that investors are less concerned at the impact of wars and assume that the accommodative monetary policy of Central Banks over the last fifteen years trumps all other risks.

It is interesting to see in figures 1.13 and 1.14 over the page how the conflicts (red lines) pre 2000 all closely coincided with declining interest rates and inflation that would be a tailwind for equities in the UK and it was a similar story for Global Equities). Post 2000 rates were either declining or at lows and even when RPI rose in 2010 rates remained low and created a "reflationary" environment after the deflation of the Financial Crisis that made the three to five years following positive for stocks.

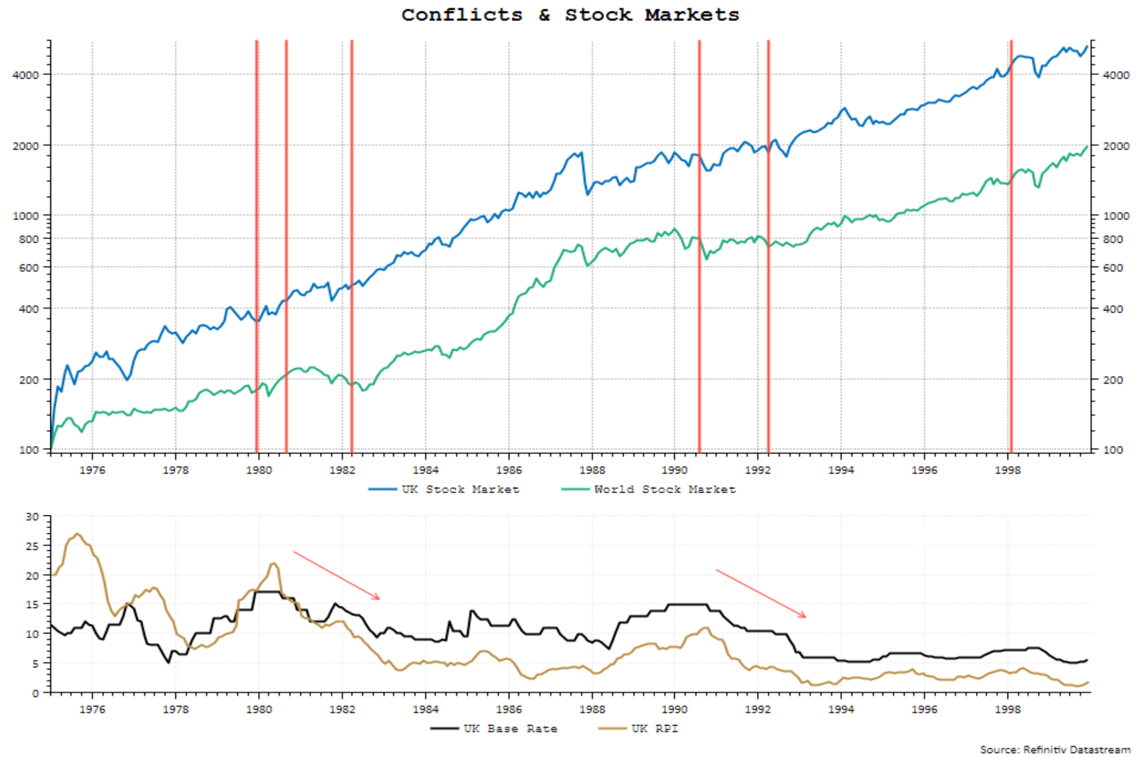

Figure 1.13 Conflicts, Stocks, UK Base Rate & Inflation 1975-2000

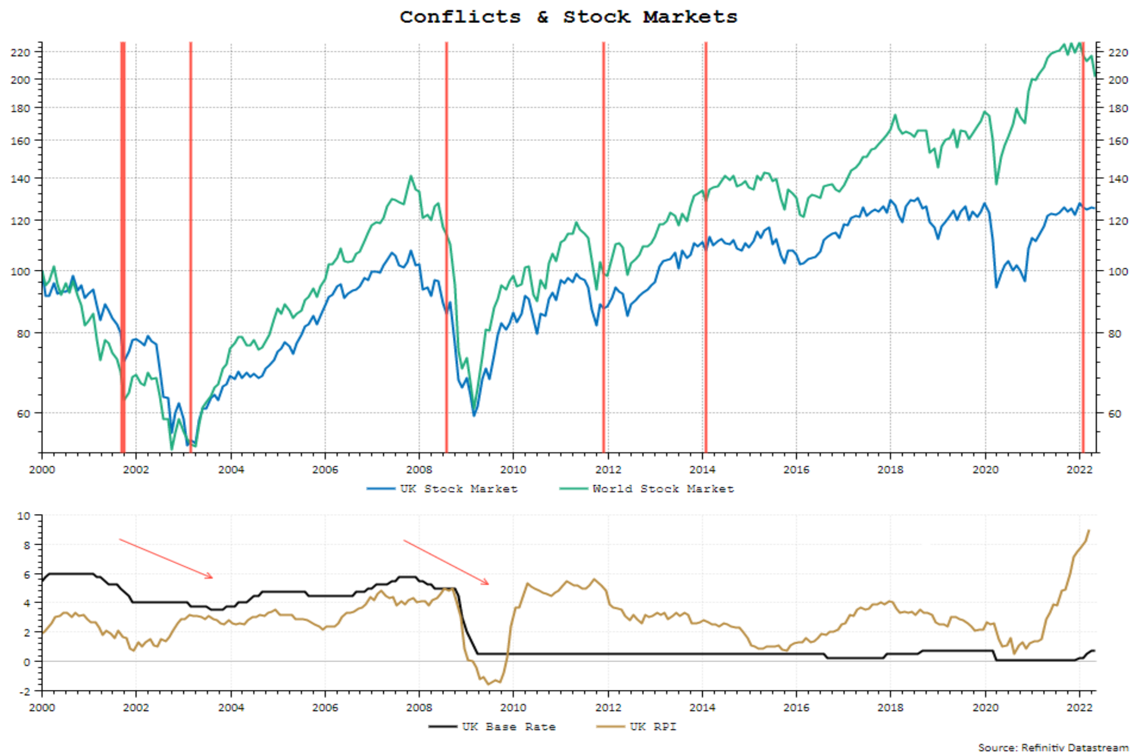

Figure 1.14 Conflicts, Stocks, UK Base Rate & Inflation 2000 - 2022

Another part of the answer may also lie in the starting point of assets; if we look back further to the Iran-Iraq War (1980-1988) why did this not have the impact on UK Stocks that oil embargos had in the 1970's?

- The risk of a rising oil price certainly existed and at the start of the conflict the price had risen over 192% in the last five years; however, the odds of this appreciation continuing at such a spectacular rate were diminishing and the price would fall over the next five years.

- Conversely stocks valuations were relatively low and in the UK on a price earnings ratio of 8x and dividend yield of 6% making them an attractive investment.

Additional factors also played their part to keep the oil price lower and provide a boost to UK Stocks.

- The US and Russia protected oil tankers in the Gulf to maintain deliveries and the boom in the North Sea Oil & Gas production meant supply was not constrained.

- The benefit of the North Sea Oil & Gas Industry would also drive the UK economy and stocks that rose by 117% by 1985.

- A pro-business environment and privatisation of major industries by the Conservative Government was positive for shares.

The reverse was already happening in 2001 following 9/11 and the subsequent war in Afghanistan

- In the five-years before the Tech Bubble Peak in 2000 the UK Stock Market had advanced 122% and traded at all-time highs for price ratios.

- The bursting of this bubble was already well underway at the time of the 9/11 attacks with the US market down -18% between January and September.

- Interest rates in the US and UK had increased in 2000 to try and slow any overheating leading to falling inflation and Oil prices. However, by the end of the first quarter both countries had reversed this policy and started to reduce interest rates.

After the 9/11 attacks stocks continued downward until 2002 as concerns regarding global economic activity remained; however, by the third quarter of 2002 the low interest rate environment and low valuation levels of the stock markets attracted investors. The next five years from the 2003 bottom would prove extremely positive for UK and Global Stock investors despite the fact it coincided with the start of the second Gulf War.

The Financial Crisis provides further evidence; the fall in World Stocks of over -35% in the year following the Russian invasion of Georgia cannot be directly linked to the conflict itself (worrying as it was it last only five days). The list of a high stock market, hot housing market, speculation, excessive borrowing, and rising oil prices would all rank above Russian incursions as a trigger for the Financial Crisis in 2008.

The concept of the importance of starting point can also be seen in Commodities returns. The graph below shows how other than in 2002/2003 each conflict was followed by periods of low or negative returns from commodities. We would speculate that this was not caused by the fallout from the conflict and its impact on economic activity but more from the growth commodities in the preceding ten years leading them to highs ripe for reversal.

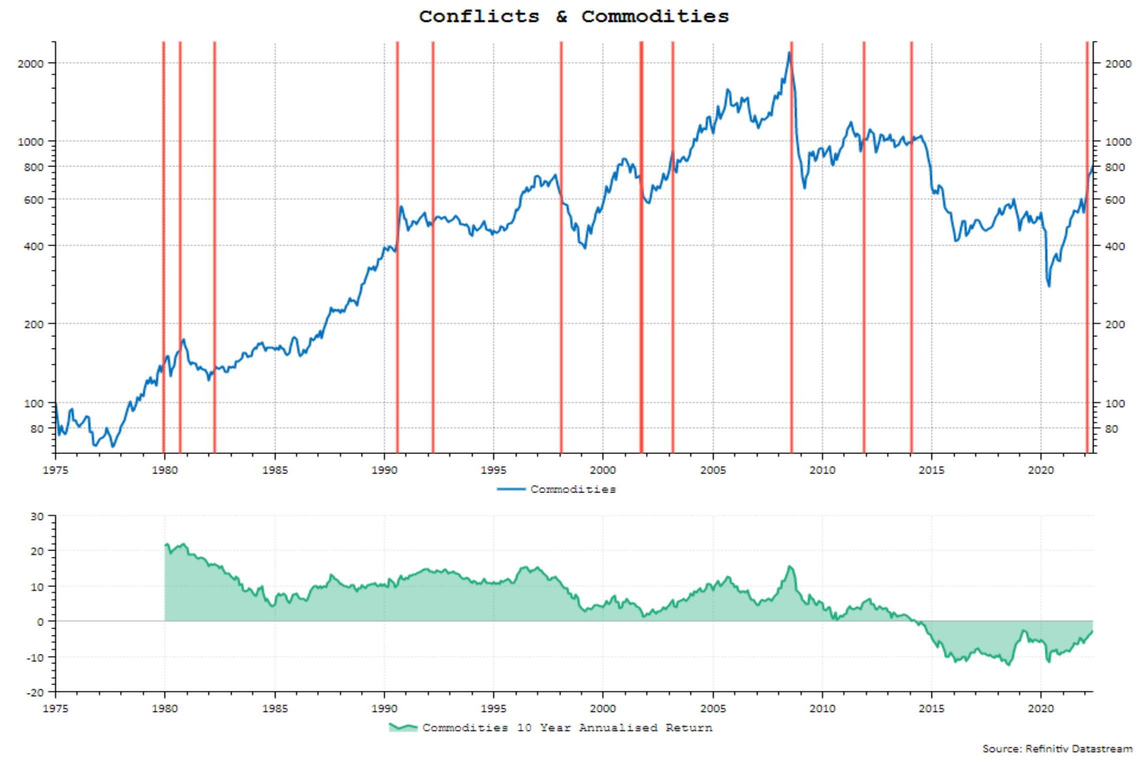

Figure 1.15 Conflicts & Commodities

Similarly, Gold does not seem to be driven by the onset of conflict; however, the graph below does show us that returns have been better when the previous ten-year performance has been low or negative. The Financial Crisis created ideal conditions for Gold to perform – almost fifteen years of low or negative returns was followed by huge Government spending, a sharp decline in interest rates and fears that the whole financial system could collapse.

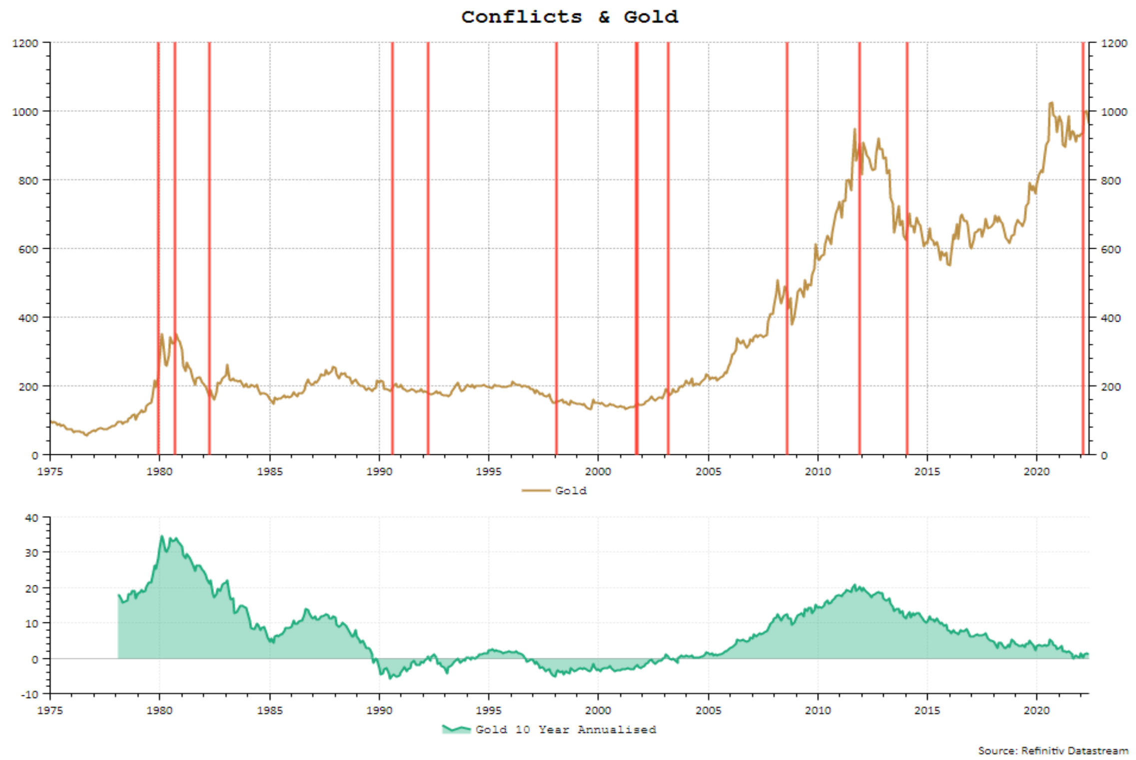

Figure 1.16 Conflicts & Gold

Drawing all of this together we can say with some confidence that economic conditions and valuation levels seem to have a bigger impact on future returns from assets. External factors – including conflicts – also have an impact but are not the main cause of returns.

2022 This Time It's Different?

The last forty years have provided us with a range of different types of conflict and unrest for analysis that we can look to with the aim of ascertaining how financial assets perform in these periods. However, we must now consider that not only in the current conflict in the Ukraine potentially very different to the preceding twelve but so too is the economic and financial landscape. The environment that we are now in sees changing conditions and trends that make it difficult to compare now with those that have gone before.

Economic Indicators

In virtually all the periods considered interest rates and inflation were falling, providing stimulus to risk assets. We are now in a period where Central Banks are carefully trying to reverse accommodative monetary policy and raise interest rates to show commitment to controlling inflation, but at the same time trying to avoid tipping economies into recession. Whilst the rise in benchmark yields may seem only modest in percentage terms, we have seen the largest change over one- and three-year periods in the last forty years.

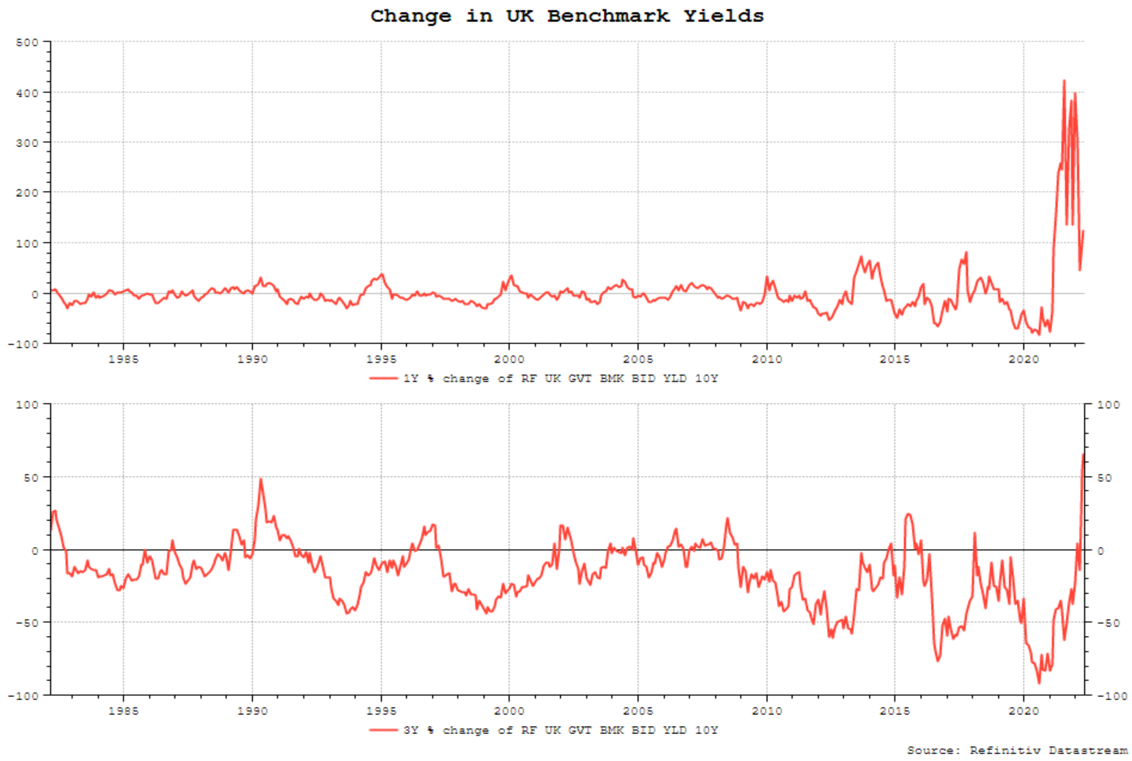

Figure 1.17 Percentage Change 10 Year Gilt Yields

As well as an end falling, or low interest rates, inflation remains extremely high based on several external factors – that are discussed below – eventually this will become deflationary as firms and consumers prioritise spending and try to make savings. In figure 1.18 we can see those periods where inflation was well above its moving average have in the UK been associated with recession. Currently inflation is more than two standard deviations above is moving average, which has not happened since the 1960's & 1970's.

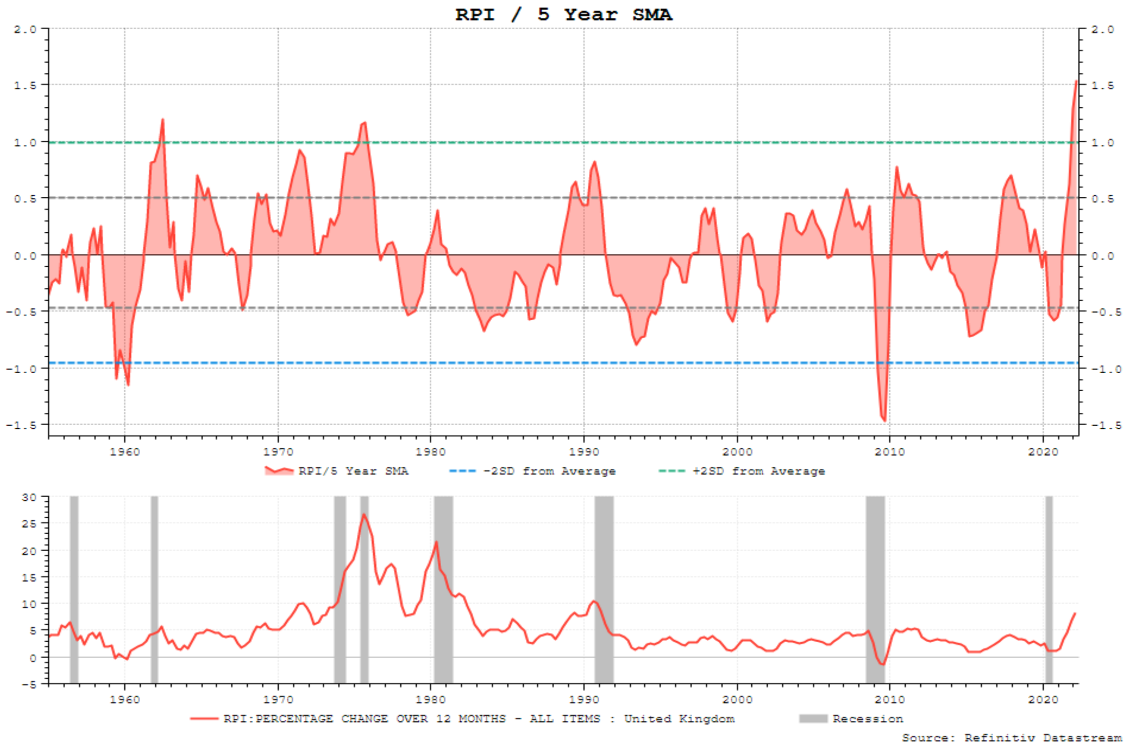

Figure 1.18 RPI and Distance from 5 Year Moving Average

If external factors keep inflation high, we could for a period see high inflation and a recession (Stagflation); there are three possible outcomes from Central Bank action

i. Bank base rate is raised enough to reduce inflation and avoid a recession.
ii. Bank base rate is not raised enough, inflation increases or doesn't fall fast enough and there is a recession.
iii. Bank base rate is raised too much leading to deflation and recession.

The most desirable, option i, seems the most unlikely and option ii perhaps seems the most likely now given the level interest rates would need to rise to curb inflation.

The price of oil initially spiked sharply on the Ukraine invasion but has since fallen, in part due to the release of strategic reserves in the US. There will be a limit to how long this benefit can last, and a lot will depend on politics including the need to reintegrate oil producing pariah states such as Iran and Venezuela to the World Economy looks likely.

In the UK, a high oil price doesn't guarantee a recession, but it certainly increases the chance of it when it is above trend.

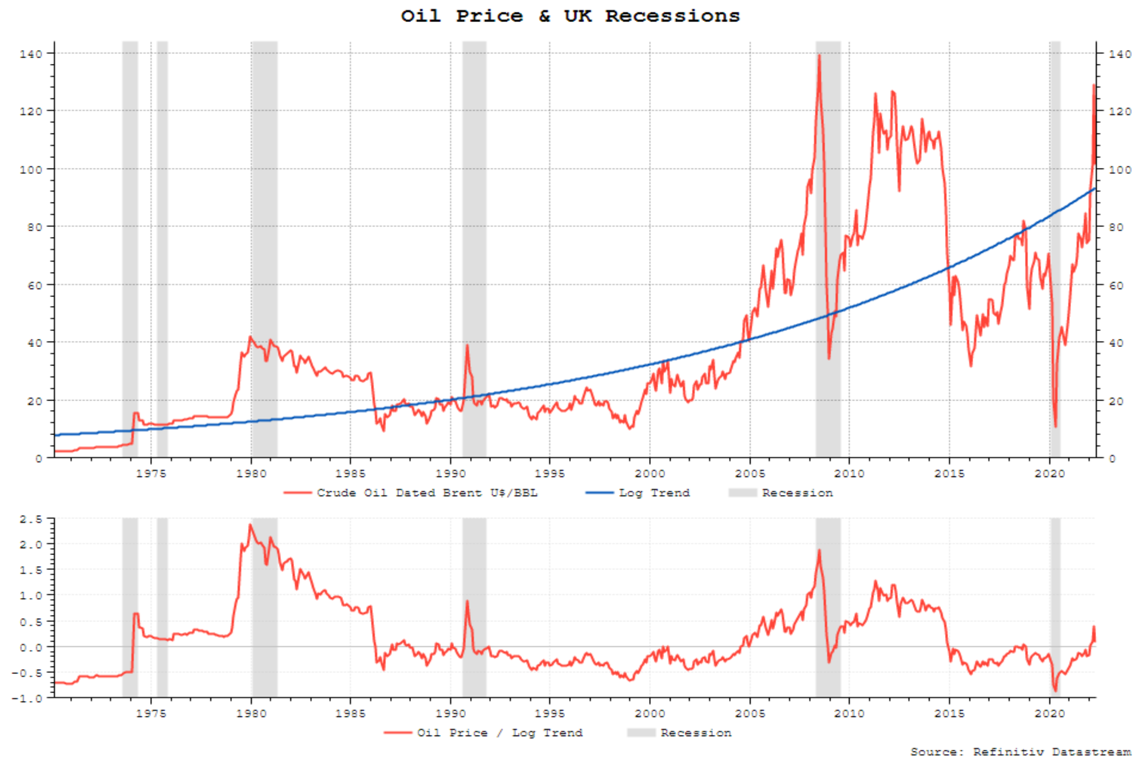

Figure 1.19 Oil Price and Log Trend

Financial Assets

Equities and fixed interest securities are at or near multi-year highs which puts them risk of reversal, without the back stop of a Central Bank able to cut interest rates in a meaningful way that they have enjoyed in previous years.

Figure 1.20 over the page details fixed interest and equity markets distance from their ten-year highs. The 10-year gilt index is now around 13% below this level reflecting the recent rise in interest rates; the UK stock market is within 10% and World stock market within 20%.

It is interest to see that all three assets had been consistently close to their 10-year highs in recent times; yet as we have seen in previous scenarios declines were already starting to deteriorate at the time a conflict started.

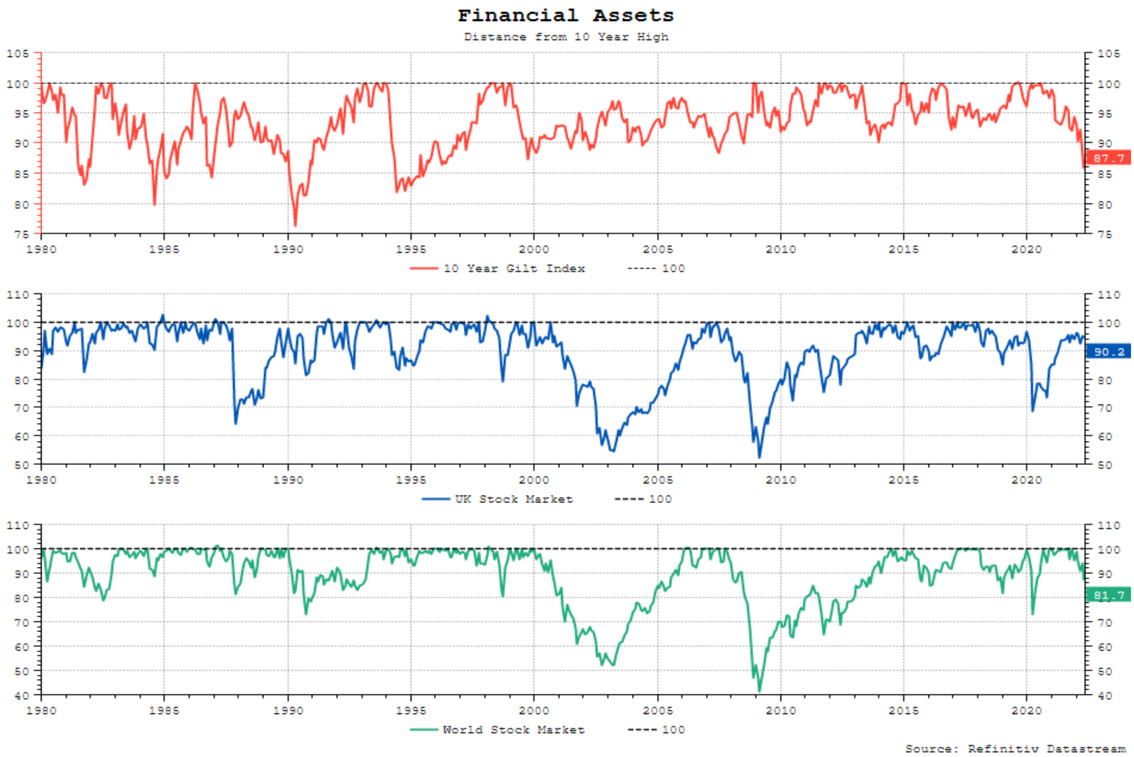

Figure 1.20 Stocks & Fixed Interest Distance from 10 Year High

If interest rates do move higher to combat inflation the impact will be negative not only for Gilts (price falls when yields rise) but also for stocks as the accommodative monetary policy that has had a positive impact for risk assets in recent times looks like it will reverse.

Historically we would expect to see fixed interest securities, and Gilts in particular, offer a potential safer haven against an overvalued stock market. However, having been pushed to all-time highs with stocks they are similarly at risk of declining in value; this leaves investors with few good alternatives.

In the UK Price Ratios are reasonable suggesting that the Stock Market is around fair value; however, this could be misleading as profit margins are also at all-time highs. If we see inflation and/or an economic downturn and profits start to fall these PE ratios will rise.

Whilst the current PE ratio for the UK Stock Market is not particularly demanding (15.9x), ratios at this level rarely happen at the current rate of inflation as

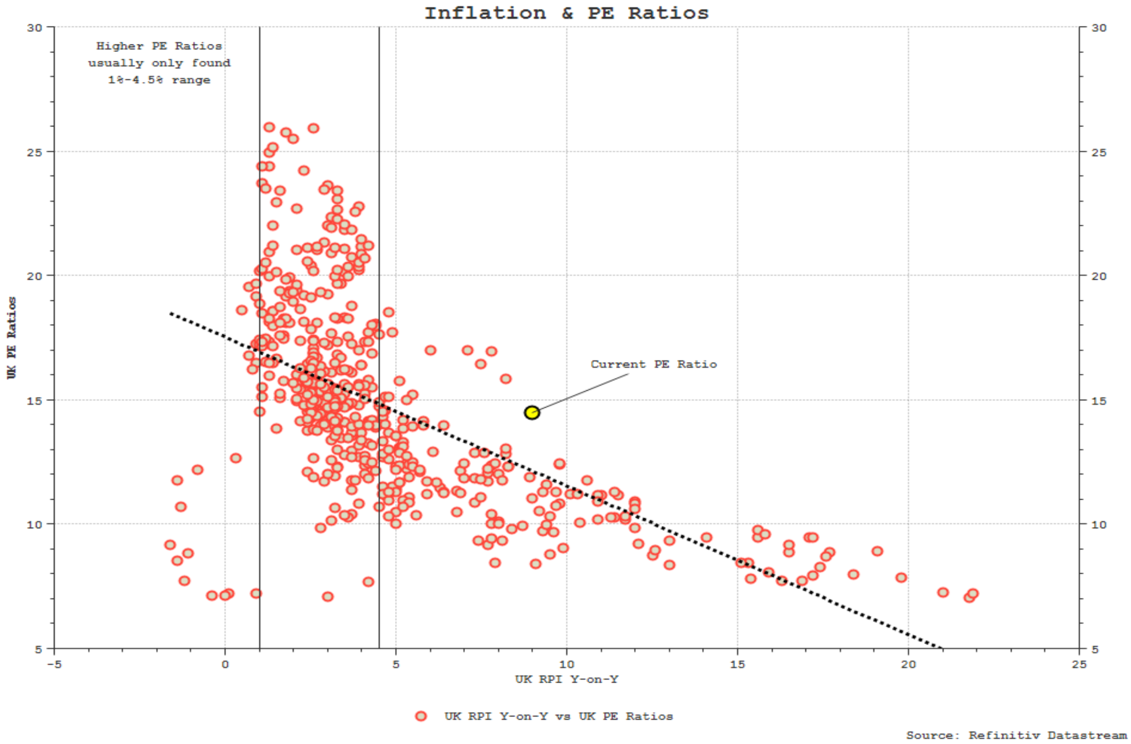

Figure 1.21 UK Stock Market PE Ratios & Inflation

There may be some opportunities in Commodities and Gold, but less so in Index Linked Gilts. As highlighted in Figures 1.15 and 1.16 both Commodities and Gold have underperformed by some margin in recent years.

Commodities 10-year annualised returns have been negative since 2014, whilst Gold's has been declining since 2011. These assets unlike equities and fixed interest securities have spent significant periods well below their 10-year highs and external factors may also provide a tailwind. The Ukraine crisis, supply chain issues, reshoring, trend to renewables, the US Budget deficit, and the possibility of a reversal in the value of the US Dollar could all push commodities particularly upwards.

Whilst conflicts appear to have come at several historic highs in commodities prices; this is not always the case and prices soared in the mid 2000's after commodities had drifted sideways and provided little in the way of returns for some years.

Figure 1.22 shows how long commodities have been in the doldrums, Gold also remains some way below its 10-year high; interestingly unlike the other financial assets are trending upwards. Despite high inflation we also see that rising rates have put significant downward pressure on index linked gilts.

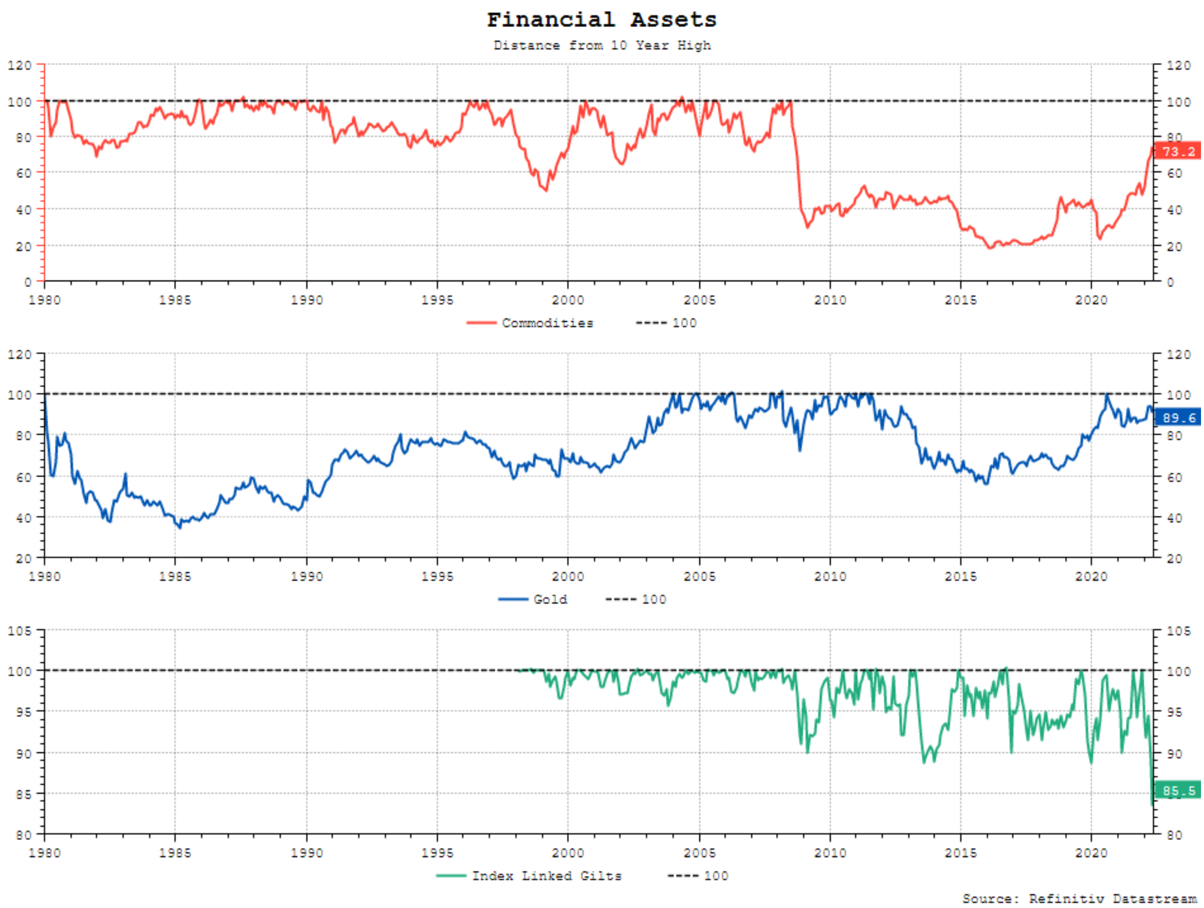

Figure 1.22 Commodities, Gold & Linkers Distance from 10 Year High

This means that market conditions for stocks and fixed interest are skewed to the downside, making them at risk from a change of sentiment caused by any number of external factors (some of which we have detailed below). In contrast there appears a higher probability that Commodities and Gold could perform well given their underperformance in recent times.

External Factors

Within this report we have demonstrated that conflicts have had very little impact on the financial assets and that economic conditions and valuation levels are more important. Invariably at market tops events occur that become associated with the subsequent bear market – usually in hindsight.

Conditions are already unfavourable, or markets are in decline before the event occurs (9/11 is probably the best example of this). This time though we are seeing a changing paradigm and not just financial markets and economies.

Unlike the period after the break-up of the Soviet Union the Western powers and NATO now face very significant military opponents in Russian and China. The risk of a more global conflict is continuing to increase. The changing geo-political dynamics are extremely important; only the Russian invasion of Afghanistan in 1980 took place during the Cold War at a time when the major powers could have been brought into direct conflict. The subsequent fall of the Soviet Union left NATO and the Western coalition unchallenged – they even received Soviet support in the first Gulf War - until now.

Russia has become more emboldened in its actions as the West took little action against its incursion into Georgia and the Crimea. Whilst it may not be in a position militarily and economically to challenge NATO alone it has built close relationships with China that itself has grown to a level where it could challenge the United States.

At the same time China also appears to harbour ambitions to return Taiwan to their own rule; something that the US would not countenance. The level of risk when considering a larger scale conflict has therefore increased substantially over the last twenty years.

Russia is a major source of energy for many European countries and if NATO remains serious on sanctions the reliance on importing energy will need to change. This and the move to more sustainable energy is likely to sustain the current inflationary trends. Any increasing demand for energy that leads to an inflationary spiral increases the risk of bringing countries and regions into disagreement and conflict.

We cannot of course discount that there could be a resolution to the conflict in the Ukraine, this does not need to be a victory by either side but a stalemate that leads them to the negotiating table. However, even if this does occur the economic trends and those in financial assets seems well underway already; whilst the monetary cost of financing Ukraine until the Wars conclusion and then rebuilding the region will be huge. In the short term resolution should improve sentiment but that may not be enough.

With Global tensions increasing the trend towards a more mercantile approach; reshoring of production after the issues caused by COVID is likely to remain popular and in turn the need to maintain trade relations reduces. This will not come cheap as Western employees demand higher wages, particularly skilled workers, as reshoring jobs will accelerate the end of cheap overseas labour and from migrant workers. This will add more inflationary pressures that have not existed in recent years.

Energy and the move to sustainable and renewable sources will be inflationary as the cost is high, requiring significant investment in by Governments, businesses, and individuals it we are to meet targets on carbon emissions.

Conclusions

During the last forty years economic conditions have for the most part been favourable when conflicts started; the combination of falling interest rates and inflation has proved positive for equities and fixed interest holdings. This coupled with increasing globalisation, free trade and falling costs have helped ensure any conflicts have had only a modest impact of financial asset performance.

Economic conditions are deteriorating with inflationary pressures at levels not seen in decades. As the deflationary boom of the last forty years starts to reverse Central Banks may need to start raising interest rates at the worst possible time and the risk of recession and stagflation is increasing.

Financial assets – except for commodities – have been close to all-time highs as interest rates remained at historic lows; this leaves them more at risk than ever of entering a period of falling values, that may have already started.

External factors are changing the dynamics of the World Economy; the shock from COVID is being followed by what seems like a new Cold War between NATO and Russia (and possibly China). This means that unlike the conflicts assessed the risk of a wider war is higher than ever before. These factors are also having an increasing impact on the outlook for economic and financial conditions.

Whilst conflicts have not impacted as much in the periods that we have assessed the changes that we are seeing now could well have wider implications, even if there is a resolution and some type of peace agreement. It will be crucial to monitor the changes to economies and the subsequent effects on financial assets as they could bring conditions that are very different to those that we have seen in more recent times.

Appendix One – World Stock Market & Conflicts

World Stocks & Conflicts	Duration Years	Interest Rates	Gilt Yields	RPI	Oil	Return from World Stocks 5 Years Prior to Conflict	Return from World Stocks During Conflict	Return from World Stocks in Year After Start of Conflict	Return from World Stocks in Three Years After Start of Conflict	Return from World Stocks in Five Years After Start of Conflict
Soviet-Afghanistan War	2.16	Falling	Falling	Falling	Falling	↑	↑	↑	↑	↑
Iran-Iraq War	7.92	Falling	Falling	Falling	Falling	↑	↑	↓	↑	↑
Falklands War	0.25	Unchanged	Falling	Falling	Falling	↑	↔	↑	↑	↑
First Gulf War (Western Coalition)	0.50	Falling	Falling	Falling	Falling	↑	↔	↔	↑	↑
Bosnia	3.75	Falling	Falling	Falling	Falling	↔	↑	↗	↑	↑
Kosovo	1.33	Falling	Falling	Falling	Rising	↑	↑	↗	↑	↓
9/11 Terrorist Attacks	0.00	Unchanged	Unchanged	Falling	Rising	↑	↔	↘	↑	↑
Afghanistan War (Western Coalition)	12.83	Falling	Falling	Unchanged	Rising	↗	↑	↓	↗	↑
Iraq War (Western Coalition)	7.75	Falling	Falling	Rising	Rising	↓	↑	↑	↑	↑
Russian Invasion of Georgia	0.08	Falling	Falling	Falling	Falling	↑	↓	↓	↘	↗
Arab Spring	1.00	Unchanged	Falling	Falling	Falling	↓	↑	↑	↑	↑
Russian Invasion of Crimea	0.08	Unchanged	Falling	Falling	Falling	↑	↗	↗	↗	↑
Russian Invasion of Ukraine	0.25	Rising	Rising	Rising	Rising	↑	↔	-	-	
Percentage +ve outcomes						**85%**	**77%**	**67%**	**92%**	**92%**
Percentage -ve outcomes						**15%**	**23%**	**33%**	**8%**	**8%**

Appendix Two –UK Stock Market & Conflicts

UK Stocks & Conflicts	Duration Years	Interest Rates	Gilt Yields	RPI	Oil	Return from UK Stocks 5 Years Prior to Conflict	Return from UK Stocks During Conflict	Return from UK Stocks in Year After Start of Conflict	Return from UK Stocks in Three Years After Start of Conflict	Return from UK Stocks in Five Years After Start of Conflict
Soviet-Afghanistan War	2.16	Falling	Falling	Falling	Falling	↑	↑	↑	↑	↑
Iran-Iraq War	7.92	Falling	Falling	Falling	Falling	↑	↑	↘	↑	↑
Falklands War	0.25	Unchanged	Falling	Falling	Falling	↑	↗	↑	↑	↑
First Gulf War (Western Coalition)	0.50	Falling	Falling	Falling	Falling	↑	↔	↔	↑	↑
Bosnia	3.75	Falling	Falling	Falling	Falling	↑	↑	↗	↑	↑
Kosovo	1.33	Falling	Falling	Falling	Rising	↑	↑	↗	↑	↓
9/11 Terrorist Attacks	0.00	Unchanged	Unchanged	Falling	Rising	↑	↗	↓	↘	↑
Afghanistan War (Western Coalition)	12.83	Falling	Falling	Unchanged	Rising	↑	↑	↓	↘	↑
Iraq War (Western Coalition)	7.75	Falling	Falling	Rising	Rising	↓	↑	↑	↑	↑
Russian Invasion of Georgia	0.08	Falling	Falling	Falling	Falling	↑	↓	↘	↔	↑
Arab Spring	1.00	Unchanged	Falling	Falling	Falling	↘	↗	↗	↑	↑
Russian Invasion of Crimea	0.08	Unchanged	Falling	Falling	Falling	↑	↔	↔	↗	↗
Russian Invasion of Ukraine	0.25	Rising	Rising	Rising	Rising	↔	↔	-	-	
Percentage +ve outcomes						**85%**	**85%**	**67%**	**75%**	**92%**
Percentage -ve outcomes						**15%**	**15%**	**33%**	**25%**	**8%**

Appendix Three –UK Gilts & Conflicts

UK Gilts & Conflicts	Duration Years	Interest Rates	Gilt Yields	RPI	Oil	Return from UK Gilts 5 Years Prior to Conflict	Return from UK Gilts During Conflict	Return from UK Gilts in Year After Start of Conflict	Return from UK Gilts in Three Years After Start of Conflict	Return from UK Gilts in Five Years After Start of Conflict
Soviet-Afghanistan War	2.16	Falling	Falling	Falling	Falling	-	-	-	-	-
Iran-Iraq War	7.92	Falling	Falling	Falling	Falling	-	↑	↘	↑	↗
Falklands War	0.25	Unchanged	Falling	Falling	Falling	-	↗	↑	↑	↑
First Gulf War (Western Coalition)	0.50	Falling	Falling	Falling	Falling	↔	↔	↗	↑	↑
Bosnia	3.75	Falling	Falling	Falling	Falling	↔	↗	↗	↔	↗
Kosovo	1.33	Falling	Falling	Falling	Rising	↗	↔	↗	↔	↗
9/11 Terrorist Attacks	0.00	Unchanged	Unchanged	Falling	Rising	↑	↔	↔	↔	↔
Afghanistan War (Western Coalition)	12.83	Falling	Falling	Unchanged	Rising	↑	↑	↔	↔	↔
Iraq War (Western Coalition)	7.75	Falling	Falling	Rising	Rising	↗	↑	↔	↔	↔
Russian Invasion of Georgia	0.08	Falling	Falling	Falling	Falling	↑	↔	↗	↑	↑
Arab Spring	1.00	Unchanged	Falling	Falling	Falling	↘	↔	↔	↗	↗
Russian Invasion of Crimea	0.08	Unchanged	Falling	Falling	Falling	↑	↗	↗	↑	↑
Russian Invasion of Ukraine	0.25	Rising	Rising	Rising	Rising	↔	↔	-	-	
Percentage +ve outcomes						**90%**	**92%**	**82%**	**82%**	**91%**
Percentage -ve outcomes						**10%**	**8%**	**18%**	**18%**	**9%**

Appendix Four – Gold & Conflicts

Gold & Conflicts	Duration Years	Interest Rates	Gilt Yields	RPI	Oil	Return from Gold 5 Years Prior to Conflict	Return from Gold During Conflict	Return from Gold in Year After Start of Conflict	Return from Gold in Three Years After Start of Conflict	Return from Gold in Five Years After Start of Conflict
Soviet-Afghanistan War	2.16	Falling	Falling	Falling	Falling	↑	↓	↑	↔	↓
Iran-Iraq War	7.92	Falling	Falling	Falling	Falling	↑	↓	↓	↓	↓
Falklands War	0.25	Unchanged	Falling	Falling	Falling	↑	↘	↑	↘	↑
First Gulf War (Western Coalition)	0.50	Falling	Falling	Falling	Falling	↓	↘	↘	↘	↔
Bosnia	3.75	Falling	Falling	Falling	Falling	↘	↗	↔	↑	↔
Kosovo	1.33	Falling	Falling	Falling	Rising	↓	↘	↔	↘	↑
9/11 Terrorist Attacks	0.00	Unchanged	Unchanged	Falling	Rising	↓	↘	↗	↑	↑
Afghanistan War (Western Coalition)	12.83	Falling	Falling	Unchanged	Rising	↓	↑	↗	↑	↑
Iraq War (Western Coalition)	7.75	Falling	Falling	Rising	Rising	↗	↑	↑	↑	↑
Russian Invasion of Georgia	0.08	Falling	Falling	Falling	Falling	↑	↘	↔	↑	↑
Arab Spring	1.00	Unchanged	Falling	Falling	Falling	↑	↗	↗	↓	↓
Russian Invasion of Crimea	0.08	Unchanged	Falling	Falling	Falling	↑	↘	↔	↘	↔
Russian Invasion of Ukraine	0.25	Rising	Rising	Rising	Rising	↑	↗	-	-	
Percentage +ve outcomes						**62%**	**31%**	**58%**	**42%**	**58%**
Percentage -ve outcomes						**38%**	**69%**	**42%**	**58%**	**42%**

Appendix Five – Commodities & Conflicts

Commodities & Conflicts	Duration Years	Interest Rates	Gilt Yields	RPI	Oil	Return from Commodities 5 Years Prior to Conflict	Return from Commodities During Conflict	Return from Commodities in Year After Start of Conflict	Return from Commodities in Three Years After Start of Conflict	Return from Commodities in Five Years After Start of Conflict
Soviet-Afghanistan War	2.16	Falling	Falling	Falling	Falling	↑	↑	↗	↔	↗
Iran-Iraq War	7.92	Falling	Falling	Falling	Falling	↑	↑	↓	↘	↘
Falklands War	0.25	Unchanged	Falling	Falling	Falling	↑	↔	↗	↑	↑
First Gulf War (Western Coalition)	0.50	Falling	Falling	Falling	Falling	↑	↔	↗	↔	↔
Bosnia	3.75	Falling	Falling	Falling	Falling	↑	↗	↔	↘	↑
Kosovo	1.33	Falling	Falling	Falling	Rising	↑	↓	↓	↑	↑
9/11 Terrorist Attacks	0.00	Unchanged	Unchanged	Falling	Rising	↑	↓	↔	↑	↑
Afghanistan War (Western Coalition)	12.83	Falling	Falling	Unchanged	Rising	↘	↓	↑	↑	↑
Iraq War (Western Coalition)	7.75	Falling	Falling	Rising	Rising	↑	↗	↑	↑	↑
Russian Invasion of Georgia	0.08	Falling	Falling	Falling	Falling	↑	↓	↓	↓	↓
Arab Spring	1.00	Unchanged	Falling	Falling	Falling	↓	↔	↔	↓	↓
Russian Invasion of Crimea	0.08	Unchanged	Falling	Falling	Falling	↑	↓	↓	↓	↓
Russian Invasion of Ukraine	0.25	Rising	Rising	Rising	Rising	↑	↗	-	-	
Percentage +ve outcomes						**85%**	**46%**	**50%**	**50%**	**67%**
Percentage -ve outcomes						**15%**	**54%**	**50%**	**50%**	**33%**