

Wars, Oil Shocks & Stock Markets

Conflicts & Stock Markets

Over the course of a war, start to finish, with one exception, the US stock market has ended higher than it had begun. Chart 1 below displays US stock market performance (indexed) over the various wars. The horizontal axis represents weeks since conflict start.



Over the course of **World War I**, the US stock market rose by 23% over a 4.3-year period.

Over the course of **World War II**, the US stock market rose by 37% over a 6-year period.

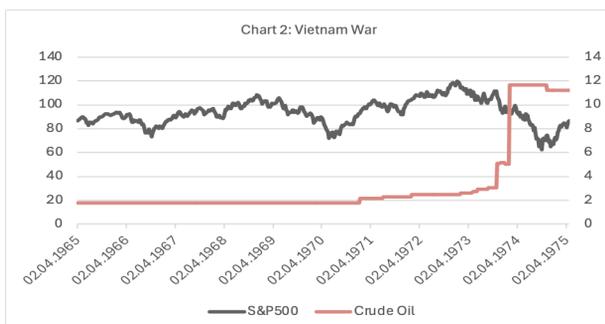
Over the course of the **Korean War**, the US stock market rose by 37% over a 3-year period.

Over the course of the **Gulf War**, the US stock market rose by 6% over a 6-month period.

Over the course of the **Iraq War**, the US stock market rose by 36% over a 9-year period.

Since the start of the **Russia-Ukraine** war until now (war ongoing), the US stock market has risen by 53%.

The exception is the **Vietnam War**. Over the course of this war, the US stock market declined by 1% over a 10-year period. The market correction, however, was attributable to Gulf oil embargo. Please see Chart 2 below.



Economic Impact of Oil

Oil price rises drive supply-side or cost-push inflation. Further, persistently high oil prices erode aggregate economic demand via lower consumption and investment.

Presently, investor and central bank focus on oil has been on its inflationary impact. Continued high oil prices, however, lead to an economic slowdown. The final result could be stagflation.

The 1970s Oil Embargo vs. Today

The 1973–74 oil embargo reduced global oil supply by approximately c. 9% at a time when global consumption stood at 55–60 mb/d and Gulf exports accounted for c. 25% of global supply prior to the embargo.

Today, global oil consumption is approximately 100 mb/d, of which c. 20% transits through the Strait of Hormuz—implying a materially larger potential disruption.

While Saudi Arabia could reroute up to 5 mb/d to the Red Sea via pipelines and the UAE could reroute up to 2 mb/d to the Gulf of Oman, a sustained disruption would still imply a c. 13% reduction in Gulf exports (as a share of global demand).

In addition, unlike the 1970s where gas exports were negligible, c. 25% of global gas consumption (in the form of LNG) was exported via the Strait of Hormuz prior to the Iran conflict, further amplifying the system-wide energy risk.

Despite this, price action has been muted: since late February, Dubai crude is up <100%, Brent <50% and WTI broadly flat while natural gas prices have risen by <100%. This compares with a c. 500% increase during the 1970s embargo.

Even if supply is more elastic today (potential production increases in other oil-producing regions, possible relaxation of Russian sanctions and release of strategic reserves) and even if demand is less inelastic (transport and industry consumers may switch to alternative energy sources), the potential for significantly higher oil prices remains. On the other hand, today’s crisis is arguably self-imposed and could be resolved relatively quickly by a US policy change.

Opinion

History shows that stock markets have proven resilient during periods of conflict. Energy shocks are, however, a different matter if supply is constrained for several months.

Irrespective of potential energy price movements, in the context of portfolio management, the great bulk of one’s portfolio should be managed and implemented in line with the initial investment plan. Unforeseen events (known unknowns) should already have been envisaged and factored into portfolio asset allocation.

Investors should avoid overreacting to geopolitical noise, stay aligned with their long-term investment strategy and limit tactical moves, implemented incrementally, to a maximum of 10%-20% of the portfolio size.

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