Geopolitical Uncertainty Weighs on Markets

Investors have been on a bumpy ride as both domestic and emerging markets have seen continued volatility over the past few months. February was no exception with the broad-market S&P 500 dipping into its first 10% correction in almost two years as geopolitical tensions intensified. The last week of February brought the somber news of escalating conflict in Eastern Europe.

The world continues to watch this very fluid situation between Russia and Ukraine. While the conflict is troubling, investors need not overreact, advises Raymond James Chief Investment Officer Larry Adam. Investors are likely to see the biggest financial impact in the form of increased prices on commodities produced in the region, namely oil, natural gas, wheat, palladium and aluminum.

The situation has added to macro uncertainty and impacted legislative priorities on Capitol Hill, says Ed Mills, Washington Policy Analyst. Generally speaking, defense considerations and supply chain security/domestic manufacturing capability have risen on the congressional to-do list. President Biden's March 1 State of the Union address will inform the direction of the domestic agenda and potential policy changes.

Investors are factoring in tighter monetary policy. The Fed is expected to start raising short-term interest rates in March and begin reducing its balance sheet later this year. Compared to the start of previous tightening cycles, the U.S. economic outlook is a lot stronger, the labor market is a lot tighter, and inflation is substantially higher, notes Raymond James Chief Economist Scott Brown.

The crisis will weigh on a market already struggling with high inflation and the coming transition to tighter monetary policy, says Mike Gibbs, managing director of Equity Portfolio & Technical Strategy. Gibbs notes that despite the elevated uncertainty, history shows that geopolitical events such as this often create a buying opportunity for long-term investors.

	12/31/21 Close	2/28/22 Close	Change Year to Date	% Gain/Loss Year to Date
DJIA	36,338.30	33,892.60	-2,445.70	-6.73%
NASDAQ	15,644.97	13,751.40	-1,893.57	-12.10%
S&P 500	4,766.18	4,373.94	-392.24	-8.23%
MSCI EAFE	2,336.07	2,177.75	-158.32	-6.78%
Russell 2000	2,245.31	2,048.09	-197.22	-8.78%

Bloomberg Aggregate Bond	2,355.14	2,260.98	-94.16	-4.00%

Performance reflects price returns as of market close on February 28, 2022. MSCI and Bloomberg Barclays Aggregate Bond performance reflect February 25, 2022, closing values.

Sector roundup

Higher commodity prices would weigh on global consumer spending, including in the U.S. Russia may be tempted to retaliate against aggressive sanctions by limiting energy exports to the European Union (EU), though Russia's own economy would feel even more pain in this scenario. The crisis has raised the issue of energy security across Europe. It's a good bet that European policymakers feel an urgency to reduce dependence on Russian oil and gas, which aligns with the EU's climate agenda to move away from fossil fuels and toward renewable energy and electric vehicles.

Despite the conflict, losses were modest in Europe and the U.K. The region's fourth quarter 2021 corporate earnings season came in slightly higher than expectations, although inflationary challenges have increased across much more than oil or gas prices. The conflict could also hinder wheat supply, as well as the global supply of palladium, which is needed for fuel cells, solar energy and electric vehicles.

The bottom line

Despite uncertainty, geopolitical conflicts tend to create buying opportunities for long-term equity investors, who may want to strategically add positions in select sectors (e.g., materials, energy and financials). Equity declines associated with previous conflicts typically are followed by higher markets six to 12 months later, analysis shows. We expect to see more market turbulence over the next several months. For now, equity valuations remain attractive and economic fundamentals remain strong in our view. Corrections can be uncomfortable, and we encourage long-term investors to stay patient.

Your financial advisor can help address questions about how current conditions may impact your holistic plan.