Economic & Market Implications of a Russian Invasion of Ukraine

by Paul Dietrich, B. Riley Wealth Management | Markets Resource | Market Insights | No Comments

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A member of Ukraine's Territorial Defense Forces during training at a former asphalt factory on the outskirts of Kyiv, Ukraine, on Saturday, Feb. 19, 2022.

Skirmishes have started in eastern Ukraine and it now seems likely that Russia could invade Ukraine at any time. Most military analysts believe Putin could take over the country within 72 hours to a week. The initial invasion will be quick and deadly. Please make no mistake about it, there will be lives lost, and the human toll in death and suffering will be terrible. I don't want to minimize the tragic nature of this war caused by one autocratic dictator. Putin's war will not only affect the country and people of Ukraine, but it will affect the stock markets, economies, and energy supplies of many other countries.

Following is my analysis of the potential impacts for the United States.

U.S. Stock Market Reaction To A Russian Invasion Of Ukraine

In January and early February 2014, Russia invaded the Ukrainian territory of Crimea. Over ten days, the stock market dropped almost 8%—but twenty days later, the stock market fully recovered and hit a new high for the year. Most analysts expect something similar this time. If an invasion occurs, the stock market will quickly drop and then recover a few weeks later.

According to a study conducted by Truist co-chief investment officer Keith Lerner, "in nine of the last 12 geopolitical shock events, the S&P 500 Index was higher 12 months later, with an average 12-month return of 8.6%."

The Truist report notes that the three highlighted instances in the graph, where stocks were down a year later, coincided with a recession. However, the major finding of the study shows "that the history of these types of events tend to have a fleeting market impact unless they lead to a recession." At this time, the consensus of almost all analysts indicates a very low to non-existent risk of a recession.

S&P 500 Historical Performance Around Major Geopolitical Shocks

Date	Select geopolitical/ military events	1 month later	3 months later	6 months later	12 months later
12/7/1941	Pearl Harbor	-3.4%	-12.7%	-9.1%	0.4%
10/31/1956	Suez Canal crisis	-2.8%	-3.8%	-0.1%	-11.5%
10/20/1962	Cuban missile crisis	8.7%	17.7%	25.1%	32.0%
10/17/1973	Arab oil embargo	-7.0%	-13.2%	-14.4%	-36.2%
11/3/1979	Iranian hostage crisis	4.2%	11.6%	3.8%	24.3%
12/25/1979	U.S.S.R. in Afghanistan	5.6%	-7.9%	6.9%	25.7%
8/3/1990	Iraq invades Kuwait	-8.2%	-13.5%	-2.1%	10.1%
1/17/1991	Gulf War	15.2%	23.5%	20.6%	33.1%
8/17/1991	Gorbachev coup	0.0%	3.0%	7.0%	8.9%
2/26/1993	World Trade Center bombing	1.2%	2.5%	4.0%	6.4%
9/11/2001	9/11	-0.2%	2.5%	6.7%	-18.4%
3/20/2003	Iraq War	2.2%	15.6%	17.4%	28.4%
	AVERAGE	**1.3%**	**2.1%**	**5.5%**	**8.6%**
	% POSITIVE	**50%**	**58%**	**67%**	**75%**

Source: Truist

"From the start of WWII in 1939 until it ended in 1945, the Dow was up 50%, more than 7% per year," noted institutional analyst Ben Carlson of Ritholtz Wealth Management.And, between 1914 and 1945, a period that includes two of the worst wars in U.S. history (WWI and WWII), the Dow was up a combined 115%, according to Carlson and S&P Dow Jones Indices.

In another study conducted by Ned Davis Research, they examined the 28 worst political or economic crises over six decades before the 9/11 attacks in 2001. In 19 cases, the Dow was higher six months after the crisis began. The average six-month gain following all 28 crises was 2.3%. In the aftermath of 9/11, which left stock markets closed for several days, the Dow fell 17.5% at its low but recovered to trade above its September 10th level by October 26th, six weeks later.

Today, many investors wonder if they should reduce their exposure to stocks because of the fear of a war between Russia and Ukraine. History would suggest that exiting the stock market now would be the wrong decision. It usually is not a good idea to sell into a panic!

The U.S. Stock Market & The U.S. Economy Are Two Different Entities

It is quite possible that in the first week of the invasion, the stock market could initially correct 10% or more. Investors often sell first and think and ask questions later. The one thing investors need to remember is that Russia invading Ukraine will have almost no impact on the underlying U.S. economy.

The U.S. doesn't buy much of anything from Ukraine and, because of sanctions, we buy and sell very little to and from Russia. We import only about $1.1 billion a year from Ukraine. We import only about $24 billion a year from Russia out of $2.8 trillion in trade from the rest of the world. Depending on how long the war lasts, the invasion will have only a small, short-term impact on the U.S. stock market. Over time, it is unlikely this will change the outlook for corporate profits or U.S. economic fundamentals. Any decline in the stock market would be temporary and a buying opportunity.

What Specific Industries Could Be Impacted By This War?

Oil & Natural Gas: It is all about energy. This war could cause significant volatility in energy prices. Russia is a key global producer of oil and natural gas with pipelines feeding many parts of Europe. If Russia were to shut off those pipelines or have its energy infrastructure damaged, it could significantly increase energy prices, especially in Europe. A barrel of oil is currently trading in the low $90s. It could reach $100 a barrel or higher in the short term. Natural gas prices could also spike in Europe.

Grains & Wheat: Interruptions to the Black and Baltic Seas ports could create shipping supply chain blockages for food and other staples headed to Europe. Any interruption to the flow of wheat to Europe is likely to increase food prices and further fuel food inflation when its affordability is a significant concern around the world. Both Russia and Ukraine are top wheat and corn exporters to Europe. Shortages of grains in Europe may also turn out to be a blessing for U.S. farmers.

Gold & Commodities: Commodities on U.S. markets have been hitting record highs. Gold has also recently spiked up in price.

U.S. Treasury Bonds: A major global risk event usually has investors worldwide fleeing to the safest havens like U.S. Treasury bonds—the safest asset in the world. Many international risk-averse investors will be buying the U.S. dollar. The 10-year Treasury yield is currently at 1.98%, and the two-year Treasury yield is 1.58%. If the U.S. dollar gets stronger, those yields could decline.

This War Could Be Bad For Inflation & Consumers —But May Be Good For The U.S. Stock Market

Higher gas and energy prices and higher food prices are bad for inflation and consumers. However, U.S. energy companies and food processing and distribution companies benefit from higher prices. Media reports have pointed out that many S&P 500 companies are raising prices higher than the inflation rate. FactSet analysts report that most companies feel they can raise prices enough not to hurt this year's earnings. In the end, the U.S. stock market may prove to be an investor's best hedge against inflation.

Closing Thoughts

One of the long-term results of Russia invading Ukraine is that this will speed up the process of Russia's eventual decoupling from the West. Only history will tell us if that will be good or bad.

At the risk of repeating myself, investors should stay fully invested in the stock market during any corrections. There will be more pullbacks and corrections this year. Still, investors need to be focused on the underlying fundamentals of the U.S. economy, which will ultimately drive the stock market up over 2022.

If something impacts the stock market and does not substantially affect the underlying U.S. economy—IT IS NOISE—TUNE IT OUT!

About Paul Dietrich, Chief Investment Strategist, B. Riley Wealth Management

Paul Dietrich is focused on managing investments for private investors, retirement funds and private institutions throughoutthe United States. He also serves as a frequent on-air commentator and regularly contributes market analysis to business and financial media includingCNBC,Fox Business,Bloomberg TV,CNN,The Wall Street Journal, Yahoo! Finance, ReutersandThe Washington Post.