Crisis lessons: Stay invested, stay active

The Russia-Ukraine war raises serious questions for investors trying to gauge its impact on the global economy. Every crisis is different and there is no standard playbook investors can reach for.

By *Gerald Cartigny*

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Managing Director, Goldman Sachs Asset Management

Some of the variance can be explained by the conditions that exist when a crisis begins. The fighting in Ukraine erupted just as macroeconomic conditions appeared to be normalizing. After a multi-year pandemic, the global economy seemed as if it was about to turn a corner. Inflation was high, but supply chain bottlenecks were showing signs of easing, suggesting price pressures would eventually ease with them. Those hopes are now fading. Commodity prices have surged, stoking concern that central banks may tighten policy even more aggressively, potentially choking off growth in the process. The longer the conflict lasts, the more likely it could push inflation higher and global growth lower.

FIGURE 1: EQUITY MARKET PERFORMANCE DURING GEOPOLITICAL CRISES

			S&P 500		Euro Stoxx 600		MSCI Emerging Markets	
Start	End	Event	During	3m After	During	3m After	During	3m After
Aug '90	Feb '91	The Gulf War	4.4	6.2	-7.5	6.8	-10.5	11.9
Sep '01	Sep '01	September 2001	-4.7	10.3	-4.5	12.2	-12.6	26.3
Mar '03	May '03	US Invasion of Iraq	4.6	7.0	4.2	7.5	5.1	19.6
Dec '10	Jan '11	Tunisian Revolution	4.0	2.0	2.7	-2.1	4.0	1.9
Jul '11	Sep '11	European Debt Crisis Peaks	-16.5	12.0	-22.1	12.6	-24.6	5.3
Feb '14	Mar '14	Annexation of Crimea	0.7	5.6	-1.2	3.3	1.9	8.1
Jun '16	Jul '16	Brexit Referendum	-0.6	2.9	-8.0	7.5	-1.9	11.9
Aug '21	Aug '21	Taliban Takeover of Kabul	1.4	0.8	-0.7	-2.1	0.4	-5.7
		Median	1.0	5.9	-2.8	7.1	-0.8	10.0

Source: Goldman Sachs Asset Management. As of March 4, 2022. Performance during and 3 months after the end of the event. Past performance does not guarantee future results, which may vary.

The perils of prediction

Market behavior can be extremely unpredictable at the best of times, and timing market moves is difficult even for seasoned investors. It's even more challenging in a crisis environment. We looked at how equities performed during and shortly after periods of elevated geopolitical risk. While stocks have shown an ability to recover fairly quickly after a crisis ends (see Figure 1), predicting when the end would have come, would have been challenging, as it is today.

It was equally difficult to predict market behavior when the COVID-19 pandemic began. Investors who reduced exposure to stocks and other risk assets, such as

PHOTO: ARCHIVE GOLDMAN SACHS ASSET MANAGEMENT, ILLUSTRATION: SHUTTERSTOCK corporate credit, to take refuge in safe-haven investments in March 2020, would have missed the rapid financial market rebound that followed. On the other hand, it would have taken investors who did nothing to their portfolios when the global financial crisis erupted, several years to recover their losses. If nothing else, this should serve as a reminder to approach portfolio decision-making during disruptive events and heightened market volatility with a healthy dose of humility.

The first thing that those with the luxury of long investment horizons should consider, in our view, is a simple one: stay invested and focus on the big picture. For example, equity performance can be highly unpredictable over the short term. As Figure 2 illustrates, the S&P 500 delivered positive returns on a daily basis just 54% of the time between 1969 and 2021 – not much better than a coin flip. Extend the holding period to three years or more and it's a very different story.

Focus on alpha

However, how investors go about staying invested, matters. Maintaining passive exposure and hoping for the best is not, in our view, an ideal strategy. Over the past decade or so, low interest rates and a rising tide of monetary stimulus lifted many boats, making simply being long market beta a strong strategy. But in the current crisis – with monetary tightening on the horizon and markets in a mid-cycle environment – we anticipate more dispersion across asset classes, sectors, and regions and between assets in developed markets and emerging markets. In these conditions, alpha-oriented active strategies will be critically important.

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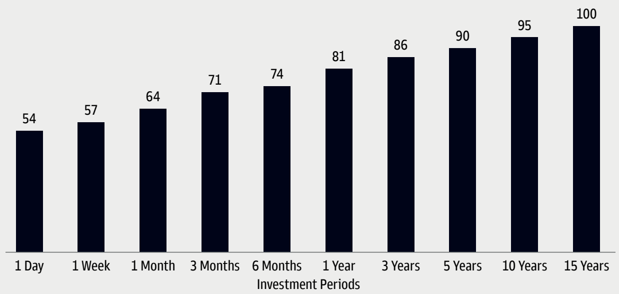
It's also important, in our view, to embrace a holistic approach to portfolio construction rather than viewing investments through a rigid asset class lens. For example, investors may be able to enhance diversification and performance potential by considering private equity investments as a complement to those in public equities rather than just a way to achieve similar beta exposure with higher leverage. An opportunistic approach to tactical asset allocation is also important in order to seek to capture investment opportunities that may arise in the short to medium term, due to relative value opportunities and market dislocations.

We expect the war in Ukraine to affect global growth primarily through commodity supply –the result of Russia's large footprint in commodities relative to its contribution to global growth and trade. Meanwhile, sanctions and supply chain issues present upside risks to core goods (including autos), food and energy inflation. From a broad market perspective, we think any escalation of tensions would likely challenge risk assets such as equities and corporate credit via market valuations rather than corporate fundamentals, while pushing commodity and high quality fixed income bond prices and perceived safe haven currencies higher.

Predicting precisely what lies ahead this time, though, will almost certainly be as difficult as it was in past crises. As investors, the best we can do is stay invested, stay informed and stay nimble enough to act as conditions change. ■

FIGURE 2: STAYING INVESTED CAN OFFER A HIGHER RETURN POTENTIAL



Source: Goldman Sachs Asset Management. As of December 31, 2021. 1-day and 1-week periods are rolling periods over daily returns. 1-month through 15-year periods are rolling periods over monthly returns. Past performance does not guarantee future results, which may vary.

SUMMARY

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As investors, the best we can do is stay invested, stay informed and stay nimble enough to act as conditions change.