Seed Weekly

24 October 2019

Equities & War

The United States economy has been at war or on the side-line of the World Wars for about one-fifth of the time since 1885 (almost a 30-year period). Interestingly, stock markets in the US do equally well in nominal returns during war and peace time. Inflation, however, averages 6% during war and 2% during peace time, giving a much lower real return during periods of war.

Also interesting, is that market volatility has, on average, been greater during peace time than during war, despite that in theory one would expect war to have a profound influence on equity prices. Government's tremendous need for resources, together with high taxes required to fund wars and increased government borrowing, compete with investor's demand for equities during these times.

Whole industries are sometimes nationalised for the war effort. When losing a war becomes a possibility, stocks often decline sharply as the victorious impose sanctions on the defeated. In the case of the economies of Germany and Japan, both were restored to health quickly following World War II and resulted in a booming stock market.

The World Wars

Market volatility in the US during World War I greatly exceeded that during World War II. The market rose nearly 100% during the early stages of the first war, then again fell 40% when the US joined the war and finally rallied when it ended in 1918. In contrast, the market never deviated more than 32% from pre-war levels during the 6-year period of World War II.

With the outbreak of World War I, investors scrambled from equities to gold and cash, and all the major European stock exchanges closed. European panic spread quickly to the US, and the Dow Jones closed down 7% on 30 July 1914 with the market closing down for an indefinite period thereafter. It reopened 4 months later on 12 December of the same year. By the time it opened, prices were rising rapidly and finished the first day 5% higher than the closing prices 4 months earlier. The rally increased, and 1915 recorded the best single-year increase of 82% for the Dow Jones Industrial Index.

With the outbreak of World War II (when Great Britain declared war on Germany on 3 September 1939), the rise in the Tokyo Exchange was so rapid that the market had to close early. The Dow Jones was up 7% and even European indexes opened firmer despite being on the foreground of the battlefield. Enthusiasm, however, faded quickly and by the time the Japanese attacked Pearl Harbour on 7 December 1941, the Dow Jones was down 25% from its 1939 levels. It continued to fall until April 1942, and when the tide turned towards the Allies, the market eventually began to climb.

By the time Germany surrendered in May 1945 the Dow Jones was 20% higher than its pre-war level.

Conclusion

The relevance and lesson for the SA investor is that fewer than one in four causes of major market movements are associated with a major news, political or economic event. Markets are unpredictable, and so are its movements.

Those who sold in panic at the outbreak of World War I missed out on the greatest year in the market. Then again, the buying surge that occurred at the outbreak of World War II was misplaced because the government was determined to place a cap on profits, which resulted in a very subdued market performance.

Equities & War

Wars, political events and even recessions are minor factors compared to world economic growth and political stability. These two factors have been proven as the main drivers of equity market returns and are what we require for a solid investment portfolio with enhanced returns and reduced risk.

Kind regards,

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Reference/s: Stocks for the long run (3rd edition), Jeremy J. Siegel

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DISCLAIMER

GLOSSARY OF TERMS

Annualised Return — Annualised return shows longer term performance rescaled to a 1 year period. Annualised return is the average return per year over the period. Actual annual figures are available to the investor on request.

Annualised Volatility — The deviation of the calendar month return stream, since launch, relative to its own average.

Highest and Lowest Annual Return — The highest and lowest returns, since launch, for any rolling 1 year period have been shown.

Maximum Drawdown — The maximum calendar month peak to trough loss, since launch, suffered by the Fund.

NAV — The net asset value (NAV) represents the assets of a Fund less its liabilities.

Positive Months — The percentage of calendar months, since launch, where the Fund has delivered a positive return.

Return Horizon — Minimum investment period to have a reasonable probability of receiving the benchmark return.

Risk Horizon — Minimum investment period to have a reasonable probability of receiving a positive nominal return.

Total Expense Ratio (TER) — The Fund's Total Expense Ratio (TER) reflects the percentage of the average NAV of the Fund that was incurred as charges, levies and fees related to the management of the Fund. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs.