MV CAPITAL MANAGEMENT

Weekly Market Flash

The Fog of War…and Markets

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On Tuesday this week a story broke early in the day about a possible withdrawal of Russian troops from the border of Ukraine. The story referenced a Russian source on the ground that the troops had "finished their training exercises" and were returning home. It didn't take long for this story to collapse itself into a Twitter-friendly meme: "Putin blinked." Asset markets, which normally don't take much notice of geopolitics, rallied strongly.

The next day, though, reports broke out about active hostilities in eastern Ukraine regions, which are generally pro-Russian, with the usual grim pictures of homes and schools destroyed by the shelling. US and European policymakers warned that the threat of invasion was no less imminent than it had been earlier in the week. On Thursday markets took another dive as stories of the shelling along the border continued and the tone of negotiators from both sides sharpened.

Why Geopolitics, Why Now?

The volatile path of markets so far in 2022 has been driven by many factors, but the crisis in Ukraine seems to have been a primary catalyst in the wild swings of the past week. For longstanding observers of markets this is a little curious. As we noted above and in many of our past commentaries, markets generally don't pay attention to geopolitics. To cite one example, the Cuban Missile Crisis – arguably the most existentially threatening crisis of the postwar period – didn't register so much as a ten percent correction in the stock market. Even the market volatility in the aftermath of 9/11 arguably had more to do with the ongoing crash in tech stocks and a contemporaneous recession than it did with the terrorist acts.

Neither Ukraine nor Russia are particularly critical markets for the global industry leaders that populate the S&P 500. If Russia were to invade Ukraine (which as of today still seems to be the outcome with greater odds of happening) it would certainly be a human crisis for many people in the affected regions, but it would barely register on the growth prospects any company communicates to the analysts gathered for its quarterly earnings call (perhaps with the exception of energy companies with some exposure to the European natural gas market, which is certainly vulnerable to anything that happens in Russia).

Troll Versus Troll

There is one feature of markets today, though, that makes it somewhat easier to understand why they are bouncing around to the tune of whatever the latest headlines are saying. Bear in mind that more than two thirds of the trading that takes place on any given day is driven by mechanized trading programs, many of which very specifically react to headlines in the news cycle. These aren't actual human beings reading a story about Ukraine, thinking about it and then barking "Buy!" or "Sell!" into the phone in the way a movie from the 1980s might depict it. They are algorithms with the capability to troll through social media and trigger an automatic trading order when the AI embedded in the program digests a piece of information. That's how the stories on Tuesday fed into a big rally, and how the subsequent news on Wednesday and Thursday took prices sharply the other way.

The problem for any trader who thinks it's a good idea to trade this way is that the actual protagonists in the real world – meaning specifically the politicians and negotiators on both sides of the conflict crafting

and executing their strategic moves – are trolling each other as well. For a couple weeks now we've seen a range of gambits, feints and dekes worthy of a Stanley Cup final as the Western allies and the Russians have sought the upper hand in the narrative. The chances of any one of those tweets or headlines picked up by the trading bots being genuinely factual are low to zero.

None of us know today how this situation in Ukraine is going to work out, either in the short term or the longer term (it would not be difficult for Russia to successfully invade Ukraine, but the degree of difficulty in making that a successful long-term project is of several magnitudes higher). What we can say today is that it is very unlikely that whatever happens is going to have a deep material impact on the constituents of the S&P 500 or the Nasdaq Composite. When markets gyrate the way they have been this week, the best thing to do is to sit back, resist the urge to get involved and, most importantly, don't panic.

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