Hot War with Russia

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Stock market corrections are a normal part of being an equity investor. Intra-year drawdowns typically average 5-15% and only last a few weeks or months. Roughly every 10 years though, a Black Swan event occurs where markets panic on unexpected doomsday news. Some examples of Black Swan events include Germany invading France in 1940, the savings and loan crisis of the 1980's, the tech bubble of the late 90's, the Great Financial Crisis (GFC) of 2008 and 2009, and COVID lockdowns in 2020. Black Swan events cause markets to drop much more significantly than a normal correction and last far longer. With history as a guide, every Black Swan on record has been an unbelievable buying opportunity for long term investors.

The market (S&P 500 Index) dropped 46% in less than a month during World War II but rallied 114% the following 4 years. The market dropped 35% in 1987 in a few days but rallied 50% within 8 months of the panic. The market dropped 50% during the tech crisis but rallied nearly 70% within 5 years. The GFC sent stocks down 60% in a few months with a 147% rally just 5 years later. One of the fastest drops and recoveries of all time were COVID lockdowns. Markets corrected 35% in a few short weeks, but the S&P 500 Index posted a 20% positive return for 2020. Trying to time these Black Swan events is impossible. Once in awhile a pundit gets it right, but plenty of math and data prove holding for the long run is far better a strategy compared with attempting to get in and get out.

Predicting the next Black Swan is even harder than timing the market but we'll do our best to take a stab at one potential issue that could cause significant short-term pain. Right now, the U.S. is in a proxy war with Russia by supplying the Ukraine with over $75 billion in humanitarian, financial and military support. It's possible we end up in an all out "hot" war with Russia as U.S. elections approach next year. As sad as it sounds, war can help the sitting President get re-elected. That's why President Xi tends to threaten Taiwan more heavily when he's up for election. When things are going poorly at home, politicians like to create conflicts and distractions abroad. War helped FDR, George W. Bush and could help Biden during an election cycle, a potential short-term risk for markets.

Long run, sadly war has also helped markets. While we don't advocate for it, war serves as a stimulus for the economy. Government spending on military not only boosts defense stocks, but technology, healthcare, and financials. In fact, famous banking dynasties have historically funded both sides of the same war, betting on the winners and the losers at the same time.

We expect markets to rally into the end of this year because earnings estimates keep revising upward. Earnings estimates for 2024 are $248 and at a 20 P/E ratio, we think the S&P 500 could reach 4,960 by year end. If we enter a hot war with Russia, don't be surprised if stocks drop 25% to the 3,700 point range, re-testing 2023's lows. Doom and gloomers will say the world is coming to an end and its time to buy gold, silver and canned food (their typical pitch). Our advice is don't take the bait. In the end, markets will trade on earnings just like every Black Swan event before. 2025 earnings estimates were $270 a month ago, were revised up to $273 a few weeks ago, revised up to $275 last week, and now revised up to $278 this week. With a 20 forward P/E ratio, we think the S&P 500 Index's fair value is 5,560 for 2025.

There will be plenty of bumpiness along the way, but over time, patient investors will be rewarded. Don't wait until the Black Swan hits to get invested. There are no guarantees in the stock market, and predictions are just that, predictions. Rather, we invest off statistical averages that show stocks compounding at a rate of 10% vs. 5.5% for bonds since the Great Depression. Stay invested in equities and use the Black Swans as buying opportunities for the long run.

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