TECHNICAL SCOOP
CHART OF THE WEEK

Charts and commentary by David Chapman
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WAR AND THE MARKETS

Wars tend to drive markets. If the war goes well (Gulf Wars 1 and 2, Kosovo), the markets tend to rally. If war is unexpected or appears to be going badly, markets tend to fall (start of WW1, Pearl Harbour). The 20th century has been called "a century of wars". That could apply to almost any century in history but the 20th century is estimated to have seen 160 million die in wars. That was the most ever. The global population was also at its highest and firepower at its most deadly, including the first (and so far only) use of an atomic bomb.

With the recent focus on the potential for a US military strike on Syria, there are questions as to how it could impact the markets. Until recently both gold and oil were rising, the US$ was rising and the broader markets were wobbly. As soon as the threat of imminent war abated, gold and oil fell, the US$ fell and the broader market rallied.

An examination of major past wars and how the markets responded might be interesting. I do not suggest that any new war would develop similarly, or that an attack on Syria could lead to a world war, although given that the US is on one side and Russia on the other, there is a risk of unexpected twists. In some respects it has become a US/Russia confrontation.

WW1

WW1 saw the Dow Jones Industrials go through a number of sharp ups and downs. Archduke Ferdinand of Austria was assassinated on June 28, 1914 and the stock market began a sharp decline shortly thereafter. On July 31, 1914, the NYSE was closed on a trading day for the first time since 1873. The fear was that the war (which began on July 28) could trigger a wave of selling from Europe and cause a stock market crash. Trading did not resume until December 15, 1914. The market fell further into the end of year.

With the US not involved directly at that point, it soon became evident that war was good for business and therefore good for the stock market. It started a rally in 1915 that eventually proved to be of historic proportions. The one big blip was the May 7, 1915 sinking of the *Lusitania* that sparked a brief but sharp sell-off. The market top came in November 1916.

In April 1917, the US entered the war, spooking the market. A sharp sell-off followed. By early 1918, the war was running in favour of the allies and the stock market started a rally that lasted until November 1919. A speculative inflationary boom got underway by February 1919 and it seemed almost inevitable that it would end badly. The Fed, as it often does, killed the boom by hiking interest rates.

The stock market followed a classic pattern of fear and greed during WW1. Fear of war and fear of disruptions sparked sell-offs, while the realization that war was good for business and the war shifting in favour of the allies helped spark rallies.

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WW2

The same template seemed to apply during WW2. War drums were beating by March 1939 as Britain and France said they would defend Poland if Nazi Germany invaded. Following an initial decline, the stock market recovered and topped out in September 1939 when Poland was invaded. With the US again not

directly involved in the war at first, the stock market managed to hang on until a series of negative events triggered a sharp sell-off.

The decline began in May 1940 when Germany successfully blitzed France, and on June 5, 1940 the Nazis marched into Paris. It was during this period that Britain had to undertake the Dunkirk evacuation. The stock market managed to recover but the recovery was feeble. The Battle of Britain got underway in August 1940 and as the war progressed in favour of Germany there was a long downward drift.

By the time of the Japanese attack on Pearl Harbour on December 7, 1941 the stock market was well established on its downward path. Pearl Harbour only exacerbated the situation. The market bottomed in late April 1942. On June 3, 1942, the US won the Battle of Midway and the tide was turning in favour of the allies. That sparked a huge rally that continued through the rest of the war, and the markets did not make their top until May 1946.

Once again the driver of the stock market was initially fear that the war was going badly or that the allies might lose. Once it appeared they were gaining the upper hand a sustained rally got underway.

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Vietnam

The Vietnam War was very different from the previous two. It was primarily the US that was involved, and North Vietnam could not be compared to Japan or Germany, two industrial powers that could match the military prowess of the allies. It also took place during the Cold War.

While the US started to enter Vietnam in a significant way in December 1961, the build-up was small compared to other wars. At the time it was largely a non-event as far as the stock market was concerned.

The market crash of 1962 was not caused by the war. In April 1962, the steel companies hiked prices and were confronted by President Kennedy. The confrontation shook Wall Street and there was a sharp sell-off. After bottoming in June, there was a rally that lasted until late August 1962. The Cuban missile crisis of October 1962 sparked another sell-off, but it proved short-lived and the stock market embarked on another long rally that lasted until 1966, briefly interrupted in November 1963 by two events: the overthrow of the government of South Vietnam and the assassination of President Kennedy.

Generally, during this period the Vietnam War had little effect on the stock market. The Gulf of Tonkin incident took place in August 1964 and all that happened was the market rallied further. War, after all, is good for business. The peak came in January 1966, and it was the Fed tightening in December 1965 that helped spark the sell-off. The Fed was trying to cool a market that many believed was overheating.

In July 1966, the war escalated when the US began a bombing campaign directly against Hanoi. This may have helped push the stock market lower before it bottomed in October 1966. The rebound that followed was feeble as taxes were hiked to help pay for the war, and then in February 1967 the US launched what was at that time its largest offensive. This steadied the stock market as the war was now creating uncertainty and there were concerns about its growing cost and the effect on inflation. The Six-Day War between Israel and the Arabs broke out in June 1967 but that caused barely a blip on the chart.

1968 was a volatile year politically but it did not stop the stock market from rising to new highs. In January the USS *Pueblo* was seized; there was the Tet offensive in late January; Martin Luther King was assassinated in April and Robert Kennedy in June. But by October there was talk of peace and that helped push the stock market to its highs in November 1968.

Once again it was Fed tightening that helped sink the stock market in 1969 and into 1970. The secret bombing of Cambodia and Laos started in March 1969. Since it was largely hidden from the public it was not a factor in the stock market drop of 1969-70. The market bottomed in May 1970, generally coinciding with the bankruptcy of Penn Central, an event that had nothing to do with the war.

The 1970s did see the Vietnam War escalate but it did not stop a major rally that got underway in May 1970 and did not top until January 1973. The bear market of 1973-74 was largely sparked by the Watergate scandal and the eventual impeachment and resignation of President Nixon. The OPEC oil crisis broke out in 1973 and that too played a role. The Vietnam War raged on in the background but sharply rising interest rates, the political maneuverings of the Nixon government, rising gold and oil prices, and a

major bank collapse (Franklin National) in October 1974 were bigger factors. In April 1975, the North Vietnamese army marched into Saigon and the war ended.

The Vietnam War was less of a factor for the stock market than WW1 or WW2. However, it contributed considerably to the inflation that was unleashed in the 1970s and it set the course for a long period of budget deficits in the US. The US recorded deficits every year from 1961 until 1998, with the single exception of 1969, when a small surplus was recorded.

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If there is a lesson here, it is that a major war with events taking an unexpected or unknown course can cause the stock market to fall. But war is good for business, and when the tide turns in favour of the US the market tends to rally. As noted earlier, the wars of the past two decades have not been major. There was rarely any doubt as to the outcome of the Gulf Wars or the war of Kosovo. As a result, war has not played a major role in the direction of the stock market for quite some time. What might be different this time is that the conflict in Syria has resulted in a confrontation between Russia and the US. That could at some point bring an element of the unknown and the unexpected to the stock markets.

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