While rate cuts by the Federal Reserve look likely to be delayed, CIO expects policy easing this year to support equity markets along with healthy earnings growth. (UBS)

How can investors deal with geopolitical risks?

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Geopolitical risks have come back into focus for investors after an exchange of strikes between Iran and Israel.

Fears of a further escalation of the conflict have contributed to a risk-off move in markets. But international crises tend to have only a brief impact on markets, so we caution against exiting stocks. Instead, we favor alternative strategies to improve the resilience of portfolios, while enabling investors to participate in market rebounds.

International conflicts and election uncertainties have been adding to volatility.

- An exchange of airstrikes between Israel and Iran has added to concerns that a cycle of retaliation could lead to a direct confrontation and draw in other nations.
- The war between Russia and Ukraine is now in its third year, and has the potential to add to market nervousness.
- Investors are awaiting the outcome of November's US election, which could lead to shifts in regulation and trade policy.

But we advise investors against exiting risk assets in response to this uncertainty.

- Our base case remains that the Middle East conflict stops short of a major escalation that disrupts oil supplies.
- Historically, the effect of international conflicts on market has tended to be short-lived.
- While rate cuts by the Federal Reserve look likely to be delayed, we expect policy easing this year to support equity markets along with healthy earnings growth.

So, we favor strategies to improve the resilience of portfolios, as we await market rebounds.

- Adding allocations to Brent crude oil can help protect portfolios against a deterioration in the Middle East. Gold also retains its value as a safe haven asset.
- Structured strategies can enable investors to retain exposure to further potential gains in stocks, while reducing sensitivity to a correction. Macro hedge funds are well-placed to help investors navigate geopolitical shifts, in our view.

Did you know?

- The effects of international conflicts on markets typically fades fast. Since the attack on Pearl Harbor in 1941, the S&P 500 has been higher two-thirds of the time, 12 months after the start of a crisis. Half the time, markets have only taken a month to recover, according to our analysis.
- 2024 is a record year for elections, with more than 2 billion people set to go to the polls in over 50 countries.

Investment view

Although market shocks from war and geopolitical crises tend to have temporary effects on long-term market growth, investors are often inclined to sell because of immediate uncertainty, hoping to reinvest in the market after the crisis has passed. Selling is counterproductive, locking in otherwise temporary losses and degrading your ability to participate in the next market recovery. Instead, we favor adding hedges. Structured strategies and an allocation to macro hedge funds can also help navigate geopolitical risks.

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