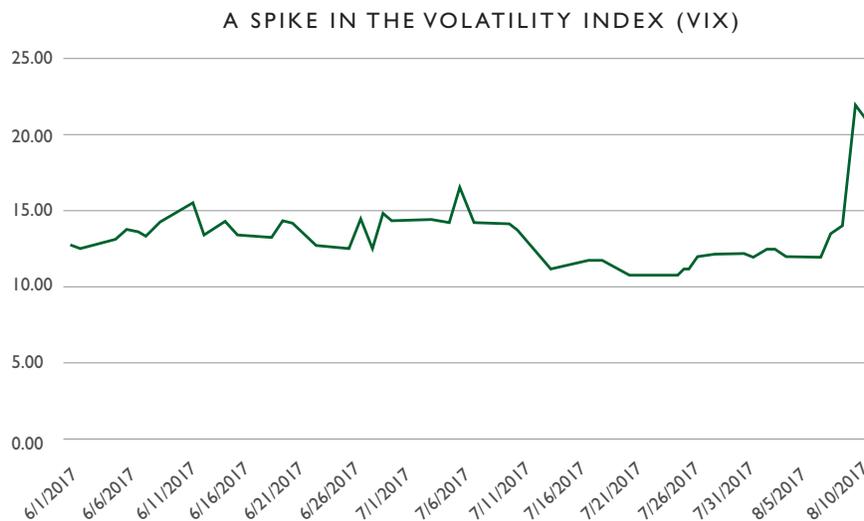


# North Korea: Market Grey Swan or Tempest in a Teapot?

## WHAT IS HAPPENING?

In response to U.S. defence official documents, which state that North Korea has the capability to miniaturise a nuclear weapon and place it on one of its missiles, U.S. President, Donald Trump, issued an ultimatum for North Korea to reduce its testing or “face fire and fury like the world has never seen.” North Korean leader, Kim Jong-un, retaliated by threatening a strike on Guam, a U.S. Pacific territory and a major American military base. Inflammatory news headlines aside, there are few signs that the U.S. is planning a first strike on North Korea or that Kim will make good on threats to hit Guam.

Still, the antagonistic exchange between the two leaders appeared like a market grey swan (a known risk that’s always lurked in the background) causing uncertainty. Market volatility, which was already on the rise in June, increased dramatically last week. The broad-based S&P500 Index fell 1.4% on August 10, the largest downward move of the year, while Canadian stocks had their biggest weekly decline since June.



Source: Morningstar Direct

VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. A higher number represents greater anxiety in the markets.

## WHAT DOES IT MEAN TO YOUR PORTFOLIO?

There are three main news cycles that generate interest among investors: corporate, political, and geopolitical.

With the winding down of earnings season, and the U.S. Congress on vacation until September, it's the geopolitical news that's dominating headlines.

Economically, the greatest concern out of the current news cycle is for South Korea, which accounts for nearly 2% of the world's economy and is home to companies such as Samsung Group and Hyundai Motor Company. A drop in business activity due to a war will have a terrible human cost and will affect growth in regional and global markets, negatively impacting equity markets. However, we do not expect war to breakout in the region. We recommend investors exercise patience and stay calm rather than get caught up in the headlines.

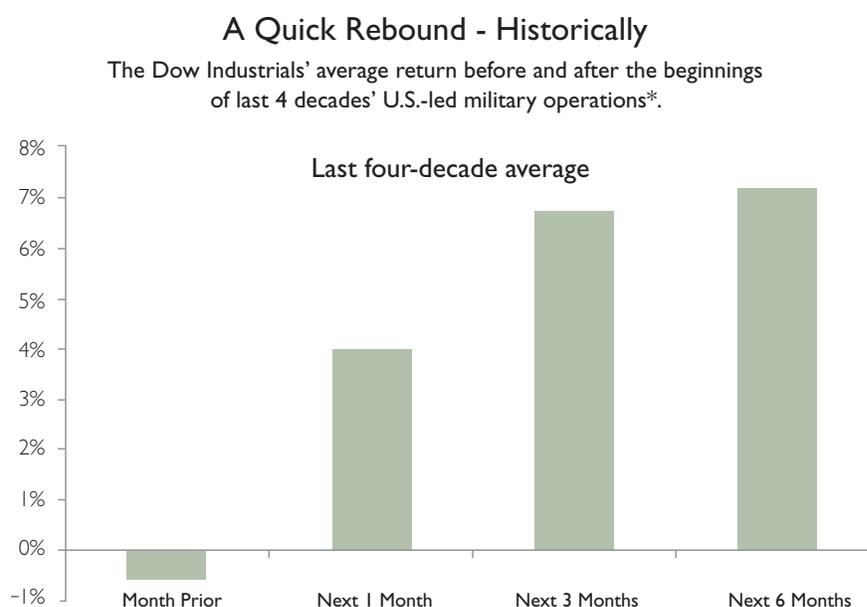
Much like we've seen with many other geo-political events, hopefully the volatility triggered by this news cycle will be short-lived. We expect to see a flight to safe haven assets such as fixed income, the U.S. dollar and the Swiss franc. We also expect price increases in commodities such as oil, as conflict concerns usually translate into higher demand for resources.

## WHAT ARE WE DOING?

For now, we continue to stick to our disciplined investment strategy. Our portfolios are structured with a balance of fixed income and equity exposure to help minimize risk. It's at times like these that we are grateful for the fixed income exposure, which can act as a shock absorber to a short-term downturn in equity markets.

The fundamentals of the global economy are good. Corporate earnings and revenues are strong. Monetary policy is still accommodative despite rate increases in North America. The breadth of the market is still strong at 68% advancers, but we are likely overdue for a short-term correction.

Historically, as the chart here suggests, markets have reacted strongly in the wake of American-led military operations, should one occur.



\*Grenada (1983); Panama (1989); First Gulf War (1991); Kosovo (1999); Afghanistan (2001); Second Gulf War (2003); Libya (2011)

We will continue to see rumours and troubling headlines circulate over the next few weeks. This may cause even more volatility. The next headline could point to problems in Venezuela, Iran, Russia, Syria, or even in the U.S., as they start to focus on the debt ceiling. We consider this normal and we've been through it many times over the last few years.

Along with the investment specialists for your portfolio, we are keeping an eye on the news cycle, but we will stay above the noise and not be distracted by it.

As part of our process, we are reviewing the portfolios for opportunities to rebalance (buy low, sell high) or to adjust our U.S. dollar hedge positions. We also have specific strategies in place for our portfolios that allow our investment specialists to preserve capital by switching out of volatile market sectors during periods of market stress. Our goal is to mitigate the risks in your portfolio as we help you achieve your return expectation.

By and large, we believe what we are seeing today is simply sabre rattling between the U.S. and North Korea, and will unlikely result in any meaningful deterioration in the global growth picture. This could well be just a tempest in a teapot and will soon pass.

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**If you would like the opportunity to review your investment strategy and goals, please give us a call.**



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