Market Memo

Research and Insights

Principles for Navigating Markets During War

When headlines are dominated by geopolitical strife and the roar of military aggression, the instinctive human response is one of caution and withdrawal. There exists a profound psychological chasm between the human tragedy of war and the cold, nonlinear economic transmission of capital markets. To the casual observer, a global crisis suggests an impending collapse of wealth. However, as a financial historian, I look to the data: since World War II, the S&P 500 has posted positive returns one year after an act of military aggression in 73% of cases. To navigate these regime shifts, one must move past the immediate chaos to understand the discounting mechanism of markets. By examining a century of conflict—from the trenches of 1914 to the current 2026 Iran-Middle East war—we can distill the principles that govern how alpha is captured when the world feels most fragile.

The “May 1942” Phenomenon: Why Stocks Bottom Before the Good News

The most counterintuitive reality of wartime investing is that equity markets rarely wait for a ceasefire to begin their recovery. Financial historian Barton Biggs famously demonstrated that the U.S. market hit its “point of maximum bearishness” and bottomed in May 1942. This was before the Battle of Midway—well before any general or intelligence officer could confirm the tide had turned. Conversely, the Berlin stock market, analyzed by Niall Ferguson, sensed that Germany’s military momentum had crested by late fall 1941, initiating a decline long before the public recognized the impending defeat.

The market is a predictive machine that prices the range of possible outcomes rather than casualties. LPL Research data confirms this rapid discounting: on average, the S&P 500 falls approximately 1.1% on Day 1 of a conflict, bottoms at a drawdown of -4.7% within 19 days, and achieves a full recovery within just 41 days. The news doesn’t have to be good, it just has to be less bad than what has already been discounted in prices. Investors sell when the scope of a conflict is unknown; they buy once that damage becomes quantifiable. The market bottoms not when the news is “good,” but when the rate of negative surprise peaks.

The Broken Safety Net: When Treasuries Fail the Test

For decades, the “flight-to-safety” playbook was simple: when the drums of war beat, buy Treasuries. However, the 2026 Iran conflict has exposed a “stagflationary oil dilemma” that renders this strategy obsolete in energy-driven crises. As missiles threatened the Strait of Hormuz—a chokepoint for 20% of global oil—the traditional safety bid for bonds evaporated. Instead of falling, yields rose sharply. The 10-year Treasury yield climbed to 4.09%, while the 2-

year yield jumped 12 basis points to 3.59%. This occurred because crude prices embedded an $18-per-barrel risk premium, equivalent to a six-week halt of Hormuz flows. When war spikes energy costs, the fear of inflation and a hawkish Fed response overwhelms the desire for safety, turning bonds from a hedge into a liability.

Gold's Secret Vulnerability: The De-escalation Trap

Gold remains a timeless crisis hedge, a status confirmed in 2026 as spot prices blasted past $5,400 per ounce. Historically, gold averages an 8.98% return over the 12 months following a major conflict. Yet, for the strategist, gold carries a specific vulnerability: it is a bet on the duration of a crisis and the presence of negative real interest rates, rather than a generic bet on "bad news." This was evidenced during "Operation Rising Lion" in 2025. As the conflict moved toward a rapid, decisive resolution, the "geopolitical premium" evaporated faster than physical demand could support, causing gold to fall 3.17%. Gold compounds dramatically during protracted, inflationary conflicts, but it can trap those who buy at the peak of a short-lived escalation.

The Inevitable Tax: War's Long Shadow on Inflation

Inflation has increased during or immediately after every major U.S. conflict since WWII. The method a nation chooses to finance its combat determines whether the economic damage is a temporary setback or a structural crisis.

Financing Method	Short-Term Effect	Long-Term Risk	Historical Example
Taxation	Consumption decline	Faster recovery, lower inflation	Korean War (1950 Revenue Act)
Debt Issuance	Stimulative short-term	Higher yields, fiscal crowding out	WWII, Iraq/Afghanistan
Monetary Expansion	Inflationary boom	Stagflation risk	Vietnam War
Deficit + Tax Cuts	Maximum stimulus	Structural fiscal crisis	Iraq/Afghanistan (First wartime tax cut)

While the Korean War's use of the 1950 Revenue Act led to a short 1954 recession, it preserved long-term stability. In contrast, the Vietnam-era reliance on monetary expansion set the stage for the persistent stagflation of the 1970s.

The 100% Success Rate: The Swiss Franc's Unique Status

While the U.S. dollar is often perceived as the ultimate haven, its performance is inconsistent. The DXY index fell 5.5% in the year following the 2024 Iran-Israel escalation. The Swiss franc, however, stands alone as the only currency to have appreciated against the dollar in every major analyzed conflict from World War I through 2025. Averaging monthly gains of 0.85% during conflict periods, the franc benefits from Switzerland's political neutrality and a financial system that remains uncorrelated with the shifting monetary policies of the major reserve-currency nations.

The “Buy the Rumor” Trap in Defense Stocks

Investors often flock to defense contractors once the shooting starts, but the “easy money” is usually captured during the pre-war escalation phase. Defense stocks exhibit a classic “buy the rumor, sell the news” behavior, often decoupling from the broader market before a headline breaks. The reliable “tipping point” for this sector occurs when defense stock correlations to the broader market drop below 0.3 while their absolute performance simultaneously accelerates. If an investor waits until missiles are in the air to buy into the sector, they are often purchasing at a peak where the anticipated contracts are already fully priced into the equity.

Conclusion: Looking Past the Horizon

The historical record suggests that while geopolitical crises are humanitarian disasters, their financial impacts are frequently shorter-lived than the public expects. The most actionable principle for any strategist is that the market bottom invariably precedes the military turn. Equities find their floor when the news is maximally bad but no longer worsening—the peak of the rate of negative surprise. As we look toward the next decade of wealth, we must ask: how is the current global landscape being financed? Are we repeating the “monetary expansion” of the Vietnam era, or the “deficit and tax cuts” of the early 2000s? The answer to that question will determine whether the coming years bring a post-war boom or a decade of structural stagflation.

All my best,

Footnote & Disclosures

This framework draws upon the principles outlined by Ray Dalio, founder of Bridgewater Associates, in his extensive study of debt crises.

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