InvestmentNews

Sections

North Korea: How should advisers react?

Saber rattling is cause for concern, but advisers are not making wholesale moves in client portfolios

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By **John Waggoner**

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If the events in North Korea go terribly wrong, it won't matter whether your clients buy or sell stocks. Should the world avoid global thermonuclear war, however, Korea could have big, short-term effects on your clients' portfolio — and you should consider what they will be, and how to manage them.

The Dow Jones industrial average fell 204.69 points, or 0.93%, on Thursday, thanks to increasingly bellicose talk by **President Donald J. Trump** and North Korean leader Kim Jong Un. The stock market rebounded modestly Friday, but Wall Street continues to watch the situation warily.

At the very least, the Korean flare-up has encouraged investors to lighten up on their riskier assets and seek safety in Treasury securities.

"Among hard-hit industry-specific stock price indices were the 3.1% dive by the PHLX index of semiconductor shares, the 2.8% plummet by the KBW index of bank stock prices, and the 2.3%

slump by the PHLX index of housing-sector share prices," writes Moody's chief economist John Lonski.

The damage spread far beyond U.S. stocks. Emerging markets fell 1.19%, according to MSCI, while developed international stocks fell 0.54%. Spreads on high-yield corporate bonds vs. Treasuries widened. The yield on the 10-year Treasury note fell to 2.20% Thursday from 2.28% Tuesday.

And the markets had justification for being spooked, said Brad McMillan, chief investment officer for **Commonwealth Financial Network**. "You might not mind the older, quiet gentleman next door who shoots as a hobby," he wrote to clients. "But a neighbor who fires a gun through his front windows is much less acceptable. Whether North Korea is actually that crazy is debatable — but the U.S. cannot take the chance."

Mr. McMillan thinks that military action in the short term is unlikely, despite Mr. Trump's warning Friday that the U.S. is "locked and loaded" for a fight. A massive U.S. strike would take time to mount. Barring an actual nuclear strike on U.S. soil, initial economic damage to the U.S. would be limited.

That's overlooking, of course, the enormous danger **South Korea faces.** "Pyongyang may soon assume that it can now act more recklessly vis-à-vis South Korea at the conventional level and well short of a major attack because it can hypothetically counter the United States at the nuclear level," writes **Richard Bush of the Brookings Institute**. "The scenario I have in mind is one in which North Korea starts at a relatively low rung of the escalation ladder: sinking a South Korean naval vessel, bombarding South Korean-controlled islands in the West Sea, or creating trouble in the demilitarized zone. It has done all of these things in the last seven years but then backed off from further conflict. Once Pyongyang can target the continental United States, it will likely take bigger risks than it has to date."

And damage to world trade could be enormous. "South Korea, which would bear the brunt of the damage in any conflict, is a major trading and manufacturing hub," Mr McMillan writes. "As such, disruption there would break supply chains around the world. Depending on the degree of damage, that disruption could last for months or years. Beyond those effects, the radical rise in uncertainty would also affect financial markets, with investors backing off and de-risking, which could drive markets down even further. Clearly, there are real reasons to try to avoid a war."

Jeffrey Hirsch, editor of The Stock Trader's Almanac, thinks the current situation is most likely to play out much like another nuclear crisis that sent stocks tumbling. "If this goes on it seems like it would play out more like the Cuban Missile Crisis, since we are currently not at war and the market has been on a tear under a new president who won in a tight race like JFK," Mr. Hirsch writes. Stocks fell until the Soviets removed its missiles from Cuba.

What should you tell clients about the current situation?

"Any major event affects markets," said Carolyn McClanahan, founder and director of financial planning at Life Planning Partners. "Thankfully, we do a great job educating clients about how any adverse event will affect their portfolio long in advance, so when events like this happen, we do not get any calls. However, if the situation warrants, we write a newsletter sharing our thoughts. Right now, we do not plan to send one, as we don't like to stuff in-boxes with too much. We'll pay attention and I may write a piece over the weekend."

Justin Rush, founder of JGR Financial Solutions, said he has addressed the issue in client meetings in recent days, reminding clients that they have sufficient cash on hand for their short-term goals so they would not need to sell if a market downturn occurs.

"It's times like these I stress the importance of not making an emotional decision based on current events, and remaining invested long-term," Mr. Rush said.

Financial adviser JJ Burns said a few clients have reached out to inquire about investing possibilities.

"They want to know if there will there be an opportunity to add additional capital to the markets based on any weakness," he said.

Kashif Ahmed, president, of American Private Wealth, isn't buying the notion that North Korea is a problem, and isn't planning on reaching out to clients.

"The North Korea situation is a non-issue, blown out of proportion by the media as usual because every bit of news has to be sensational," he said. "It doesn't help that the leaders of both countries are taking bombast to the highest level. The North Korean leader may be homicidal, but he is not suicidal. And our wonderful system of checks and balances will also ensure something reckless is not done without much thought."

Jeff Benjamin and Liz Skinner contributed to this story.

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