

RISK EVENTS

TENSIONS WITH NORTH KOREA



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Founded in 2010, we now have global presence in over 90 countries, with main offices in the separately regulated markets of Australia, Cyprus, New Zealand and the United Kingdom.

We believe that sound investment and trading decisions begin with a strong grounding in financial education. Our goal is to make this available to everyone - and this free eBook is part of that commitment.

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DEALING WITH UNCERTAINTY

FOREWORD

Investors and traders spend most of their days analysing price charts and economic data. But what happens when the unexpected occurs? How can participants in the financial markets protect themselves?

Tensions with North Korea are currently dominating the world's news cycles. It's a classic example of a geopolitical event affecting the financial markets.

The purpose of this eBook is to explore the developing situation with North Korea - before outlining some common steps traders can take to limit their exposure to volatility. I'm sure you'll find it useful.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

WHY WORLD EVENTS MATTER

FAMILIARISE YOURSELF WITH GEOPOLITICS

There's a special category of global events that can have a sudden impact on the financial markets. These events include acts of terrorism, geopolitical tensions, shock election results or declarations of war.

Clearly, these events are typically difficult for traders to anticipate - and when they do occur, it can cause noticeable volatility in the financial markets.

Let's look at recent history for examples of these dynamics coming into play.

SEPTEMBER 11TH 2001

The tragic events of September 11th 2001 forced the US government and other counterparts to take drastic action to protect the global financial system.

This action included closing trading for major Stock Indexes around the world, such as the New York Stock Exchange and London Stock Exchange. Why was this necessary? Governments were concerned that the financial markets would crash, stemming from a panic selloff of equities by investors.

In hindsight, it was prudent action. When the New York Stock Exchange opened almost one week later (Monday 17th September 2001) - many airline and tourism companies saw their value sharply fall. The US dollar also lost ground against its major counterparts.

Investors started moving their capital into what are known as 'safe haven' assets. These are financial instruments that market investors tend to flock to in times of high volatility. Gold is one of the most popular safe haven assets. After the attacks of September 11th 2001, the value of Gold increased by 33%. The price of other commodities - such as Oil and Gas - also increased after the attacks.

THE PARIS ATTACKS, NOVEMBER 2015

More recently, the world witnessed another horrific terrorist attack in mainland Europe. On Friday 13th November 2015, Paris was hit with a series of coordinated terrorist attacks that resulted in 130 people losing their lives.

The reaction of the financial markets to this event again hit travel and tourism stocks. The euro also fell to a six month low against the US dollar.

THE COMMON THREAD

By studying recent history, we can see that the financial markets are incredibly sensitive to this category of risk events. Panic and uncertainty can spread through the financial markets quickly.

That's why it's extremely important to monitor the current situation with North Korea. This is a geopolitical event that has the potential to cause significant volatility. In the next section, we'll analyse the current situation and outline steps you can take to protect yourself.

NORTH KOREA: A COMPLEX PROBLEM

NUCLEAR AMBITIONS

For the past two decades, North Korea has been classed as a rogue state by the majority of developed Western countries.

Currently, the country is ruled by a dictatorship - and there are strict censorship controls in place to keep the current ruling structure in place.

While these issues are of a concern to the United Nations, the issue that is causing most unrest is North Korea's nuclear weapons programme. For many years, the international community had used a combination of diplomacy and economic sanctions to encourage North Korea to abandon its nuclear weapon ambitions.

However, in recent years, it's widely accepted that North Korea has made progress in developing nuclear weapons that could be used on ballistic missiles. This is of particular concern to South Korea, Japan and the United States of America - all of whom have

territories close to the Korean peninsula.

In 2017, tensions with North Korea have increased further. Under the instruction of Supreme Leader, Kim Jong Un, the state has undertaken a series of provocative weapons tests. The most recent (at the time of writing in September 2017) is thought to be a thermonuclear detonation underground. Estimates suggest that this weapon was between 50 kilotonnes to 120 kilotonnes - meaning that North Korea has made substantial progress with its nuclear weapons programme.

POTENTIAL IMPACT ON FINANCIAL MARKETS

The role of the United States is pivotal to the potential impact on the world's financial markets. As the world's only superpower, it's broadly accepted that any military solution to North Korea would require US armed forces.

However, military action could have devastating consequences for the Korean peninsula. North Korea certainly has the weapons arsenal to cause significant damage to South Korea and other territories in close proximity.

So military action at this moment in time is unlikely.

However, this hasn't stopped strong rhetoric from both the United States and North Korea about using military force. So far, this is the phenomenon that has caused volatility in the financial markets. Let's look at a recent example.

On August 9th 2017, US President Donald Trump stated that

North Korea would be subject to ‘fire and fury like the world has never seen’ if it continued to threaten the United States.

This comment caused a noticeable move in the financial markets. Specifically, we saw investors shift their capital to safe haven currencies - including the Swiss franc (which gained over 1% on the US dollar after President Trump’s statement) and the Japanese Yen. Investors also moved to other safe haven assets - including Gold.

Clearly, the words of world leaders are going to be key to trading through any geopolitical tensions. Therefore, considering the current situation, we believe it is reasonable to expect more volatility in the US dollar as its standoff with North Korea develops.

To protect your exposure to these volatile moves, you should closely monitor the news in the coming weeks and months. In particular, you will want to ensure you have a solid risk management strategy in place, as this will limit your losses should the markets move against you.

Furthermore, you might want to consider trading safe haven assets as this situation plays out. The US dollar is facing downward pressure from domestic issues too - so moving your trades to a more stable asset is a viable option if you are risk averse.



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