

Commentary

Major Escalation in the Middle East Adds Fresh Uncertainty for Markets

- Military escalation involving the U.S., Israel, and Iran has increased geopolitical risk and energy market volatility.
- Oil prices have moved higher, but broader financial conditions remain orderly.
- While uncertainty has increased, markets are not exhibiting signs of systemic stress.

While our analysis focuses on markets, we recognize that these events affect the lives of many people in the region. We approach this update with that awareness as we discuss the potential economic implications.

Recent coordinated military actions by the United States and Israel against Iranian targets have significantly escalated tensions in the Middle East. Reports indicate that Iran's political leadership has been materially disrupted, representing a meaningful shift in the region's power dynamics and introducing elevated geopolitical uncertainty.

In response, Iran has launched attacks against Israeli targets and U.S. military assets across the region. Disruptions to regional air traffic and heightened diplomatic responses underscore the expanding scope of the conflict. As with most geopolitical events, the situation remains fluid, and headlines are likely to evolve rapidly.

For investors, the key question is not the headlines themselves, but how these developments may transmit through markets, the economy, and investment portfolios.

Geopolitical Risk Adds to an Already Uncertain Backdrop

Events in the Middle East are occurring against a backdrop of existing market challenges:

- Elevated equity valuations leave less margin for investor disappointment.
- Investor enthusiasm around artificial intelligence had already begun to moderate as profitability timelines were being reassessed.
- Inflation progress has been uneven, complicating central bank policy paths.
- Labor market data has shown signs of gradual cooling, pointing to slower economic momentum.

Why Markets Are Likely to Avoid a Disorderly Selloff

Despite the severity of this geopolitical escalation, global equity markets should not experience a sharp or disorderly selloff. Several structural factors help explain this resilience:

- **Ample liquidity remains on the sidelines.** Higher interest rates over the past several years have left investors holding a record \$26 trillion of cash and money market assets. This sideline capital can act as a stabilizer during periods of volatility rather than exacerbating downside moves.
- **Financial conditions remain stable.** Markets are functioning normally, and there are no signs of stress in lending, liquidity, or the financial system that would typically accompany a broader market disruption.
- **Corporate fundamentals remain supportive.** For most companies, earnings and profit margins are solid, giving markets an underlying cushion even as headlines change quickly. That helps reduce the odds that volatility turns into broad, forced selling.

Historically, sharp market drawdowns are typically associated with forced deleveraging, credit stress, or systemic liquidity events. We do not believe those conditions exist at this time.

Watching Potential Economic Implications

Oil prices have been trending higher this year alongside an increased U.S. military presence in the Middle East, reflecting rising geopolitical risk well before this weekend's events. The primary market concern remains the potential disruption of shipping through the Strait of Hormuz, a critical artery for global energy flows (an estimated one-fifth of global oil moves through it). While reports of limited shipping delays and rerouting have emerged, the ultimate impact on supply will depend on whether tensions persist and disruptions become more sustained. The attack on Iran likely incapacitated its navy, so the threat of a blocked Strait of Hormuz has been greatly reduced. In fact, on Sunday evening Iranian leadership said they do not have plans to disrupt navigation in the region at this time.

Generally, oil prices react first to fear and headlines, then recalibrate to fundamentals. Oil price moves historically are driven by what could happen, not what has happened. As such, expect a short-term bounce in oil prices as shipments remain suspended in the region. If oil prices remain elevated for an extended period, macroeconomic effects could emerge including the following:

- Energy-related inflation pressures could reaccelerate, particularly in transportation and services.
- Higher fuel costs may weigh on consumer spending.
- Central banks could face additional constraints to easing monetary policy.
- Global growth expectations may be revised lower, especially for energy-importing economies.

That said, the U.S. economy is structurally more energy-resilient than in past cycles, supported by domestic production and diversified supply chains, and OPEC+ has just announced modest increases in production to help keep oil prices in check.

Investment Perspective: Discipline Over Reaction

The recent escalation in the Middle East has moved geopolitical risk back to the forefront of market attention and contributed to renewed market jitters. Periods of geopolitical stress often test investor resolve. History suggests that disciplined and diversified portfolios are better positioned to navigate these environments than reactive strategies.

- **Diversification remains critical.** Geopolitical events affect asset classes and sectors unevenly, reinforcing the value of balanced exposure across equities, fixed income, and other assets.
- **Maintain a long-term focus.** Markets have historically absorbed wars, policy shocks, and geopolitical crises. Long-term outcomes are driven more by earnings growth, productivity, and innovation than by short-term headlines.
- **Avoid emotional decision-making.** Rapid shifts in sentiment often lead to poor timing decisions that detract from long-term results.

Our team continues to monitor developments closely and remains focused on fundamentals rather than headlines. As always, investors should avoid being distracted by short-term swings and work with their financial professional to determine strategies aligned with their goals and risk tolerance.

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