Iran conflict and related risks

Campbell Alexander Financial Management Ltd
Personal and Corporate Financial Planning

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Key Points

1. US & Israeli strikes on Iran are a targeted threat to the regime
2. Iran is maximising its retaliation
3. The conflict's duration determines its impact

A bloody start to the year

The beginning of the year saw pro-regime change protestors being brutally and lethally crushed. Trump threatened Iran with intervention if the crackdown didn't stop leading to an uneasy truce. US-Iran negotiations around Iran's nuclear programme then recommenced.

The Strait of Hormuz closure would mirror the 1973 oil shock.

Negotiations over what?

We saw discussions around the nuclear programme as a potential off-ramp. Talks were really about muting Iran's nuclear intentions: and efforts by US (and Israel) to contain Iran, and open a pathway to an alternative, less bloody, regime. The embattled regime has little leverage. Less popular at home, with an economy that has all but collapsed following systematic targeting of capital flows by US sanctions. Iran has also seen its regional proxies weakened following systematic targeting by their adversaries.

Send in the Navy

Following a massive build-up of US forces in the Gulf, consisting of two carrier strike groups that can project massive firepower, on 20th February Trump gave Iran a 10-15 day ultimatum to come to the negotiating table to discuss its nuclear programme - or else "bad things" would happen.

We are currently on a worse case path with no clear timeline on when the conflict could stop or US objectives achieved.

Not just for show

Following the assertive Venezuala intervention at the start of this year, the US build up is not merely a show of force or posturing: it is providing Trump with military options. And regional actors now know there is a willingness and ability to act if necessary. On the night of 28th February, that action began.

Iran's retaliatory actions

For the Iranian regime, this is an existential threat, with a growing risk that Iran could react unpredictably following a strike that killed the Ayatollah and his family. Iran's retaliation thus far has been to launch rocket and drone attacks at Israel, retaliate against US military bases hosted by Gulf allies in the region, and disrupt shipping in the Strait of Hormuz (which is also its own economic lifeline for oil sales to China). In each case, Iran is looking to maximise the cost of US military action to its military, its allies and the global economy.

Iran's retaliation, is designed to maximise the cost of US military action to its allies and the global economy.

Continued escalation

This widening of the conflict (with a Sunni/Shia subtext) is the broadening escalation that was feared as it 1) creates an open-ended scenario, 2) is existential leading to Iran to take high-risk/maximialist impact actions, and 3) there is growing risk of unintended consequences as falling debris from missile interceptions cause damage to civilian areas in non-belligerent states (such as the UAE where both the civilian airport and hotels have been struck or damaged by falling debris).

The longer the conflict persists, the more elevated the oil price and the greater the risk to inflation and economic growth.

Duration of the conflict

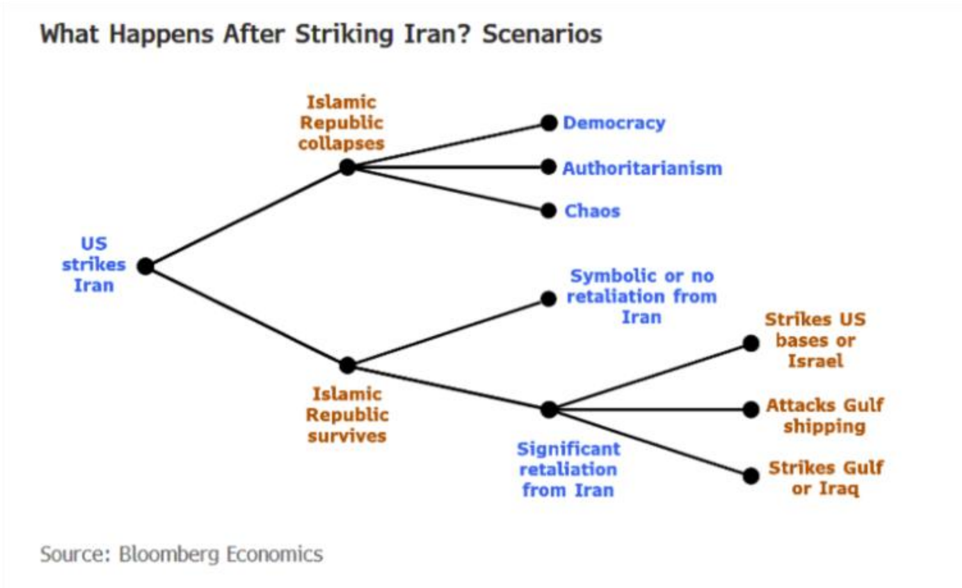
The conflict is a tragedy for the region and its duration will determine the extent of disruption. The longer the conflict persists, the more elevated the oil price, the greater the risk to inflation and economic growth.

Why the Strait of Hormuz is so important

About 20 million barrels per day – some 25% of global production – passes through the Strait each day. A shutdown owing to military action and a risk to shipping, or an Iranian blockade would be similar to the 1973 oil blockade in terms of impact. Back then, a severe oil spike exacerbated inflation, and even pushed some economies into recession. A closure of the Strait is a materially negative scenario for global growth.

Potential paths

The chart below outlines a high-level set of potential paths that the events could have potentially taken - we are currently on a worse case path with no clear timeline as to when the conflict could stop or the US objectives of regime change (without ground troops) could be achieved. The domestic pressure remains the US mid-term elections in November 2026. Trump had promised an end to the "forever wars" of his predecessors, but has just started one against a major adversary.



What it means for markets

Near-term: A military conflict in the Gulf leads to a spike in the oil price, so direct Energy exposure as part of a diversified assets mix has helped act as a form of portfolio insurance, particularly now that Gold so volatile it is behaving more a risk asset than a protection assets at the moment.

Medium-term: Depending on the duration of the conflict and any disruption to the Strait of Hormuz – this could require a reassessment of assumption on 1) inflation and 2) global growth. The US-Iran proxy war has been fought for years. By turning "hot," it makes the world a far more dangerous place.

Building in portfolio resilience

For asset allocators, the question is how to ensure portfolio resilience going into this shock. We took the view earlier this year that to mitigate the risk of a broadening conflict in the Gulf, we would revisit the traditional "geopolitical shock absorbers".

In our Investment Committee discussions, we have been focusing on

1. Sizing the Equity allocation to adapt to changing risk posture
2. Build in resilience by using a global diversified assets fund which includes allocations to Copper, Oil and Gold (or "COGs" - see below
3. Reappraising outlook for inflation and global growth depending on how long the conflict lasts

Introducing the "COGs" within diversified assets

The risk of a protracted conflict in the Gulf is that sustained energy prices lead to a reacceleration of US/UK inflation which could negatively impact growth. How best to protect against that? The best way to ensure portfolio resilience in our view is to include diversified assets in a portfolio allocation. Diversified assets are those alternative assets that are not equities, bonds or cash.

Of particular interest within the diversified assets space are the "COGs"

- **Copper:** long-term structural demand from the AI revolution for chip and electronics manufacturing as well as broader infrastructure formation.
- **Oil:** short-term protection against geopolitical risks in the Middle East in an increasingly fragmented world, for inflation-hedging purposes
- **Gold:** medium-term protection against the so-called "debasement trade," with growing concerns around the value of fiat money given 1) debt affordability and 2) persistent, moderating but vulnerable inflation measures.

These COGs can be readily bought and sold using Exchange Traded Commodities (ETCs). Whilst platforms cannot easily trade ETCs, a diversified asset funds can do so easily and rapidly if needs be.

By introducing diversified assets in general, and "COGs" in particular into a traditional equity/bond portfolio, it is possible to increase portfolio resilience with assets that can act as shock absorbers whilst also being diversifiers owing to their uncorrelated behaviour.

Getting in touch

If you would like to find out more or discuss any of the above, please contact your financial adviser.

Contact us

For more information, please contact your financial adviser.

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