

The Middle East Conflict: How Wars Impact Investors

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The conflict between Israel and Iran has captured global attention and created uncertainty in financial markets. Israeli strikes on Iranian nuclear facilities and military targets began on June 13 and quickly led to retaliatory attacks. While the situation is still evolving and can change quickly, there are now reports that Iran would be open to ending hostilities and resuming talks over its nuclear programs. This is occurring even as the Israel-Gaza war rages on, and regional conflicts continue in other parts of the world.

While the humanitarian consequences are the most important consideration, it's also necessary for investors to understand how such events impact markets. Perhaps the biggest concern among investors is whether events like these could escalate into full-scale global wars. While this is always possible, recent history does not point in this direction. Instead, even serious conflicts, including Russia's invasion of Ukraine and Hamas's attack on Israel, remained contained, leading only to short-term stock market volatility.

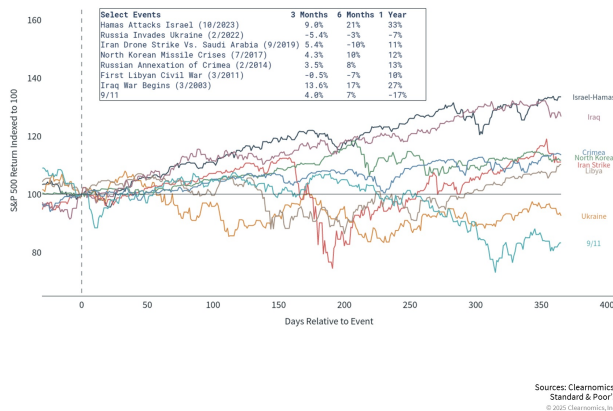
This is not to diminish the severity of these conflicts, but to remind ourselves that overreacting to these events with our portfolios can be counterproductive. In times like these, it's more important than ever to maintain perspective and focus on the lessons of history and long-term market trends. What should investors focus on in this environment to stay disciplined in these markets?

Middle East tensions have escalated

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Geopolitical Events and Stocks

Historical events and S&P 500 price returns 3, 6, and 12 months after



The latest developments mark an escalation between Israel and Iran. Israeli forces targeted Iranian nuclear sites and military leadership, with reports indicating damage to uranium conversion facilities. In turn, Iran has responded with missile and drone attacks, with some reaching Israeli territory. The conflict has also damaged critical infrastructure on both sides, including natural gas facilities and oil refineries.

At the risk of oversimplifying, historians tend to view every event as unique, with its own narrative, causes, and consequences. Economists, on the other hand, tend to look for patterns and

similarities between events to draw broad conclusions. As investors, both perspectives are important in order to understand what lessons do and do not apply. After all, a common saying is that history doesn't repeat itself, but it often rhymes.

The accompanying chart provides some historical perspective around geopolitical events over the past 25 years. This includes conflicts in the Middle East that impacted oil prices, such as the Iranian drone strikes against Saudi Arabia in 2019. These periods show that while there can be market swings in the short term, markets have typically recovered from geopolitical shocks, often within weeks or months of the initial event. What mattered more during these periods were the underlying business cycle trends.

Oil prices have been volatile

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Global Oil Prices

WTI and Brent Crude



In the short run, oil prices can act as a transmission mechanism by which regional conflicts impact the rest of the world. The immediate market reaction to the latest conflict focused on energy markets, with Brent crude futures rising above \$74 per barrel. Oil prices remain volatile but fell back toward \$70 per barrel on a possible de-escalation.

Oil prices affect the global economy since they are still a significant input into all products and services. Higher oil prices lead to more expensive gasoline and transportation costs, raising prices for everyday consumers and businesses. This is compounded by the possible closure of

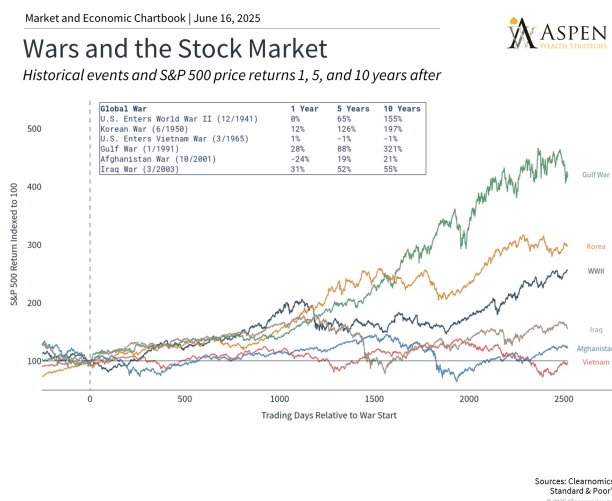
important shipping lanes, including the Strait of Hormuz in the Persian Gulf. This strait is a critical

waterway through which approximately one-third of the world's oil supply passes.

Still, it's important to maintain perspective on current oil price levels. While recent swings are notable, prices remain well below the peaks reached in 2022 during the early stages of the Russia-Ukraine conflict, when oil exceeded \$120 per barrel. The current price level around \$70 is within the range experienced over the past few years. Just this year alone, oil prices have fluctuated between \$60 and \$82 per barrel.

It's also important to note that the U.S. has grown increasingly energy independent over the past two decades. American oil production now exceeds 13.5 million barrels per day. Some may find it surprising that the U.S. is the world's largest producer of both oil and natural gas. While the U.S. still requires foreign oil and is sensitive to global oil prices, the fact that there is a significant domestic supply helps to insulate the U.S. economy and financial markets.

The impact of wars on portfolios depends on business cycles



For investors worried about escalating conflicts around the world, zooming out can help provide perspective. From World War II to the Iraq War, markets may have reacted to these conflicts in the short run, but were driven by investment fundamentals in the long run.

For example, World War II jump-started industrial production after the Great Depression, and led to a significant shift in the labor market with women entering the workforce. These factors helped propel the economy through the rest of the century. Similarly, the Gulf War affected oil prices, but also coincided with the Information Technology revolution of the 1990s. In

contrast, the decade following the Vietnam War coincided with high oil prices and stagflation, resulting in poor market performance.

Again, none of this is to trivialize the humanitarian and societal consequences of these wars. For the current situation, much will depend on whether the conflict expands further or begins to de-escalate. The involvement of major powers and threats to critical supply routes add complexity, but history suggests that even significant regional conflicts tend to have limited long-term impact on global financial markets.

The bottom line? While Middle East tensions have created short-term market volatility, investors should maintain perspective and avoid overreacting to headlines. A portfolio aligned with long-term financial goals remains the best approach for navigating periods of geopolitical uncertainty.

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