

Global equity markets have seen increased volatility as the war in Iran has prompted regional contagion. A consequent surge in oil prices has lifted concerns that cost-of-energy flow-through will lift going-forward inflation; the rise in interest rates that has come as a result has pressured bond markets. But the Iran war is only the latest source of market worry:

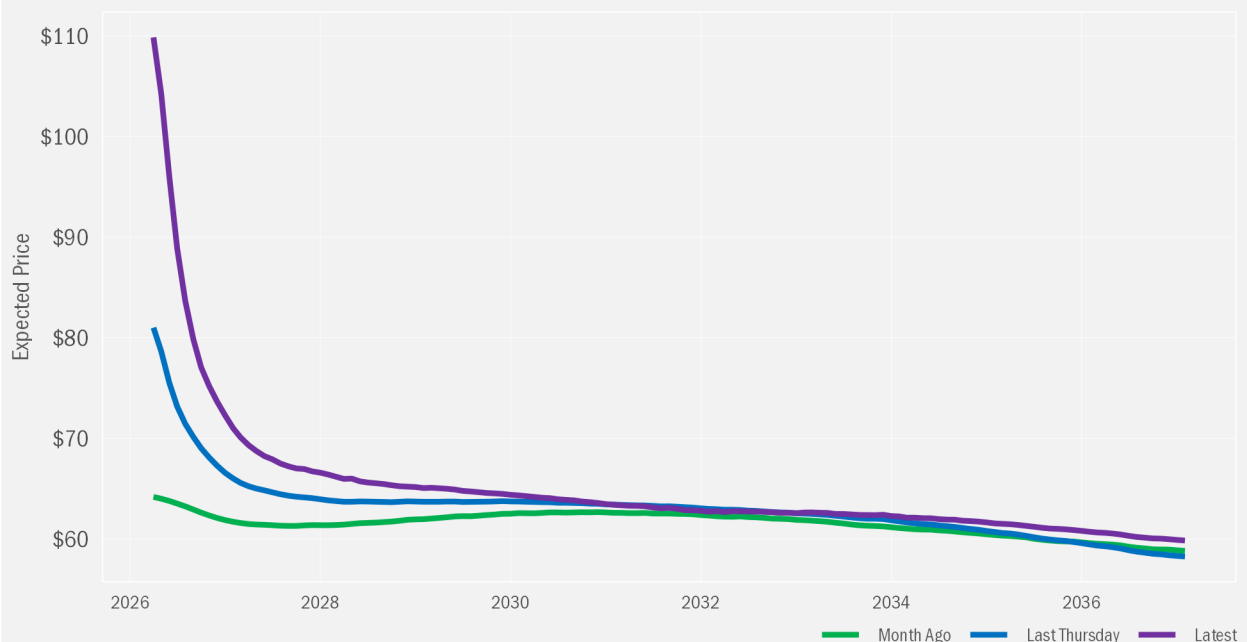
- Investors have reacted (in our opinion far too injudiciously) in knee-jerk fashion to each revelation on the artificial intelligence (AI) front, dumping potential losers, tenuously as that connection has been made
- That AI fear-trade has expanded to private credit, where AI infrastructure overspend and a heavy software-focus has prompted rushes to withdraw funds from generally illiquid products that have struggled to meet demand
- Each case is a reminder that investment risk comes in many forms, arises at any moment, may compound with contemporaneous risk and generally scales along with expected return (higher expected return = higher risk)
- Investors who accept these characteristics of investment markets as core to their natures may find such periods of turbulence easier to understand and endure

## All Eyes on Oil

For all the geopolitical angst, we'd argue the equity market might be seen as yet lacking in comparable drama. This may be because investors have looked to history to understand that tense geopolitical moments tend to resolve with little enduring macroeconomic consequence. But increasing strains in oil markets from the expanding Iran war may well add to market jitters. Assuming the perceived timing of the end of the war is the primary driver of recent changes in assumptions, oil traders now are thinking the conflict will last a good bit longer than they did in the middle of last week. So, while oil futures markets still suggest the price of oil is expected to fall in reasonably short order once the war concludes, present expectations now foresee oil prices at higher levels for longer. Price expectations could quickly reverse (further inflate), were the war to end (escalate even further).

**Figure 1: Oil Futures Market Prices**

The jumps in the curve reflect increasing investor anxiety as to the Iran war's end



As of 03.08.26. These oil futures market curves show the prices today for contracts delivering oil in the future. The costs reflect investor expectations for immediate-delivery prices plus costs and benefits of carry (such as interest rates, storage and convenience). SOURCE: SRCM using data from Bloomberg

## Where to from Here?

Perhaps of greatest potential risk to equity markets might be an Iran left without firm leadership, a region broadly unstable, and therefore an oil shipping market left markedly riskier as a result. Supplies thus could remain strained, with the price of oil maintaining a multi-year high. As those costs flow through to other goods, concerns of persistent inflation will grow. Bond markets will struggle to balance rising prices with a still modestly growing economy that has barely lifted employment over the last year, with interest rates potentially rising on account of the need to clear a higher inflation hurdle and potentially weaker growth (which might, then, boost rates of corporate debt defaults). Stories with “stagflation” in the title referencing the 1970s will become more numerous.

Meantime, markets are likely to continue to gyrate, given the present tension and lack of clarity as to its release. As statements by President Trump and his administration remain near wholly vacant of specifics regarding the intentions of the war, methods to model its denouement remain elusive. And talk of boots on the ground over the weekend lifted the likelihood of a war measured in months.

The war with Iran comes as investors could be read as struggling (and increasingly so) to balance the promise of artificial intelligence (AI) with its budding potential boost to productivity against the actual costs of the technologies, including the radically escalating spend on AI computing infrastructure and still broadly elusive profits, at least given what one can glean from company statements.

At the same time, the AI story has cast a shadow on private credit markets, which already were suffering rising concerns that the relatively opaque debt market has grown too quickly and without commensurate safeguards/oversight and that some manner of dislocation might soon be forthcoming.

## Optimists...for the Long Term

Readers will know that we generally maintain a long-term optimistic outlook. We hold that stance, generally, regardless the present market situation. And that’s because we can honestly argue that we’ve been here before. If not specifically so, then contextually so. There have been other wars, many in the Middle East, with particularly negative impacts on energy markets. And such wars have sometimes arisen amidst a relatively strong market, some participants in which may have been looking for a reason to sell.

It would be pollyannish of us to believe that the war in Iran might end with no lasting global macro consequence. We already have learned that the regime is more intractable than this administration might have thought. Until oil shipments can proceed through the Strait of Hormuz unmolested—and until such time as shippers and their insurers firmly believe that’s the case—oil prices are likely to remain well above the \$55-to-\$65 range of the past year. Equity investors are likely to continue to fret increased aggression as they incorporate higher inflation into their expectations (which, all other things equal, should depress current valuations). And as bond investors do the same, yields are likely to maintain an upward drift. The Federal Reserve now will be even more challenged to substantiate shifts in monetary policy, given the potentially diverging trends working against its dual mandate of stable prices and full employment. Lower rates may support employment, but potentially at the expense of higher inflation. And higher inflation may force the Fed to leave rates where they are, perhaps even lift them to provide a countervailing force on prices.

The upshot is that increased market volatility is to be expected for the near term. We hope not over the medium term, too, but we should not be surprised if that proves the case. Even so, we believe investors who have properly understood that investment markets routinely see periods of increased tumult on account of the realization of such risks, and who had already aligned their risk exposures according to their expected levels of comfort during such periods, may find some manner of relief knowing that markets generally have recovered in the fullness of time.

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