

Market Insight – Middle East Instability

The Middle East conflict between the US/Israel and Iran is likely to cause near-term nervousness and concern for some investors regarding the potential flow-on effects of the conflict. Our comments are directed towards any potential global market impacts that may adversely affect our clients' investments.

At this stage we are making 'no' changes to the positioning of client portfolios, and we give our reasons for not making any changes below. However, as always, we continue to monitor the situation and remain ready to respond appropriately to any adverse developments.

The US and Israel continue to strike Iran after the killing of Supreme Leader Ayatollah Ali Khamenei, along with some forty plus senior government officials. Strategic military sites are being targeted and will continue to be targeted in coming weeks, as the US and Israel seek to neutralise the Iranian military and possibly bring down the regime.

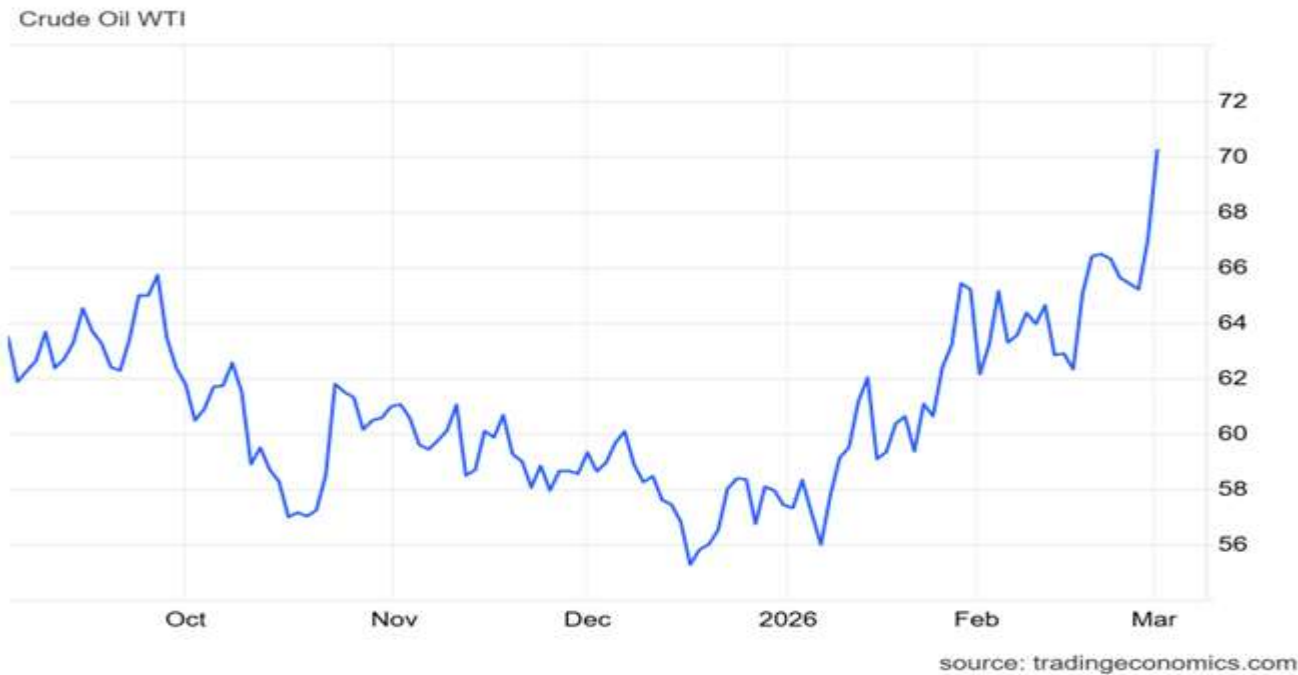
Being the Middle East, the main focus for investors is the impact on oil prices, which feeds into energy costs, inflation, and the broader economy. The region, including Saudi Arabia, Iraq, Iran, UAE, Kuwait, Qatar, Bahrain and Oman, produces 27% of the world's crude oil. About three-quarters of that, which equates to about 20% of the world's total oil supply, passes through the Strait of Hormuz.

The air war between the US, Israel and Iran has closed the Strait of Hormuz to shipping, which is a critical shipping route connecting the region's biggest oil producers to the world. Reuters has reported several tanker owners, oil majors and trading houses have suspended crude oil, fuel and liquefied natural gas shipments via the Strait of Hormuz. The question is how long it will last, as to what impact the conflict will have on the global economy!

Our view is the US and Israel will focus on securing this region as soon as possible as they understand its importance to the global economy. We feel they are likely to achieve this given Iran is isolated and have lost control of their air space, so we are told by the media, making it challenging for them to provide a sustained resistance. However, these are fluid situations where there is always an element of the unknown, so we remain vigilant.

In the interim, we expect volatility and oil prices to increase until there is more certainty that the Strait of Hormuz is secure and that the Iranian military is considerably weakened. Below is a chart displaying the latest crude oil price:

Crude Oil Price Chart (Six months)



In managing portfolios, we look to avoid making short-term decisions around geopolitical events, until greater clarity is ascertained. Usually there is a response to any potential supply disruptions, which is difficult to time, but with OPEC+ already committing to raise output should it be required provides a level comfort that any short-term supply disruption is unlikely to be for a lengthy period. Furthermore, Iran itself represents around 4% of the world's oil production, which is not that large for other countries to replace, should they wish to.

We feel markets will look through the current instability and remain focused on monetary policy and economic strength. As shown by the chart above, the market is not yet pricing in a major disruption to global oil supplies, nor the supply of goods via shipping channels in the region, but this can change quickly. Oil has jumped 5.75% in current trading since opening following the commencement of the conflict, and is around \$71 per barrel, which is still relatively cheap. Shipping costs are also expected to increase as they detour and take safer and longer routes. However, we do not anticipate a significant impact on global markets.

While higher oil and shipping costs does have the potential to see inflation go higher for longer and delay potential rate cuts for some countries, this is not our base case. Should things deteriorate beyond short term noise, and we start seeing a longer-term structural supply problem emerging, then we would take appropriate action in line with the developments. To this end we continue to monitor the situation but for now remain sanguine with respect to the Middle East instability.

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