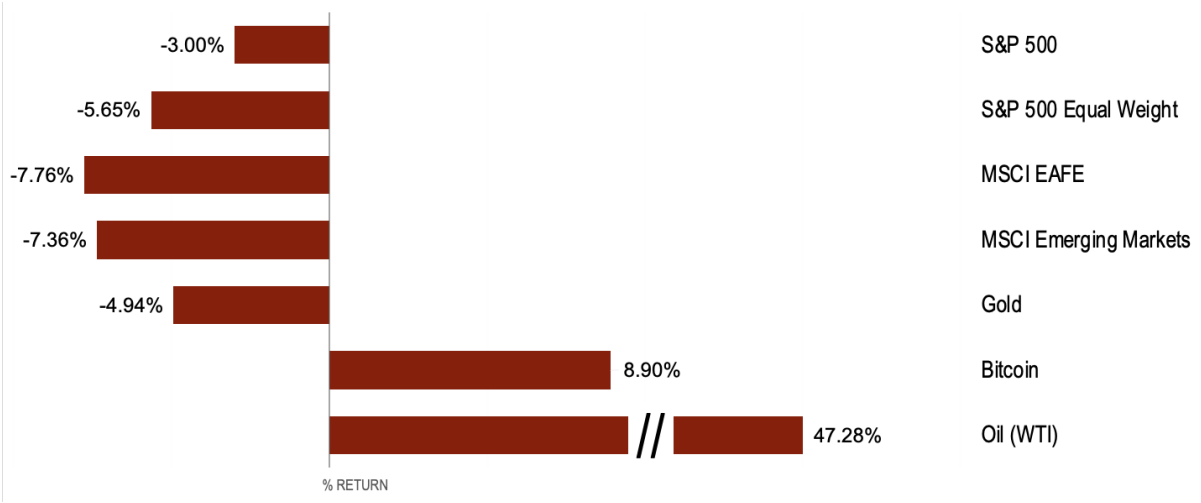
"Markets hate uncertainty" is a well-known maxim for investors, as significant disruptions have typically driven share prices dramatically lower. The latest war in the Middle East has certainly introduced gobs of geopolitical and economic uncertainty, yet Wall Street appears remarkably unfazed. Since hostilities commenced on February 28, global equities have declined, led by energy-dependent economies in both developed and emerging markets. However, no regional equity markets have fallen into correction territory. (Figure 1) At least, not yet.

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Source: Bloomberg , Brooklands Partners, LLC

Predictably, energy prices have jolted higher and the dollar is up slightly, yet gold is down roughly 5% and Bitcoin is 9% higher. (More on these later in this note.) Inevitable questions about how long the war will last, its economic impact, and what constitutes victory are being debated 24/7. The financial commentariat advises that the appropriate response for investors is to remain diversified and not overreact. While this advice is correct and prudent, it fails to provide comfort in the face of roiling markets and images of things blowing up while questions abound about winnable wars.

On a personal note, when hostilities broke out, Caroline and I happened to be at the U.S. Army Center of Military History at West Point. As a history lover, this was a trip that I had long been keen to make. An overwhelming takeaway from my time there in the context of current events is how exceptional our military has been throughout our country's history.

(cont'd.)

The fact that it answers to a democratically elected civilian leadership and is obedient to that leadership with an ethos of service to and protection of the American citizenry is rare indeed. Moreover, our military's history of successfully overcoming some of the most challenging tactical and logistical obstacles a battle force can face is worth keeping in mind as the war continues and concerns about outcomes mount.

Winning a war with Iran is not the question. Winning a lasting peace is. The leaders of Iran have had decades to entrench their theocratic beliefs into the institutions of state. The vested interests of the ruling class will not be relinquished quickly or easily. Unquestionably, the Iranian theocracy's fight for power is existential and our history of regime change in the region is unburdened by success. What plans emerge to break our historic experience dealing with middle eastern despotates are being watched by both Wall and Main Streets.

For the here and now, we should be monitoring a handful of things which will impact portfolio investing over the weeks ahead:

- **On the military front, securing the Strait of Hormuz.** Traffic through this pinch point of the Persian Gulf has practically come to a halt. Some 20% of the world's oil and LNG supply transits through this strait. It is critical this sea lane is durably secured so maritime traffic can resume thus reducing the pressure on the energy-dependent regions in Asia and Europe.[1]
- **Whither goes the future of the Iranian government.** Does an Iranian opposition begin to coalesce around the liberalization of life, casting off or at least loosening the strictures of the Islamic Revolution? This might precipitate a civil war, but it creates an alternative group with which to engage.
- **Broadening of the hostilities in the region.** Will Iran's continuing strikes on its neighbors catalyze a regional response to the aggression beyond American and Israeli action.
- **Energy relief.** Will President Trump suspend the Jones Act providing a modicum of relief from high energy prices for consumers on the east and west coasts of the United States.
- **Effects of higher energy prices.** How long before higher energy prices work their way through the production chain forcing a cost share between businesses and consumers. This is already happening in the freight and transport industries. Think of this as a form of cost-push inflation.

From an investing perspective, we need to watch for any sign that elevated energy prices begin to threaten profit growth this year and next. Similarly, watch yields on Treasury notes and bonds to glean investor perception of the financing burdens that a prolonged conflict entails. A longer war means larger deficits when they are already running at wartime levels. It is hard to see how the expected and longed for interest-rate cuts happen with energy prices at $100/bbl.

(cont'd.)

[1] *For real-time visuals of traffic in the Strait of Hormuz go to www.marinetraffic.com*

A few market curiosities: While the inevitable run to the dollar ensued after hostilities commenced, it rallied 2.97%, a rather anemic response given the potential magnitude of the disruptions. Likewise, the pull back in U.S. shares were similarly muted as seen in Figure 1. Indeed, the S&P 500 Index, already priced for perfection, failed to register anything resembling an oversold position. Complacency or confidence? It is hard to tell but investors have been rewarded over the years by "buying the dip," which may account for the supine response of U.S. stocks. On the alternative asset front, it's strange that gold and Bitcoin prices have diverged, with the latter being so dependent on energy for its very existence. Investors should not infer from this that bitcoin is a better crisis asset than gold. Gold's performance this year has been so much stronger than bitcoin that this may simply be a lean into a relatively cheaper asset.

Now that theaters of war exist in Europe and the Middle East and an epic power rivalry is unfolding in the Far East, exposure to global defense stocks is an important hedge to evolving geopolitical landscape. Interest rate hedges make sense as longer-term rates appear set to rise with escalating war financing needs. Finally, a measure of currency diversification continues to look appealing as the fallout from multiple "hot wars" unfold.

[2] *A useful measure of whether a stock or index is overbought or sold is gleaned from the relative strength index for the security.*

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