



THE IRAN WAR & MARKETS

Keeping perspective amidst uncertainty

There's a particular kind of unease that creeps in when market headlines start mixing geopolitics with talk of oil prices and recessions. That feeling has been hard to avoid, as the escalating war in the Middle East spooked global markets and brought fresh uncertainty to an already fragile economic landscape.

For investors, watching so many forces moving at once and volatile numbers, there can be a strong temptation to "do something".

Before reacting, a good understanding of what's driving market movements is useful to assess the short and medium term. More importantly, it helps to work out how your long term strategy fits in.

Energy markets have felt the most immediate effect of the conflict. Iran is at the centre of one of the world's most strategically important regions for oil and gas production.

As tensions escalated, markets quickly priced in the risk of supply disruptions, particularly through critical shipping routes in the Middle East. That alone has been enough to push oil and gas prices sharply higher.

History shows that energy markets tend to react first and fastest during geopolitical crises.ⁱ

Even when physical supply is not immediately interrupted, uncertainty itself drives speculative buying. Higher energy prices then feed into almost every corner of the global economy: transport, manufacturing, agriculture and ultimately household budgets.ⁱⁱ

Global share markets responded quickly to the crisis with sharp drops after the first bombs in Iran.

Share prices have fallen and recovered several times since the conflict began, often related to US President Trump's announcements. But, in both Australia and the US, the markets were down by almost eight per cent by the end of March. Technology stocks have fallen particularly hard.

The conflict has come at a time when the global economy was already fragile. Before March, analysts were debating whether the US economy would manage a "soft landing" or slip into recession as higher interest rates worked their way through the system.

Adding an energy price shock into the mix increases the risk that higher costs slow spending and investment. Rising fuel prices act like a tax on consumers and businesses. Money spent at the petrol station is money not spent elsewhere in the economy. As a result, concerns about slowing economic growth have been quick to re emerge.

In Australia too, there's increasing talk of recession – as much as a 30 per cent chance within the next 12 months, according to AMP.ⁱⁱⁱ

However, Treasurer Jim Chalmers disagrees saying that, while the economy is expected to take a "sizeable hit", a recession is not expected.^{iv}

The immediate effects

Market volatility is likely to continue with sharp price swings as the markets react to either good or bad news coming out of the Middle East.

For households, the most visible impact is likely to be at the pump and in their power bills. Widespread price



risers here are likely to affect consumer confidence and spending patterns.

So-called “safe-haven” assets such as cash, government bonds and some currencies often benefit during uncertain times as investors look to defend their portfolios, however bond yields have experienced volatility as investors assess the evolving situation in the Middle East.

Gold was also once on the list of safe havens. But, during the most recent crisis, its value has plunged nearly 15 per cent during the month. Nonetheless the price remains high – up by almost 300 per cent over the past decade.^v

While there'll be plenty of market “noise” ahead, it's important to remember that short term market reactions may be driven as much by emotion as by fundamentals. Fear, uncertainty and rapid shifts in sentiment often exaggerate price moves in the early stages of a crisis.

Looking further ahead

Looking beyond the immediate panic, the medium term (the next six to 18 months) will depend on how the world adapts to the energy prices shock.

Continued high oil prices can have several effects:

- **Inflation pressures may linger.** Energy price rises affect almost every sector of the economy. However, some sectors may perform better including commodities, energy companies and defensive assets such as infrastructure, healthcare, utilities and consumer staples.
- **Economic growth may soften.** Higher input costs squeeze businesses and reduce consumer spending power. Over time, this can weigh on economic growth and corporate earnings.
- **Structural change can accelerate.** Energy shocks often act as catalysts, encouraging investment in alternative energy sources, efficiency improvements and

supply chain diversification. While disruptive, this can create long term opportunities in certain sectors and regions.

It is also worth remembering that energy shocks don't last forever. Markets adapt, alternative supply routes emerge and prices eventually reflect new realities. The timing is uncertain, but history suggests that economies and markets are more resilient than they often appear in the heat of the moment.

Strategy over fear

Perhaps the most important thing to remember right now is that your financial plan was built for times like this.

Sound financial planning anticipates that markets will be periodically disrupted by wars, pandemics, financial crises and recessions.

Diversification is your first line of defence. A portfolio spread across various asset classes doesn't eliminate volatility but it means that no single event can derail your entire financial position.

Ensuring your investment mix reflects your time horizon (the length of time you expect to hold an investment) and capacity for loss is your second.

The discipline required in moments of market stress is to distinguish between short-term fear and long-term strategy. Fear says: sell everything and wait for calm. Strategy says: stay invested, stay diversified and if anything has changed, let's talk about it properly.

If the events of last month have raised questions for you, we're here to help you navigate with confidence. Please give us a call.

i <https://gulfnews.com/business/energy/anatomy-of-oil-shocks-what-historical-data-shows-about-key-geopolitical-moments-1.500472984>

ii <https://www.iea.org/reports/sheltering-from-oil-shocks>

iii <https://www.abc.net.au/news/2020-03-27/fuel-shortages-price-hike-businesses-consumers-inflation/106497260>

iv <https://www.theguardian.com/australia-news/live/2020-mar/30/australia-politics-live-national-cabinet-fuel-prices-oil-crisis-labor-anthony-albanese-chris-bowen-coalition-angus-taylor-ntwnfb?filterKeyEvents=false&page=with%3Ablock-69c98e908f08a9060e5eca3b#block-69c98e908f08a9060e5eca3b>

v <https://theconversation.com/gold-is-meant-to-be-a-safe-haven-in-uncertain-times-why-is-it-crashing-amid-a-war-279095>

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