Navigating the Israel–Iran conflict: What investors need to know

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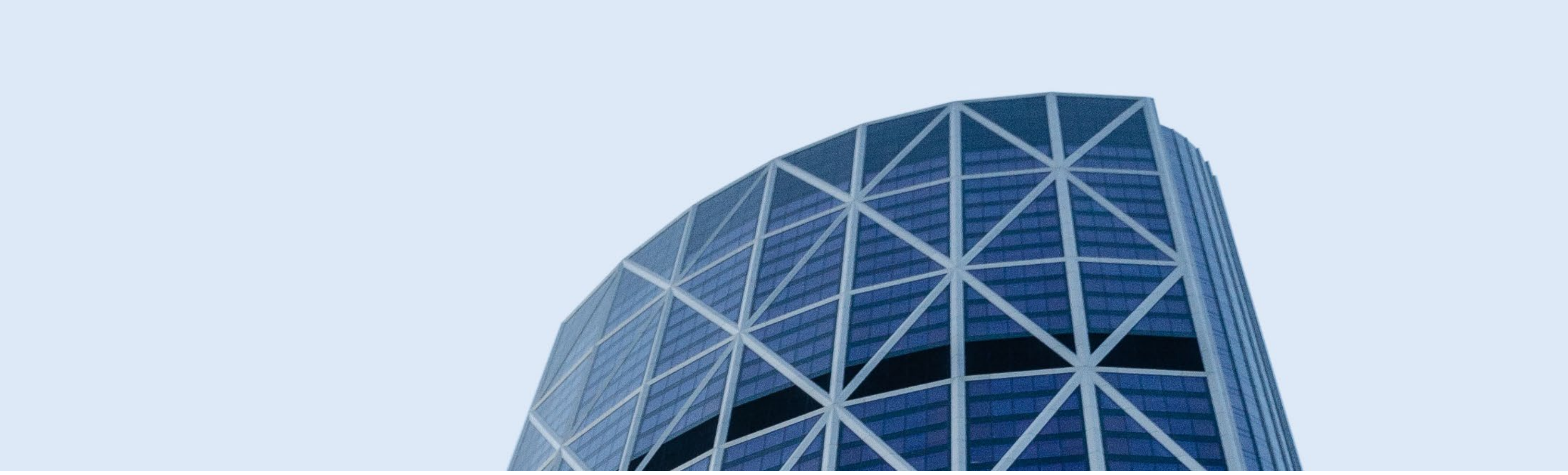

How might the conflict evolve? A quick resolution appears unlikely but we see limited escalation

Israel acted to disrupt Iran's nuclear program before it reached a point of no return — when Iran could produce a nuclear weapon quickly. Iran has an incentive to retaliate to restore deterrence and political credibility at home, but wants to avoid a broader conflict it likely cannot win, especially one involving the US. The most likely outcome is a calibrated strategy: limited but targeted attacks over several weeks. Israel appears prepared for sustained operations.

What could go wrong?

U.S. military involvement: If Israel cannot destroy underground nuclear infrastructures, it may seek to push the US into a direct strike campaign (involving "bunker-buster" bombs). That said, inflation concerns arising from surging oil prices reduce the likelihood of this event or one requiring large-scale US support.

Strait of Hormuz disruption: Iran may threaten or attempt to block the Strait of Hormuz — a chokepoint for 1/5 of global oil exports. Even partial disruption could spike oil prices, but trigger the risk of a likely US military response, posing a direct threat to Iran's regime. At this time, it appears unlikely that Iran will take this avenue.

Regime-change perception: Strikes on Iranian leaders and infrastructure may be seen as an existential threat, particularly in a context of domestic tensions in Iran. If Iran believes regime change is the goal, retaliation and escalation could expand materially.

What are oil price prospects and risks?

Our base case: Limited upside for oil prices in the near term, followed by downside pressures towards a $60–$70 range, which is the 12-month range we published in our Spring outlook. That said, ongoing tensions are likely to keep oil prices above $70 in the near term due to a political risk premium. Barring a major supply shock, a lasting spike appears unlikely. If we are wrong, a prolonged conflict with significant escalation could push oil to $100 for a few months. In this risk scenario, we would expect Saudi Arabia and other OPEC producers to ramp up output quickly to mitigate the negative impact of higher oil prices on the global economy — and ultimately on their revenues. It is worth noting that oil prices declined following the start of the Iraq war in 2003 and the US invasion of Afghanistan in 2001, as military strikes deliberately avoided targeting oil infrastructures.

What are the implications for investors?

In the current environment, it is important for investors to stay invested. Markets generally recover rapidly from contained geopolitical shocks. We expect them to look through this. A well-diversified portfolio aligned with long-term goals remains the best defense against short-term volatility.

The balance of risks for oil prices is skewed to upside given geopolitical risks. This risk skew may favour inflation-protective cyclical assets such as commodities, infrastructure, and defense-linked industrials. Equities — especially the most energy-exposed — are likely to remain resilient, albeit with periods of heightened volatility. Oil price risks reduce the attractiveness of long-duration bonds. The US dollar may face less downside or even some temporary upside depending on oil's trajectory.

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