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New fighting in the Middle East and market impact

Key takeaways

- After the U.S. and Israeli forces struck hundreds of military and government targets in Iran beginning on February 28, capital markets reacted with lower equity prices, but higher fixed income and energy prices.
- If, in our view, the conflict turns out to be a series of quick but heavy blows on Iran, then the capital markets path should show a short spike in risk aversion, followed by stronger risk appetite as the escalation quickly peaks and fades.
- Escalation remains a risk to watch, but we believe that investors are best served by staying with a diversified portfolio that follows our guidance for a 2026 U.S.-led global economic recovery.

What's happened so far

After rapidly concentrating military force on the largest scale since the Iraq War of 2003, at 7:00 am local time on Saturday, February 28, U.S. and Israeli forces struck hundreds of targets in Iran with air-, land- and ship-launched missiles in a more extensive attack than the one last June.¹ The initial targets appeared to focus on Iran's leadership (by Israel), as well as its navy and ballistic missile inventory and production facilities (by the U.S.).² Internal security forces also are a target, and Iran's nuclear facilities figure to be hit as well.³ Iran retaliated immediately with short- and medium-range ballistic missiles against Israel and against U.S. military bases and regional targets (including some airports) in the United Arab Emirates, Bahrain, Qatar, Dubai, and Saudi Arabia.⁴

With help from China, Iran has partially recovered its ballistic missile stocks and production capacity following the 12-day war last June.⁵ The likely implication, in our analysis, is at least some recovered capacity for Iran to amass ballistic missiles for strikes against Israel and U.S. regional bases. We believe that the U.S./Israeli strikes could last for several days to try to reduce Iran's missile inventory.

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1. UK Telegraph, "Attack 'to be more extensive than last year's strikes'", February 28, 2026, and *New York Times*, "What to know about the U.S.-Iran conflict", February 28, 2026.

2. *Ibid.*

3. "Operation Epic Fury and the Remnants of Iran's Nuclear Program, Center for Strategic & International Studies, February 28, 2026.

4. *Ibid.*

5. Can Kasapoglu, "Assessing Defense Cooperation Between Iran and China in the Wake of the 12-Day War | MENA Defense Intelligence Digest" Hudson Institute, September 9, 2025.

As of March 1, confirmed casualty reports included the deaths of Iran's Supreme Leader, Ali Khamenei, and a number of top military leaders.⁶ (A three-man governing council has taken over leadership in Iran.) President Trump publicly confirmed on March 1 that the U.S. military suffered its first casualties, three dead and five seriously injured.

So far, Iran's regional proxies have been mostly quiet. The Houthis warned from Yemen that they might close the Bab el-Mandeb Strait exiting the Red Sea to all Israeli and U.S. shipping.⁷ We view broad involvement by Iran's regional allies as a risk but not necessarily inevitable, as we discuss below.

Overnight February 27/28, President Trump listed the campaign's objectives⁸:

- i. Stop Iran's nuclear weapon development
- ii. Destroy Iranian missiles
- iii. Disable the Iranian navy (to prevent it from closing the Strait of Hormuz and attacking U.S. Navy ships)
- iv. Facilitate a popular overthrow of Iran's government

What may come next

We would expect, based on current information, a days-long but fast and furious campaign. President Trump may prefer a short campaign for several reasons:

- i. Attacking Iran appears to us to lack strong popular support in the U.S.
Any quickly accumulating U.S. casualties could become a significant political negative for the president and Republican leaders in a U.S. midterm election year.⁹
- ii. The campaign seems to stretch the Pentagon's resources
According to the Center for Strategic & International Studies, the 18 U.S. Navy ships and two submarines now on stationed in the region roughly match the force used in a four-day U.S. bombing campaign against Saddam Hussein's Iraq in 1998. However, today's Navy is smaller, so those 20 vessels are 41% of the Navy's 49 total vessels currently at sea.¹⁰
- iii. Trump meets with China's President Xi in a few weeks
The president may want to avoid complicating trade talks by handing China negotiating leverage because of a sustained U.S. military action.

Risks

Boxer Mike Tyson allegedly once said (paraphrasing) that everyone has a plan until he gets punched in the mouth. We believe both sides face high-risk/high-reward outcomes, and any pre-war plans may evolve quickly under strikes and counterstrikes that may escalate the conflict. These dynamics suggest considerable risks around predicting timing and outcomes.

In this case, we are watching particularly for news about strikes on Iran's missile launchers and nuclear facilities, two major U.S./Israeli objectives. According to at least one report, Iran may have 2,000 ballistic missiles, but they

6. Joe Barnes, "Two days or two months? What will determine the length of Iran conflict", Telegraph UK, March 1, 2026.

7. Stuart Chriels, "Iran-backed Houthi warn of new Red Sea attacks", Bloomberg, February 28, 2026.

8. Dan Clifton, "FLASH POLICY NOTE- US, Israel attack Iran, urge regime change", Strategas, February 28, 2026.

9. *Ibid.*

10. Mark F. Cancian and Chris H. Park, "U.S. Military in the Middle East: Numbers Behind Trump's Threats Against Iran", Center for Strategic & International Studies, February 20, 2026.

can't go anywhere without launchers.¹¹ Israel destroyed many of Iran's launchers during the 12-day war of 2025. Any remaining launchers are likely high-value U.S. targets now. The U.K. Telegraph reported on March 1 that the U.S. had used 2,000-pound bombs from stealth B-2 bombers against Iran's missile factories. As the Iranian ballistic missile threat degrades, the U.S. may prioritize Iran's nuclear facilities, as it did in 2025, probably by the same long-range B-2s and possibly also B-52 bombers.

The longer it takes the U.S./Israel to achieve their objectives, the greater the chance that Iran escalates its retaliation. So far, and except for targeting airports in the Gulf States, it appears that Iran's retaliation has been proportionate — returning missile strikes on Israel and U.S. bases for strikes on Iranian military assets. If Iran wants to escalate, we believe it is most likely to attempt to overwhelm the U.S./Israel on multiple fronts — missiles from proxy forces in Lebanon, Iraq and Yemen, and swarms of missiles and drones against U.S. bases and ships in the region.

Escalation levels we are watching

Escalation may produce casualties that widen the scope of the U.S./Israel attack (e.g., to target other Iranian security infrastructure or regional proxies). We are watching five potential levels of possible Iranian retaliation, in order of increasing potential severity:

- i. **Level 1:** Iranian missile attacks on U.S. bases
These are occurring now and seem a proportionate response to the initial U.S./Israeli attacks.
- ii. **Level 2:** Iranian maritime attacks
Including in the Red Sea and the Persian Gulf, proxy attacks and swarm drone attacks on U.S. Naval and commercial vessels. There is no evidence yet of such attacks.
- iii. **Level 3:** Cyber warfare
An Iranian computer virus in 2012 attacked Saudi Aramco oil production, knocking out 30,000 computers. Iranian hackers may now target U.S. military and civilian infrastructure, especially U.S. transportation, energy infrastructure, financial systems and military computer networks.
- iv. **Level 4:** Iranian cyber attacks
Computer hackers could target U.S. military communication networks, or transportation, water, and power networks in the U.S. homeland. In 2012, Iranian hackers disrupted 30,000 computers at the Saudi national oil company, Saudi Aramco, and, now, U.S. Cyber Command reportedly has been preparing to counter-attack Iran's energy, power, water and military networks.¹²
- v. **Level 5:** Iran could, in our view, attempt to strike at global oil supply
Iran, Saudi Arabia and the Gulf States fill tankers for transit through the Strait of Hormuz, accounting for roughly 20% of daily global oil supply and roughly the same proportion of liquid natural gas. One Iranian option is to forcibly close the Strait of Hormuz. Iran practiced this maneuver last week and has available anti-ship missiles, naval mines, drone swarms, and attack speed boats to cripple or harass shipping in the Persian Gulf and especially the very narrow Strait. Also, Iran could attack oil production networks in the region. Iran attacked Saudi Arabia in September 2019 and took down roughly 6% of global oil production and the largest single-day spike in oil prices in history.¹³

11. Michael Herzog, "On War with Iran, a U.S.-Israeli Division of Labor", Washington Institute, February 25, 2026.

12. Akhtar Makooi, "How Iran plans to go to war with the US and win", Telegraph UK - Akhtar Makooi, February 20, 2026.

13. Scott Neuman, et al. "Attack On Saudi Oil Facilities Makes Oil Prices Spike", National Public Radio, September 16, 2019.

Current and potential impact on the global oil market

As of March 1, S&P Global reported on March 1 that tanker traffic through the Strait had fallen by somewhere between 40%-50%.¹⁴ And liquid natural gas shipments through the Strait are all but halted. S&P Global also reports that some commercial traffic is getting through, but that tankers are stacked up in the Gulf of Oman or the Arabian Sea, unwilling to run the risk of any Iran-U.S. crossfire. What we are seeing is not a closed door but a space that tanker traffic is reluctant to enter.

Iran has military assets in the Persian Gulf and in the Strait, but we do not expect them to attempt to close that extremely narrow passage, except as a last resort, because oil exports are the government's main revenue source. Short of a military confrontation between Iran and the U.S. in the Strait, we believe temporary price hikes on oil are the most likely outcome, not a structural or persistent loss of global supply.

Our base case

Our base scenario assumes a heavy but relatively quick blow to Iran's national leadership and its military assets and production facilities. If neither side escalates beyond current levels, the fighting may end in a few days. In that case, the U.S. and Israel will have again degraded Iran's offensive capabilities, and the regime probably survives. It's important to remember that we believe Iran's regime feels an existential threat from anti-regime demonstrations and military attacks but also believes it need only survive to declare victory. Iranian escalation is quite possible from here, but the regime may prize survival even more highly.

Under this base case, we would expect a short spike in risk aversion, until investors can see the wind down in hostilities. This would be consistent with past episodes of regional violence, which caused pullbacks in bond yields and equity markets, but sent oil prices higher. These movements reversed quickly once the wind down began.

What investors should do now

Overall, we see potentially sharp but likely transient negative impacts for economic and earnings growth and commodity demand.

We do not see any single asset that can fully avoid the uncertainties about the timing and extent of the fighting, but the U.S. dollar may again prove to be an effective hedge. The fact that the U.S. has become a crude oil net exporter is an advantage, especially while uncertainty about how soon regular passage through the Strait can resume. And there are other reasons. The U.S. financial markets are the largest and most liquid in the world, and that liquidity typically helps reduce the difference between buying and asking prices for financial assets during periods of uncertainty. U.S. legal and regulatory transparency also increase the greenback's credibility.

We believe now is a good time to remember that the "sell America" trade of the past 12 months has been very misleading and, in our view, an unwise investment premise. International investors have not abandoned the dollar, and events may further strengthen the case for U.S. markets. We do favor holding international equities and Emerging Market Debt at long-term strategic weightings, but we still prefer the U.S. equity and fixed income markets over foreign markets.

Therefore, we prefer to hold steady with a diversified portfolio but one oriented towards U.S.-led global economic growth. This year so far has provided ample opportunity for us to reiterate our 2026 Outlook theme to look through headlines to focus instead on that favorable global economic outlook. Admittedly, the latest headlines are the most serious so far in 2026, and certainly tragic for the loss of human life. And, until the fighting began, capital

14. "Oil tanker traffic disrupted in Strait of Hormuz main shipping lanes", S&P Global, March 1, 2026.
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markets had registered only slight acknowledgement of a possible conflict, so that an initial U.S. equity pullback may be more significant — a catch up.

That said, we expect a short, hard-hitting regional conflict. The conflict should offer likely signals to help investors know if a longer conflict is developing, but we do not yet see a more serious conflict as likely. Past violent flareups in the Middle East moved markets towards risk aversion, but sentiment rebounded quickly, once it was clear that the conflict was subsiding and regional oil supply would continue.

While the conflict lasts, a diversified portfolio may be the best defense. We continue to prefer Large- and Midcap U.S. equities but also favor holding strategic weightings in Emerging and Developed ex-U.S. equities, as well as Commodities. Fixed income should also help mitigate unforeseen risks, and we favor investment-grade corporates with maturities between three and seven years.

Risks Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility. **Currency risk** is the risk that foreign currencies will decline in value relative to that of the U.S. dollar. Exchange rate movement between the U.S. dollar and foreign currencies may cause the value of a portfolio's investments to decline.

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