



Market Ramifications from Middle East War

October 12, 2023

This brief note is not meant to cover all the events of recent days or exhaust the potential economic and market implications of the war in the Middle East. Our goal is to provide you insight into our view of the potential impacts of these events on the global markets.

Factors impacting economic and market conditions

Short-term

1. This war could be lengthy, as Israel has stated its determination to destroy Hamas. Any escalation to include Iran is speculation at this point.
2. The U.S. and West will likely provide abundant supplies to Israel, perhaps at the eventual expense of aid to Ukraine (although U.S. munitions are running short due to the Ukraine war).
3. Regardless of the eventual outcome, there will undoubtedly be many more casualties.
4. Defense spending will rise, period.
5. Foreign policy will likely play a bigger part in the 2024 election debate.

Longer-term

1. The U.S. and Israeli intelligence failure will likely be the subject of investigations in the future.
2. The decline of U.S. hegemony will continue to have far-reaching implications on world stability.
3. Deglobalization (which is inflationary) is expected to continue.
4. Potential diplomatic mutual recognition between Israel and Saudi Arabia is shelved for now.
5. Recent attempts at rapprochement with Iran by the Obama and Biden administrations will likely be criticized.

The effects of these factors on the economy and markets

1. War is generally an inflationary, risk-off period and, at a minimum, creates capital markets volatility (both stocks and bonds).
2. Oil prices are likely to be higher than what would otherwise be the case. (Investors should not be complacent about the risk of a major oil shock.)
3. Stocks are finding a reprieve from the pullback in bond yields after Fed policymakers said that tighter financial conditions strengthen the case for proceeding cautiously on rates (independent of anything to do with the Middle East).
4. The direction of bond yields will likely continue to have the biggest influence on stock prices.
5. This war likely increases the appeal of bonds over stocks, large cap over small caps, U.S. relative to the rest of the world, and energy and defense stocks over other cyclicals.

Our prayers go out to all the victims of the atrocities associated with this war.

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