

Middle East Conflict: Market Impact and Potential Flashpoints

Geopolitical tensions are lifting near-term market risk, while fundamentals and escalation risks remain the key drivers ahead.

Geopolitical Significance May Outweigh Market Impact

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The conflict introduces a wide range of potential outcomes with differing market implications. At the time of this writing, oil prices have risen, equities have declined (with European markets under greater pressure due to higher natural gas prices), US Treasury yields have increased, and both the US dollar and gold have strengthened. These moves largely reflect higher risk premia¹ rather than a fundamental shift. Absent a sustained disruption to oil supply, I expect them to fade.

Historically, the market impact of US-involved geopolitical conflicts has tended to be short-lived, with risk premia reversing over time. Consistent with this pattern, the current US administration has favored short, forceful responses, primarily through air and naval power, to achieve rapid outcomes. Given this approach, and the limited political appetite for a prolonged US military presence in the Middle East, this conflict may prove relatively short-lived.

What Else Could Impact This View?

Downside risks to this view include:

- A prolonged conflict keeping oil prices in the \$85–\$100 per barrel range could represent a meaningful supply shock, raising recession risk and increasing political pressure ahead of US midterm elections.
- Escalation risks include significant US casualties; full closure of the Strait of Hormuz, through which oil is transported; or civil unrest in Iran leading to deeper US involvement.

Upside risks to this view include:

- Oil markets remain well supplied, and Saudi Arabia has agreed to increase production in support of lower prices. At the same time, a geopolitical risk premium was already embedded in oil prices prior to US action.
- Regional responses within the Middle East suggest increased alignment with the US, rather than pressure to de-escalate.

Investment Implications

Equities:

- The rotation toward international and value-oriented equities has continued.
- Within this, European equities face greater uncertainty given elevated natural gas prices.
- Support remains for US AI-infrastructure beneficiaries as well as emerging-market equities.
- The backdrop may also favor a shift from oil exploration and production toward higher-quality integrated energy companies.
- Gold equities, meanwhile, offer catch-up potential relative to bullion.

Insight from sub-adviser Wellington Management



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Key Points

- Recent market moves largely reflect higher geopolitical risk premia, which may fade absent a sustained disruption to global energy supply.
- Escalation risks remain elevated, with energy infrastructure, shipping routes, and the duration of military operations serving as critical signposts.
- Market fundamentals continue to provide important context amid elevated uncertainty.

Fixed Income:

- Recent bear flattening² reflects concerns about sticky inflation and reduced expectations for rate cuts.
- That said, long duration³ may become more attractive if yields rise further, particularly if AI-driven productivity helps temper inflation.
- In credit, a more defensive posture in investment grade may be warranted given tight spreads⁴ and expected issuance.

Commodities:

- Consider maintaining long exposure to gold, with greater upside potential in gold equities.

Overall, investors across asset classes may do well to remain focused on underlying fundamentals beyond the conflict, including AI-driven growth, rotation into real assets⁵ and international equities, and opportunities in private credit.

US-Iran Conflict: Risks to Watch

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The confirmed death of Supreme Leader Ayatollah Ali Khamenei, along with other senior regime figures, injects significant uncertainty into the outlook, spanning Iranian military capabilities and cohesion, as well as broader questions around regime stability and succession.

Regional risks remain highly elevated. From a market perspective, energy infrastructure and key shipping lanes are critical areas to monitor. Iran's president and Iranian Revolutionary Guard (IRGC) leadership have vowed retaliation, while President Donald Trump has said US and Israeli attacks will continue "throughout the week or as long as necessary to achieve our objectives of peace throughout the Middle East and, indeed, throughout the world."

Taken together, these developments point to further military action, alongside sustained macroeconomic and market risks.

Three Key Developments to Monitor

- **Iran's Military Response and Target Selection** – Iran resumed retaliatory missile and drone attacks on March 1, signaling continued military capabilities despite leadership disruption. A broader target set raises the probability of sustained and widened regional conflict, including attacks on civilian infrastructure, economic targets, or cyber assets.
- **Energy Infrastructure Risk** – Watch for confirmed attacks on, or credible threats to, Iranian oil and gas facilities as well as Gulf energy infrastructure.
- **Shipping and the Strait of Hormuz** – Risks include harassment of commercial shipping, mining activity, rising insurance costs, rerouting, or sustained slowdowns.

Additional Factors Shaping the Outlook

- **Duration and Tempo of Military Operations** – Do US and Israeli strikes slow following initial battle-damage assessments, or shift from days to weeks, signaling incomplete degradation of Iranian capabilities?
- **Proxy Activation and Engagement** – Watch for responses from the Houthis, Shiite militias in Iraq and Syria, and Hezbollah in Lebanon.
- **US Force Posture and Exposure** – Focus on force-protection measures for the roughly 40,000 US personnel in theater, watching for evidence that forces are being dispersed to reduce risk, as well as any successful Iranian strikes on US military assets.



Iranian targeting decisions will be a key signal for whether the conflict widens or stabilizes.

- **Gulf Cooperation Council “Pull-in” Indicators** – Monitor missile interceptions or other impacts on Gulf states hosting US forces, including the scope and duration of airspace closures or defensive operations.
- **Diplomatic Signals vs. Rhetoric** – Prioritize actions over statements to assess whether and when diplomatic efforts resume.
- **Iranian Domestic Political Response** – Look for mass protests, visible regime support, and the IRGC’s capacity to suppress dissent.
- **US Domestic Political Reaction** – Monitor polling trends and Congressional responses.
- **Great-Power and Allied Responses** – Assess whether China or Russia move beyond rhetoric and what US allies’ reactions suggest about the durability of US security relationships.
- **Risk of Mission Creep** – Evaluate whether expanded US engagement in the Middle East reduces capacity or attention on other priorities, including Venezuela, Cuba, or the upcoming US-China summit in Beijing.

In the near term, markets should focus less on headlines and social-media commentary and more on observable signposts, particularly Iranian targeting decisions and regime-military cohesion, risks to energy infrastructure and shipping, and whether the conflict is finding a ceiling vs. drifting toward a more prolonged campaign.

Over the longer term, the broader context matters. This ongoing and seismic development reflects a wider shift in the global geopolitical environment and is likely to accelerate fragmentation and conflict, reduce policy cohesion, and further entrench national security as a dominant global policy priority.

If you’re concerned about the impact of geopolitical events on your portfolio, please reach out to your financial professional.

¹ Risk premia is the investment return an asset is expected to yield in excess of the risk-free rate of return.

² Bear flattening refers to the convergence of interest rates along the yield curve as short term rates rise faster than long term rates and is seen as a harbinger of an economic contraction.

³ Duration is a measure of the sensitivity of an investment’s price to nominal interest-rate movement.

⁴ Spreads are the difference in yields between two fixed-income securities with the same maturity but originating from different investment sectors.

⁵ Risk assets refers to assets that have a significant degree of price volatility, such as equities, commodities, high-yield bonds, real estate, and currencies.

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increase liquidity risk, volatility and risk of loss if adverse developments occur.

• Different investment styles may go in and out of favor, which may cause underperformance to the broader stock market.

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