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Global Investment Strategy

The US and Iran: Three Strikes and You're Out?

As US strikes rattle Iran's nuclear infrastructure, markets weigh muted reactions against geopolitical fallout and an uncertain path forward.

While it appears the US strikes on Iran's three nuclear sites—Natanz, Fordow, and Isfahan—have caused significant damage, many important questions remain. Among them are concerns about the impact on Iran's nuclear capabilities, the extent of Iran's retaliatory actions, and the likelihood of a short- or long-term conflict involving the US.

Perhaps due to these known unknowns, the market reaction has been relatively muted. That said, it was surprising that markets took the news in such stride, in the early hours at least, considering the wide range of possible outcomes. In the past, geopolitical events involving the Middle East have generally triggered higher oil prices and risk-off price action.

Given the fluid nature of the situation, it's difficult to have high conviction on any view at the moment. For that reason, I find it more useful to have a framework within which to think about the current situation. More specifically, informed by views from many of my Wellington colleagues, I'm focused on identifying key scenarios and market drivers, which may help to assess potential market reactions.

- **Scenarios** – Three possible scenarios I'm considering are:

  1. Iran yields and comes to the negotiating table;
  2. Iran retaliates but in a measured way; and
  3. Iran, Israel, or the US escalates, and the conflict broadens.

  My base case is scenario 2, and we've already seen some indications of this with Iran's modest attack on a US base in Qatar. I expect scenario 1 could be bullish for risk assets,[1] and scenario 3 could move us into a risk-off environment.

- **Economic Fundamentals** – The impact on growth and inflation centers on oil and natural-gas prices. A spike in either will likely be in response to a supply disruption, potentially in the Strait of Hormuz or other energy-producing regions in the Middle East. In this scenario, the impact would likely weigh on growth first, potentially dragging down interest rates and equities. If recession risks rise meaningfully, central-bank rate cuts could mitigate the risk-off market response. Inflation dynamics from tariffs could also pull interest rates in the opposite direction.

- **Energy Prices** – A spike in oil to US $100 or higher a barrel due to a supply shock would be negative for growth and could, if prolonged, lead to recession. This would be a risk-off environment with different impacts, depending on each region's dependence on oil and the effect on natural gas prices. For instance, Europe is more dependent on natural gas than oil. China is an oil importer, making it more sensitive to a spike in oil prices. The US is an oil exporter, making it less vulnerable. Higher oil prices can drive up the broader rate of inflation, but that outcome tends to be driven by increased demand rather than a supply shock.

Insight from sub-adviser Wellington Management

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Key Points

- US strikes on Iran's nuclear sites have dealt a blow to its capabilities, but markets have remained surprisingly steady amid uncertainty.
- Three potential scenarios frame the evolving geopolitical risk landscape: diplomatic resolution, limited retaliation, or broader escalation.
- While recent events are significant, underlying forces such as energy costs, inflation, and the trajectory of the US dollar are likely to drive market direction.

- **US Dollar** – Given the 10% or so decline from its peak, I think it's worth considering whether the US dollar regains some of its "US exceptionalism" owing to the US show of strength/decisiveness, military superiority, and engagement with global affairs. If so, this could be positive for US equities and negative for other equity markets, which have benefited from a weaker US dollar.

Of course, we haven't considered the *unknown* unknowns, including the timeframe in which the above scenarios might take place or the probabilities of each scenario. For now, markets are cautiously optimistic that the US military attack was successful in severely hampering Iran's nuclear program and that Iran's response will be limited. I'm on the lookout for any deviation from these assumptions.

Investment Implications

Here are three considerations for investors:

- **Ongoing uncertainty may warrant a risk premium[2] for oil prices** – Until we see a definitive response to the attacks, I am assuming Brent oil retains a US $5–$10 risk premium. That said, any reduction in uncertainty could translate into lower oil prices, in my view, given the surplus of more than 1 million barrels per day that our oil experts expect over the full year 2025.
- **Geopolitics is less important than economics for markets** – In the past, the impact of geopolitical events on markets tended to be smaller and shorter than the impact of economic events (e.g., the business cycle). In this context, the two are interconnected. That said, if the market drops sharply due to geopolitical news, I'd expect history to repeat and would take on more risk at more attractive levels.
- **The longer-term trend may continue to shift away from US exceptionalism** – The US strike may lift the US dollar, but I would interpret that as a temporary reprieve and would consider positioning portfolios toward a weaker trend that would benefit equities outside the US.

Talk to your financial professional about how to position your portfolio amid geopolitical uncertainty.

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

[2] A risk premium is the investment return an asset is expected to yield in excess of the risk-free rate of return.

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