



Conflict in the Middle East

The world has been shocked by the terrible events in the Middle East since Hamas first attacked Israel on Saturday 7th October. Elevated geopolitical risk has been a key theme for some time due to already high tensions between US and China, China and Taiwan and Russia and Ukraine. The situation in the Middle East adds further to global tensions and in this flash update we will consider the impact on markets.

The largest market impact has been in commodities. While moves in oil and gold have been fairly contained (both 4-5% higher), in some pockets of the market the impact has been much greater - European gas prices are up around 25% since before the first attacks after disruption to production at the Tamar gas field in Israel has raised fears of a decline in exports to trading partners, exacerbating concerns related to Australian industrial action at natural gas facilities. There is some reassurance from gas storage levels in Europe being high, in preparation for winter. However, this disruption potentially adds to existing growth challenges for Europe where the World Economic Forum has recently revised down growth estimates. Israel is not a key oil producer, hence the immediate influence on the oil price has been quite limited. If the conflict escalated significantly (eg with formal involvement of Iran) we could see a scenario that brings greater disruption to shipping routes and, as a result, a greater increase in oil prices.

In stocks, there has been a sizeable impact (more than 10% declines) in the local Israeli and Palestinian markets, but for those markets that dominate global indices moves have been very limited - US and UK equity markets are actually higher (by 1.5-2%) than before the attacks as other drivers have dominated. Bond yields are little changed.

Economic data and monetary policy are providing some more positive news for global markets at present. Inflation has fallen sharply from recent highs although, at present, remains well above target in US and UK with the most recent data pointing towards stickiness in core prices. Additionally, labour market data remains strong with low unemployment and above inflation wage growth. Despite this, both the US and UK central banks have recently paused their aggressive rate hiking cycles citing that the future economic path is highly uncertain. While challenges remain for global economies as there is adjustment to higher interest rates, this change in stance from central banks provides support to both short-maturity bonds and to equity markets. Upcoming economic data and the earnings season will provide more information on economic health.

From here, investors will be closely watching the move in commodities in the weeks ahead. We believe there is little geopolitical premium in the oil price currently, and there is a risk of a sustained shift higher in commodity markets (if cool heads do not prevail) which could derail the positive progress on bringing inflation down.

Bottom Line

Whilst investors may be underestimating the risks of the escalating conflict in the Middle East - Individual geopolitical events tend to not have a lasting impact. However, ongoing events in the Middle East adds to already elevated global geopolitical tensions and further emphasises the attractiveness of holding commodity exposure within a multi asset portfolio.

For more information, please contact your adviser.

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