

War and Peace Dividend



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The U.S. and Israeli military action against Iran over the past few days has injected risk and uncertainty into the global economy and investment markets. Compared to the state of markets only a week ago, it's not a stretch to say that everything has changed in only a few short days (It obviously has for those closest to the conflict). Yet, in other ways, nothing has changed.

First, we must emphasize that nobody "knows" what will happen next in the days, weeks, and months ahead. The situation will change frequently, and the range of outcomes is wide. After collecting insights from our trusted network of subject matter experts, ranging from independent investment research teams and chief economists to former U.S. Generals, here's **what we think investors need to know**.

The geopolitical stakes:

- This is truly a **potentially historic and significant development**, and not merely another "targeted" military operation. As the leading sponsor of terrorism around the world and in particular the Middle East, the likely neutering of Iran's military and the impact on their economy should be a global positive (all else being equal, which of course, is not guaranteed) in both the short and intermediate term.
- One of the key questions is...*how does this end?* While it's possible that it may end very quickly, the experts we trust think that's unlikely. A campaign lasting a few weeks is the most plausible scenario, with the U.S. standing down once we declare our military objectives to be complete.
- The other key, and **perhaps most important question is whether this results in "regime change"** from the religiously extreme faction that has been in control of Iran for decades to a more global and western-friendly government? If this occurs, it could yield a historic

"peace dividend" globally, resulting in a safer planet, with less violence, lower energy prices, and many more potential benefits.

- Over the past twelve months, the two operations in Iran and the one in Venezuela are net negatives for both China and Russia. This could have second order benefits like reducing the risk of conflict around Taiwan.
- It remains to be seen if the conflict spreads beyond the Middle East. Are there Iranian-sponsored terror cells in the U.S., Europe or Asia that will be "activated" in response to the attacks? We hope not. This could affect the political calculus.

The potential impact on the U.S. and global economy:

- The **largest wild card is the price of oil** and its impact on businesses and consumers. You can't have a war in the middle east without risking significant increases in the price of oil and gas. But OPEC has already pledged to increase oil production and since the U.S. is now a major oil producer, the spike may be limited, or at least short-lived. KKR predicts the price of gas in the U.S. is likely to jump 40 cents. Manageable. But countries that depend more on Iran for their supply of oil will likely see much higher energy prices. And Europe is likely facing much higher Liquid Natural Gas (LNG) prices until the conflict ends.
- Global Trade could be hurt not just by higher energy prices, but by higher insurance costs and constrained shipping. In the U.S., consumer confidence was already very low. Higher gas prices and the stress of being at war will only hurt. Lower confidence could crimp consumer spending, denting the economy.

The current and long-term investment implications:

- At least in the short term, **some measures of inflation will go up** along with energy prices. In the last few days, interest rates have gone up slightly in response. An inflation spike could give the Fed reason to pause in their expected interest rate cuts.
- Also in the short term, **expect continued volatility**. There will be days like we've had this week with relatively large declines of 2% or more. There may be a week or two of 5% down moves. Looking at the market's historical reaction to geopolitical shocks and the current market technicals, we think an 8% down move is not out of the question. In fact, it might be quite likely. Even a short-term decline of up to 15% is possible, but there should be strong support at those levels if we get there.
- In many ways, the factors and themes that were important at the start of the year – including a rotation from growth to value and from U.S. to non-U.S. assets - remain unchanged.

During crisis events and times of elevated volatility, investors are well served to remember:

- Historically, sharp down days are clustered with sharp up days too. Timing these moves is very difficult and can be risky. We don't think it's wise to try to *"get out until things calm down and then get back in."*
 - Crisis-related selloffs don't last forever. Ned Davis Research (NDR) has identified 59 crisis-related market declines since 1907. The **average decline has been 7.0%**. On average, six months later markets were 9.7% higher, and 15.1% higher a year later. The big exceptions and negative outliers to these averages were when they accompanied major economic weakness, which while possible, appears unlikely this time around. Since 59 incidents over 119 years is a lot, and many are not relevant to today, NDR identified the nine incidents most similar to today in this chart. Stock market returns 21, 63, 126, and 252 days later are

Event	Market Day Before Event	% change in the DJIA			
		21	63	126	252
Korean War	6/23/1950	9.1	15.3	19.2	26.3
Cuban Missile Crisis	10/19/1962	12.1	17.1	24.2	30.4
Cambodia invasion	4/29/1970	0.4	3.8	13.5	36.7
Iranian Hostage Crisis	11/2/1979	4.7	11.1	2.3	17.0
U.S. bombs Libya	4/14/1986	-4.3	-4.1	-10	25.9
U.S. enters Gulf War	1/16/1991	11.8	14.3	15.0	24.5
Afghanistan War	10/5/2001	5.9	11.5	12.4	-16.8
Iraq War	3/19/2003	5.5	9.2	15.6	-22.0
U.S. bombs Iranian nukes	6/20/2025	5.4	9.7	13.6	N/A
Median		5.5	11.1	13.6	25.2

Source: Dow Jones, NDR

included. We highlighted the very small number of negative returns. More reason for optimism.

- One of the most important elements of your investment plan is to make sure that your portfolio is aligned with your personal tolerance for volatility, investment goals, and time horizon. If these all line up correctly, then **short-term uncertainty and volatility is a non-issue**.
- Investment predictions and short-term trading are very difficult. As I write this, the price of Gold is down almost 6% TODAY ALONE. You'd think it would be up significantly in times of global war and heightened inflation risks.
- Today's **markets are full of leverage and crowded trades** that can **amplify short-term declines**. When someone yells "Fire" in a crowded movie theater, the exits get backed up. The hottest investments can turn cold in the blink of an eye. Forced or panic selling by overleveraged investors is the most logical explanation for the sharp decline in Gold. Within stocks, one of the strongest stock markets this year, South Korea, which you'd also think would be somewhat insulated from the conflict in the Middle East, is down 16% in the last two days. The fingerprints of leverage and excess risk taking are all over these moves.
- In the end, we are once again reminded of the **importance of building resilient, truly diversified portfolios**. Reliable diversifiers are important to designing portfolios that can smooth volatility and that have a chance to succeed in a variety of economic outcomes. Stocks and Bonds are not the only tools at our disposal - alternative assets and strategies can be particularly useful during periods of inflation and geopolitical stress.

The future is uncertain. This most recent military action could backfire on the U.S. both politically and economically, or it could result in a tremendous peace dividend that lasts for years or even decades. So far, most of the subject matter experts that we've checked in with think the most likely outcome is

somewhere in between – once the military action is over,

a somewhat positive (for the U.S. and global economy) development but a new, unpredictable, and sticky situation if Iran does not experience regime change. While we wait and watch, we may be **opportunistic** if we see an investment that we think experiences an unjustified decline. And if we do nothing, we will do so comfortably thanks to the sophisticated diversification embedded in our portfolios and the knowledge that these times of crisis rarely lead to longer-term or significant dislocations in core asset classes.

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