

MARKET SIGHT LINES



Iran Conflict: What Happened, and What It Means for Markets

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For months, U.S. and Iranian representatives have engaged in on-again, off-again indirect nuclear negotiations, with Oman playing a key intermediary role and the latest round taking place in Geneva. President Trump continued to signal that military action remained on the table if diplomacy failed to deliver meaningful progress. While there were some reports that talks had stalled and others that progress was being made, the window for an agreement closed quickly. Early on the morning of Saturday, February 28, the U.S. and Israel launched a coordinated strike on Iran and Iran responded, triggering a fast-moving military conflict that is still unfolding. Stifel thought leaders came together to discuss the situation in a **client webinar** this week. And in this Sight|Lines, I provide an update on the conflict, initial impacts on economies and markets, and where investors should be focused from here.

THE TAKEAWAY: TOPICS IN FOCUS INCLUDE MOTIVATIONS, OIL, DURATION, AND EXPANSION RISK

Motivated by nuclear risk – and, potentially, a bid to destabilize the regime – the U.S. and Israel launched strikes on Iran, jolting markets even as the conflict continues. In summary:

- Months of on-again, off-again indirect negotiations between the U.S. and Iran failed to produce a durable nuclear framework, and President Trump's approach ultimately shifted from diplomacy to force.
- The U.S. and Israel launched an attack on Iran with the goal of reducing nuclear risk and, especially for Israel, potentially weakening Iran's regional influence and destabilizing the regime.
- Iran's aggressive retaliation has not been confined to Israel, with strikes and threats extending across U.S. assets and key regional partners, increasing the risk of broader engagement from Iran proxies and allies.
- The most immediate market impact has been on energy, with the Strait of Hormuz effectively closed, disrupting oil and liquefied natural gas (LNG) flows and tightening near-term supply conditions.
- The conflict has evolved into an ongoing exchange of strikes, with no clear off-ramp visible and a fluid set of military, political, and logistical factors shaping day-to-day developments.
- Markets have responded in a familiar pattern – oil prices are up, uncertainty has increased, volatility is elevated, and equities markets mixed to lower – while investors continue to weigh how long disruptions will last.
- Key areas in focus from here include the continued impact on oil markets, the duration of the conflict, the risk of escalation and global expansion, and the risks to critical infrastructure, shipping, and supply chain logistics.
- The economic impact can be meaningful: Higher energy costs can add to inflation and slow growth, complicating the path for central banks and impacting markets going forward.

IN-DEPTH: WHY THIS ESCALATED, THE IMPACT ON THE STRAIT OF HORMUZ AND OIL MARKETS, THE IMPORTANCE OF THE DURATION OF THE CONFLICT, AND THE RISK OF EXPANSION

Motivated by nuclear risk – and, potentially, a bid to destabilize the regime – the U.S. and Israel launched strikes on Iran, setting off a conflict that has lifted oil prices, increased volatility, and impacted global markets, even as fighting continues. Going deeper:

- After months of negotiations failed, the U.S. and Israel launched an attack on Iran on February 28:
 - This has been a substantial campaign and response, with the U.S. and Israel launching a large-scale strike campaign, and Iran responding with hundreds of missiles and thousands of drones, although Iran's launches are declining daily.
- Then the U.S. and Israel appeared to have parallel goals in this effort:
 - The U.S. sought to reduce the Iran nuclear risk, while Israel seeks to destabilize or even eliminate the regime.
 - Initial targets included nuclear facilities, other military facilities, and government military leadership.
 - The Ayatollah Ali Khamenei and dozens of other senior government and military leaders are reported killed.
- Iran has targeted U.S. bases and civilian areas in the region, increasing the risk of broader engagement from proxies/allies:
 - The targets include multiple Gulf states and regional targets (including attacks reported as far as Cyprus).
 - Hezbollah launched attacks on Israel from Lebanon, drawing a counterattack from Israel, with other Iranian-backed militias reported to have joined the fight.
- The Strait of Hormuz is effectively closed, disrupting oil and LNG flows and tightening near-term supply:
 - In normal times, approximately 20% of the world's oil flow passes through the Strait each day.
- The conflict remains active with an ongoing exchange of strikes, with a focus on how long supplies will last:
 - While Iran's launches were trending downward, its hardened underground infrastructure may be tougher to destroy.
 - There are also reports questioning if the supplies of interceptor munitions will be sufficient moving forward.
- Markets have responded, with investors focused on how long disruptions will last:
 - The S&P 500 is down 0.1%, MSCI EAFE is off 5.4%, and MSCI Emerging Markets is down 8.6%.
 - The VIX Index, a measure of equity volatility, is up 6.5%, with the MOVE Index, a volatility index for bonds, down 4.6%.
 - Oil prices have risen 11.7%, and oil futures signal a return to Friday's close in roughly seven to eight months.

WHAT WE THINK

We remain focused on the shape and possible duration of the conflict. Futures markets are signaling seven to eight months to return to normal. Iran's responses seem to be weakening each day, but the risk of escalation includes conflicts with proxies and other actions around the world. Following the death of Ayatollah Ali Khamenei – a figure viewed as a key authority by approximately 10% of the global Muslim population (largely Shia communities) – global security alerts have been elevated. Specifically, the Department of Homeland Security has issued a notice highlighting the heightened risk of proxy-led retaliation.

We are also focused on the impact of the conflict on the global economy and markets, including supply/flow of oil, critical infrastructure, shipping, and supply chain logistics. These bottlenecks, combined with potential retaliatory actions, threaten to dampen business and consumer confidence, creating a challenging environment for corporate earnings and market stability. Higher energy costs can be inflationary, motivating central banks to keep rates steady or increase them, while slowing economies call for lower rates to stimulate activity, together presenting a challenge to central banks. For now, we maintain our view for one or two rate cuts by the Federal Reserve this year. While we hope for a quick resolution to this conflict, we must be prepared to weather increased volatility during an extended campaign.

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