

# MARKET SIGHT LINES



## Global Impacts of the U.S./Israel-Iran Conflict

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March 27, 2026



This month, we shared **what initially happened in the U.S./Israel-Iran conflict, four possible scenarios looking forward, and how the conflict may be impacting Federal Reserve policy.** With the closing of the Strait of Hormuz, this conflict has most impacted global oil and other energy markets. More recently, markets have responded positively to talk of peace negotiations. But the risk of an extended conflict remains. All of this begs the question: What are both the immediate and downstream impacts of higher energy prices here in the U.S. and elsewhere? In this Sight|Lines, we take a step back and inventory the various ways higher oil prices – and higher energy prices more generally – may further impact the economy and markets both here and abroad.

### **THE TAKEAWAY: THE EFFECTS ARE WIDE REACHING AND POTENTIALLY LONG LASTING**

The Iran conflict has already had an impact, of course, but we should also consider the longer-term implications if the conflict extends further in time. In summary:

- Investors are appropriately focused on near-term inflation, but we should also consider the extended inflation effects as higher energy costs impact the prices of goods and services.
- The 10-year Treasury yield has jumped, and forces may keep it higher for longer.
- The U.S. dollar has strengthened some, but our fiscal trajectory may be muting that effect.
- Gas prices at the pump jumped globally, one additional affordability burden on an already-shaken consumer, risking the confidence that would drive continued consumption growth.
- These energy shocks are known to be a headwind to the global economy, and while we expect to see positive U.S. growth forecasts to decline some, economists are not calling for a recession ... at least yet.
- Forecasts related to U.S. equities (earnings, indexes) do not yet reflect this energy shock fully, setting up the potential for more volatility and weak market pressures.
- The economies and markets of Europe, Japan, and China – all big net importers of energy – are at greater risk from an extended conflict and disruption to global energy production and flow.

## IN-DEPTH: THE EFFECTS OF THE IRAN CONFLICT ARE WIDE REACHING ACROSS THE GLOBE AND HAVE THE POTENTIAL TO BE LONG LASTING

While the Iran conflict has had an immediate impact, we should also focus on the longer-term impacts if peace is elusive and the conflict extends further out in time. Going deeper:

- The jump in energy prices will affect near-term inflation, but higher energy costs will impact prices over time:
  - The one-year breakeven rate sits at 5.1%, with the five-year breakeven rate at 2.6%, above the Fed's 2% target.
- Interest rates have risen since the start of the conflict, and forces may keep them higher for longer:
  - The 10-year Treasury yield has risen from 3.95% to 4.37%, with the increase attributed to inflation worries.
  - Experts also point to higher term premiums – yield compensation – related to the risks of increasing U.S. debt.
- While the U.S. dollar has strengthened, our fiscal trajectory puts the dollar's appeal at risk:
  - The U.S. dollar is up 1.9% against the euro and 2.3% against the yen this month.
- Affordability, weakened by elevated inflation this decade, will be further impacted by this energy shock, and prices of gas at the pump have jumped globally:
  - This month, average gas prices are up 33% in the U.S., 9% in Europe, and 13% in Japan.
- Energy shocks are a headwind to economic growth, but economists are not calling for a recession ... at least yet:
  - Some economists estimate that every \$10 increase in oil prices reduces global GDP by roughly 0.1-0.2 percentage points.
  - The consensus 2026 U.S. GDP growth rate is 2.4%, declining to 2.0% in 2027.
- Forecasts related to U.S. equities (earnings, indexes) do not yet reflect this energy shock fully:
  - 2026 S&P 500 earnings growth is now forecasted at 16.7%, compared to 16.0% at the end of February.
  - The average year-end 2026 S&P 500 target has moved from 7,561 to 7,501, with most targets unchanged.
- Europe, Japan, and China – all big net-importers of energy – are at greater risk from extended disruptions in global energy production and flow:
  - Almost 38% of China's oil imports pass through the Strait of Hormuz in normal times.
  - Some estimates indicate Europe and Japan GDP growth could fall 0.5% if the conflict extends beyond six months, well above the 0.2% estimated decline for U.S. GDP growth.

### WHAT WE THINK

The U.S./Israel-Iran conflict has shaken global markets, with reactions much the result of a jump in oil and other energy prices triggered by a supply disruption to the global production and flow of oil. While people are hopeful about recently announced potential peace negotiations, we must also prepare for the possibility that negotiations fail, or never begin, leaving the possibility of an extended conflict. The oil supply shock, and especially the closing of the Strait of Hormuz, reminds us of the importance of considering the near-term and potentially long-term effects of the conflict. In some ways, the U.S. is insulated from the worst, as Europe and Asia – each more dependent on oil imports – take more of the brunt of the effect. But if the conflict is extended, the energy shock will disrupt global economies and markets further.

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Asset allocation and diversification do not ensure a profit and may not protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. The Bloomberg software Index is a price-weighted index of software companies located or doing significant business in the Silicon Valley. The Bloomberg 500 Financials Total Return Index tracks the financial sector within Bloomberg 500 Universe. This index includes 87 constituent companies spanning various financial services sectors. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. The DJIA was invented by Charles Dow back in 1896. The MSCI EAFE Index (Europe, Australasia, and the Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. VIX is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains. Volatility is measured by calculating the standard deviation of the annualized returns over a given period of time.

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