

# MARKET SIGHT LINES



## A Managed Off-Ramp Takes Shape: Markets, Inflation, and the Fed

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The **war in the Middle East** started as a fast-moving conflict that closed the Strait of Hormuz and sent oil sharply higher. As events unfolded, we laid out **four possible paths** the conflict could take, ranging from a dangerous escalation to a durable peace. The scenario now taking shape appears to be the one we called a “Managed Off-Ramp” – a negotiated, conditional de-escalation rather than a clean and final resolution. After nearly four months of fighting, the United States and Iran have agreed to a framework that extends their ceasefire, reopens the Strait of Hormuz, and lifts the U.S. naval blockade. Markets have responded quickly: Oil has fallen to a three-month low, equities have pushed to record highs, and Treasury yields and inflation expectations have eased as the energy-driven risk premium unwinds. In this Sight|Lines, we look at the immediate market impact across oil, stocks, and rates, examine how inflation expectations are shifting, and note what it all means as the Federal Reserve – under new Chair Kevin Warsh – delivers the first policy decision of his tenure this week.

### **THE TAKEAWAY: A FRAGILE PEACE IS ALREADY EASING OIL, INFLATION, AND RATE PRESSURES**

The path to a lasting peace is not yet secure, but the early market reaction shows how much market worries have been tied to energy and the Strait of Hormuz. In summary:

- The deal reopens the Strait of Hormuz and lifts the U.S. naval blockade.
- Oil has fallen sharply, with WTI and Brent down roughly 5% to three-month lows.
- The oil futures curve now points to WTI near \$70 a barrel by late 2027.
- Breakeven inflation rates are pulling back as energy fears fade.
- Equities have rallied to record highs as investors focus further on a resilient economy and earnings growth instead of Middle East worries.
- The 10-year Treasury yield is unchanged despite easing inflation concerns.
- Expectations for rate hikes have increased following the Fed meeting.
- In Chair Kevin Warsh’s first meeting, the Fed left rates unchanged but adjusted its approach to communicating decisions.

## IN-DEPTH: A MANAGED OFF-RAMP IS UNWINDING THE ENERGY RISK PREMIUM

The market's response is less about confidence in a signed peace deal and more about the removal of an energy shock that had been feeding into inflation and interest rates. Going deeper:

- The agreement reopens the Strait of Hormuz and lifts the U.S. naval blockade, easing energy concerns:
  - Roughly one-fifth of the world's oil and LNG trade flows through the strait, at a standstill during the conflict.
  - The framework extends the ceasefire for 60 days, but shipping and production may take months to fully normalize.
- Crude prices have dropped as the threat to global supply recedes:
  - WTI fell roughly 4.8% to about \$81 per barrel and Brent about 4% to about \$84, both near three-month lows.
  - Oil is now down roughly 20% from its 2026 peak as traders unwind the premium built up since the Strait closed.
- The forward curve signals that markets expect supply to normalize and remain ample:
  - WTI futures are pricing near \$70 per barrel for delivery in December 2027.
  - Analyst forecasts have followed, with some cutting Brent forecasts to \$70 for the fourth quarter of 2026.
- Lower energy prices are pulling down market-based inflation expectations:
  - The one-year breakeven inflation rate has eased from 5.4% in March to 2.0%.
- Equity markets have rallied to record highs as the risk premium unwinds:
  - The S&P 500 is up 1.1% since the framework was announced.
  - The MSCI EAFE Index is up 1.4%, with Korea's Kospi rising 8.0% and Japan's Nikkei up 5.0%.
- Treasury yields have been range bound:
  - The 10-year yield has remained steady around 4.45%, reflecting that **other forces are keeping rates higher**.
- Expectations for rate hikes have increased following the Fed meeting:
  - Prior to the announcement, fed funds futures signaled two 0.25% hikes over the next two years.
  - Now futures are signaling two 0.25% hikes between now and April.
- The Fed's decision this week is Kevin Warsh's first as chair:
  - The Fed kept its policy rate unchanged, but signaled there is a clear shift away from explicit guidance, no rush to cut as inflation is still above target, and the economy is strong enough to tolerate restrictive policy.
  - There will be a task force for monetary policy on fed communication, the balance sheet, the use/reliance of existing data, productivity of jobs, and inflation frameworks.

### WHAT WE THINK

While early market reaction has been encouraging, the fragile framework is not a signed and durable peace, and the path from here has potential pitfalls. Implementation will be challenging – it will take time and a concerted effort to reopen the Strait of Hormuz to normal traffic, as sea mines must be cleared, damaged infrastructure repaired, and both sides must honor a 60-day ceasefire that has broken down before. Any setback – a renewed closure of the strait, or a return to fighting, for example – could quickly send oil and inflation expectations back up while pressuring stocks and bonds. In fact, gold rose as risk assets rallied, signaling investors may not yet fully trust the deal. After nearly four months of conflict, a managed off-ramp – even a fragile one – is a real and welcome step. We will watch closely as the details come together, and we remain hopeful that a lasting peace can be achieved.

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