RATHBONES

Weekly Digest

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# Keep your seatbelts fastened

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***For now the focus remains squarely on the Iran conflict and closure of key shipping lanes, but hopes for a de-escalation have helped reduce the turbulence. Holding to our long-term focus is still the best way to keep our seatbelts fastened.***

**Quick take:**

- Strait of Hormuz remains closed to supplies of oil, other commodities.
- Markets have regained composure, but extended closure remains a risk.
- Balanced portfolios are flat for the year, and sticking to long-term strategies still seems best.

I started last week's commentary by noting the numerous forces at work in the markets, beyond the conflict in the Middle East, and tried to convey a sense of the bigger picture that long-term investors need to be mindful of. One week on, and investors' immediate focus continues to be on the Iran conflict and related market convulsions. And rightly so – we understand our clients' concerns about the implications for their portfolios of the escalating conflict.

While we remain vigilant as the situation develops, we still believe that it's best to stick to long-term strategies. That's still preferable to trying to trade on the unpredictable twists and turns of this war.

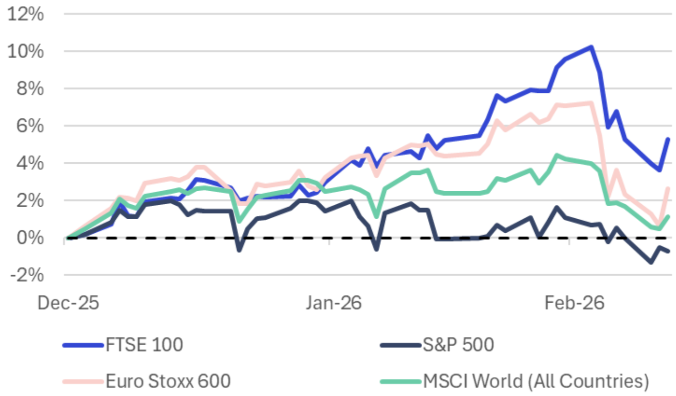
## Underestimating Iran's reaction

As the first week of hostilities unfolded, it became clear that the wider investment community (and possibly the US government) had underestimated the scale of Iran's reaction. The consequences included, most strikingly of all, the effective closure of the Strait of Hormuz because of Iranian attacks on shipping. Before the conflict, about 20% of the world's oil passed through the Strait.

The cost of a barrel of Brent crude oil rose from $70 on the eve of the attacks to an intra-day peak of close to $120 on Monday, 9 March. Stocks also fell.

But when markets closed on Monday, they'd bounced back from the initial steep selling that started the week. Major regional equity markets were between 2% and 10% lower from when the crisis started. That's left global equity indices, in aggregate, back where they started, although the UK's FTSE 100 has delivered a total return (including reinvested dividends) of 5.3% (see chart below).

### Stocks are mostly little changed or up for the year so far




Sources: FactSet, Rathbones; total returns in local currency as of 11 Mar, set to zero from 31 Dec 2025.

Yields on longer-dated government bonds have risen again as inflation, through higher oil prices, becomes a bigger threat, delivering capital losses to holders.

A balanced sterling-denominated portfolio, however, is roughly flat for the year so far.

The greatest impact has been on commodities, especially energy, with the world focused on the Strait of Hormuz, the narrow body of water between Iran and Oman. The key question is how long the flow of energy through the Strait will be affected. This will determine how large any potential stagflationary shock might be. By that, we mean a shock that pushes up inflation and pushes down growth.

Natural gas prices will be of more concern to importers, including the UK and Europe. UK wholesale gas prices had doubled from £80 per thousand therms (one therm = 1,000 British thermal units) per day to £160, before falling back somewhat.  And gas is the marginal price-setter for UK electricity prices. At least the blow is softened in the short term by the fact that household utility prices are now set until July. The government may also reintroduce subsidies to cap them in future.

Moreover, supply disruptions don't just affect household energy. UK farmers are already suffering from flooded fields and crops have also been disrupted by extreme weather in Southern Europe and North Africa. So these supply disruptions will make it more likely that fresh food prices rise too.

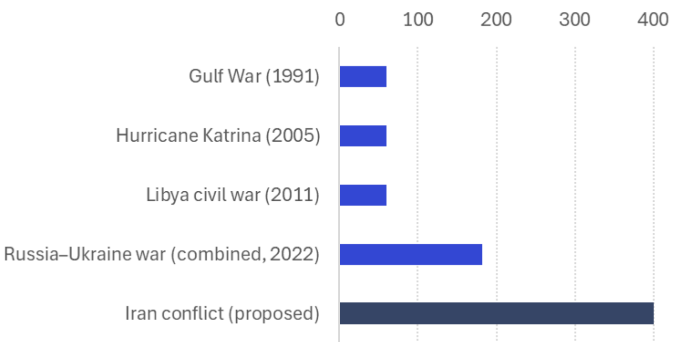
And taking a wider view, many countries on the Asian sub-continent, notably India, count on fertiliser supplies from the Middle East. Shortages could unleash a humanitarian crisis.

### Light at the end of the tunnel?

Since Monday's dramatic moves, there's been better news and a more positive market response. The International Energy Agency (IEA) has proposed releasing 400 million barrels of oil from strategic reserves, the largest in the IEA's history (see chart below). This is more than double the agency's biggest prior release. It's also the equivalent of about a month's worth of the reduced supply from the Middle East, taking into account the fact that the Saudis are diverting as much oil production as they can to the Red Sea via pipelines, avoiding the Strait of Hormuz.

### Historic release of strategic oil reserves

**IEA releases of strategic oil reserves (mn barrels)**




Source: IEA; 2022 is a combined total for March and April releases in that year; the 2026 figure is a proposal that is awaiting agreement with IEA members.

The need to keep supplies flowing was emphasised by US plans to provide naval escorts through the Strait. France has also offered to send destroyers to the region to keep shipping lanes open. In addition, the US plans to offer a government-backed reinsurance facility for tanker owners. But markets responded most positively to comments by US President Donald Trump on Monday evening, suggesting that he saw the end of hostilities approaching.

Brent crude front-month futures (contracts to purchase Brent crude with the nearest expiry – the most actively traded price for crude), have settled to around $88 per barrel at the time of writing. That's down from an intraday high close to $120 on Monday. US equity markets, which had at one stage early on Monday been priced in for a 2.5% fall in futures markets, ended the day gaining almost 1% and were roughly unchanged from there by Tuesday's close. You can read more about the context of these moves in our recent Investment Update.

### What action to take?

We're operating in a different market regime compared to the last 40 years, characterised by heightened geopolitical tension and inflationary pressure. Geopolitical events are hard to predict and it's not advisable to trade them. In fact, history mostly suggests the right reaction is not to panic. Instead, the best policy is to stick to a long-term investment strategy.

Moreover, various 'tilts' can play a part in protecting against the negative effects. These include:

- Owning quality companies
- Reducing exposure to inflation-sensitive longer-term bonds
- Having a good mix of diversifiers that don't move in tandem with other assets

Within equities, we would expect higher-quality companies to be relatively resilient in the current environment. Our decision to invest in shorter-dated bonds has been beneficial as they've avoided the worst of the sell-off suffered by their longer-dated counterparts.

**Staying invested**

Of course we remain prepared for further disruption and volatility in the short term. But the fact that the US administration has set a changing, and sometimes contradictory, list of objectives for success means it has given itself choices. It can decide what success is – and de-escalate when it asserts that success has been achieved. As we've witnessed with other decisions from Trump, this could happen at any moment – and there would be no time for investors to react.

Sticking with long-term strategies and well-constructed portfolios remains the best way to keep our seatbelts fastened through the current turbulence.

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## Regional highlights

**US.** The S&P 500 is now roughly unchanged for the year so far. In the last few days US stocks in aggregate have recouped losses from both last Friday's unexpected losses in the payrolls report for February and the latest Iran-related selling. Nonfarm payrolls declined 92,000 in February, significantly worse than the gain of 55,000 that was expected. The unemployment rate increased slightly to 4.4%. The jobs report suggests a higher risk of weakening in the labour market, which could in turn weigh on consumer confidence. For now, consumption seems stable, with core retail sales (excluding autos and gasoline) increasing 0.3% in the latest figures for January, in line with expectations. The negative report is offset by larger-than-expected gains in the previous month, and won't lead to any significant changes in the outlook for US growth and interest rates. The main risks to current forecasts stem from the Iran conflict.

**UK.** Despite the recent turbulence, the FTSE 100 had still managed a 5.3% total return by the close of play on Tuesday. Fresh evidence to suggest that the UK economy had strengthened into the new year came from January's money and lending data. An increase of £1.8bn in consumer credit (slightly better than the £1.7bn increase expected) added to other evidence of strengthening activity. Consumers also seemed to be spending more, with January's £4.2bn rise in bank deposits being below the average rise of £7bn for the previous six months. Weak employment growth and slowing wage growth are likely to keep consumer spending from growing by much more this year. Any potential inflationary shock from events in the Middle East would both weigh on consumption and limit interest-rate cuts by the Bank of England.

**Europe.** Equities have come through the recent ructions with slight gains on a year-to-date basis. However, recent data has signalled a soft start for the year for Germany, the growth engine of Europe. Industrial production declined in January, with widespread weakness across manufacturing sectors. As is the case elsewhere, rising energy prices and ongoing geopolitical uncertainty are weighing on the outlook for already-fragile growth in Europe. In terms of more real-time data, the latest figures from the Eurozone's Sentix index of investor sentiment on the economic outlook was downbeat, falling 7.3 points to -3.1 in the latest reading for March.

**China.** Recent data has boosted hopes for some 'reflation' following a period of weak growth and falling prices. Headline CPI inflation was 1.3% in February, with broad-based increases across food and consumer goods. Core CPI, excluding more volatile food and energy components, increased to a 7-year high of 1.8%. Although they remain in deflation, there was also improvement in producer prices (PPI), from -1.4% in January to -0.9% in the February reading.

# Additional information

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