INDOSUEZ WEALTH MANAGEMENT

CIO PERSPECTIVES

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Clashes Between Israel and Iran: What Impact on Our Investment Strategy?

The recent clashes between Israel and Iran serve as a stark reminder of how geopolitical tensions can weigh on financial markets and the global economic outlook. While this conflict adds a new layer of uncertainty to an environment characterised by global challenges, we continue to closely monitor its potential impact on oil prices, inflation, and economic growth. In this context, our analysis examines various potential scenarios for how the situation could unfold, reaffirming our commitment to managing your portfolios with the right balance of prudence and conviction. As investors, it is essential to navigate these turbulent times with a long-term perspective, bearing in mind that opportunities can emerge even in a climate of uncertainty.

We are now on the seventh day since the start of hostilities, and our first thoughts go out to the victims of this conflict, who add to the many casualties of the war in Ukraine. Our hope, along with that of the international investment community, is that these conflicts will be resolved peacefully.

This edition of CIO Perspectives focuses on the potential impacts of the conflict on oil prices, inflation, and, consequently, our investment strategy. To provide context for our perspective, we find it valuable to share the analysis from our colleagues at Amundi Institute, which highlights several potential scenarios for how the conflict may evolve. Israel has struck Iran's military and nuclear capabilities, but without military support from the United States, it is unlikely that Israel could permanently destroy these capabilities. In the worst-case scenario, Iran might choose to escalate asymmetrically in the Strait of Hormuz. In the optimistic scenario, diplomacy remains an open avenue, with Iran viewing it as its best option for survival. Finally, there is the possibility that Israel might aim to destabilise the Iranian regime—potentially with the goal of toppling it—by targeting domestic infrastructure, thereby increasing the risk of public unrest.

The market impact of each of these scenarios could be summarised as follows: an asymmetric escalation might lead to a significant rise in oil prices, with knock-on effects on global inflation and economic growth. If diplomacy prevails, markets could see reduced volatility and stabilisation in oil prices. Attacks on Iran's domestic infrastructure could increase market volatility, particularly in the energy and commodities sectors. These impacts are summarised in Table 1.

Table 1: Scenarios for the Evolution of the Conflict Between Israel and Iran and Possible Market Impacts

Iran/Israel Scenarios

	Scenarios and possible evolutions		Market implications
1	**Talks follow Israel attack**	Iran opts for diplomacy to survive before Israel/US decimates its nuclear/military capabilities. Talks begin as military escalation calms. A deal remains possible, though risk of wider war persists due to Iran's nuclear ambitions.	Market calms as escalation risk decreases in the short term.
2	**Regional escalation**	**Only Iran/Israel:** Iran avoids wider regional involvement to keep talks possible and reduce regime change risk. Retaliates enough to 'save face' but avoids major regional escalation. Risk spikes if Strait of Hormuz is targeted.	Higher risk for oil, but still contained if oil sites are not directly targeted.
		Broader region: Militias in Iraq, Yemen, Hezbollah get involved causing broader instability. Iran may attack Gulf countries. Oil risk higher if Strait of Hormuz disrupted or Gulf oil facilities attacked.	Risk sentiment worsens; regional contagion possible (Jordan, Lebanon, Egypt, Gulf).
		With US involvement: US forces attacked, Gulf drawn in. Largest escalation scenario, potential for wider regional war.	Highest impact on oil prices, risk sentiment, safe havens, gold, and shipping routes.
3	**Attempted regime change**	Israel attempts to eliminate nuclear threat completely and change regime. Targets top leadership. Iran escalates aggressively with nothing to lose.	Market impact similar to major regional escalation scenario.
4	**Nuclear escalation**	Israel attacks Iran's major nuclear sites in way that causes environmental disaster. Iran retaliates by targeting Israel's nuclear facilities.	Market impact similar to major regional escalation scenario.

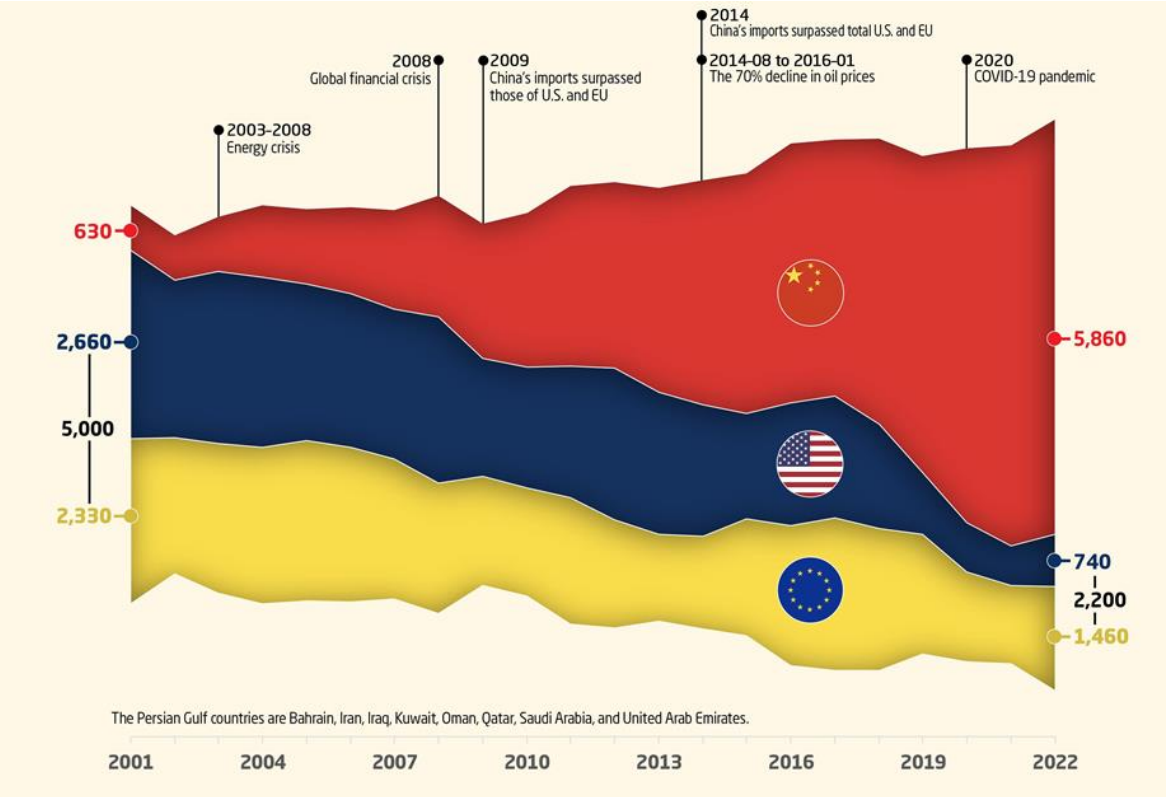
Source: Amundi Investment Institute, internal elaboration. Data as of 13 June 2025. These scenarios are most likely, not exhaustive.

Let us focus on the scenario of asymmetric escalation resulting from severe disruptions to traffic in the Strait of Hormuz, particularly on the impact that a new surge in oil prices could have on inflation. It is worth recalling that the 1970s and 1980s experienced two successive oil shocks, and consequently, two successive inflationary episodes—the second of which was referred to as the "inflation echo." Some fear that after an initial inflation episode in 2021-2022, a second episode—a new "inflation echo"—could arise from the hostilities that began on the night of 12 to 13 June.

For oil prices to have a significant impact on inflation, we would need to see a price rise similar to that observed in 2022, when the market feared that sanctions imposed on Russia would create a shortage of crude oil, destabilising the precarious balance between supply and demand. At that time, the price of Brent crude surpassed 120 dollars per barrel. This increase added to the post-lockdown surge in the prices of manufactured goods and triggered second-round effects that pushed inflation in the United States above 9%. Since then, the situation has normalised, and US inflation has fallen, standing at 2.4% as of May.

What likelihood should we assign to the closure of the Strait of Hormuz and the potential "inflation echo" that would follow? In our view, it is low. Iran's ability to leverage threats to oil transit through the Strait of Hormuz has diminished because, as shown in Chart 2, the United States and the European Union have become less reliant on energy imports from Gulf nations, unlike China. If Iran were to attempt to block the Strait of Hormuz, it would primarily impact China's economy—a strategic partner—rather than that of the United States. This shift in paradigm has resulted in relative stability in the oil market over the past three years, despite numerous tensions in the Middle East. Reflecting the low probability of such a scenario, our colleagues at Amundi Institute have maintained their target price for Brent crude at 68 dollars per barrel by 2026, while acknowledging upside risks in the event of further escalation.

Chart 2: Crude Oil Exports from Persian Gulf Countries to the United States, the European Union, and China (in thousands of barrels per day)



Source: Voronoi.

For several months now, we have been expecting US inflation to accelerate, particularly in the goods component, over the coming months due to rising tariffs. However, we anticipate this rebound to be temporary, as the labour market has significantly rebalanced since the inflationary shock of 2022, which should limit second-round effects on inflation. Thus, barring an escalation in the Strait of Hormuz, inflation is expected to converge towards its target by the end of 2026. Consequently, we believe the Federal Reserve (Fed) is likely to carry out the two additional rate cuts in 2025, followed by two more in 2026, as we have forecast since last year, prioritising caution regarding the slowdown in employment over the temporary inflation peak we expect at the end of the year.

It is worth noting that we took advantage of the stock market rebound in April to reduce our equity exposure. This tactical move aimed to manage risks in a persistently unpredictable geopolitical environment. That said, we maintain a significant weighting in equities and continue to believe that 2025 could be a favourable year for equity markets, supported by decent earnings growth and a gradual monetary easing.

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