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MIDDLE EAST CONFLICT RE-ESCALATION TAKES PORTFOLIO VOLATILITY HIGHER

July 2026

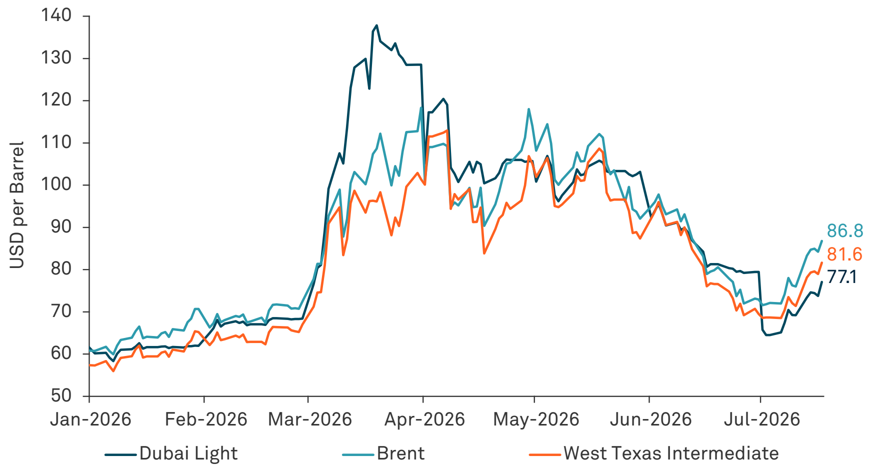
KEY POINTS

- Renewed hostilities in the Strait of Hormuz risk disrupting key energy flows and have pushed oil prices higher. However, the global macro cycle remains resilient due to greater energy management flexibility.
- Our base case remains a "muddling through" scenario where the global economy continues to expand but a renewed spike in energy costs will likely raise market pressure.
- Our outlook remains cautious, favoring Japan and emerging market ex-China equities, real assets, and value-oriented stocks — which we believe are better positioned to withstand supply-side portfolio volatility.

Renewed hostilities in the Strait of Hormuz are once again threatening the energy flows the global economy depends on — and oil prices are already responding. Futures curves are slipping into backwardation with front-dated crude oil contract prices now trading significantly above longer-dated futures prices. The spot price of various grades of crude oil (Brent, West Texas Intermediate and Dubai Light) is beginning to rise sharply again. The price of short-dated refined products has risen even further since late June on a worsening shortage of refined oil products around the world.

Key Oil Price Benchmarks

Dubai Light Vs. Bent & West Texas Intermediate, short-dated contracts, USD per barrel



Source: Macrobond, Data as of July 17, 2026.

De-escalation Still in View

In our latest Quarterly Investment Outlook, we noted that stagflation risks had not entirely disappeared. Despite a memorandum of understanding between Iran and U.S., which resulted in a ceasefire, persistent energy shortages could lead to an inflationary shock at the core of the global economy. This scenario incorporates a more hawkish monetary policy reaction by the U.S. Federal Reserve (Fed) to anchor inflation expectations and to prevent energy price pressures from seeping into core inflation.

Asset prices could tilt toward a stagflation-like scenario in the near term, but it is too soon to conclude that heightened geopolitical outcomes and adverse policy reactions will become the base case. With the U.S. mid-term elections in view, we continue to believe that the political calculus in Washington still favors de-escalation. Iran, possibly facing internal divisions, is unlikely to want its lifeline of oil export revenue to come under renewed and prolonged pressure from an American embargo.

A More Resilient Energy Landscape

Despite the rising re-escalation risks, the global macro cycle has remained resilient due to greater energy management flexibility around the world. Alongside trend improvements in energy efficiency, several countries moved rapidly to alternate energy products and diversified sources of supply. The coordinated and aggressive drawdown of oil product and crude inventories by the U.S. and the Organization for Economic Co-operation and Development (OECD) countries, a group of developed economies, has also helped.

These developments helped limit sharp supply disruptions and shortages of key upstream oil and petrochemical products. In fact, the increase in the twelve-month moving average price of oil has been quite tame relative to other recent energy price shocks such as Russia's invasion of Ukraine in 2022 or the Arab Spring episode from 2011-13. Moreover, recent inflation prints had begun surprising to the downside in the U.S. and elsewhere as energy prices abated toward pre-conflict levels through the month of June.

What This Means for Markets and Portfolios

Our base case remains a "muddling through" scenario where the global economy continues to expand but a renewed spike in energy costs will likely raise market pressure. A shift in the stance of Fed policy and the onset of rate hikes – in line with the market's recent hawkish re-pricing of Fed policy – could raise market volatility as well as elevate stock-bond correlation and strengthen the U.S. dollar. This could create potential buying opportunities in the equity market. We remain cautious, favoring Japan and emerging market ex-China equities, real assets, and value-oriented stocks — which we believe are better positioned to withstand supply-side portfolio volatility.

Important Information

The **Organization for Economic Co-operation and Development (OECD)** is an influential international organization of 37 member countries that discuss and develop economic and social policy.

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