

Middle East tensions prompt market volatility

Key takeaways

- U.S. involvement in Iran has added volatility to financial markets, even as the economic backdrop remains solid.
- Oil prices moved sharply higher as investors focused on risks to shipping routes through the Strait of Hormuz.
- Diversification — and staying anchored to a long-term plan — can help investors navigate short term market swings.

What happened: U.S. intervention in Iran

The United States and Israel carried out air strikes on Iran beginning Saturday morning, after U.S.-Iran nuclear talks in Geneva ended without an agreement. The strikes hit multiple targets and resulted in the reported deaths of Iran's Supreme Leader, Ali Khamenei, and four other senior government leaders. As of midday Tuesday, military actions remain underway. The United States and Israel continue air strikes, while Iran has retaliated against U.S. regional targets and has struck energy infrastructure and airports in Middle East countries.

Market reaction

Energy prices led a quick market reaction. Brent Crude oil rose about \$10 per barrel to nearly \$83 and natural gas prices jumped 10%, though they remained well below the highs from the late January/early February cold snap. Those moves spilled into interest rates and equities as investors reassessed inflation risks and the likely path for Federal Reserve (Fed) policy.

Bond markets adjusted as expectations for 2026 Fed interest rate cuts declined, moving from nearly 2.5 additional cuts this year to 1.9 cuts as of midday Tuesday. U.S. government bond yields rose roughly 0.08% to 0.12% across two-to-30-year maturities. The rise in yields reflected the view that higher energy prices could push inflation higher and reduce the need for near-term rate cuts.

Stocks fell overall, with the largest declines in regions that rely more heavily on imported energy. Since Friday's close, developed international stocks dropped 6.5% and emerging market stocks fell 7.8%, while the S&P 500 declined 1.7%. Energy stocks gained 2.0%, and lower-rated corporate bonds fell 0.4%.

Oil markets and their economic impact

Iran supplied 3%-4% of the world's oil in 2024, compared with 22% from the United States, according to the International Energy Agency (IEA). Even so, markets often focus on transportation risk because about 21% of the world's oil supply moves through the Strait of Hormuz, a key shipping lane bordering Iran and Oman. Security concerns and rising insurance costs contributed to an initial reduction in oil supply, and the timing of any resolution remains uncertain.

Equity markets in countries and regions that depend heavily on energy imports have felt the largest impact so far. Japan imports 87% of its total energy use and the European Union imports 64%, according to the IEA. By contrast, the United States is a net exporter and produces more energy than it consumes in total.

Higher oil prices can pass through to consumers, and a Rice University analysis suggests that every \$10 per barrel increase can raise gasoline prices by about \$0.25 per gallon. Investors worry that prolonged disruption through the Strait of Hormuz could lift energy and gasoline prices further, which can act like a tax on companies and households and weigh

Investment products and services are:

NOT A DEPOSIT • NOT FDIC INSURED • MAY LOSE VALUE • NOT BANK GUARANTEED • NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY

Important disclosures provided on last page

on growth. Rising oil prices can also push inflation higher, which has reduced the odds of near-term Federal Reserve rate cuts.

Economic backdrop

The broader economic backdrop remains strong, with productivity gains and consumer spending supporting economic and corporate earnings growth expectations. U.S. wages continue rising faster than inflation, which has helped sustain growth in high frequency consumer spending measures. Finally, policy support, including lower corporate and individual taxes and recent Fed rate cuts, adds a tailwind to economic activity and provides support to look through near term volatility and event risk.

Portfolio management through volatile capital markets

Near-term portfolio volatility has increased, but it remains within normal long-term ranges, especially for diversified investors. Since Friday's close (using intraday prices Tuesday), a portfolio holding 60% global stocks and 40% core bonds fell about 2%, a two-day move that has occurred about once per month on average since 2008. We encourage investors to stay focused on long-term goals during periods of volatility, because missing the best 30 days from 1990 to 2025 cut performance roughly in half, reducing annualized S&P 500 returns from 10.8% to 5.3%.

We continue to emphasize diversification paired with a growth orientation in portfolios, and we are monitoring developments for signs the situation could extend beyond near-term volatility. In particular, we would watch for sustained pressure on the S&P 500 below the November lows, which could signal softening fundamental expectations.

Please reach out to your Wealth Management advisor if you would like additional support or information.

This information represents the opinion of U.S. Bank. The views are subject to change at any time based on market or other conditions and are current as of the date indicated on the materials. This is not intended to be a forecast of future events or guarantee of future results. It is not intended to provide specific advice or to be construed as an offering of securities or recommendation to invest. Not for use as a primary basis of investment decisions. Not to be construed to meet the needs of any particular investor. Not a representation or solicitation or an offer to sell/buy any security. Investors should consult with their investment professional for advice concerning their particular situation. The factual information provided has been obtained from sources believed to be reliable but is not guaranteed as to accuracy or completeness. U.S. Bank is not affiliated or associated with any organizations mentioned.

Based on our strategic approach to creating diversified portfolios, guidelines are in place concerning the construction of portfolios and how investments should be allocated to specific asset classes based on client goals, objectives and tolerance for risk. Not all recommended asset classes will be suitable for every portfolio. Diversification and asset allocation do not guarantee returns or protect against losses.

Past performance is no guarantee of future results. All performance data, while obtained from sources deemed to be reliable, are not guaranteed for accuracy. Indexes shown are unmanaged and are not available for direct investment. The **S&P 500 Index** consists of 500 widely traded stocks that are considered to represent the performance of the U.S. stock market in general.

Equity securities are subject to stock market fluctuations that occur in response to economic and business developments. **International investing** involves special risks, including foreign taxation, currency risks, risks associated with possible differences in financial standards and other risks associated with future political and economic developments. Investing in **emerging markets** may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. Investing in **fixed income securities** are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. Investment in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. Investments in **high yield bonds** offer the potential for high current income and attractive total return but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a bond issuer's ability to make principal and interest payments. The **municipal bond market** is volatile and can be significantly affected by adverse tax, legislative or political changes and the financial condition of the issues of municipal securities. Interest rate increases can cause the price of a bond to decrease. Income on municipal bonds is free from federal taxes but may be subject to the federal alternative minimum tax (AMT), state and local taxes. There are special risks associated with investments in **real assets** such as commodities and real estate securities. For commodities, risks may include market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties (such as rental defaults).

U.S. Bank and its representatives do not provide tax or legal advice. Your tax and financial situation is unique. You should consult your tax and/or legal advisor for advice and information concerning your particular situation.

