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Iran conflict scenario update: The Strait of Hormuz and market implications

Key takeaways:

- Renewed U.S.-Iran fighting keeps Strait of Hormuz shipping, oil prices and inflation central to the market outlook.
- U.S. and developed international stocks have recovered near all-time highs, but ongoing energy disruption could pressure consumers, businesses and global growth.
- Portfolio discipline remains important: confirm allocations, invest excess cash into markets gradually and address diversification gaps deliberately.

Renewed U.S.-Iran fighting has interrupted recent diplomatic progress and raised fresh questions about the safety of commercial traffic through the Strait of Hormuz. The United States and Iran have exchanged attacks, Iran has expanded strikes across Gulf states, and attacks on tankers have renewed pressure on a waterway that carries roughly 20% of global oil supply. Brent crude has moved higher as investors reassess the risk of a longer disruption, although market pricing still suggests many investors expect the inflation effect to fade.

The conflict continues to influence markets through oil prices, shipping costs, inflation expectations and the outlook for global growth. When fighting began, the S&P 500 fell 9% from its January peak, while developed international and emerging market equities declined 8% to 12%. U.S. and developed international markets have since recovered to near all-time highs as investors refocused on resilient consumer spending, strong corporate earnings growth and signs that Gulf energy supplies may begin moving more freely.

How the Iran conflict affects oil prices and global shipping

The Strait of Hormuz ranks among the world's most important energy transit routes, and few alternatives can handle a similar volume in the near term. The U.S. Energy Information Administration estimates that roughly 20% of global oil supplies and global liquefied natural gas shipments moved through the strait in 2024. Risk extends beyond Hormuz because disruption at the Bab el-Mandeb Strait, which carries about 12% of global trade, can raise transportation costs and lengthen delivery times.

The economic effects reach beyond oil and natural gas. The Fertilizer Institute reports that nearly half of global nitrogen-based fertilizer exports typically travel through the region, linking shipping conditions to farming costs. Slower shipments can tighten fertilizer supplies and eventually lift food prices, particularly in countries that depend heavily on imported energy and agricultural products.

Recent shipping data point to a partial improvement, not a full return to normal. Hormuzstraitmonitor.com reported that shipping volume through the strait reached 34% of normal as of July 14. Gulf producers have started preparing for a recovery, but restoring supply will take time: Kuwait Petroleum Corporation said it could bring back 70% of its production within at least six weeks after the strait reopens, while Saudi Arabia has begun restarting exports from Gulf ports and moving oil delayed during the conflict.

How geopolitical conflict can affect inflation and markets

Oil and gasoline prices rose sharply when the conflict began, then eased as diplomacy improved the outlook for Gulf energy supplies. The latest escalation has renewed some upward pressure, showing how quickly geopolitical events can change energy costs. Lower prices would ease pressure on household budgets, while another sustained increase could lift inflation and crowd out spending on other items.

Higher oil, natural gas and fertilizer prices affect the economy through several channels. They can raise transportation, manufacturing and farming costs, and businesses may pass part of those increases to customers. A prolonged disruption would therefore create a broader inflation risk rather than an energy-market issue alone.

International markets remain more exposed to renewed energy pressure because many European and Asian economies import a large share of the energy they consume. The United States benefits from its position as the world's largest oil producer and a net energy exporter, although global price increases still reach U.S. households and businesses. Domestic production, resilient consumer spending and rising corporate profits may help the U.S. economy absorb an energy shock better than many import-dependent economies.

Scenario framework: Three scenarios driving stock market volatility and oil prices

The disruption of global oil supplies through the Strait of Hormuz represents a key variable for markets, with additional risk if stress spreads to the Bab el-Mandeb Strait. A political agreement can lower the risk premium in oil prices, but physical shipping, insurance coverage, vessel positioning, producer logistics and security conditions determine how quickly energy reaches global customers. We outline three scenarios below based on the impact on oil prices and global energy supplies:

Scenario 1 (low-impact case): De-escalation and near-term normalization

In the low-case scenario, shipping through the Strait of Hormuz improves as diplomacy holds, security risks decline and commercial operators regain confidence in safe transit. A near-term normalization could support a further equity market rally, especially in hardest-hit sectors and geographic regions, as investors re-anchor on existing constructive trends in corporate earnings, economic growth and relatively stable to moderating inflation.

- Foreign stock declines in March reflect their significant dependence on imported energy. With a near-term resolution, these regions would avoid the worst scenarios and strong fundamental trends in place prior to the conflict would remain intact.
- The S&P 500 returns to its pre-conflict upward trend toward our 8,040 year-end price target, with the 50-day average price of 7,450 and 100-day average price of 7,100 representing short-term support levels.
- Inflation expectations should remain contained in this scenario, with the 10-year Treasury yield holding in the recent range of 4.00 to 4.75%.

Scenario 2 (mid-impact case): Gradual reopening coupled with global oil conservation efforts

In the mid-case, shipping conditions gradually improve, coupled with global efforts to reduce immediate energy demand. Insurance coverage broadens, the U.S. Navy helps secure passage and military pressure sharply reduces Iran's ability to disrupt transit. An impairment such as this would keep energy prices elevated and push inflation higher in the short term. Stable labor markets and consumer momentum could cushion some pressure on U.S. spending, but higher fuel and input costs would still create a more difficult environment in the interim.

- Equity markets could remain volatile during this period. The S&P 500 could break below its longer-term 200-day moving average with a traditional 10% correction near 6,850 representing a key support level.
- This outcome would keep volatility within historical annual norms while creating opportunities for disciplined investors to rebuild U.S. equity positions with constructive economic fundamentals remaining intact.
- Higher 10-year U.S. Treasury yields would give investors an opportunity to add to bond portfolios at relatively attractive interest rates.
- Global equities would likely produce more mixed results through more persistent inflation and short-term damage to economic growth. Energy importing economies, including Europe and parts of Asia, would face larger economic and market impacts than the U.S.

Scenario 3 (high-impact case): Ongoing shipping constraints with elevating energy prices

The high-impact scenario assumes the Strait of Hormuz remains virtually closed into the fall, leaving energy prices elevated for months and potentially pushing oil and gasoline prices above levels seen in 2022. U.S. consumers could eventually exhaust the additional Federal income tax refunds received in 2026 from last year's tax cuts, while persistently higher energy prices erode spending power. Oil importing nations could draw down existing oil supplies and some countries' energy rationing programs are exhausted.

Even after shipping resumes in an eventual resolution, a recovery could take time if regional infrastructure requires repair and energy producers have limited storage capacity for output that cannot leave the region. Supply constraints could last well beyond the Strait reopening.

- Global equity markets may reach correction territory, with the S&P 500 falling below the post-conflict March low around 6,300 and potentially down as much as 20%, with foreign markets under greater pressure because of their greater dependence on imported energy.
- 10-year U.S. Treasury yields could rise above 5% as greater inflation pressure builds. Over time, higher prices could reduce discretionary spending and increase recession risk, potentially pushing yields lower if investors expect the Federal Reserve to cut interest rates to ease tight financial market conditions.
- In this scenario, we would closely monitor the labor market for rising layoffs as companies adjust plans in response to higher short-term costs and pressure on profit margins.

Client guidance: Three recommended actions for your portfolio

The fragile reopening supports our view that oil transportation constraints may begin easing in the near term, but renewed conflict remains a risk and a durable agreement could still take time. Ongoing uncertainty reinforces the value of portfolio discipline rather than rapid shifts based on headlines. As investors evaluate risks and opportunities, we continue to emphasize that economic fundamentals were solid as the conflict began and remain constructive for now.

While we await resolution of current negotiations and evaluate emerging opportunities and risks, we encourage investors to take this opportunity to evaluate their long-term investment plan against current risk tolerance and liquidity needs. Through this evaluation we encourage the following three actions:

- **First, confirm your target allocation and rebalance if needed.** If you and your wealth professional determine that your portfolio no longer aligns with your risk tolerance or investment objective, build a plan to rebalance your portfolio toward the correct allocation. Equity market volatility can reveal changes in personal risk tolerance, and relatively high bond yields that remain elevated compared with the past 15 years may allow you to reduce portfolio risk while staying aligned with your long-term plan.
- **Second, consider a phased approach if you hold excess cash.** If you are on the sidelines or find yourself with excess cash than your plan requires, you can use volatility to start dollar-cost averaging into your target positions. A measured approach can help you build exposure over the next few months without relying on a single-entry point during a fluid geopolitical environment.
- **Third, address diversification gaps deliberately.** If you find you lack exposure to asset classes such as foreign stocks, smaller U.S. companies, global infrastructure or credit-oriented fixed income, plan a measured transition now. We see meaningful forward opportunities across diversified asset classes such as residential mortgage-backed securities and high-yield municipal bonds. Recent volatility may provide opportunities to add exposure in a disciplined way.

If you have questions about how current conditions relate to your plan, contact your wealth professional to review risk alignment, liquidity needs and any planned rebalancing decisions. A structured review can help separate near-term market stress from long-term investment objectives. That discipline becomes especially important when geopolitical events create fast-moving risks across energy prices, inflation expectations and global equity markets.

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