Composition Wealth

From The CIO's Desk

Market Commentary | June 2025

Middle East Tensions

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On June 21st, the United States enacted a military operation to strike nuclear facilities in Iran. The United States has thus far been clear that its actions are focused on destabilizing Iran's development of a nuclear weapon. At this point, the hope is that this won't become a broader conflict. Furthermore, unless provoked, we suspect there would be limited support both internationally and among U.S. policymakers for a more protracted engagement. However, we recognize there remains a range of outcomes in how this conflict can play out. As is custom in our investment discipline, we are actively considering various scenarios and assessing how we might adjust portfolio positioning under specific circumstances.

The initial economic and financial concerns are centered on the potential impact on oil prices. The Middle East produces roughly 30% of global oil production, with Iran supplying approximately 5 million barrels of oil per day, equivalent to 5% of global output[1]. Should Iran's supply become impacted, or if Iran counters by impeding tanker traffic through the Strait of Hormuz, we could see a swift upward inflection in the price of crude oil. This would serve as a short-term inflationary impact, as higher oil prices translate to higher gasoline prices, which are quickly passed on to consumers.

We would expect the market's immediate reaction to escalations in Iran to lead to a reduction in risk exposure, namely by selling higher-risk assets such as equities. We anticipate that traditional flight-to-safety assets such as gold and the U.S. dollar will also benefit in the near term. Treasury bonds, which can act as a flight-to-safety asset, may also be contending with concerns around the inflationary impact of higher oil prices. This could ultimately send bond yields higher and consequently bond prices lower. Whatever market movements occur over the next few days, what is most pertinent for investors is what happens in the weeks and months ahead.

Past U.S. military operations, such as the U.S. invasion of Panama in 1989 and actions in Kosovo during 1999, had minimal impact on equity prices. The bigger concern will be whether the actions in Iran are a short-term conflict or a more intensive and prolonged military engagement. No one knows exactly how this will play out, and given the ambiguity, we are evaluating a range of ways to manage risk and be opportunistic depending on how conditions evolve. If this becomes a short-term conflict, we don't expect any significant or long-lasting impact on the market. Should tensions increase, we could see pressure on equity prices as investors look to adjust risk exposures. In addition, Treasury bonds could be hampered as existing concerns around deficit spending will only grow should expectations for greater defense spending increase. In such an environment, diversification across sectors and geographies is prudent. In addition, higher-quality companies with strong financial profiles and consistent earnings will be preferred. Given the economic uncertainty throughout 2025, we have been leaning into quality businesses in our stock and bond portfolios.

CONCLUSION

Following episodes such as this weekend's actions in Iran create opacity around the geopolitical landscape that naturally extends to economic conditions and financial markets. We recognize the increased range of risks following this weekend. However, the financial outcomes will vary depending on how the conflict evolves from here. As such, we believe it's most appropriate to be patient and see how conditions progress. Understanding the range of scenarios and potential portfolio adjustments will be our focus as we seek to gain greater clarity in the days and weeks ahead.

We encourage you to reach out to your Composition Wealth team if you have questions or want more perspective on our views.

[1]Source: Energy Institute. *2024 Statistical Review of World Energy*. As of December 31, 2023.

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