Iran, Israel and the US: Markets on Alert Amid Escalation

In recent days, the conflict between Iran and Israel has escalated from cross-border missile exchanges to full-scale military strikes now involving the United States. The geopolitical landscape is shifting quickly, and markets are responding in kind. Below, we break down the situation, the key risks, and what it means for investors.

What Happened: From Rising Lion to Midnight Hammer

On Friday 13th, Israel launched Operation Rising Lion, a salvo of missiles targeting Iran's plutonium enrichment facilities in an attempt to halt Iran's progress toward nuclear capability. Iran responded with hundreds of drones and ballistic missiles, most of which were intercepted by Israel's Iron Dome.

Then, just days later, the United States formally entered the conflict. In Operation Midnight Hammer, US B-2 bombers and cruise missiles struck Iran's Fordow, Natanz and Isfahan nuclear sites. The Fordow facility, buried 20 metres underground and previously seen as impenetrable, was reportedly destroyed using Massive Ordnance Penetrators (MOPs) munitions only available in the US arsenal.

Iran retaliated with strikes on Israel and a US base in Qatar. A temporary ceasefire is now in place, but military experts warn Iran's nuclear capabilities may not have been fully dismantled and could be rebuilt within months.

Oil, Inflation, and Market Reaction

The oil market responded as expected as prices initially surged past $90 a barrel before settling back to around $76–$77. Brent crude's pullback reflected the absence of immediate disruption, but volatility remains high.

Oil is a key driver of headline inflation. If prices stay elevated, this could challenge central banks' plans to lower interest rates especially in the US, where markets had been pricing in cuts for 2025. Equity markets dipped on the news of military escalation, while gold and the US dollar saw modest safe-haven inflows.

Interestingly, US Treasuries did not behave as the traditional haven. Inflation worries outweighed risk-off flows, reinforcing the market's focus on interest rate direction.

Chokepoints and Strategic Risks

Iran produces around 3 million barrels of oil per day, roughly 3% of global output. This supply could theoretically be offset by increased production from Saudi Arabia. The larger risk is Iran closing the **Strait of Hormuz**, a critical shipping route for 20% of the world's oil.

Although Iran's parliament has called for its closure, such a move is unlikely at least for now. China buys 90% of Iran's oil and is heavily reliant on Hormuz. As Iran's main economic partner, China has strong incentives to discourage any disruption.

Strategic Aims and Political Calculations

Israel's primary objective remains clear: to eliminate Iran's nuclear ambitions. But there's also speculation of a secondary goal; to destabilise the regime and potentially prompt internal change.

The US's involvement significantly shifts the balance. President Trump has always taken a hard line on Iran, and with US forces now directly involved, the pressure on Iran's leadership has increased. Still, it remains unclear whether this is a prelude to deeper engagement or a strategic show of force aimed at bringing Iran to the negotiating table.

There is a theory that the US may be leveraging its military superiority to avoid a protracted conflict using the threat of escalation to compel Iran to abandon its nuclear ambitions voluntarily. If successful, this could lead to de-escalation and a renewed period of diplomatic engagement.

Investment Implications and TAM's Positioning

If the situation stabilises and oil prices retreat, we expect equity markets to regain their footing. The resilience of risk appetite even in the face of geopolitical shocks suggests investors remain willing to 'buy the dip'.

However, if the conflict widens or the Strait of Hormuz is closed, we would expect:

- Oil above $90
- Global equities under pressure
- Gold and the US dollar stronger
- Interest rate cuts delayed, particularly in the US

TAM portfolios remain balanced. We retain core equity exposure but are prepared to shift more defensively if conditions deteriorate. We're monitoring oil volatility, signs of stagflation, and the possibility of a re-escalation closely.

In Summary

- The Israel-Iran conflict has broadened with US involvement and targeted strikes on nuclear sites.
- Markets are watching oil, inflation, and central bank responses closely.
- A peaceful resolution could boost risk assets and reduce inflation pressure.
- A wider conflict would likely bring renewed volatility and defensive market moves.

TAM continues to track the situation and stands ready to respond swiftly. As always, we remain focused on protecting and growing client capital in a fast-moving world.

Want to discuss how this impacts your clients?

Contact **Eric Silvestre**
+34 651 86 08 36
eric.silvestre@tameurope.com

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