RATHBONES

REVIEW OF THE WEEK

THE ISRAELI-HAMAS CONFLICT
9 OCTOBER 2023

This week has seen harrowing atrocities committed by the terrorist group Hamas against Israeli civilians. With so far more than 1,200 people reported to have been killed, this is the most serious cross-border attack Israel has faced in decades.

The acts perpetrated by Hamas have led to a joint statement of condemnation from the leaders of France, Germany, Italy, the UK and America. Israel has formally declared war on Hamas; exactly what that means is yet to be seen. Clearly financial markets are of trivial importance compared to the devastating human impact of these events, but many of our clients look to us to keep them informed of events that could impact the value of their investments. Here we look at some of the likely implications for markets.

Oil and politics

Financial market reaction has been muted so far, beyond the 8% drop in the Tel Aviv stock market. Swiss and UK markets are up because they have less exposure to economically sensitive industries, and the FTSE has a slug of oil majors. Brent Crude Oil is up just over $2 to $87 a barrel, but that's still $11 lower than where it traded just a couple of weeks ago, before analysts became more concerned about lower economic demand and a rumour that Russia would lift a ban on fuel exports.

Whether this market calm continues is conditional on how this battle influences the broader political economy of the Middle East. If fighting is contained to the land around the Occupied Territories, markets will likely ignore it, even despite the loss of civilian lives. If, however, it leads to proxy or even direct wars between Iran – which supports Hamas – and Israel, or causes the US to rethink its approach to sanctioning Iranian oil, then it may result in another energy shock. That could increase global inflation.

The big trigger for concern would be if Israel moved against Hamas's backer Iran, rather than Palestine. Iran is adjacent to the narrow Straits of Hormuz, a chokepoint for global energy shipping, through which an estimated third of seaborne oil trade and quarter of seaborne natural gas trade pass every year. Iran itself also accounts for around 4% of global oil production and 6% of global natural gas production. There are clear parallels to the two oil shocks of the 1970s. The first, in 1973, was caused by OPEC's response to Western support for Israel. The second, in 1979, was sparked by falls in output linked to the Iranian Revolution.

When it comes to geopolitical risk, we follow a mantra used by Howard Marks, the famed investor: "You can't predict, but you can prepare." Earlier this year we prepared for an Iran-Israel war by compiling an investment 'playbook'. We did this by:

- Determining the key channels through which each risk might affect the global economy
- Assessing the possible impact on global growth and inflation
- Identifying any effects specific to individual regions, sectors or commodities
- Translating the economic effects into likely implications for different asset classes
- Analysing the possible consequences for equities at a sectoral level

In short, shorter-dated inflation-linked bonds, gold and actively managed strategies that can trade commodity futures tend to do well in this kind of scenario. The equity of companies that are particularly sensitive to higher bond yields (such as non-profitable technology companies), that have energy-intensive inputs (such as construction and materials), or that are particularly sensitive to economic slowdowns that tend to result from oil price shocks (such as carmakers) are likely to do particularly poorly. Meanwhile, energy companies, some utilities, and defence stocks may do relatively well.

We will be watching the conflict carefully for signs of escalation and continuing to assess the likely impact on markets.

Our thoughts remain with those affected by the horrific events unfurling in the Middle East.

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