Evolving dynamics in the Middle East conflict, 17 March 2026

In late February, US and Israeli forces launched Operation Epic Fury, a coordinated strike targeting Iranian leadership and military infrastructure, resulting in the death of Iran's Supreme Leader and a series of retaliatory attacks across the Gulf. In response, Iranian forces declared the Strait of Hormuz effectively closed, targeting shipping and energy infrastructure across the region.

Initial expectations that markets would treat the conflict as a short-lived geopolitical shock have since evolved. While military dynamics remain fluid, the closure of the Strait of Hormuz and disruption to regional energy infrastructure have the potential to materially extend the economic consequences, transforming what initially appeared to be a risk premium into a tangible supply shock in global energy markets.

Oil markets have responded dramatically. Brent crude briefly surged to around US$120 per barrel before easing back to near US$100 per barrel level, representing a roughly 35–40% increase since the start of the conflict.

The International Energy Agency has responded by coordinating a record release of approximately 400 million barrels from global strategic petroleum reserves to stabilise markets and offset supply losses.

While historical precedent suggests war-related market disruptions often reverse once the scope of conflict becomes clear, the physical disruption to energy supply chains now presents a higher potential macroeconomic risk as the initial campaign against Iran's regime has evolved into a regionalised conflict, triggering a significant disruption to Middle Eastern energy and shipping flows.

Despite near-term volatility, the medium-term outlook for equities remains supported by AI-driven productivity, supportive fiscal policies and the tendency for markets to overprice initial geopolitical risk. Bond markets, however, may grapple with upward inflationary pressures and a potentially weaker growth outlook.

Historical similarities and differences

While each geopolitical conflict has unique characteristics, financial markets tend to react in broadly similar ways to sudden military escalation. Historically, investors initially price in a geopolitical risk premium, typically expressed through higher oil prices, stronger safe-haven assets such as gold and government bonds, and a short-term sell-off in global equities. As the scope and duration of the conflict become clearer, these moves often reverse.

The current conflict shares several similarities with past energy-linked geopolitical events, particularly the 1990–1991 Gulf War, the 2003 Iraq invasion, and the early phase of the Russia-Ukraine conflict in 2022.

Key similarities

1. Initial oil price shock and safe-haven flows

As seen in previous Middle Eastern conflicts, the immediate market response has been a sharp spike in oil prices and a rotation toward defensive assets. This mirrors the early stages of the Gulf War in 1990, when crude prices surged amid fears of supply disruption before retreating once coalition forces established military control over the region.

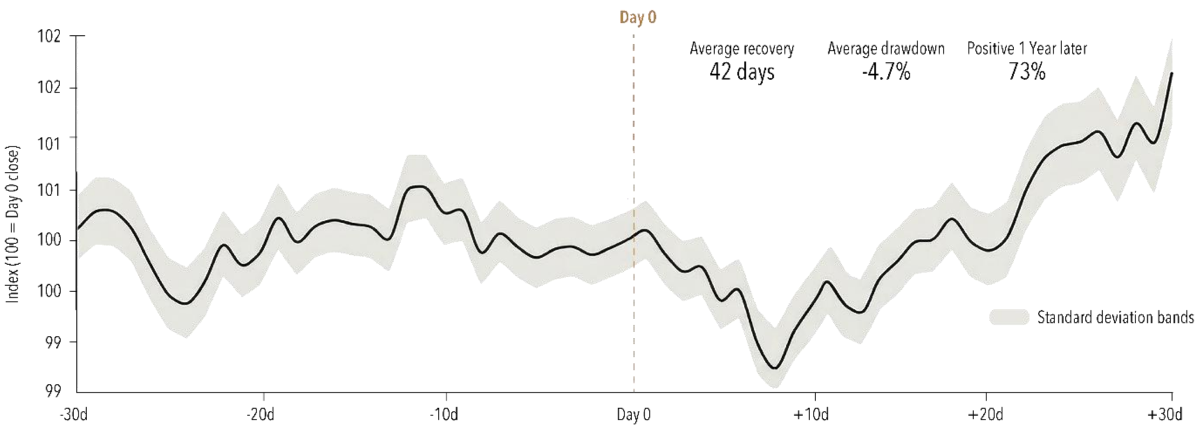
Similarly, the early stages of the Russia-Ukraine conflict in 2022 triggered sharp rises in energy prices and strong inflows into gold and government bonds as investors reassessed geopolitical risk.

2. Short-term equity market volatility

Equity markets historically react negatively to the initial outbreak of hostilities but tend to stabilise relatively quickly, as Chart 1 illustrates. Analysis of past oil-linked conflicts suggests that once the trajectory of military operations becomes clearer, equities frequently recover lost ground as uncertainty diminishes.

This pattern reflects the fact that markets typically price uncertainty more aggressively than the actual economic impact of many conflicts.

Chart 1: S&P 500 average performance during major wars and conflicts



Note: Average S&P500 path across 16 conflicts.

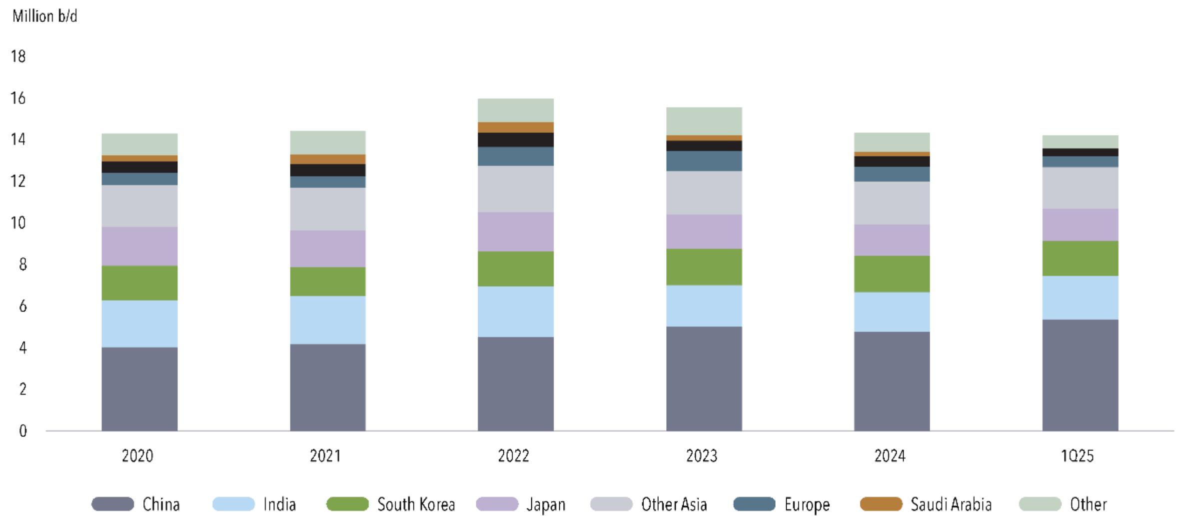
Source: LSEG, Quilla Consulting

3. Sector and regional dispersion within equity markets

Another recurring feature across conflicts is significant dispersion between sectors. Energy and defence companies tend to outperform during periods of geopolitical stress, while sectors sensitive to consumer spending or transportation costs, such as airlines, travel and discretionary retail, often underperform due to higher fuel costs and weaker sentiment.

The regional impacts are also likely to become more evident as oil flows through the Strait disproportionately affect Asian economies, as shown in Chart 2, especially China, which buys ~90% of Iran's oil exports.

Chart 2: Volume of crude oil through the Strait of Hormuz by destination



Source: US Energy Information Agency, Apollo Chief Economist

Key differences

Despite these similarities, several factors distinguish the current conflict from many previous geopolitical episodes and may lead to a more persistent economic impact.

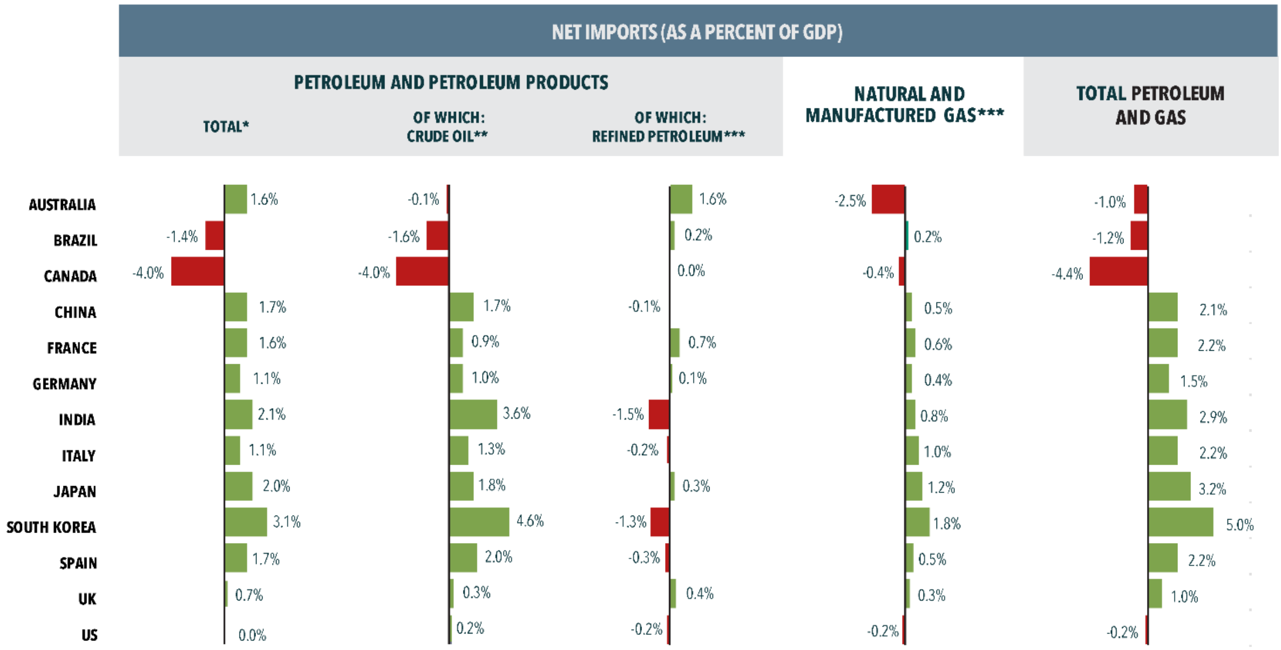
1. Disruption to a major global energy chokepoint

The most important difference is the scale of disruption to the Strait of Hormuz, which is one of the most critical energy shipping routes in the world. Approximately one-fifth of global oil trade (~20m barrels per day) normally passes through the strait, meaning even partial disruptions can have significant implications for global supply.

Previous Middle Eastern conflicts have threatened the Strait of Hormuz, but few have resulted in the sustained disruption to shipping and insurance markets currently being observed. Even if physical flows eventually resume, elevated insurance costs and security concerns could prolong supply friction.

As Table 1 shows, the impact of energy price volatility varies significantly by country. Although Australia is a net exporter of total petroleum and gas (1% of GDP), this surplus is driven primarily by gas exports. This masks a structural vulnerability in refined products, where Australia is a net importer to the value of 1.6% of GDP.

Table 1: The impact of the oil and gas price shock varies across countries



* Petroleum, petroleum products and related materials (SITC REV. 4 Commodity code 33).
** Petroleum oils and oils obtained from bituminous minerals, crude (SITC REV. 4 Commodity code 333).
*** Petroleum oils and oils obtained from bituminous minerals (other than crude); preparations (SITC REV. 4 Commodity code 334).
**** Gas, natural and manufactured (SITC REV. 4 Commodity code 34).
Source: UN Comtrade , IMF.
Note: All data is for year 2024.

Source: BCA Research

2. A tighter global energy system

The global energy system today is structurally tighter than during several past conflicts. Spare capacity within OPEC+ is limited, global inventories are lower than historical averages, and years of underinvestment in upstream energy infrastructure have reduced the ability of producers to rapidly increase supply. This contrasts with the early 1990s, when spare capacity in Saudi Arabia helped offset supply disruptions during the Gulf War.

3. A more fragile inflation backdrop

Another key difference is the current macroeconomic environment. Many previous conflicts occurred during periods when inflation was relatively contained, and central banks had greater flexibility to support economic growth.

A sustained rise in energy prices risks re-igniting inflation pressures. As highlighted in Chart 3, US inflation expectations have risen materially since the onset of the conflict, complicating central bank policy planning and potentially delaying the expected easing cycle across several major economies.

Chart 3: The Iran war has pushed up US inflation expectations

Source: BCA Research

4. Greater integration of energy and financial markets

Global energy markets are also far more integrated today than in earlier decades. Liquidity in futures markets, the growth of algorithmic trading, and the financialisation of commodities have amplified the speed at which geopolitical risks are transmitted across global asset prices. As a result, market reactions to geopolitical developments tend to occur more rapidly and with greater volatility than in earlier conflicts.

5. Disruption is not just confined to oil and gas

The Strait of Hormuz is also a critical export route for a wide range of other commodities produced across the Gulf region. Major producers including Saudi Arabia, the UAE, Qatar, Kuwait and Iraq rely on the Strait to ship petrochemicals, refined fuels, fertilisers, aluminium, helium, sulphur and other industrial inputs to global markets.

The region is a major supplier of fertiliser feedstocks such as ammonia and urea, which are heavily dependent on natural gas production. Disruptions to these flows can therefore impact agricultural supply chains, potentially affecting fertiliser availability and food production costs globally.

Other less recognised exports are helium and sulphur, both of which are critical industrial inputs. Helium is used in semiconductor manufacturing, medical imaging (MRI machines), and aerospace applications. Whilst sulphur is typically associated with fertiliser production, it is also essential in processes for extracting copper, cobalt, nickel, zinc, and uranium.

What this means

The current conflict exhibits many of the typical short-term market dynamics seen in past geopolitical events, including an initial spike in oil prices, safe-haven demand for and a temporary sell-off in risk assets.

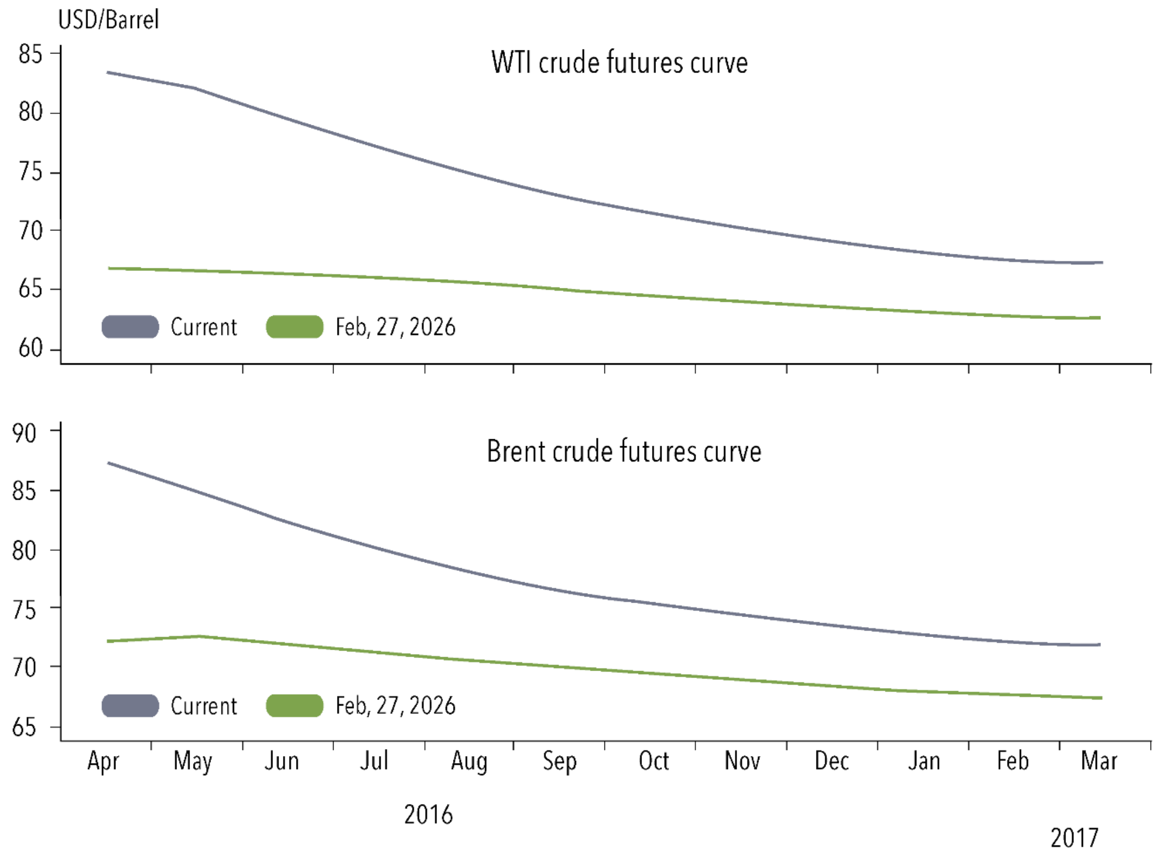
However, the direct disruption to one of the world's most important energy transit routes, combined with a relatively tight global energy market and a fragile inflation backdrop, means the economic implications may prove more persistent than those observed in several recent geopolitical conflicts.

While it remains too early to determine the ultimate duration of the disruption, markets are likely to remain particularly sensitive to developments affecting shipping flows, energy infrastructure, and the availability of spare production capacity.

Military developments and the status of the Strait of Hormuz will remain the dominant drivers of markets in the near term. Nevertheless, if shipping lanes reopen and energy infrastructure stabilises, markets may unwind a significant portion of the current risk premium that has become priced into markets.

Furthermore, the oil futures curve, depicted in Chart 4, suggests that investors and oil market participants do not expect a prolonged supply disruption based on the downward trend in price of oil futures contracts.

Chart 4: Backwardation of oil futures curve



Source: US EIA, CME, ICE

Positioning for the medium term

Despite heightened near-term volatility, we maintain a constructive medium-term outlook for equities, supported by resilient earnings and favourable fiscal policy settings. While geopolitical tensions, specifically centred on Iran, drive short-term fluctuations, these episodes often create relative value opportunities as markets tend to overshoot on pricing risk.

A key pillar of our conviction is the secular tailwind from AI. We believe AI integration is transitioning from a Capex-heavy theme into a genuine productivity driver, providing a structural floor for corporate margins and broader earnings resilience.

In fixed income, sticky inflation and moderating growth demand a selective approach. While higher yields provide a robust income cushion, the risk of stagflationary impulses suggests duration may not offer its typical defensive properties.

We expect regional and sector dispersion to remain elevated and stand ready to act dynamically as risk and reward conditions evolve. We continue to monitor energy markets and their impact on inflation closely, ensuring portfolios navigate immediate uncertainty while remaining aligned with long-term investment objectives.

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