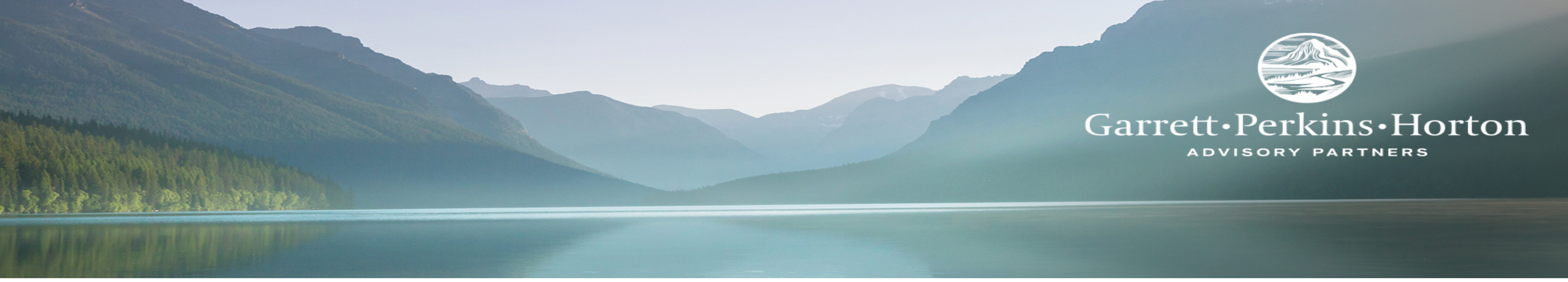

Summit Thoughts on the Iran and Middle East Conflict

Quick Take:

- Early Saturday morning the U.S. and Israel launched an attack on Iranian infrastructure that killed Supreme Leader Ayatollah Ali Khamenei and other high level government officials. The reaction both globally and within Iran was sharp but polarized. Iran quickly launched retaliatory attacks in the Persian Gulf on military as well as civilian targets.
- Market reaction was initially somewhat muted, although more substantial than during the recent U.S. foray into Venezuela, but intensified as the conflict escalated. Stock markets in Europe and Asia sold off, energy prices climbed, and global interest rates rose as investors gauged the impact on the global economy and capital markets.
- The greatest near-term risks are higher inflation and energy costs due to supply disruptions. A further uptick in inflation and increased government spending to fund the war may result in an extended period of higher interest rates.
- A globally diversified portfolio with a healthy mix of inflation-sensitive and defensive assets may help investors withstand uncertainty and volatility.

The world woke up Saturday morning to the news that the United States and Israel had launched an attack on Iran. For those that follow events in the Middle East this was not a surprise. President Trump had alluded to aggressive action if Iran did not halt the development of its nuclear program and the U.S. was observed building up the largest air and naval force in the region since the invasion of Iraq over twenty years ago. In addition to eliminating the nuclear threat and weaking Iran's military infrastructure, President Trump also stated that a goal of the attack was to eliminate the ruthless religious and security regime that had ruled Iran since the Iranian Revolution and allow the Iranian people to elect new leadership.

The initial attack early Saturday morning killed Supreme leader Ayatollah Ali Khamenei and other high level government officials. The reaction both globally and within Iran was sharp but polarized. Iran quickly launched retaliatory attacks in the Persian Gulf on military as well as civilian targets. While some Iranians were overjoyed, the regime has some support from domestic loyalists and a network of regional militias antagonistic to the U.S. and Israel. Opposition to the regime is highly fragmented without a compelling leader. The outlook for the Iranian people and the transition to a democratic and well-run country is highly uncertain.

While a few allies supported the U.S. soon after the attack, others condemned the military action and asked for stability. Iran initially retaliated against Israel and U.S. military infrastructure but soon broadened its attacks to include other Western interests including civilian targets such as hotels in several Arab countries. While the military action so far has not included land troops, President Trump has not ruled out escalation to direct combat. As Iran has expanded its targets, support for continued military action to stamp out the country's military infrastructure has grown and the Trump administration appears to be laying the groundwork for an extended war.

Market reaction at first was somewhat muted, although more substantial than during the recent U.S. foray into Venezuela, but intensified as the conflict developed. Stock markets in Europe and Asia sold off, energy prices climbed, and global interest rates rose as investors gauged the impact on the global economy and capital markets. Safe-haven assets such as gold and silver and currencies including the U.S. dollar and Swiss franc rose. U.S. stocks initially pared back loses, buoyed by gains in energy and defense stocks, but as of this writing seem to be joining the global market sell-off.

Energy infrastructure has been damaged in several countries and shipping traffic halted in the Strait of Hormuz, triggering spikes in crude oil and natural gas prices. Both commodities remain well below peak levels reached during past Middle East crisis and even after increasing over 10%, are still at price levels that can be absorbed. Global oil supply has some wiggle room due to material strategic reserves in China and the U.S. and the potential for non-Middle Eastern oil producers to increase supply. However, long-term shipping disruptions in the Strait of Hormuz will have a devastating impact on global supply chains and shipping costs and add to the disruptions caused by U.S. tariff policy.

The greatest short-term risks triggered by this conflict are higher inflation and energy costs. A further uptick in inflation and increased government spending to fund the war may result in an extended period of higher interest rates. Incoming Fed Chair Kevin Warsh is believed to be supportive of further interest rate cuts, but the Federal Open Market Committee (FOMC) is divided and an uptick in inflation may further delay policy rate cuts. War is expensive and the U.S. is quickly depleting stockpiles of military equipment and munitions that will need to be replaced. U.S. federal debt levels were already elevated, and war-time spending may push up long-term interest rates which flow through to mortgages and other borrowing costs. This will hamper efforts to shore up the housing sector and put pressure on credit and equity markets.

The conflict may also be stimulative with certain sectors such as defense and energy benefiting from increased spending. A shift in investor sentiment to defensive sectors should create a more balanced market after an extended period of AI and tech dominance. Over time, the weakening of an Iranian regime that has caused instability for decades may increase regional cooperation and unleash growth momentum in the Middle East once hostilities have ended.

Current expectations are that the turmoil will end in a few weeks and have little long-term impact on economic growth, commodity prices, and the capital markets. Most geopolitical strategists do not expect U.S. rivals China and Russia to get directly involved, but the duration and scope of the conflict will likely continue to evolve. If hostilities eventually involve countries outside the region or drag on for months or longer the human and economic costs will intensify. We entered 2026 with expectations that capital markets would be volatile and buffeted by known events such as the upcoming U.S. election as well as unexpected developments. Now is the time for investors to consider rebalancing towards the lower end of their risk tolerance and to monitor tax loss harvesting opportunities that may arise from market volatility. A globally diversified portfolio with a healthy mix of inflation-sensitive and defensive assets may help investors withstand uncertainty and volatility. This should include holdings such as TIPs that benefit from unexpected inflation, lower duration debt, and real assets such as real estate and infrastructure. The Summit Investment Team will continue to closely monitor developments and the impact on client portfolios.

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