



THE WAR WITH IRAN AND THE IMPACT ON INVESTMENT PORTFOLIOS

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As the war with Iran enters its second month, Phillip Nelson, NEPC's head of asset allocation, provides an update on its potential impact on the global economy and investment portfolios in a sit down with Aparajita Bubna, NEPC's managing editor.

What is the economic impact of the war between the United States, Israel and Iran?

This is a complicated question. So far, the economic impact of the war is more regionally focused. Its global impact will depend on the duration of the war, the intensity of the fighting, and the scale of damage done to the energy infrastructure in the Middle East.

The supply shock of restricted flows of natural gas and oil are especially pronounced for Europe and parts of Asia, posing a much bigger risk for those economies. This is where the duration of the conflict will potentially have a larger impact. We could see more severe economic pain, as the price of fertilizer, natural gas and oil move higher, as these regions are more vulnerable to inflation.

Presently, for the United States, the economic impact is low. Its economy is less exposed and is less sensitive to the price of energy since it is a net energy exporter. But when we think about U.S. economic spending, higher gas prices can start to eat into consumer sentiment. There is a tipping point, and no one knows what the tipping point is, where rising oil prices impact consumer behavior and sentiment.

The U.S. consumer can likely withstand the current pricing of oil, but a 50% surge from this point can lead to consumers pulling back and spending less across all areas. Under this scenario, inflation pressures may be less of a concern as consumer spending slows down. Ironically, this lowers the risk of inflation but increases the risk of an economic downturn in the United States.

Speaking of inflation, is it back on NEPC's radar because of the spike in oil prices?

Yes, but not necessarily because of the conflict in Iran. We started the year with the view that markets were overlooking the potential risks of higher inflation flowing through the United States and the global economy. Obviously, that concern did not factor in any military action in Iran.

Over the first three months of the year, we have seen warmer inflation prints, and that reinforces the risk that inflation is running higher than what the market is comfortable with. The war with Iran has the potential to exacerbate inflationary pressures, especially in Europe and Asia.

This is less of a concern within the U.S., but higher prices could dampen consumer sentiment and willingness to spend.

What are the investment risks related to higher oil prices?

The investment risks stemming from higher oil prices will depend on the region. Western Europe and many parts of Asia tend to be net importers of energy, and a potential supply shock of natural gas and oil flows poses a significant stagflation risk for some of these economies to operate.

The response from central banks will matter as the Bank of England, the European Central Bank, and other central banks in Asia consider higher interest rates to manage any inflationary conditions that result from the war in Iran. This could result in tighter financial conditions across Asia and Europe, which is not supportive for capital markets.

For the U.S., the investment risks arising from higher oil prices are less pronounced compared to the rest of the world. Shifts in Federal Reserve policy, market sentiment, and tighter financial conditions are more of a focus for the market.

What are NEPC's primary concerns in this environment?

Historically, geopolitical events are relatively short-lived in terms of their market impact.

We are closely watching as the war unfolds, and monitoring the impact on market sentiment and inflation. A longer and more intense war would be a concern especially where market valuations are stretched across the global equity complex.

We are intently focused on the evolving situation and potential risks, and the impact on the consensus themes expected to drive the market. For example, when we started the year, many market participants were looking to lower interest rates in 2026, and that trend appears to be on pause. While the omnipresence of AI in capital markets has been a big positive over the last three years, the market has been less enthusiastic about the potential destabilizing influences of AI as seen by the recent volatility in the software sector.

Also, many looked to a variety of economic tailwinds to support the U.S. economy in 2026, whether it be lower interest rates, an expansion of M&A activity, or tax cuts driving higher consumer spending. Prolonged uncertainty surrounding the conflict in Iran runs the risk of offsetting those economic tailwinds. It is fair to say this is one of the more confounding market environments I have seen.

What should investors learn from the volatility of the last month?

If you had said at the beginning of the year that oil prices would be above \$100 a barrel, there would be hotter inflation prints coming out over the course of 2026, we would be in a war with Iran, and the VIX would be less than 30, I wouldn't have believed you!

While interest rates are higher and Treasury bond yields have moved up, many would have expected a more severe drawdown than we have seen over the course of this last month. The market has been in a wait-and-watch mode. There is uncertainty over the outcome in Iran, but hope persists that it will be a short-lived war. History tells us, and investors know this from experience, that geopolitical events, at times, can cause markets to overshoot.

As we think about current portfolio positioning, we recommend investors be mindful of their liquidity needs to ensure they are in line with their safe-haven fixed-income exposures. We also advise patience

in putting dollars back to work in equities under current conditions. We have had three years of great equity returns and a little patience would probably go a long way in markets today.

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