



# Market Watch

## Iran: What happens next?

### Summary

**Event:** The US struck Iran's three main nuclear sites on Saturday. President Trump declared the facilities "completely obliterated" and indicated no further military action unless Iran retaliates. In response, Iran stated it reserves "all options" to defend itself.

**Market reaction:** Markets have taken the action in its stride so far. Risky assets are implicitly indicating further significant escalation is unlikely. US stock index futures are down around 0.5% and the USD index is up less than 0.5%. Oil prices rose over 5% initially, but have given up half of these gains this morning. Bitcoin fell around 4% on Sunday, but recouped half of its losses in early Monday trading.

**Investment strategy:** Iran's next move is crucial. Initially, the response was to increase attacks on Israel, but markets are likely to be more sensitive to any attacks on US military assets in the region or moves to close the Straits of Hormuz. **In the very short-term, the market reaction is likely to be characterised by higher oil prices, a pullback in risk assets and a USD short squeeze.** An aggressive Iranian response in this regard could see oil prices testing USD 100 per barrel and deepen the sell-off in risk assets. Gold, oil-linked currencies like the CAD and NOK, and US TIPS bonds offer hedges against such a response.

However, **a calibrated Iranian response**, which we view as the most likely scenario, should result in any market volatility being short-lived. This means **investors should be prepared to buy the dip on any significant equity market weakness.** Any USD short-squeeze higher would offer an entry opportunity to non-Dollar bonds.

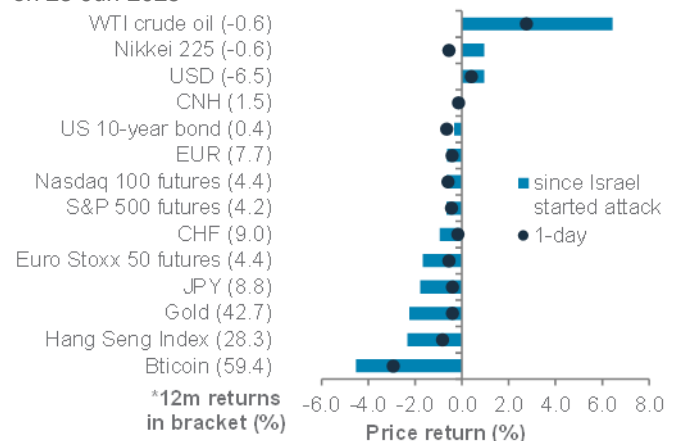
### Supply shock risks limiting Fed flexibility

The US strikes add to global uncertainty that could dampen business sentiment and weigh on investment and hiring decisions. For the US, a scenario of sustained, elevated oil prices would be an additional supply shock, with the main risk channel operating via the **high correlation between oil prices and US inflation expectations.** This would place the Fed in an even tougher spot by limiting its room to cut rates unless growth slows significantly. **Powell is due to give his semi-annual testimony to the House and Senate this week**, which will give us an update on his latest thinking in this regard.

Oil importers, particularly in Asia, face greater challenges from a sustained rise in oil prices in a downside scenario. This could reignite inflation at a time when many EM central banks are easing policy.

### Market reaction in risk assets has thus far been relatively muted

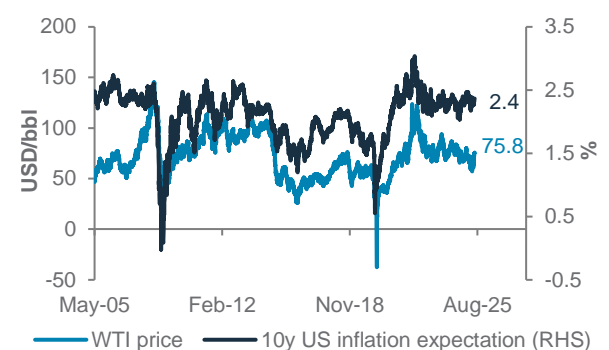
Asset class returns since 13-Jun and 20-Jun; as of 9:30am SGT on 23-Jun-2025



Source: Bloomberg, Standard Chartered

### Any jump in oil prices poses a risk to US inflation expectations and limits room for Fed interest rate cuts

WTI oil prices vs US inflation expectations



Source: Standard Chartered

## What does this mean for investors?

### Bonds

**Our View:** We expect longer-dated US government bond yields to remain rangebound. Add UK Gilts and EM local currency bonds after any USD short squeeze. Add to US inflation-protected bonds (TIPS) to protect against surge in inflation expectations. Any spread-widening in GCC credits is likely to be short-lived.

**Rationale:** While safe-haven demand normally pushes US government bond yields lower, worries of higher oil prices (and, therefore, US inflation expectations) are likely to offset this. Over the next few days, we expect **the US 10-year yield to test its 200-day moving average around 4.30%**. However, a sustained break below this level is unlikely given inflation and fiscal worries. US inflation-protected bonds (TIPS) can help mitigate the risk of a sharp rebound in inflation expectations. **A USD short squeeze is likely to create an entry opportunity in UK Gilts and EM local currency bonds.**

Yield premiums (credit spreads) are likely to widen initially as risk-off sentiment initially dominates. However, this is likely to reverse unless a sustained rise in oil prices raises credit quality concerns.

### Equities

**Our View:** Use any notable drawdown to (1) add to diversified global equity holdings, (2) tilt towards non-US equities, especially Asia ex-Japan equities, and (3) add to some of sector overweights or opportunistic equity ideas. (see below and Global Market Outlook – ‘Positioning for a weak dollar’ for more details)

**Rationale:** Rising geopolitical tensions could trigger a near-term risk-off. We expect the S&P500 index to test support at 5,767. Given notable drawdowns spurred by geopolitical events are typically short-lived, we would take this opportunity to rebalance our portfolio towards global equities with a tilt towards Asia ex-Japan equities.

Within US equities, we recommend tranching-in to policy-supported major banks, on expectation for the US administration to relax the supplementary leverage ratio to fund growth. Within US technology, we would rotate out of semiconductors into software, as the latter's earnings are more resilient given the recurring nature of revenue.

For non-US equities, we suggest using any notable drawdown to add to quality Chinese high-dividend non-financial state-owned enterprise shares, as well as policy-aligned Korea equities and EU industrials.

### FX

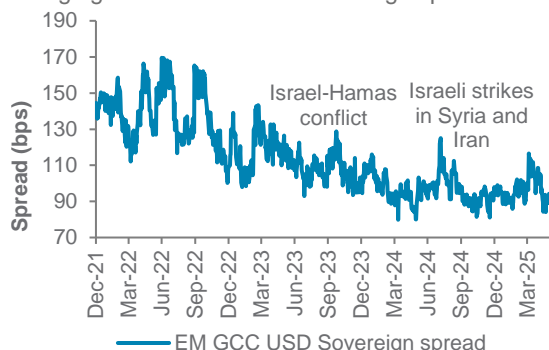
**Our view:** USD poised for a short-squeeze in the short term. CAD and NOK offer a more direct hedge against an oil price surge risk.

**Rationale:** Speculative positioning in the USD remains very short, at more than negative one standard deviation relative to history. This suggests room for a squeeze higher if risk-off sentiment dominates. Gains last week during Israel's strikes suggest investors have not completely dismissed the USD's role as a safe haven. However, we would view **any USD rebound as an opportunity to position for a weaker USD over a longer horizon.** We expect the USD index (DXY) to initially test its 50-day moving average at 99.48.

Traditional safe-haven currencies like JPY and CHF may see limited upside given their sensitivity to oil prices as net importers. Neither currency benefited from safe-haven demand at the beginning of the Russia-Ukraine war nor when Israel first struck Iran last week. Oil-linked currencies, such as CAD and NOK, are better placed to serve as a hedge against oil supply disruptions.

### Spread widening in GCC sovereign bonds have tended to be short-lived during past flare ups of Middle East tensions

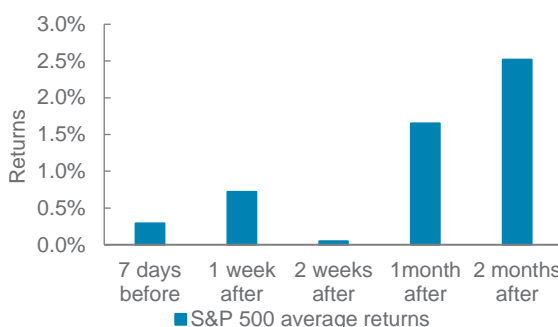
Emerging Market GCC USD sovereign spreads



Source: Bloomberg, Standard Chartered

### There has been no discernible long-term impact on S&P 500 returns based on historical episodes of major conflict

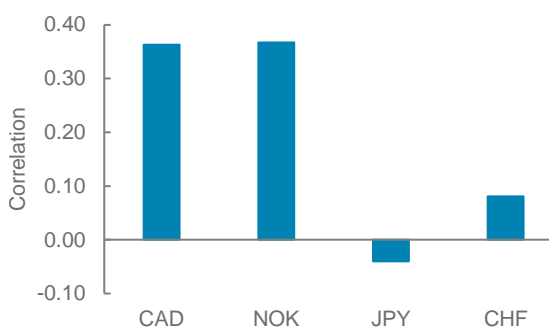
Average S&P 500 returns post major conflicts\*



\* Israel Hamas war: Oct 23, Russian invasion of Ukraine: Feb 22, US-Iran tensions: Jan 20, Jul 18; Iran attack on Saudi oil: Sept 19; ISIS declares caliphate: Jun 14; Arab spring: Mar 11; Iraq invasion: Mar 03. Source: Bloomberg, Standard Chartered

### CAD and NOK have historically been more positively correlated to oil prices, making them better placed to serve as a hedge against oil supply disruptions

Correlation of weekly returns since Dec 1999



Source: Bloomberg, Standard Chartered

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