Capital Insights

GEOPOLITICAL RISK HAS RISEN: ENERGY DISRUPTION IS THE KEY MARKET CHANNEL TO WATCH

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KEY SUMMARY POINTS

- Recent Middle East escalation has lifted geopolitical risk, driving near-term volatility, softer risk appetite, and rotation toward safe havens.
- Markets are watching energy supply/transport disruption—especially key shipping chokepoints—as the main channel to inflation and growth expectations.
- Base case is a temporary risk premium that fades with containment; a prolonged conflict could keep energy higher and raise stagflation risks, particularly for energy-importing economies.

Geopolitical Context and Immediate Market Reaction

The weekend attack on Iran has raised geopolitical risk and short-term market volatility, with attention centred on risk of escalation rather than the initial development. In the near-term, this is likely to weigh on risk assets and support traditional safe havens (gold, US dollar), with cross-asset correlations rising as market participants reduce exposure to crowded positions and respond to headline-driven developments.

Energy Market Impact: Oil Transmission Channels and Price Scenarios

The most immediate concern would be the impact on energy production, transportation and energy prices. Oil prices already reflected a geopolitical risk premium by Friday's close, with further upward price pressure still to come. The Strait of Hormuz is the key chokepoint to watch, with ~20% of global oil supply passing through the corridor. Energy, therefore, represents the most immediate and economically meaningful transmission channel for regional tensions. That said, the depth of US naval presence and aligned incentives among producers and consumers argue against a prolonged disruption.

The conflict and its impact on oil prices via a risk premium for the volumes shipped through the Strait of Hormuz is likely to be resolved within the next two weeks. Either Iran will capitulate, or its strike capability will be eliminated, allowing the estimated $18/barrel (bbl) risk premium to fade. If the conflict drags out, the ~20% risk premium could increase further, with oil prices (West Texas Intermediate) potentially reaching $80-$90+/bbl, a level where demand destruction begins.

Natural Gas Market Link

Natural gas prices are also being impacted as ~20% (80 million tonnes per annum (mtpa) in a >400 mtpa market) of Liquified Neutral Gas (LNG) volumes transit the Strait. This supply distribution supports European natural gas prices at the Title Transfer Facility (TTF) as well as North American gas prices (Henry Hub), given that rising US LNG exports have increased the tether to global gas prices.

Equities Impact & Potential Outcomes

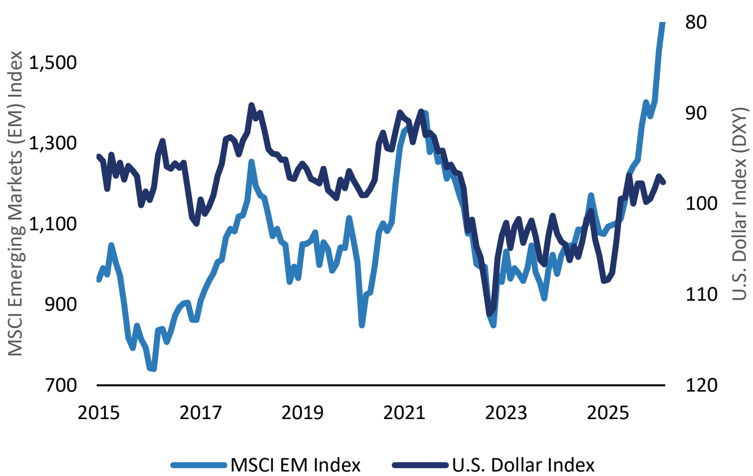
Early-stage developments of the Iranian conflict, including escalation and potential regime change remain highly fluid. The lack of clear direction complicates forecasting and potential positioning changes. Incoming information is being absorbed by the market in real-time, resulting in increased volatility.

The two scenarios facing the market include (i) tension easing near-term leading to some stabilization, or (ii) prolonged disruption with elevated volatility, uncertainty, and higher energy prices.

Exhibit 1:

USD: From macro headwind to tailwind

Emerging Markets (EM) equities typically underperform when the dollar rallies – but USD weakness is beginning to emerge



Source: Bloomberg Finance L.P., as February 28, 2026.

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Potential Resolution Scenarios and Oil Price Implications

The move in oil equities was not of the same magnitude as oil prices due to:

- Oil equities were already moving higher since the start of the year due to sector rotation and already discounting a geopolitical risk premium.
- Canadian oil equities, for example, were already discounting an implied $70+/bbl oil price before the conflict.
- The equities are also likely reflecting expectations around China's inventory position.
- Geopolitical risk premiums tend to fade after the initial reaction.
- There was already an expectation of growing inventories in the first half of 2026, so the timing of the attack was during an expected softening in supply-demand balance.

Regional/Emerging Market Sensitivity

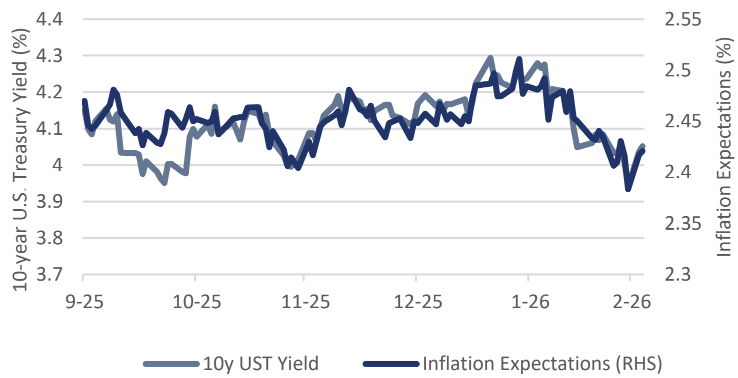
Disruption of energy corridors (e.g. Strait of Hormuz) or infrastructure in the GCC (Gulf Cooperation Council) would cause inflation and stagflation risks to rise materially and would have an adverse impact on many Emerging Markets, including the GCC, as well as Turkey, Egypt, South Africa, Hungary, and several countries in Asia (India, Indonesia, South Korea, Philippines, and Taiwan). We anticipate these Emerging Markets to be disproportionately impacted by a prolonged higher energy price environment, especially for countries with limited strategic energy reserves.

Macroeconomic and Portfolio Impacts

From a macroeconomic and portfolio perspective, the central issue is whether higher energy costs become persistent enough to influence inflation dynamics and growth expectations. The balance of risks points toward containment rather than escalation. The US and regional partners have both the capability and the incentive to keep shipping lanes open, while recent signals from OPEC+ (the coalition of the Organization of the Petroleum Exporting Countries (OPEC) and allied non-OPEC producers) suggests a willingness to respond pragmatically to supply concerns if needed. As a result, second round effects on inflation and economic activity remain a downside risk rather than a base case outcome.

As investors, the key issue is how these developments affect portfolio risk rather than the immediate market reaction. While near term volatility across energy and broader risk assets is likely to persist, the balance of evidence does not support embedding a sustained growth or inflation shock into baseline scenarios. This argues for treating energy driven price moves and safe-haven flows as tactical and reversible, prioritizing flexibility and avoiding extrapolation of geopolitical volatility into longer term asset allocation decisions.

Exhibit 2:
U.S. Treasuries (USTs) have moved with inflation expectations



Source: Bloomberg Finance L.P., as February 28, 2026.

Rates Market Reaction & Policy Expectations

Going into the weekend, US Treasury yields had dropped below 4%, as USTs caught some safe-haven demand on mounting geopolitical concern. Once the conflict broke out, government bonds' safe-haven performance was extremely short-lived, with yields rising sharply through the day. The move intensified as oil prices came off their intraday peak, equities moved higher, and risk sentiment improved.

At the centre of the yield spike are concerns about the inflationary impact of a protracted conflict that can keep oil and gas prices elevated. While energy cost-driven inflation and potential spillovers will contribute to higher headline inflation, the passthrough to core is much less certain. Markets are still pricing in two cuts from the Federal Reserve by year-end but shifted the odds to a later start. The magnitude and duration of the increase in oil prices will be crucial in determining the impact to the global economy and the outlook for yields, a theme we are closely watching.

For more information, please visit ci.com

GLOSSARY:

Correlation: A statistical measure of how two securities move in relation to one another. Positive correlation indicates similar movements, up or down, while negative correlation indicates opposite movements (when one rises, the other falls).

Volatility: Measures how much the price of a security, derivative, or index fluctuates. The most commonly used measure of volatility when it comes to investment funds is standard deviation.

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