

Israel/Hamas War

Key Takeaways

- The Israel/Hamas war is a terrible human tragedy and may escalate in the coming weeks.
- The economic impact is expected to remain largely regional, but the war may impact investor sentiment, commodity prices, and monetary policy.
- We suggest investors remain disciplined to their long-term investment strategies.

Human tragedies and markets

One of the most challenging things about investing (and writing about investing) is that markets are shockingly unemotional when it comes to human tragedy. Markets simply do not care about human suffering – whether caused by an earthquake, a hurricane, or a war. The Israel/Hamas war is no exception. Despite the unspeakable human tragedy, markets typically focus on economics. And the economic impact is likely to be largely confined to the region, with marginal impacts on commodity prices and monetary policy.

Oil price volatility

The regional impacts of the war are still uncertain. While Israel and Palestine do not produce substantial amounts of oil, Iran, Saudi Arabia, and other Gulf nations account for almost one-third of the world's oil production. If the conflict extends to Iran or Saudi Arabia, we could see substantial volatility in oil prices. However, it is too early to tell how the story unfolds and how the regional dynamics may evolve.

Oil prices did increase from \$83 to \$87 on the day of the attack, but they have settled down over the last three days and have generally traded sideways. The war's impact on other assets is similarly unclear.

Investor sentiment

Investor sentiment is fickle and unpredictable. Despite higher volatility in an already volatile region, US equity markets (S&P 500) are up about +2% since the attack. VIX, a measure of US equity market volatility, is -8% lower since the attack. On the surface, this might seem odd. One possible explanation is the impact on monetary policy. The Federal Reserve may be less likely to hike interest rates because of the additional geopolitical risk.

Indeed, the market was implying a 30% probability of a rate hike in November before the attack and a 12% probability after the attack. This is consistent with previous Fed communications, which have repeatedly cited the Russia/Ukraine war as a source of risk to economic growth (and a reason for keeping rates more accommodative). On the other hand, the Fed has also cited the Russia/Ukraine war as a source of inflation (and a reason for keeping rates higher). How the Fed reacts to the war will likely depend on the scope of the countries involved, but at this point, markets are reflecting a marginal impact on the US economic growth and inflation picture.

Key takeaway

Despite the human tragedy of this war, the investment impact on US markets is likely to be limited to marginal declines in investor sentiment. As such, we recommend that investors remain disciplined in their long-term investment strategies.

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