FULLERTON FUND MANAGEMENT

MARKET UPDATE

# Our Views on the US-Iran Tensions

**10 January 2020**

## In Brief

- Despite initial jitters, global financial markets have rebounded and oil prices have stabilised following the seeming de-escalation of the situation in the Middle East.
- A direct confrontation between the US and Iran is unlikely in the near future, given the lack of appetite for prolonged conflict for both countries.
- Economic indicators suggests a bottoming of the manufacturing and capex cycles in both developed and emerging economies. Central bank support have created a benign environment to support equity prices.
- We continue to monitor market conditions and the developments in the Middle East, and will adjust the portfolio's risk exposures correspondingly in the event of a re-escalation of tensions.

Following the US airstrike that killed Iran's top military general on 2 January, Iran responded on 8 January with a missile strike targeting two military sites in Iraq that house US troops. The possibility of a widening of the geopolitical tension had created some market jitters over the past week, and had investors pondering on the implications on oil prices and a possible widening of conflicts in the Middle East.

Look beyond the rhetoric and posturing, and it becomes clear that neither sides are keen or have the appetite to start a war. Iran's response to strike came with advance warning to Iraq to minimise casualties, and its foreign minister has reiterated that the country does not intend to escalate the situation. Iran is grappling with a weak economy as a result of international sanctions, and has also struggled to contain the recent anti-government protests. While Iranians are clearly angered by the killing of the popular general, its leaders understand that in the event of a direct confrontation, there are limited scenarios which Iran can come out ahead.

The United States have a superior firepower against Iran's armed forces, but little appetite to start another protracted war following its experience in Iraq and Afghanistan. It is re-election year for President Trump who had run his first election on withdrawing the "endless" wars in the Middle East, and starting another war at this point could unsettle his support base. Moreover, higher oil prices could take a toll on US economic activities and hurt voter sentiments. In addition, the US House has indicated a vote soon to limit the President's military actions with Iran. Iran's restrained response have also provided the US President with a way out, whom indicated that he still wants to make a deal with Iran.

Indeed, the global financial markets' calm response indicates investors discounting the possibility of a military conflict. The S&P 500 and Nasdaq Composite indices both hit their all-time highs on 8 January, and oil prices fell 4.1% after briefly rising to above $70 this week[1].

In the meantime, the trade truce announced in December, along with relatively strong data prints pointing to healthy economic growth, could underpin a recovery in corporate earnings in 2020. Additionally, the policy environment (both monetary and fiscal) is likely to remain accommodative while investor sentiment is still neutral at best. As such, we would expect greater participation and further inflows to bolster equity markets in coming months.

We continue to keep an eye on the fluid situation in the Middle East and oil prices. In the event that tensions re-escalate, our absolute return strategy provides portfolio managers with the flexibility to adjust the portfolio's sector exposures, and to employ cash or index hedges for downside protection.

[1] Source: Bloomberg, as of 9 January 2020

*Please do not hesitate to contact us if you require further clarification.*