



Markets & Economies

U.S.-Iran Conflict: Implications for Key Asset Classes

In the wake of the market volatility that followed the start of the military conflict in the Middle East on February 28, we offer some observations about the positioning of key asset classes.

IN BRIEF

- **High Quality Fixed Income:** While the fundamentals of the U.S. economy remain favorable, the risk of higher energy prices and a broadening of the conflict suggest an emphasis on higher-quality, more resilient sectors.
- **Leveraged Credit:** While the current conflict is certainly a concern, the major factor poised to influence the market remains AI disruption. As for sectors, we would emphasize cyclical areas such as basic industry and energy.
- **Equities:** Investors should continue to focus on quality and sustainable competitive advantages. In the United States and elsewhere, defense and aerospace stocks should continue to lead, while those being disrupted by AI are likely to see continued pain in the near term. The current Iran-driven dislocation is likely to provide an even more attractive entry point for already discounted valuations in non-U.S. stocks.

Global financial markets have experienced volatility in the past several days, given the uncertainty and potential scope of the impact of the military conflict involving the United States and Iran that began on February 28. Our senior investment leaders are continuing to assess the potential implications of these events for key asset classes, and we are providing below some early views of what to look for from an investment standpoint and where we may find opportunity in the weeks and months ahead.

High Quality Fixed Income

The escalation of the U.S.-Iran conflict is adding to market volatility through higher oil prices and renewed inflation concerns. However, the U.S. economy is less sensitive to energy prices than in the past, and underlying macroeconomic and policy fundamentals remain supportive, which reduces the likelihood that sustained energy price increases would materially alter the domestic growth or monetary policy outlook. While risks appear greater in regions more exposed to energy, a wider range of potential outcomes supports maintaining a degree of caution in the near term.

More broadly, elevated geopolitical risk, ongoing uncertainty around AI-driven disruption across certain industries, and still relatively tight credit spreads align with a measured approach to risk, in our view. Even after recent spread widening, valuations in many segments of the high-quality fixed income market remain tight relative to history.

Our investment portfolios entered this period with relatively conservative and balanced positioning overall, with an emphasis on higher-quality, more resilient sectors. Across high quality fixed income strategies, we have been reducing exposure to positions more vulnerable to structural disruption from advances in AI, while increasing emphasis on higher-rated securitized sectors where carry, liquidity, and structural protections remain attractive, as well as select areas of the corporate bond market. Within corporates, we favor industries focused on physical assets, such as utilities, power generation, energy, and commodities, along with larger money center banks.



Leveraged Credit

Prior to the U.S.-Iran conflict, leveraged credit markets were already experiencing volatility, beginning in February amid technology sector softness tied to AI-disruption risks and rising geopolitical tensions. High yield spreads have widened 30 bps year to date and 40 bps from year-to-date (through March 3) lows.

Despite this volatility, performance has been resilient. The ICE BofA U.S. High Yield Index (High Yield Index) returned 0.17% in February and 0.66% year-to-date through March 3, with higher carry offsetting spread widening. We remain constructive on high yield given a stronger ratings mix, low duration, and solid fundamentals.

While the Middle East conflict bears monitoring, we view AI disruption as the more significant structural risk. Markets are increasingly pricing in the potential displacement of incumbent software vendors. However, technology and software issuers have only a minimal weighting in the High Yield Index, and we are underweight software—particularly in lower-quality segments.

Sector positioning continues to favor cyclicals, particularly basic industry and energy, while trimming financials, consumer exposure, and select names with higher AI-related risk. We remain longer duration, favoring shorter-dated issues.

In leveraged loans, we are underweight software relative to the Morningstar LSTA Leveraged Loan Index and have concentrated capital in highest-conviction credits. We favor utilities, aerospace & defense, and telecommunications, which benefit from AI catalysts or are relatively insulated from geopolitical risk, while maintaining strong liquidity. Market volatility has broadened opportunities, with many issuers trading below par at attractive levels.

Across portfolios, we are closely monitoring geopolitical developments and believe active positioning and disciplined liquidity management remain critical amid continued volatility.

Equities

While geopolitical shocks can increase volatility, they have historically had surprisingly limited impact on long-term equity returns. We have identified 36 major geopolitical events since 1940 that significantly affected markets. Based on data as of March 3, 2026, forward six- and 12-month S&P 500 returns following these events matched long-term averages (+2.6% and +5.5%). Nevertheless, memories of the outlier events that have sharp negative consequences (1973, 2001, 2008) are what always concern investors; however, as of now, we do not see this instance as one of those more dire scenarios.

With Iran already under sanctions and largely isolated from foreign investment, the economic impact of continued conflict is likely indirect. Key variables include energy prices, inflation expectations, interest rates, global trade flows, and defense spending. A sustained rise in energy prices could pressure inflation and consumer spending and influence rate expectations, depending on the conflict's scope and duration.

In this environment, active management is critical. We continue to emphasize three themes: (1) own leading innovators driving AI and other secular growth trends; (2) add ballast through Value and Dividends; and (3) increase exposure to non-U.S. equities amidst what we see as a long-awaited earnings revival.

- **Innovation:** Beyond AI and biotech, we favor defense and aerospace given potential growth tied to rising global defense spending. Secular growth drivers should outweigh the impact of short-term oil price spikes.
- **Value:** Investors should remain disciplined and avoid overreacting to headlines. An emphasis on quality companies with consistent earnings and strong free cash flow yield should support relative performance if volatility persists. Defense exposure remains attractive here as well.
- **International:** We see compelling value outside the U.S., where stimulus efforts in Germany, the EU, China, and Japan are supporting an earnings rebound across Europe and Asia-Pacific.

Over the long term, earnings and secular trends matter most. According to FactSet (March 2, 2026), EPS growth for 2026 is estimated at 15% for the S&P 500 and 14% for the Russell 2000. Non-U.S. equities are forecast to grow earnings by 18% (based on the MSCI All Countries World Index [ex-U.S.]), with valuations more than 30% below U.S. markets. The composition of those forecasts may shift if the conflict persists, with potentially stronger earnings coming from energy, defense, aerospace, and other industrial stocks, with potential weakness coming in from other economically sensitive areas such as consumer cyclicals. While near-term volatility may persist, strong fundamentals across regions suggest current conditions could present an attractive long-term entry point.



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A Final Word

Here are two concepts we think investors should keep in mind during periods of market tumult:

The Value of Active Management: Volatility can be difficult to live through—no one knows how long it may persist. But volatility often creates opportunity. As we have noted many times, short-term market dislocations, such as the ones experienced in April 2025, can create attractive entry points and allow active managers to identify opportunities.

The Value of Investing for the Long Term: News headlines may be alarming, but staying invested has long proven to be far more successful than trying to time “getting in” and “getting out” of the market.



Glossary & Index Definitions

A **basis point** is one one-hundredth of a percentage point.

Carry is the difference between the yield on a longer-maturity bond and the cost of borrowing.

Duration is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates.

Earnings-per-share is the monetary value of earnings per outstanding share of common stock for a company. It is a key measure of corporate profitability.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (which equal one-one hundredth of a percentage point). The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the spread versus Treasuries.

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value. Yield-to-maturity (YTM) represents the expected return (expressed as an annualized rate) from the bond's future cash flows, including coupon payments over the life of the bond and the bond's principal value received at maturity. Yield-to-worst refers to the lesser of a bond's (a) yield-to-maturity or (b) the lowest yield-to-call calculated on each scheduled call date.

Yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. One such comparison involves the two-year and 10-year U.S. Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

The ICE BofA U.S. High Yield Index tracks the performance of U.S. dollar-denominated corporate debt that is rated below investment grade and publicly issued in the U.S. domestic market. This index includes bonds with a fixed-coupon schedule and a minimum outstanding amount of \$100 million.

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The Morningstar LSTA US Leveraged Loan Index is a market-value weighted index designed to measure the performance of the US leveraged loan market.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index. **The Russell 3000® Index** measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market.

The S&P 500® Index is widely regarded as the standard for measuring large cap U.S. stock market performance and includes a representative sample of leading companies in leading industries.

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