

Gulf War III? The view from London

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Research Report

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Key Risks to Price Target

Not applicable

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My paper's weekend headline 'Starmer rocked by Greens' victory' seemed borderline irrelevant when it landed Saturday morning. The print media is possibly of a bygone age, it cannot keep up in this environment of permanent military activity.

Permanent military activity is impossible due to the lack of targets and the reality of nuclear warfare / nuclear proliferation. So the tutors said 40 years ago when the class was studying George Orwell's '1984'. The notion that US military targets give up quickly these days is true, but nothing stops warring powers coming back a second time, and a third etc. 20 years ago it was important to show an imminent military threat, but that approach is dead.

Prior to the 1979 Islamic Revolution, the previous Iranian government led by the Shah of Iran was a US backed absolutist monarchy that indulged in vast self enrichment, and was held in place by the Savak a ruthless secret police. The Iranian Revolution, a direct result of vast societal inequalities delivered a theocratic government that saw Iran's monarchy and business elite replaced with a theocracy run by clerical administrators, who increased repression via a secret police and morality police. There have been power struggles, but no credible opposition leader to the mullahs has emerged since 1979.

During the last Israel/ Iran military conflict ("the 12 day war", June 2025) the clear Israeli objective was destroying Iranian military and expertise, a shopping list of targets, alongside their normalised bumping off of Iranian scientists. This time, a new shopping list has emerged whose objectives involve uprooting the Iranian political and military leadership and encouraging an uprising. The US appears to be pushing for regime change, however previous US engagements have repeatedly demonstrated, this is hard to achieve without 'boots on the ground' - which appears unlikely.

Two months on from the US military assault on Venezuela which removed President Nicolas Maduro from office, the old regime remains in place with the country experiencing life as usual. The 'new' leadership under Delcy Rodriguez, a Maduro loyalist, is calling for the return of Maduro along with many others in Caracas. This result, leadership musical chairs, orchestrated from Washington, with zero democratic process, is a wasted effort that leads to demoralisation as hopes for change are dashed.

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There are a few factors preventing this new anti-Iran engagement from becoming a drawn out conflict:-

- i) Iran has finite, rapidly diminishing missile supplies, estimated at 3,000 in 2022 by US Centcom. About half have been used already. The deliverability of Iran's remaining arsenal is questionable due to bombardment/ loss of airspace. These estimates may be unreliable due to the scale of military preparedness since. However, the Iranian military response appears scatter-gun and by targeting 11 Gulf nations, its retaliation lacks military focus. Iran might not have use of its hypersonic capability. Soon it might be unable to fight back.
- ii) Iran is diplomatically isolated and cannot rely on a superpower partner for support, supplies or diplomatic engagement. Its leadership is likely to be focused on self-preservation, and the survival of the theocracy. This approach aimed at pressure release can undermine any military effort.
- iii) An internal uprising is possible however the bombing campaign needs to stop for a protest movement to feel safe enough to return to the streets. The problem with expecting protestors to remove the Iranian government is the lack of a credible opposition leader. This is not Ayatollah Khomeini organizing mass strikes in Tehran from his home in the Paris suburbs. There is no such individual right now. Furthermore the last time, there were months of mass demonstrations in 1978/1979 before the Shah fled. Can an internal uprising occur in these forced circumstances? not sure, but it all sounds like American 'cakeism'.
- iv) Neither the US nor Israel appear willing to commit to boots on the ground, a prolonged naval blockade or prolonged aerial bombardment likely to quickly involve civilian casualties and collapsing support.

A counter argument could be that Iran is able to sustain bombardment for a period of time that exceeds the US President's ability to concentrate on the issue. The cornered regime might reject an exit strategy anyway.

A 'text book' response so far

The market response has so far been text book for Gulf crises. However we also note the investor tendency to view the conflict as i) short-lived ii) inflationary.

- i) **An oil price spike** (similar to Gulf War) Brent + \$5.54 (+7.7%) is certainly a 'mini-spike' however OPEC+ has promised to increase

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production to compensate (+206k) having debated options ranging from +137k / +548k. Iran has warned that the Strait of Hormuz is closed, however it appears that its ability to enforce the closure will be impacted by conflict and the US naval presence that can organize a tanker escort. A path to \$100/ bbl is possible but remote. In my view the optimism over oil majors is misplaced.

- ii) **Gold** (+\$114) has benefited from 'flight to safety' – de-dollarisation and the geo-political situation lurching from one crisis to another. Hence gains in leading precious metal miners.
- iii) **Gilt yields** (2 YR 3.61% + 10bps. 5 YR 3.85% + 17 bps, 10 YR 4.35% +12 bps) modestly higher on the inflationary implications/ risk of a longer conflict and possibly a MPC waiting to see how events unfold before relaxing monetary policy further.
- iv) **Defence / military equipment** sector has risen sharply with gains focused on munitions specialists on the view that an inventory build will be likely soon.
- v) Sell off in **travel stocks/ airports** with specific exposure:- Informa (Dubai World Partnership), International Consolidated Airlines/ Wizz Air/ Intercontinental Hotels, Carnival Corp, TUI AG
- vi) **Base metal miners**, optimism over copper looks insulated from Iran, hence today's gains in Antofagasta, BHP Group, Rio Tinto.
- vii) **Financials** – the 4% sell-off in UK banks is a possible buying opportunity.
- viii) **Emerging markets equities**, we note the relative resilience of both India/ China/ Asia Pacific equities, and this should continue.
- ix) **Technology companies**, in our view the ongoing sell off / exposure reduction in tech names is organic in its evolution and development with Iran a factor of limited relevance.
- x) **UK indices** – blue chips up c. 8% YTD had enjoyed their best start for decades. The mark down is a modest 1.4%, a measured repricing that demonstrates an unwillingness to panic sell.

Conclusion

Our thinking is this is yet another limited conflict likely to deliver little in the way of clear outcomes / tangible change. US bombing campaigns, on their own have gone badly wrong before, Hanoi solidified resistance, creating conditions where North Vietnam ended up winning the Vietnam War. The same happened in Cuba at the Bay of Pigs (April 1961) and Mogadishu, Somalia (October 1993). The notion that a US/ Israeli bombing campaign is a magic wand that will disappear the Iranian regime, I am frankly sceptical. Though I may be wrong.

In my view it is only a matter of time before the US Navy offers shipping safe escort through the Straits of Hormuz, this will cut crude oil's war premium. I see crude oil's gains as highly reversible given Chinese demand

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for EVs. Either way, my view is these events should not cause a market correction or panic, some areas might have oversold a bit. Our view is to wait and see how events develop. But I don't see current events as endangering balanced equity portfolios.

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