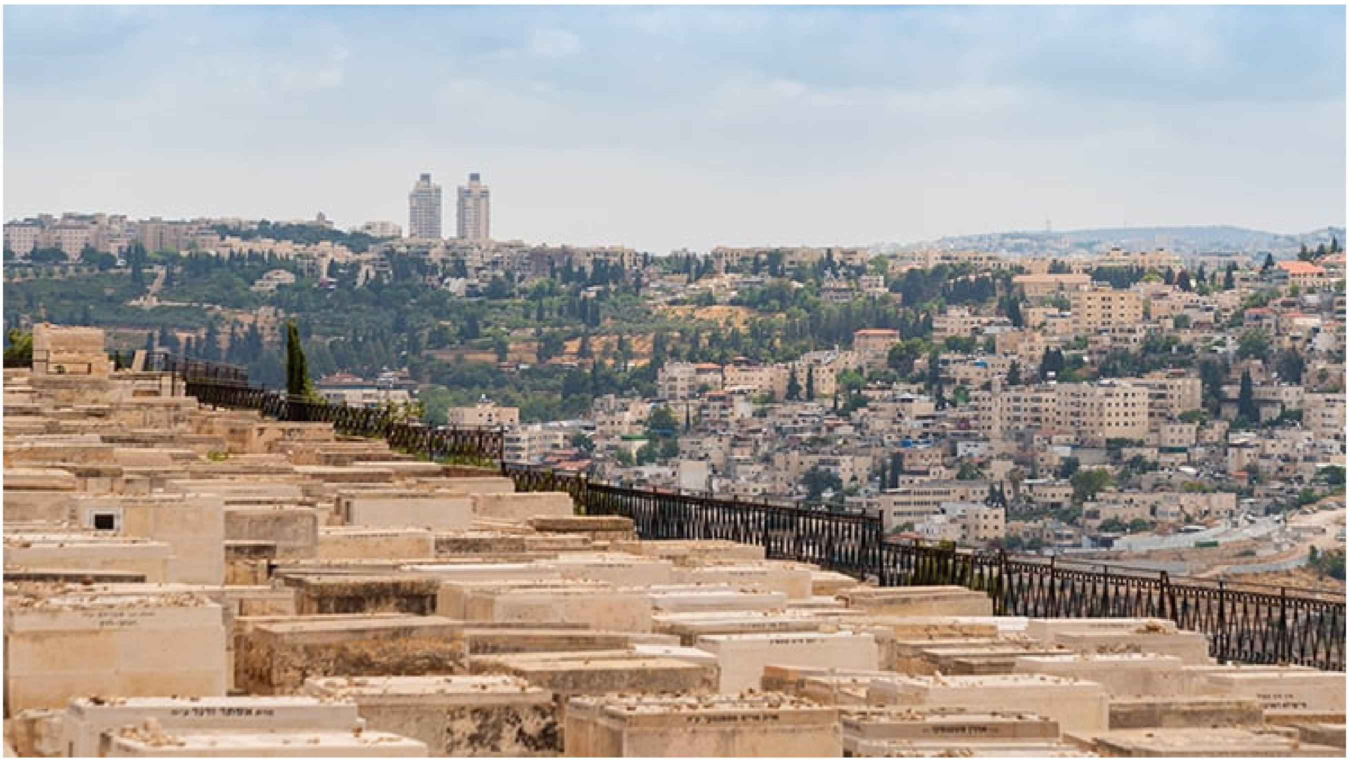
Beyond the human tragedy: what war in the Middle East means for global markets

By Perpetual Asset Management
17 October 2023



The crisis unfolding in the Middle East will have broader ramifications for an already fragile world order, says Barrow Hanley's JAMES CARPENTER

MOST Australians will be rightly focused on the fate of innocent civilians caught up in the Israel-Hamas conflict.

The killing of more than 1000 Israeli civilians by Hamas gunmen and the subsequent shelling of the Gaza Strip is the most significant conflict in the region for 50 years.

Beyond the unfolding humanitarian crisis, there will be broad ramifications for regional stability and an already fragile world order.

The war poses challenges for central banks and policymakers trying to engineer a soft-landing for the global economy, says Barrow Hanley's James Carpenter.

The conflict carries direct implications for investors, including heightened uncertainty, increased energy prices, prolonged inflation and the potential for sustained higher interest rates potentially triggering a global recession.

"It's a tragic situation, which could have significant ramifications for markets," says Carpenter, a client portfolio manager at Barrow Hanley, a global value investing leader which is part of Perpetual Group.

"If the conflict does not de-escalate soon, the potential for it widening grows. This could hinder global oil supply in addition to other second derivative effects."

Impact on oil

The biggest ramification for investors lies in the region's importance to oil supply.

While the conflict does not directly affect oil-producing territories, the political implications of the attack are likely to see sustained upwards pressure on oil prices.

"We could easily see oil top $100 a barrel in the near future," says Carpenter.

Key for investors is how the US responds, he says.

The US administration has recently been supportive of loosening sanctions on Iran to allow more oil supply into global markets.

This stance could now be under threat, raising the prospect of less oil in the system, higher energy prices and ultimately more inflationary pressure, argues Carpenter.

Iran, which has been allowed to supply an incremental 700,000 barrels a day into global markets, has denied involvement in the invasion — but has long provided financial support to Hamas.

“We’re estimating that a risk premium could be $5 to $10 a barrel if the conflict spreads to other countries, especially to a direct hot war between Iran and Israel, which seems unlikely at this point.”

The US administration has also been courting Saudi Arabia — partly in the hope of encouraging an increase in production — but this too is now under threat.

“More inflation means higher rates for longer — and whether it’s one more hike or two more hikes isn’t relevant.

"What people are not factoring in is persistent higher rates. They are expecting high rates to eventually come back down.”

Inflation and rates

It’s worth remembering that a multitude of factors have contributed to inflation, says Carpenter.

The initial catalysts were disrupted supply chains, a surge in food and oil prices following Russia's invasion of Ukraine, coupled with the effect of fiscal stimulus measures aimed at preventing a pandemic-induced economic downturn.

More recently, strike action and rising wages are also putting further upwards pressure on prices.

“There is this thought that central banks are going to be able to engineer a soft landing — that they are going to be able to land this thing.

“But this conflict likely presents a formidable challenge to that.”

Complicating matters is the weakened ability of the US to step into to supply the world’s energy needs.

The US Strategic Petroleum Reserve, a reserve of crude oil stored in underground caverns, has been heavily drawn down over the past 12 to 24 months, and replenishing stockpiles would be counterproductive to lowering oil prices.

“This time around, US shale oil producers will probably not be able to come to the rescue like they have in the past.

“The shale industry is mature — rig count (which represents new drilling sites for oil) has come down precipitously in the last 10 years,” says Carpenter.

“So, if there is an energy shock, it may be difficult to unwind so long as the global economy continues to hum along.

“The big takeaway is we could be looking at turbulent times ahead just as global markets have entered into bull territory in the last year.”

About Barrow Hanley

Barrow Hanley is a global leader in value investing, managing assets for clients for more than 40 years.

Barrow Hanley Global Share Fund aims to provide investors with long-term capital growth through investment in quality global shares.

Rated "Highly Recommended" by Zenith, "Recommended" by Lonsec and with a Morningstar Medallist rating of "Gold", the investment team focuses on finding value in all the right places.

Find out more here.

Barrow Hanley is distributed by Perpetual Group in Australia.

Contact a Perpetual account manager

related party of PIML. Perpetual Corporate Trust Limited (ABN 99 000 341 533, AFSL 392673) has appointed Barrow Hanley as its authorised representative (Representative number 001283250) under its Australian Financial Services Licence.

It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information.

The product disclosure statement (PDS) for the Fund, issued by PIML, should be considered before deciding whether to acquire or hold units in the Fund. The PDS, including for the Active ETF, issued by PIML, and each of the Active ETF's other periodic and continuous disclosure announcements lodged with the ASX, should be considered before deciding whether to acquire or hold units the ETMF. The respective PDS and Target Market Determination for the Fund and Active ETF, issued by PIML, can be obtained by calling 1800 022 033 or visiting our website www.perpetual.com.au.

Neither PIML, Barrow Hanley nor any company in the Perpetual Group (Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of, or any return on an investment made in the Fund or the Active ETF or the return of an investor's capital. All investments carry risk, including loss of principal. Past performance is not indicative of future performance.