JUNE 16, 2025

GEOPOLITICAL TENSIONS FLARE UP: MIDDLE EAST UPDATE

Executive Summary

- Last Friday, Israel launched a series of airstrikes on key Iranian nuclear and military targets (Operation Rising Lion). The specific focus on Iran's uranium enrichment facilities represents a significant escalation and a key difference relative to prior confrontations between the two countries.
- The next few weeks will determine the scale, ramifications and impact of this military operation by Israel, and we will closely monitor these developments. A further escalation and a sharp rise in oil and gasoline prices could dent market sentiment and pose a fresh set of risks to the U.S. and global economies.
- Historical precedents suggest that investors should resist the temptation to react to volatility induced by geopolitical developments and should remain broadly diversified within (i.e. mix of U.S. and non-U.S. equities) and across (i.e. mix of equities and bonds) asset classes, according to their unique individual financial plans.

What happened?

Last Friday (Thursday night in the U.S.) Israel launched a series of airstrikes on key Iranian nuclear and military targets (Operation Rising Lion). The specific focus on Iran's uranium enrichment facilities represents a significant escalation and a key difference relative to prior confrontations between the two countries. The timing of this military operation coincides with the International Atomic Energy Agency declaring on Thursday that Iran was found to be in breach of non-proliferation obligations for the first time in 20 years. Israeli Prime Minister Benjamin Netanyahu motivated the preventive actions by stating that Iran has enough enriched uranium for nine atomic bombs.

Tensions remained high throughout the weekend, with both Teheran and Tel Aviv gripped by intense and continued bombardments and rising civilian casualties. The round of nuclear talks scheduled to occur on Sunday, June 15 between the U.S. and Iran in Oman were canceled, and the Iranian regime threatened to target U.S., UK and French military bases as part of its retaliatory operations.

Israel seems determined to extend Operation Rising Lion over several weeks, with the stated objective of destroying Iran's nuclear program. To this extent, while significant damage was inflicted to Iran's Natanz nuclear site (a facility where uranium had been enriched up to 60% purity[1]), the subterranean Fordow site (where in 2023, international inspectors found uranium enriched to 84% purity, close to weapons-grade) has proven much more difficult to target. Consequently, geopolitical strategists suggest that deeper and more long-lasting damage to

1 Weapons-grade uranium needs 90% enrichment.

Iran's nuclear capabilities might require U.S. direct intervention, something that President Trump did not rule out during an ABC News interview on Sunday.

The extent of further military escalation, the possibility of involvement by other countries, and the role played by diplomacy over the next few days and weeks will be key geopolitical factors to watch. For investors, what happens to the supply of crude oil is the overarching concern, as we explain in detail below.

How have financial markets reacted?

At the time of writing (9.30 a.m. ET on Monday, June 16), the S&P 500 has fallen by a modest 0.6% since Thursday night, after dropping more than 2% overnight following the initial airstrikes. This suggests that investors are assuming little impact on macroeconomic fundamentals for now.

The relatively benign equity market reaction is at least partly due to the smaller-than-feared rise in oil prices. The price of the WTI Crude Oil benchmark is up ~5% since Thursday night ($71.60/barrel), a significant moderation relative to the initial ~14% increase.

Bond yields have been reflecting two different dynamics. The initial decline (the U.S. 10-year Treasury yield fell by more than 5 basis points [bps] in the early hours) was an expression of the general risk aversion on Friday morning, when equity volatility spiked; however, concerns about the potentially inflationary impact of rising oil prices have pushed yields higher since then, with the U.S. 10-year Treasury yield (currently at 4.43%) now 6 bps higher since Thursday night.

What could this mean for investors?

Historically, regional conflicts and geopolitical shocks have at times spurred significant yet generally short-lived market volatility (Figure 1). However, the Iraqi invasion of Kuwait in 1990 and the Russian invasion of Ukraine in 2022 provide historical evidence that some large-scale events can have a more durable impact when they exacerbate an already fragile economic and market backdrop. The key determinant is often the price of oil. A sudden and sharp rise in oil prices could further worsen price affordability for U.S. households, where data pointing to a gradual slowdown in consumer spending is already mounting. Additional cost-pushed[2] inflationary pressures could also create another obstacle for the Federal Reserve (Fed) in their efforts to balance the dual mandate of stable prices and full employment. That said, our view is that the Fed is unlikely to change its cautious and wait-and-see stance for now.

Finally, rising geopolitical stress would compound already elevated trade and economic uncertainty, further clouding the outlook for consumers and businesses.

2 Inflation not caused by strong consumer demand outpacing supply, but by often-exogenous factors pushing the cost of production inputs higher.

As a result, a prolonged conflict between Israel and Iran could have more far-reaching implications for the global economy, especially if other countries get involved militarily and the supply of oil is impaired. To this extent, investors will be carefully monitoring two fronts:

- Will Iran target key energy facilities, pipelines and trading routes in the region, either directly or through regional proxies like the Yemen-based Houthis? The fate of the Strait of Hormuz will be crucial, given that more than 20% of oil traded globally is transported through this waterway.

- Will Israel widen the scope of its military operation to target energy facilities in Iran in an attempt to curtail its primary source of revenue?

FIGURE 1

Geopolitical shocks historically have short-lived impacts on financial markets. But there are exceptions.

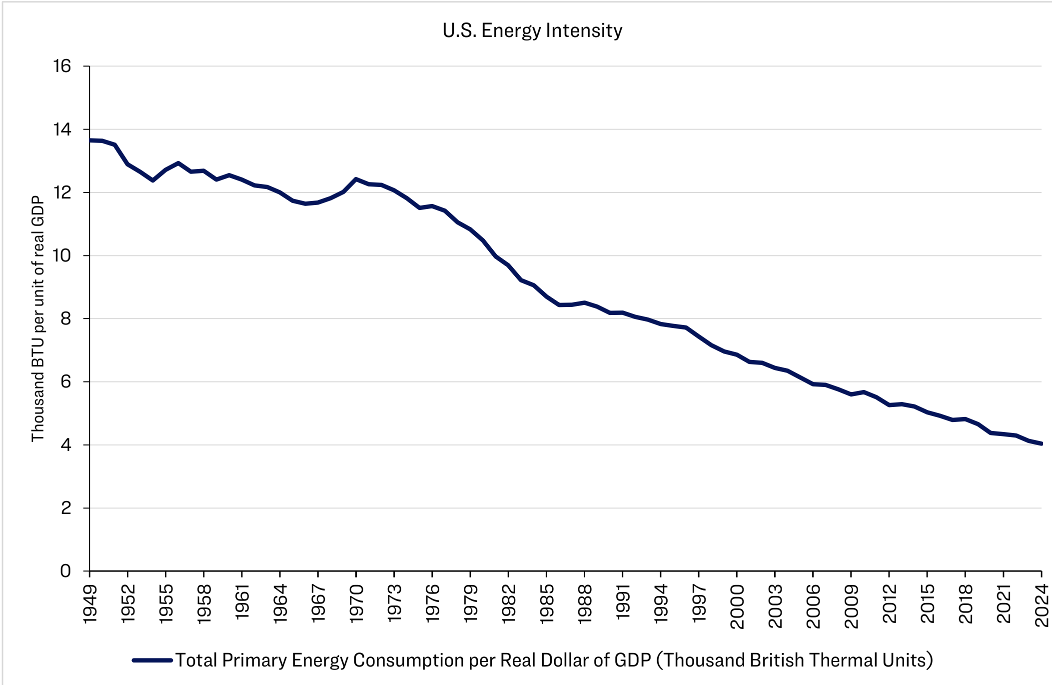
		After one day		After three months		
Date	**Event**	**WTI Oil Price**	**S&P 500 Price**	**WTI Oil Price**	**S&P 500 Price**	**Notes**
10/26/2024	Israel strikes Iran (no nuclear facilities targeted)	-6.1%	0.3%	-14.3%	-6.9%	
10/7/2023	Hamas terror attacks on Israel	4.3%	0.6%	-15.0%	10.1%	
2/24/2022	Russian invasion of Ukraine	0.8%	1.5%	21.8%	-7.7%	The rise in oil prices worsened the inflation spike in the U.S. and globally, fueling market volatility.
8/30/2021	U.S. full withdrawal of troops from Afghanistan	0.7%	0.4%	11.7%	3.8%	
1/3/2020	Iranian General killed in airstrike	3.1%	-0.7%	-64.8%	-22.0%	Covid pandemic - unrelated
9/14/2019	Drone strikes on Saudi Aramco	14.7%	-0.3%	7.6%	4.3%	
7/28/2017	North Korea missile tensions	1.4%	-0.1%	5.0%	4.0%	
4/7/2017	Bombing of Syria	1.0%	-0.1%	-10.9%	2.8%	
4/15/2013	Boston Marathon terror attack	-2.8%	-2.3%	13.0%	3.2%	
7/5/2005	London Subway terror attack	1.4%	0.9%	10.8%	1.8%	
3/11/2004	Madrid terror attack	1.9%	-1.5%	8.8%	-0.6%	
9/11/2001	September 11 attacks on the U.S.	0.5%	-4.9%	-28.9%	4.8%	
8/2/1990	Iraq invades Kuwait	7.3%	-1.1%	59.0%	-12.8%	The oil price shock was one of the main reasons for the relatively shallow 1990 U.S. recession.
Average		**2.2%**	**-0.6%**	**0.3%**	**-1.2%**	

Source: Bloomberg, TIAA Wealth Chief Investment Office.

With all this in mind, it is also important to point out that the U.S. economy is more insulated from oil price shocks than it was during the 1990 Persian Gulf war. Since then, its energy intensity (how much energy consumption is required to produce one dollar of Gross Domestic Product) has almost halved (Figure 2), and the U.S. has turned into a net exporter of crude oil and other petroleum products, therefore reducing its reliance on global oil markets (Figure 3).

FIGURE 2

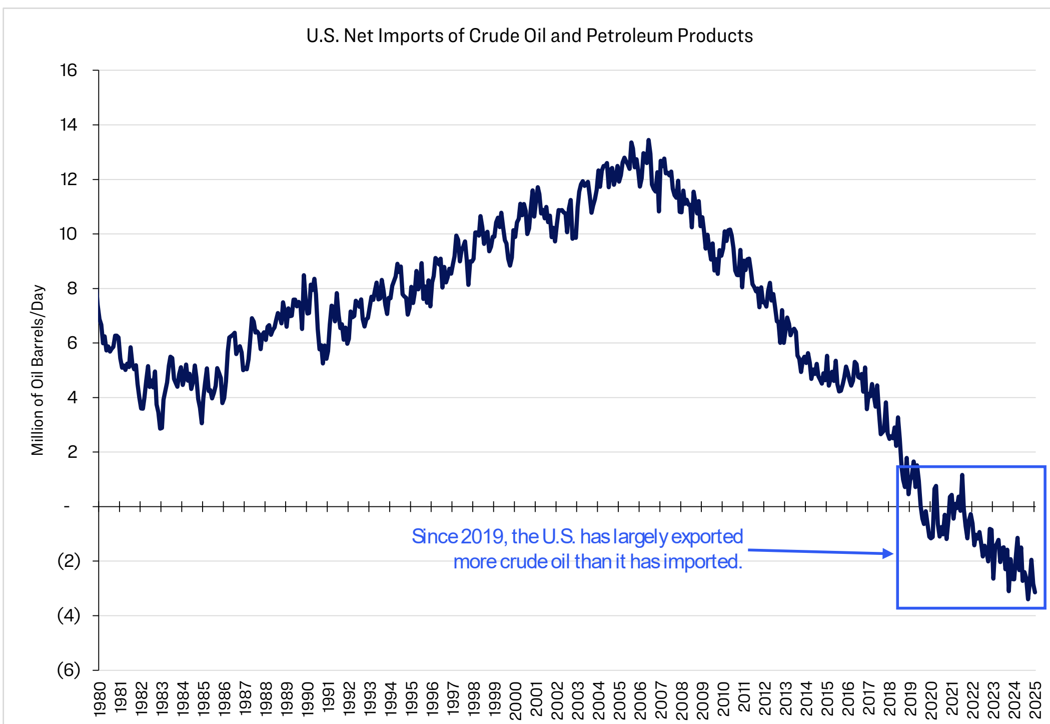
U.S. energy intensity has more than halved over the past 40 years.



Source: U.S. Energy Information Administration, TIAA Wealth Chief Investment Office.

FIGURE 3

The U.S. has become a net exporter of petroleum products.



Source: U.S. Energy Information Administration, TIAA Wealth Chief Investment Office.

Historical precedents (Figure 1) suggest that investors should resist the temptation to react to volatility induced by geopolitical developments and should remain broadly diversified within (i.e. mix of U.S. and non-U.S. equities) and across (i.e. mix of equities and bonds) asset classes, according to their unique individual financial plans.

That said, the next few weeks will determine the scale, ramifications and impact of this military operation by Israel, and we will closely monitor these developments. A further escalation and a sharp rise in oil and gasoline prices could dent market sentiment and pose a fresh set of risks to the U.S. and global economies.

Against this backdrop, we maintain a neutral tactical allocation to equities (relative to the long-term, Strategic Asset Allocation [SAA]) relative to bonds to reflect the wide range of potential economic outcomes that is now further complicated by rising geopolitical uncertainty. Within equities, higher oil prices could lead to a reversal of the recent U.S. equity and U.S. dollar (USD) underperformance, at least temporarily. Many developed and emerging market economies are more sensitive to fluctuations in energy prices than the U.S., and demand for the dollar from oil-importing countries (due to oil barrels being priced in USD) could increase. As a result, we keep the long-term mix of U.S. and non-U.S. stocks unchanged.

We continue to hold an overweight to high-quality U.S. bonds relative to riskier high-yield U.S. bonds within fixed income to reflect our view that risks facing the U.S. economy don't seem to be fully reflected in expensive market valuations.

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