

# Iran escalation: Potential scenarios and market implications



## Executive summary

- Over the past 48 hours, the U.S. and Israel launched joint operations, conducting major strikes across Iran that targeted leadership and military sites. Iran responded with drone and missile launches toward Israel, U.S. military targets, and, importantly, several Gulf countries. The situation remains highly volatile, with both sides signaling that operations may continue.
- A key difference from June's more narrowly framed objective—disrupting Iran's ability to enrich uranium to weapons grade—is the explicit U.S. push for regime change.
- We see several possible scenarios unfolding over the next several weeks, from a best-case scenario of a quick resolution of tensions, to adverse scenarios of a regional conflict or a significant curtailment of global oil supply.
- Global market reactions to geopolitical shocks hinge primarily on oil prices. If oil prices rise meaningfully, current economic and earnings projections would be undermined, which would likely drive market volatility higher and prompt a pullback in equity prices.
- Should oil prices remain elevated, interest rates are likely to be pulled between safe haven demand and the inflationary impulse from higher oil prices, gold may continue to benefit from an increase in demand, and renewed geopolitical instability could weigh on investors' sentiment already strained by shifting narratives around artificial intelligence (AI) disruption, potential AI over-spending, and U.S. policy uncertainty.

Over the past 48 hours, the U.S. and Israel launched joint operations—Epic Fury and Lion's Roar—conducting major strikes across Iran that targeted leadership and military sites. Iranian state media and multiple officials confirmed that Supreme Leader Ayatollah Ali Khamenei was killed, marking the most consequential leadership shock in the Islamic Republic's recent history. Iran responded with drone and missile launches toward Israel, U.S. military targets, and, importantly, several Gulf countries. The situation remains highly volatile, with both sides signaling that operations are set to continue.

These strikes follow weeks of U.S. naval buildup in the region, as the Trump administration weighs a complex balance: diplomacy versus regime removal; the uncertain outlook of a post-regime Iran; the risk of an expanded regional war; and the unwillingness to put American troops in harm's way—a stance tested by the announcement that four U.S. soldiers were killed on Sunday.

A key difference from June's more narrowly framed objective—disrupting Iran's ability to enrich uranium to weapons-grade—is the explicit U.S. push for regime change. The Trump administration is now openly encouraging the Iranian population to “seize the opportunity” and rise up against the regime, and America's Central Command (CENTCOM)—responsible for the Pentagon's operations in the Middle East—stated that the end goal is to “dismantle the Iranian regime's security apparatus.” While the killing of Khamenei represents a major blow to the religious core of the regime, Iran's power structure is multilayered. The clerical establishment and the Islamic Revolutionary Guard Corps (IRGC) each hold distinct centers of authority, and true regime change

would require neutralizing these layers. Continued escalation aimed at forcing their surrender raises the risk of stronger retaliation, potentially involving additional Gulf states and threatening oil flows through the Strait of Hormuz, which accounts for roughly one-third of global seaborne oil trade.

## What's next?

We see four potential scenarios unfolding:

- 1. Swift removal of the regime (including the IRGC) by the U.S. or a popular uprising.** This could lead to outcomes ranging from a transition to democracy, to chaos and the breakdown of the Iranian state into several factions. Markets would struggle to price such uncertainty, and oil prices would likely continue to embed a geopolitical risk premium. That said, this scenario could also lead to some stabilization in oil prices. The 19% year-to-date (YTD) rise in the Brent crude oil benchmark as of Friday, February 27 implies that a potential escalation of tensions in the Middle East had been already partially anticipated by investors. In a best-case long term scenario—the establishment of a democratic government and sanctions relief—oil prices could even fall. **However, this scenario could take time to materialize, and many geopolitical strategists note that a complete eradication of the Iranian regime via air power alone is highly unlikely.**
- 2. Diplomacy returns to the table.** The scale of the joint operation could push remaining senior Iranian regime figures to negotiate on nuclear and security issues. This would mirror the Venezuelan dynamic, where new leadership accepted U.S. terms to avoid deeper intervention. **This is the most market-friendly scenario, with oil prices likely moderating in this case. However, senior IRGC officials have so far signaled no willingness to negotiate and have stated Iran is prepared for a prolonged conflict.**
- 3. Maximum-pressure retaliation by the IRGC, including targeting regional oil supply and the Strait of Hormuz.** A full blockade of the Strait would be difficult given the U.S. military presence in the region, but Iran could engineer persistent disruption via drones or small boats, deterring insurers and shippers from using the waterway. Tanker traffic has already declined in recent days. **This scenario would have the most direct and immediate impact on global oil supply, and could cause the sharpest short-term spike in oil prices.**
- 4. Regional conflict involving Iranian proxies and Gulf states.** This scenario would carry the risk of more long-lasting ramifications for global markets than Scenario 3. Strikes on Dubai, Abu Dhabi, Bahrain, Saudi Arabia, Qatar, and even Oman—alongside attacks on Israel and U.S. military bases—underscore the plausibility of this path. **A prolonged regional conflict would force investors to price in the risk of sustained oil supply disruption, keeping the oil risk premium elevated as a result.**

## Market implications

As we [noted](#) last June during the 12-day war between Iran and U.S./Israeli joint forces, global market reactions to geopolitical shocks hinge primarily on oil prices (Figure 1). To this effect, a few considerations are important:

- While Iran supplies roughly 4% of global oil—3.3 million barrels per day—the broader Gulf region accounts for close to 30% of world output. As a result, while Iran’s production is material, the greater risk to global energy markets stems from any regional conflict that disrupts Gulf producers or oil transit through the Strait of Hormuz.
- OPEC<sup>1</sup> countries announced on Sunday that they will accelerate the pace of oil production increases by adding 206,000 barrels a day in April. However, this announcement may be insufficient to offset the short-term impact of scenarios 3 and 4 on oil prices, as reflected in the 8% increase in the Brent benchmark price relative to Friday’s closing (as of 11:30 a.m. on Monday, March 2).
- Another mitigating factor may be represented by the U.S. Strategic Petroleum Reserve (SPR), which holds approximately 415 million barrels of oil. However, this reserve has been partially depleted and not rebuilt since 2022, and currently sits well below its maximum capacity of 714 million barrels. As it stands, the SPR would provide a maximum drawdown rate of 4.4 million barrels per day, equivalent to less than three months of daily U.S. oil imports.

If oil prices rise meaningfully, current economic and earnings projections would be undermined, which would likely drive market volatility higher and prompt a pullback in equity prices. Value stocks may outperform growth stocks in the near term, due to a larger exposure to the energy and defensive sectors. International equities could also see a temporary pause in their outperformance versus U.S. equities, given:

- greater sensitivity to fluctuations in energy prices across many developed and emerging economies, and
- potential U.S. dollar appreciation driven by a flight to quality engendered by global rather than U.S.-centric uncertainty.

Interest rates are likely to be pulled between safe-haven demand and the inflationary impulse from higher oil prices. Thus far in 2026, flight to quality dynamics have dominated, with the U.S. Treasury 10-year yield falling from a high of 4.3% to 3.93% as of Friday, February 27. However, recent Producer Price Index (PPI) inflation data reminds us that upside inflation risks remain, and an oil shock could complicate the Federal Reserve’s (Fed) messaging around the future path of monetary policy. As a frame of reference, 10-year yields fell by 25 basis points (bps) following the Russian invasion of Ukraine on February 24, 2022 before rising significantly over the next several months as inflation climbed. With the U.S. Treasury 10-year yield up 11 bps to 4.04% as of 11:30 a.m. on Monday, March 2, investors are focusing on upside inflation risks stemming from the sharp rise in oil prices.

Gold may continue to benefit in this environment. As investors continue to price in a larger risk premium in traditional asset classes due to spreading geopolitical and policy uncertainty, a prolonged conflict in the Middle East could extend this dynamic and drive sustained demand for gold. As of 11:30 a.m. on Monday, March 2, the price of gold was roughly unchanged relative to Friday’s closing.

More broadly, renewed geopolitical instability could weigh on investors’ sentiment already strained by shifting narratives around artificial intelligence (AI) disruption, po-

tential AI overspending, and U.S. policy uncertainty. However, geopolitics have already featured as a top of mind risk for investors since the Venezuela operation on January 3, and further deterioration in market sentiment depends on how the situation evolves over the next few weeks, with scenarios 3 and 4 above representing key risks to current market consensus. As we highlighted in the note [“Assessing the U.S. policy shift in Venezuela”](#) our view is that geopolitical uncertainty may remain a key source of market volatility in 2026.

**FIGURE 1**

Market reaction to past geopolitical shocks.

Date	Event	After one day		After three months		Notes
		WTI Oil Price	S&P 500 Price	WTI Oil Price	S&P 500 Price	
6/13/2025	12-day War (U.S./Israel strikes on Iranian nuclear facilities)	7.3%	-1.1%	-13.9%	13.3%	
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 attach	1.9%	-1.5%	8.8%	-0.6%	
9/11/2001	September 11 attacks	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.
<b>Average</b>		<b>2.5%</b>	<b>-0.6%</b>	<b>-0.7%</b>	<b>-0.1%</b>	

Source: Bloomberg, TIAA Wealth CIO.

**Endnotes:**

<sup>1</sup> An alliance of Organization of Petroleum Exporting Countries (OPEC) members and other major oil-producing countries (including Russia) intended to more effectively coordinate global oil supply and pricing.

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