Initial Thoughts on Strikes on Iran

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Strategas, a Baird Company, gives initial thoughts on the market and economic impact of U.S. strikes on Iran.

INVESTMENT STRATEGY: JASON TRENNERT, CHIEF INVESTMENT STRATEGIST

Last week was one of the longest weeks for investors and analysts in recent memory. On Monday morning, CNBC kicked off its coverage of major events by discussing the Supreme Court's decision to reject use of IEEPA to impose tariffs on foreign countries. Over the next several hours we all became experts in sections of the 1962 and 1974 Trade Acts that the president could use to keep the tariffs in place. Later on Monday, a doomsday research report on AI and human labor sent software stocks lower, Nvidia's report of strong earnings on Wednesday didn't arrest the decline in tech stocks, and on Friday major fintech company Block announced layoffs of 4,000 people. The finish came on Saturday when the Trump administration took out Iran's senior leadership and over 1,000 military and intelligence targets. Quite the week.

Experience tells us two things: 1) the first, second, and often third reports of major geopolitical events are often incorrect and 2) financial dislocations alone tend to have a greater lasting impact on the markets than geopolitical events in isolation. Mercifully, we do not have an example of those two types of unhappy events happening simultaneously. As it stands now, we see little reason to change our base case: 1) stronger economy, mediocre S&P 500 return in 2026; 2) sector and style preferences for non-tech cyclicals, equal-weight over market-cap weight, small over large, value over growth; 3) populism and deglobalization continue (and may be strengthened by the conflagration in the Middle East) and we are long gold, long global defense stocks.

Major US Military Activity	Date Of Event	Trading Day Of	+65 Trading Days	+125 Trading Days	+250 Trading Days
Pearl Harbor	12/07/41	-3.8%	-10.5%	-5.6%	3.7%
Korean War	06/25/50	-5.4%	7.2%	10.0%	17.6%
Bay of Pigs	04/17/61	0.5%	-3.0%	2.0%	1.8%
Vietnam War	03/08/65	0.0%	-2.1%	0.9%	3.0%
Panama	12/20/89	0.1%	-1.5%	4.7%	-4.9%
Gulf War	01/17/91	3.7%	16.2%	16.2%	28.2%
Kosovo	03/24/99	0.5%	3.7%	3.1%	14.8%
Afghanistan	10/07/01	-0.8%	8.9%	5.2%	-24.6%
Iraq War	03/20/03	0.2%	12.1%	17.2%	28.3%
Libya	03/19/11	1.5%	-0.9%	-6.3%	8.1%
Average		**-0.4%**	**3.0%**	**4.7%**	**7.6%**

Source: Strategas, FactSet

Depending on the length of our engagement in the region, the strikes on Iran could lead us to be further skeptical of bonds and the U.S. dollar. As a potential source of risk across financial assets, we are currently more concerned by the opacity and illiquidity of the private markets than by what is happening in the Middle East. But that could change.

WASHINGTON POLICY: DAN CLIFTON, HEAD OF POLICY RESEARCH

Over the weekend, Israel and the United States launched an attack on Iran. Retaliation from Iran followed with missiles targeted at U.S. military assets in the region and Israel. As we have noted, the U.S. does not move this level of military assets into a region to bluff. President Trump's comments over the weekend detailed the history of Iran's aggression to the U.S. and the goals of the operation – including but not limited to 1) stopping Iran from building a nuclear bomb, 2) destroying Iranian missiles, and 3) defeating the Iranian Navy (making it more difficult for Iran to attack the U.S. by sea – a critical detail for oil markets).

It is likely this will be a rolling operation conducted over several days. As such, we are not expecting a "one and done" surgical event like Operation Hammer in June or Venezuela in January. We expect this will be very different than other geopolitical events since Trump was elected. This is important because there is little public support in the U.S. for an attack on Iran and previous geopolitical successes had limited impacts on improving public support for Trump.

In our view, the president has a short window to act and there's a lot of risk involved. There was a view in DC that Trump would hit Iran and try to bring it back to the negotiating table (as the administration thought negotiations had become fraught with stall tactics). Actions taken this weekend were in broad daylight in Iranian time, with the goal of creating a surprise attack that targeted not just the location of the missiles, but the locations where the missile programs are developed. President Trump noted in his State of the Union that he believed a missile program was being developed to target the U.S. in the future.

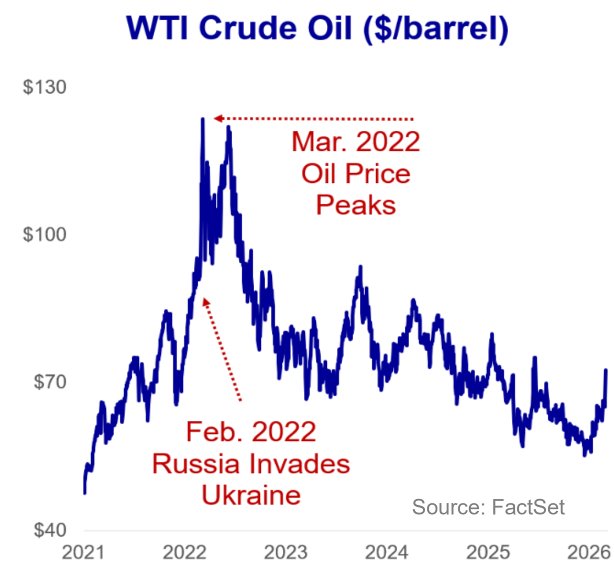
A key issue is whether the Strait of Hormuz is being mined. If so, even after the conflict, the global economy could be impacted over the course of time it takes to demine the Strait. U.S. military planners, however, believe Iran is defenseless against U.S. air and missile attacks after Israel took down Russian-provided military defense batteries.

More broadly, as we have noted, U.S. foreign policy is no longer directed at China or Russia directly. Rather, President Trump is targeting their proxies and making it more expensive for these countries to disrupt U.S. interests via those proxies. Moreover, Trump is trying to redirect proxy resources, such as oil, away from China and Russia's use and/or distribution. Venezuela was the first step and delivered a policy change with the country more aligned with U.S. interests. If the U.S. is successful and has more coordination with Venezuela and Iran, the cost of a China blockade or attack on Taiwan increases substantially. We believe Trump's push on Venezuela, Cuba, Iran, etc. is happening because of the Trump-Xi meeting that is just 4 weeks away.

President Trump is making it clear that he is creating the conditions for the Iran leadership to fall. But this depends on whether the Iranian people rise up. Regime change has been an Achilles heel of U.S. foreign policy over the past 30 years. Public opinion in the U.S. is more aligned against an attack on Iran and will likely make U.S. consumers and businesses less confident in the short run. We expect a chorus of Democrats and libertarian Republicans coming out against the military actions given the ongoing debate over the president's war powers.

TECHNICAL STRATEGY: CHRIS VERRONE, HEAD OF MACRO AND TECHNICAL STRATEGY

Let's start with a fact…we know we don't know. It's always true, but this is an important time for such a reminder. What we do know is that an open mind, an imagination, and a price first approach is about as useful a skillset as there is to navigate the unknowns. Consider the last few weeks…Venezuela, SCOTUS ruling, AI-apocalypse, and now the breakout of war. Energy's ascent to the top of our objective sector rankings over recent months is a good real-time example to the utility of a "price first, narrative second" approach. We didn't know why the sector was improving (it could have been economic momentum, inflation pressures building, or the more obvious answer – something geopolitical), but it got us there early and now with the advantage of operating from a position of strength (rather than having to chase). We are reminded that Oil peaked about a week after Russia's invasion of Ukraine in February 2022, but if there's a difference between then and today, it's that positioning and attitudes are more modest. That can change quickly, but with both price and relative trends strong, we'd still be more inclined to be a buyer of pullbacks among the Energy stocks in the weeks ahead.



What we have seen throughout our careers is how surprise events do more to reinforce the trends already underway rather than introduce something new. The equal-weight S&P 500 is days removed from a new cycle high and its relative turn vs. the Nasdaq has been ongoing for months. Parts of Tech may be oversold, but Software could rally some 20% and still be below its downward-sloping 200-day moving average. Healthcare has been a good antidote to Tech's weakness lately. There's already been a defensive / late-cycle feel to this market over recent weeks with 2-year yields breaking down as Staples and traditional Utilities outperform. Is it a recessionary message? That still seems like a big leap, but we'll let the Banks and credit help answer that question. It hasn't been a pretty last few weeks for Bank stocks, but they're in the ballpark of an oversold condition with the number of stocks making 20-day lows expanding through 75% on Friday. Can they stabilize and resume the uptrend, or is a topping sequence starting? That will have be judged over time. Importantly, Industrials are still in good shape.

In the days ahead we want to be particularly alert to what is not acting as intuition might suggest. There will be clues out there, but they must be actively sought out. We'll do our best to publish anything unusual or noteworthy in this regard.

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