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# Oil, inflation and corporate earnings: markets caught between geopolitical tensions and still-solid fundamentals

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In recent weeks, virtually all the attention of financial market participants has been focused on the conflict in the Middle East, with the state of trade flows through the Strait of Hormuz taking centre stage. Indeed, the Strait is a key choke point for maritime traffic. Twenty per cent of the world's oil supply, destined mainly for China, passes through it each year. Since the start of the conflict, global oil supply has been reduced by nearly 12 million barrels per day – two to three times more than during the two previous Gulf Wars or the last two oil crises. The blockage of the Strait is driving up oil prices, which in turn are fuelling inflation expectations, altering central banks' monetary policy outlook and impacting global growth prospects.

Even though Donald Trump boasts of having destroyed almost all of Iran's military capabilities, securing maritime traffic in the Strait of Hormuz appears to be more complicated, highlighting Iran's capacity to cause disruption even with limited resources. What is more, until now the market had been banking on the 'TACO' effect (Trump Always Chickens Out), referring to Donald Trump's past tendency to backtrack as soon as his policy decisions had negative repercussions on the markets (tariffs, the Greenland episode, etc.). This time, however, the market seems to be realising that Trump cannot unilaterally decide to end the conflict, and as things stand, Iran does not appear to be on the verge of capitulating. This realisation is fuelling investors' fears.

## **Oil, inflation and central banks: the markets are closely monitoring the situation in the Strait of Hormuz**

Admittedly, the world is far less dependent on oil today than it was during the 1973 oil crisis, with the amount of oil required to generate one unit of GDP now at least half what it was then, thanks to improvements in energy efficiency and diversification into other energy sources, as well as a decline in industrial activity. Oil accounted for 46% of energy demand in the 1970s, whereas it now accounts for 'only' 29%. Furthermore, unlike in previous oil shocks, members of the International Energy Agency (IEA) theoretically hold strategic reserves equivalent to 90 days' worth of imports, which



could somewhat limit the risk of short-term disruption, but probably not the impact on prices. Although higher oil prices over a longer period could affect US inflation, the United States, currently a net oil exporter, also benefits from this situation. Europe, meanwhile, is much more vulnerable, although it is now only 40% dependent on Middle Eastern oil, compared with 70% fifty years ago.

In the equity markets, conflicts tend to have the same impact: during the eight major geopolitical conflicts since 1945, the S&P 500 fell by an average of 9% and took on average just three months to recover its losses. This is because the market rebounds as soon as a de-escalation appears on the horizon and continues to rise after a ceasefire is declared. Despite significant volatility and a rise in oil prices since the start of the war in the Middle East, the reaction of the equity markets has so far remained relatively moderate, with the S&P 500 index down 4% from its peak. However, the decline is somewhat more pronounced in Europe and emerging markets, with the Eurostoxx 600 index down 5.5% and the MSCI Emerging Markets Index down 8.5%. The market is watching for signs of de-escalation, which remain difficult to discern at this stage.

Traditional safe-haven assets have not provided much support so far. Gold has failed to react to rising inflation expectations or geopolitical tensions, falling by 5% since the start of the conflict, while a strengthening dollar has dampened its response. Sovereign bond yields have also failed to reflect a potential shift by investors into 'risk-off' mode, with US and German 10-year yields rising by 0.3%, driven by rising inflationary risks, which are fuelling expectations of higher interest rates.

On a broader scale and beyond oil, many sectors may also be directly impacted by the conflict in the Strait of Hormuz. For example, significant aluminum production has developed in the Middle East in recent years, and neither aluminum nor bauxite - the ore required for its production - are currently being transported. Furthermore, nearly 50% of sulphur essential for copper production passes through the Strait of Hormuz, as does a quarter of the world's fertilisers, which are particularly crucial for agriculture at this time of year. The tourism sector is also severely affected, with losses amounting to hundreds of millions of dollars a day.

This rise in prices could therefore affect inflation in various ways, and the markets have clearly recognised this, revising interest rate forecasts upwards and growth prospects downwards. In the United States, the Federal Reserve's dual mandate (price stability and maximum employment) could, despite everything, give it the opportunity to cut rates. This is based primarily on the lack of momentum in the US labour market and the need to revive slowing growth, as evidenced



by the revision of GDP growth from 1.4% to 0.7% in the 4th quarter of 2025. That said, whilst markets were expecting two to three rate cuts from the Fed this year as recently as early March, these expectations have collapsed, with the market now forecasting only one cut in 2026.

In Europe, market expectations have shifted from a rate cut in early March 2026 to two rate hikes at present. A rise in interest rates by the European Central Bank, whose mandate is primarily focused on controlling inflation, could dampen the recent upturn in growth seen in Europe. The most striking reversal comes from the Bank of England: investors, who initially anticipated two rate cuts, now expect a rise. Finally, the market even expects a rate rise in Switzerland, whereas just a short while ago the return of negative rates was being considered.

Beyond this adjustment in monetary policy expectations – which are inherently volatile due to uncertainties in the commodities market – history shows that central bankers focus primarily on ‘core’ inflation. Furthermore, the fragile state of the labour market, the absence of structural excess demand for oil, the slight slowdown in growth and the high level of debt (the sustainability of which is heavily dependent on long-term rates) should not prompt central banks to react hastily or too strongly.

#### **Beyond the conflict: solid corporate results for the 4th quarter and a positive outlook for 2026**

Alongside the geopolitical situation, the 2025 fourth-quarter corporate earnings’ season is drawing to a close, and results are proving solid.

In the United States, earnings per share (EPS) growth stood at +13%, in line with the previous quarter. 67% of companies beat EPS expectations and 70% beat revenue expectations, both figures exceeding historical averages. This growth is thus five percentage points higher than expectations at the start of the reporting season, a surprising rate that remains slightly above its historical average of 4.5%.

Unsurprisingly, earnings momentum continues to be driven by the technology sector, although it is increasingly spreading to other, more cyclical sectors, such as industrials and materials. Thus, the Magnificent Seven and the information technology sector as a whole continue to exceed expectations, with EPS growth of +26% in the fourth quarter of 2025 compared with +6% for the S&P ex. technology. Although we believe this sector will continue to lead the way in 2026, this gap is expected to narrow further in the coming quarters, resulting in a more balanced contribution from non-technology sectors to EPS growth.



Another key point has emerged from these results: capital expenditure expectations for hyperscalers in 2026. These now stand at around \$715 billion for Meta, Alphabet, Amazon, Microsoft and Oracle, compared with just \$510 billion at the end of last year – an upward revision of more than \$200 billion in the space of three months.

Overall, the outlook reported by companies is generally optimistic, with S&P 500 EPS growth for 2026 expected to reach +14%, with the most significant upward revisions in the materials, technology/communications and financial sectors. Conversely, consumer discretionary, healthcare and energy have seen their earnings expectations contract over the last three months. The latter sector will likely see its momentum reverse in the first quarter of 2026 due to the impact of rising oil prices.

In Europe, over 80% of companies have already reported their results, with expected growth for the quarter standing at 2%, whereas the consensus forecast at the start of the reporting season was for a 1% decline – a better performance, albeit still relatively below the pace seen in the US. Financials remain the dominant sector in terms of contribution. Excluding financials, Stoxx 600 EPS is down by 4%, although this is a significant improvement versus the 7% decline expected at the start of the reporting season. EPS growth expectations for 2026 have been revised downwards over the last three months, from +14% to +10%, which is still high by comparison with the near-zero earnings growth of the past two years.

For investors, the next factor to watch, beyond the duration of high oil prices, will undoubtedly be its impact on corporate earnings' growth in the first quarter of 2026, which will be published from mid-April onwards.

At this stage, our central scenario remains that of a conflict limited to a few weeks, followed by a phase of de-escalation, either through Donald Trump's capitulation following a 'war of attrition' (a capitulation that could, however, be presented as a victory), or following a regime change in Iran, with the possible rise to power of a more 'pragmatic' Guardian of the Islamic Revolution willing to accept a compromise to save the regime. Volatility is therefore likely to continue to prevail in the equity markets in the short term, with defensive stocks outperforming, giving way to a medium-term recovery driven by cyclical stocks. We are maintaining our overweight position in equities relative to bonds, which we believe offer the greatest potential for positive returns in a diversified portfolio over the medium term.



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