Special Market Update: Navigating Global Volatility and Energy Shifts

The events of the past few days represent some of the most significant geopolitical shifts in recent history. Following failed diplomacy and internal unrest in Iran, a high-intensity military campaign involving the U.S. and Israel began in late February.

We examine how markets are responding, and why a disciplined, 'keep calm' approach remains the most robust strategy.

The Situation: A Global Energy 'Chokepoint'

The current conflict has moved from regional tension to a significant military confrontation. Operations have targeted Iranian command structures and military facilities. In response, Iran has attempted to block the Strait of Hormuz—the world's most vital artery for energy.

Why this matters to you:

- Roughly 20% of the world's oil and natural gas flows through this narrow passage. With shipping traffic dropping by 86% and insurance companies pausing coverage for the region, we have seen an immediate spike in costs.
- Price Shocks: This month alone, Oil is up 21% and European Natural Gas is up 60%.
- Modern Resilience: While these jumps are sharp, the global economy is much more efficient than it was during the infamous 1970s oil crisis, when certain

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Middle Eastern countries banned oil exports causing substantial inflation. The U.S., for example, uses 80% less oil to produce the same economic value today than it did in 1980. This efficiency acts as a buffer against a long-term economic crisis fuelled by higher energy costs.

Market Reactions: The 'Flight to Quality'

In times of extreme uncertainty, investors globally follow a predictable pattern called a 'flight to quality', seeking safety in established assets:

- Gold: Has surged to record highs, acting as an 'insurance policy' against chaos.
- The U.S. Dollar: Has strengthened as the world's preferred reserve currency which is always seen as a safe haven.
- Stock Markets: Major markets like the ASX 200 and S&P 500 have seen initial knee-jerk declines of 2% to 4%as they price in the conflict's unknown duration.

The Australian Perspective: A Unique Vantage Point

For our clients, there are self-correcting mechanisms that help protect your wealth during Middle Eastern instability:

1. *The Gold and Energy Hedge:* Australia is a massive exporter of Liquified Natural Gas (LNG) and Gold. When these prices rise, our local energy and gold giants often see their values supported, providing a natural cushion for markets like the Australian Stock Exchange.
2. *The Currency Effect:* When global tension rises, the Australian Dollar (AUD) typically falls against the US Dollar. While this sounds negative, it actually boosts the value of international share funds. Because a portion of global shares are priced in foreign currency, they are worth more when converted back into a weaker Australian dollar.

The Market Impact

If we enter a more inflationary environment, we will consider a few key market dynamics. Our primary focus will always be capital preservation while identifying opportunities arising from market dislocations.

1. Equities (Shares) Historically, persistent inflation can put downward pressure on broad stock market valuations. There are a few key strategic focuses:
   - *Prioritising Value over Growth:* Rising energy costs and inflation typically favour established 'Value' companies - those with strong cash flows and tangible assets - over high-growth firms that rely on future earnings.
   - *Regional Diversification:* While the U.S. remains a core market, it carries a substantially higher 'growth' allocation than the Australian and Emerging Markets. These markets often provide a higher concentration of 'Value' sectors, such as materials and energy, which can act as a natural hedge during supply shocks.

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2. Fixed Income (Bonds): Geopolitical conflict and resulting inflation usually cause interest rates and bond yields to rise.

- *Capturing Higher Yields:* The recent rise in Australian bond yields makes longer-duration bonds look more attractive (as yields rise, bonds become cheaper). If yields continue to move higher due to the current conflict, it provides a potential catalyst to lock in more attractive rates of return. Increasing exposure to high-quality bonds at these higher levels would position portfolios to benefit significantly when inflation eventually cools and interest rates start to fall again (bond prices rise).

Our Outlook: Patience and Discipline

Keeping calm is an active strategy. History shows that while geopolitical shocks cause sharp, painful reactions, markets typically recover once the initial uncertainty fades. We construct our portfolios with these 'black swan' events in mind. The diversification is designed so that some allocations perform better when others are impacted

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