On Thursday evening, Israel launched an attack against Iranian nuclear facilities and military bases, which sent oil prices surging while stocks sold off. Concerns regarding Iran's nuclear development ambitions have been simmering for a while, and this strike has now increased the likelihood of a new prolonged Middle East conflict. While this could pressure global energy production over the near-term, we believe the significant increase regarding domestic energy capacity in the U.S. should help mitigate the impact domestically. Therefore, while an escalating conflict in the Middle East is an unfortunate development, it is our view that a severe energy price shock and resulting economic fallout is less likely compared to historical precedents, such as what occurred in the 1970s when OAEPC imposed an oil embargo against the U.S.

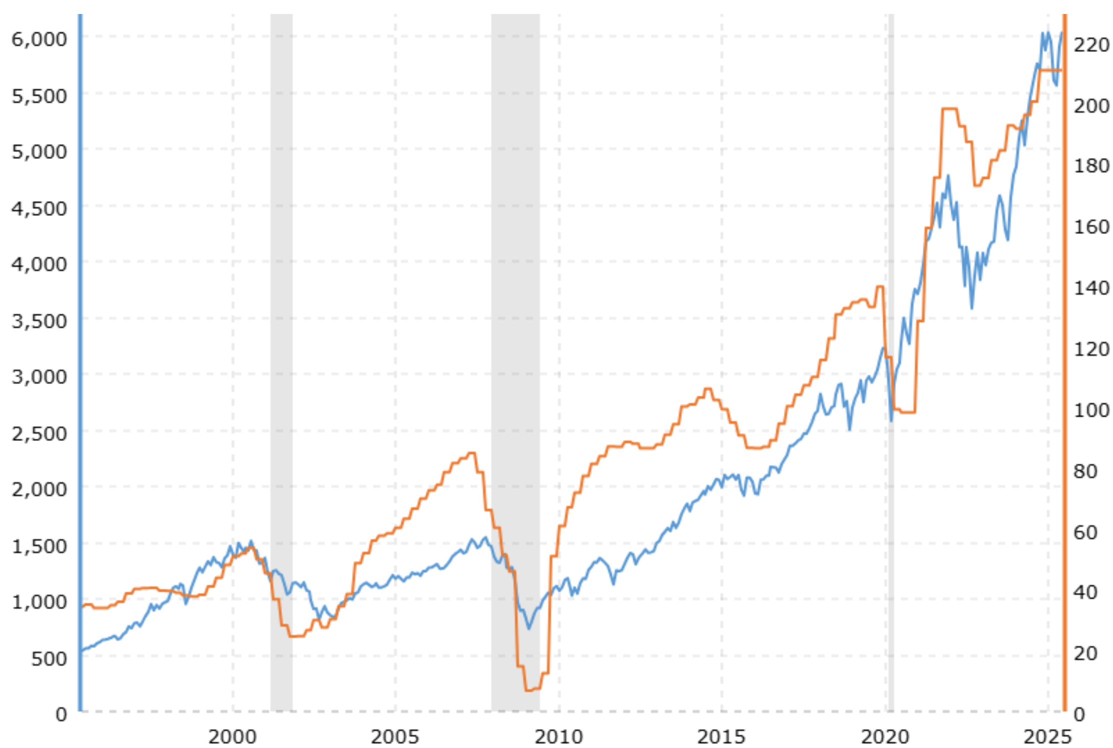
Source: Trading Economics

As we have written previously, markets are often faced with shock events that cause investors to quickly reprice assets. The ultimate impact on American businesses and consumers as a result of these occurrences vary based on the nature and severity of the particular event. In this case, there are renewed concerns that elevated energy prices caused by a supply disruption could pressure consumers against an already uncertain economic backdrop. While the outcome regarding the conflict unfolding is anyone's guess, we remain optimistic that any spike in energy prices is likely to be temporary with muted impact on the financial health of Americans.

Despite Friday's sell-off, markets have remained much calmer in recent weeks compared to the heightened volatility earlier in the year. This is true for both equities and bonds. Given the sharp sell-off and subsequent reversal from the beginning of March through early May, it is our view that markets may be somewhat range-bound over the near term as recent gains are digested. Inflation data has been relatively benign while the Federal Reserve has indicated its intention to leave short term rates unchanged over the immediate term, which has promoted stability across bonds. While further escalation across the Middle East poses near term headline risk, investors appear to be currently breathing a sigh of relief as extreme levels of volatility have subsided.

The question which remains is whether or not investors are currently too complacent given the uncertainty that persists regarding the economic environment and heightened geo-political risks. Given recent strength across corporate earnings and generally upbeat forward guidance, there are reasons to be optimistic despite elevated valuation levels. Furthermore, credit spreads remain well anchored at low levels, which highlights the strength of corporate balance sheets and a still relatively healthy consumer. While there are recent signs of softening across the labor market, the hard data as a whole is holding up well, suggesting an imminent recession is unlikely. The overall picture, from our perspective, points to a constructive backdrop for risk assets and continued earnings expansion. Consensus estimates for S&P 500 earnings growth are 10% and 16% in 2025 and 2026, respectively, following 9% growth last year.

S&P 500: Price Level (Blue, Left Axis) & Earnings (Orange, Right Axis)



Source: S&P Global, Macrotrends

In short, while there is always plenty to worry about as investors, the current backdrop remains fairly constructive. Massive capital investment across the AI landscape continues to accelerate along with the free cash flow generated by the largest technology companies. The seven largest companies in the S&P 500, for example, are forecasted to generate a combined $2.2 trillion of after-tax profits this year followed by $2.5 trillion in 2026 with robust margins and very little balance sheet leverage. The motto “the only thing we have to fear is fear itself” might not feel appropriate for any specific market environment, although it is generally well heeded advice for long-term investors following a solid plan which suits their specific objectives and appetite for risk.

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