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Considering Broad Investment Implications of US/Iranian Tensions

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Our senior investment leaders recently met to discuss rising US/Middle East tensions. Here, they share a few initial thoughts on the potential market implications.

Following the January 3rd US airstrike near Baghdad airport, which killed Iranian General Qassem Soleimani, we convened a meeting of our senior investment leaders across various Franklin Templeton investment teams—including several of our Middle East-based investment professionals—to consider the market implications of recent events.

General Soleimani was the commander of the QUDS Force in Iran's Revolutionary Guard Corps (IRGC), which oversees Iran's foreign-facing military actions. He was commonly viewed as the second most powerful person in Iran, after Supreme Leader Ayatollah Ali Khamenei. His assassination heightened tensions in the Middle East, and is likely to push the regime in Tehran to decide how to respond to this action.

Unsurprisingly, we found a range of opinions within our various investment teams about these developments, stretching from concern about the potential for an increase in longer-term risk to a more sanguine view of a rational Iranian response to this action.

Importantly, numerous other world powers—notably France, Britain, Germany and China—have expressed positions that are supportive of near-term de-escalation of current tensions. This opens the door to possible diplomatic solutions.

Tensions between the United States and Iran actually seem to have been increasing since last summer, largely through a series of proxy attacks, including those on oil tankers in the Strait of Hormuz, oil infrastructure in Saudi Arabia, and more recent attacks on US facilities in Iraq.

We believe the recent US airstrike may indicate a shift in US policy disallowing Iran's stance of "plausible deniability" as it relates to proxy actions. It remains uncertain whether making Iran responsible for the actions of its proxies will truly act as a deterrent to further asymmetric threats by the Iranians, particularly while they remain under pressure of severe economic sanctions. However, preservation of the Islamic Revolution appears to remain the Iranian leadership's primary objective.

The market reaction thus far has been more modest than we would have anticipated, and suggests that, in the absence of a retaliatory act by Iran, investors expect that this period of tension will pass. That said, we would note gold prices have been moving up over the past month, which in some part, can be attributed to increasing tail risks, including geopolitical tensions.

We would also note that when a new piece of information or an occurrence such as this is introduced, investors may reassess positions or rotate exposure into different holdings or sectors. This catalytic effect may result in changes that seem only tangentially linked to the situation at hand.

As a broad characterization, our equity investment teams were more sanguine about the outlook and our fixed-income teams saw the potential for heightened risk-premia in global markets.

Broadly, from a Global Macro and Multi-Asset Solutions perspective, we are focused on the potential for the tails of the distribution of potential market outcomes (from the most negative to most positive ends of the spectrum) to become “a little bit fatter,” emphasizing the importance of protecting the downside if events don’t follow the more likely benign path that we all hope to see.

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