
Investment review

We are writing this quarterly review against a fast-moving and unusually turbulent geopolitical backdrop, as events surrounding the conflict in Iran continue to evolve rapidly and inject unexpected uncertainty into financial markets.

The first quarter of 2026 actually began on quite a positive footing for investors, with returns supported by resilient economic growth, improving forward-looking expectations and robust corporate earnings – particularly within technology sectors benefiting from continued advances in artificial intelligence ('AI'). At the same time, moderating inflation and the prospect of lower interest rates across advanced economies provided a supportive backdrop for risk assets.

However, the investment landscape has shifted significantly since the end of February, with the escalation of the war in Iran introducing a renewed source of geopolitical risk, resulting in greater economic uncertainty and market whiplash. Energy price volatility and rapidly evolving headlines, including often incoherent social media posts from an irascible US president, have led to more volatile market conditions, as markets search beyond hearsay for hard facts that allow investors to properly reassess the outlook for inflation, economic growth and monetary policy. Encouragingly, while volatility has risen, market drawdowns have so far remained relatively contained, limiting damage to portfolio returns in the first quarter. This reflects both the underlying strength of the global economy entering the period and the benefits of diversified, long-term investment positioning.

Higher inflation the likely outcome

Undoubtedly, there are a number of scenarios from here, ranging from one where we have a severe but short-lived conflict – which sees a rapid defeat of Iran or brokered ceasefire that then allows energy shipments through the Strait of Hormuz to resume quite soon – to a longer and more impactful conflict with lasting damage to energy infrastructure and more severe inflationary and economic consequences.

As things currently stand, we are navigating in highly choppy waters somewhere between these two extremes: we can currently support a view that sees damage to critical infrastructure being limited and quickly repaired but even if this risk is contained it is likely to take some time for energy supplies to resume and prices to subside. Some greater persistency in elevated inflation is therefore now a more realistic proposition that requires closer attention and some action.

Holding pattern for central banks but inflation risks for fixed interest assets

Recently, key central banks have tried to reassure financial markets by keeping interest rates on hold – no changes were actually expected anyway at this juncture ahead of the conflict, but pencilled-in cuts in rates, particularly in the UK and US, have now turned into potential hikes on the back of the likely rise in inflation.

With such a dearth of facts and myriad outcomes even within a more central scenario, the risk of central bank policy error has certainly grown in recent weeks, making life particularly tricky for fixed interest markets that rely so heavily on inflation stability and clear monetary and fiscal signage. Uncertainty is particularly acute in the UK, where recent events pile pressure on an already fragile economic and fiscal position, not to mention its political leadership.

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In view of this increased uncertainty, we are reducing commitments to longer-dated government bonds, preferring instead to hold higher levels of cash which can still earn a reasonably competitive, and more stable, return. We are aware of the corrosive impact that inflation can have on cash, so this should not be seen as a long-term solution and will be redeployed either to fixed interest markets or to alternative investments once the backdrop is a little clearer. We consider the opportunity cost of holding some short-term cash to be quite minimal, preferring (at present) the certainty of a positive return versus the likelihood of some continued volatility and the slimmer prospect of a quick rebound for fixed interest's fortunes, even if inflation uncertainty subsides.

Staying the course

Turning to stockmarkets, within reason this asset class still offers the best solution for sourcing real (inflation-beating) long-term investment returns. We recognise that market risks are more elevated, and this is reflected in the downward adjustments already seen in equity (and fixed income) markets since the end of February. Whilst a further setback in markets is still possible, at this juncture – and we have to assume there is some grain of truth in President Trump seeking a de-escalation of the crisis he has created – we believe that stockmarkets can broadly tolerate the prospect of some near-term, energy-related inflationary spike and that they can avoid a much greater risk-off episode.

Furthermore, witnessing, as we are, sharp days of recovery on the back of more positive de-escalation rhetoric is encouraging, reminding us that staying the course during periods of conflict or heightened geopolitical uncertainty – something we have seen several times in recent years – is often the better option so as to participate fully in the ensuing recovery. We know that missing out on just a small handful of recovery days in markets can be very damaging indeed to longer-term returns. For the time being we are therefore comfortable maintaining equity risk levels at the upper end of their strategic ranges.

A conflict with no plan

All the above said, however, what is becoming increasingly clear is that this conflict is unlikely to be over in the few weeks that were initially signalled by President Trump when the attacks on Iran first began at the end of February. Unlike his 'Liberation Day' tariff pronouncements at this time last year, Trump has little, if any, control over how this conflict ends. He may now want to strike a deal with Iran, but Iran may prefer to continue to use the leverage it has – essentially the control over energy passing through the Strait of Hormuz – for longer, thereby deepening Trump's self-inflicted wounds and those of the broader world economy. As things stand, whilst the military attacks may diminish and critical Middle Eastern energy and desalination infrastructure may be spared irreparable damage, it is becoming harder to see inflationary pressures caused by higher energy costs subsiding in very quick order.



Asia and Europe most exposed

This leads us to examine exposures to those areas that are most at risk from a more prolonged conflict, especially those economies most reliant upon imported energy. Here, the finger points towards Asia, notably Korea, Taiwan, Japan and smaller Asian economies. Encouragingly, Japan, which imports around 95% of its crude oil from the Middle East, has seen its government act decisively to introduce subsidies to cap gasoline prices and it is also releasing oil from its huge strategic reserves, all of which should help contain any inflationary and economic shock from this conflict. A fair amount of Middle Eastern oil and gas exports may be destined for China, but it is a relatively small proportion of the country's overall net energy imports. China has also significantly diversified its energy mix towards renewables in recent years and is believed to have very sizeable oil reserves so, economically, the impact of energy restrictions and higher prices should not be too great. Furthermore, China and India – another key importer of Middle Eastern oil – seem to be finding covert ways to circumvent trade sanctions and shipping blockades.

Although the eurozone has taken significant steps to diversify its energy risk through more diversified supply sources – principally shifting imports from Russia to the US since the war in Ukraine began – it does remain dependent on imported energy and its economy is vulnerable to higher gas prices in particular, especially at a time when storage tanks are low after winter and energy stocks now need to be replenished ahead of the next heavy consumption period. Similarly, the UK economy is also in a more precarious position as a result of the current energy crisis – it is still reliant on imported energy, even though little is sourced from the Middle East, and is therefore very exposed to a spike in global energy prices which could add markedly to business costs and consumer price inflation. Indeed, the Organisation for Economic Co-operation and Development ('OECD') has warned that the UK economy could see one of the largest hits to gross domestic product ('GDP') growth among G20 economies if the conflict persists or escalates further.



US resilience

As far as the US is concerned, however, this should be the most economically-resilient economy from an energy perspective: it is now quite self-sufficient, producing around 85% of its own energy needs. But whilst energy supply is not the issue, it does still mean the US economy is vulnerable to higher global energy and related commodity price inflation. On a more positive note, however, continued strong AI-related investment could easily counterbalance any modest weakness in US economic activity brought about by the Iran conflict.

Drawing all these threads together, of the advanced world economies both Europe and Japan (including their stockmarkets) are potentially quite vulnerable to this crisis.

However, we already have relatively small commitments to these regions and do not feel the need to reduce exposures. But we do feel it is appropriate to trim some Asian (excluding Japan) equity risk: broadly speaking, Asian investments have fared very well in the past year and whilst we are still strong believers in this region providing many exciting investment opportunities and contributing meaningfully to long-term global growth, reducing slightly our exposure when we see heightened conflict-related vulnerability seems a sensible step.

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Infrastructure assets – the real deal

As far as reinvestment is concerned, we not only wish to increase exposure to the more resilient US economy but also to 'real assets' – tangible assets that have intrinsic value due to their physical attributes. This leads us to increase exposure to infrastructure assets. These generally have more defensive qualities, including income provision, explicit inflation protection due to long-term contracts, and stable cashflows generally not dependent on the economic cycle. Here we are not just talking about toll roads, pipelines and utilities but also critical services-related infrastructure assets to supply and store water, power and (increasingly) data. Furthermore, the general rise in geopolitical instability, now compounded by the Middle East conflict, is accelerating investment in alternative energy infrastructure (e.g. renewables and grid modernisation) to improve domestic energy security, making energy infrastructure a key beneficiary of government spending. Our planned increased investment to a global infrastructure fund will automatically provide slightly more exposure to the US economy but also the US dollar, which has gained strength so far during this conflict and shown, yet again, that it is still a 'go to' currency in times of heightened uncertainty.



Our current and planned changes could prove unnecessary. But when we stand back from the immediate market noise and ask ourselves whether anything has changed, on balance we feel that it will be hard for economies not to shake off the current risk of higher inflation. This probably means higher central bank policy error risk and the possibility of certain asset classes not resuming their previous likely paths in quick order. Therefore, taking some action, rather than waiting for the current dark clouds to blow over, does seem appropriate.

Basal strength in the world economy should help

It is unusual for a quarterly investment review to be so narrowly focused on one topic, but that exemplifies just how central this conflict is to the future inter-connected world of inflation, interest rate policy, global economic growth and, by association, the financial health of consumers, businesses and markets generally.

As noted, there is a range of potential outcomes from here depending on how long the conflict lasts and whether the path ahead focuses more on negotiation and de-escalation than on deploying more brute force and ignorance. But in all of this it is worth reiterating that the world economy was in pretty good shape going into the conflict. Forecasts for global economic activity for this year and next had been upgraded, particularly in the US, and business surveys in both the services and manufacturing parts of most key economies were suggesting expansion rather than contraction.

Had hostilities coincided with a much weaker fundamental backdrop then the magnitude of recent market falls might have been greater: even though energy prices have spiked, the fact that stock and bond markets have seen only moderate declines overall, albeit with significantly elevated volatility, is a reflection of that position of basal strength in the world economy when the conflict began. Investment returns in the first two months of 2026 had actually been strong, indicative of a generally upbeat and improving backdrop being aided by continued technological advancements (notably emanating from the US and Asia) and the prospect of lower inflation and monetary policy both this year and next. Whilst markets have retraced some steps, having that early-year buffer under investors' belts has probably acted as a handy cushioning influence on market sentiment.

As things currently stand, there is still a central scenario where not too much long-term damage is done to that hitherto healthy economic backdrop, which means that it will take some significant escalation in hostilities and prolonged disruption to energy supplies for the world economy to lurch into recession. Whilst we remain alert to that risk, our working assumption at present is that this conflict is not heading towards a very bleak and dark place.

But nonetheless we do believe it is prudent to de-risk portfolios a little, holding a little more cash than usual by reducing fixed interest investments most sensitive to elevated inflation and change in monetary policy, whilst also making some modest changes within equity market risk to introduce a little more economic defensiveness and resilience.

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Balancing short-term caution with longer-term opportunity

Events are fast-moving and whilst media outlets are understandably consumed with negative newsflow (they always are) there are still corners of the world and businesses that are not in the crosshairs of this conflict, plus useful investment vehicles like market-neutral alternative investments that can navigate more safely through troubled waters. We are also aware of the potential for rapid recovery in market confidence once newsflow turns in a more positive direction, as it always does eventually. That balance between keeping skin in the game for the longer term – including participating in important recoveries when they occur – and taking more defensive action to protect capital in the near term is never an exact science or something that can be fine-tuned to perfection.

At present, our strategy is to have a nod to both the near-term uncertainties and the longer-term opportunities that will undoubtedly reappear once this conflict is consigned to the history books. Hopefully it will not be too long before markets can re-focus on some of the more positive aspects of the world economy, but in the meantime exercising a little more caution and remaining flexible to further adapt our strategy as events unfold seems prudent.

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