Clark Capital MANAGEMENT GROUP

Commentary

Navigator® Market Update

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Crisis in the Middle East

Over the weekend, relative calm in the Middle East was violently interrupted by the Hamas (backed by Iran)-led invasion of Israel, resulting in the largest attack on Israel in 50 years. Our thoughts are with the people of Israel and the impact on the human lives at stake. Already, hundreds have been killed, over a hundred people kidnapped, and thousands injured. Shortly after the attack, Prime Minister Netanyahu declared war on Hamas and stated, "We are embarking on a long and difficult war that was forced on us."

The political landscape in the Middle East shifted in September 2020 with the signing of the Abraham Accords, opening diplomatic agreements between Israel, the United Arab Emirates, and Bahrain. Geopolitical experts speculate that Hamas attacked Israel to undermine a new Israeli-Saudi deal that is currently being negotiated by the two nations. An agreement between Israel and Saudi Arabia would further isolate Iran, but the new conflict in the region could present a reason to pause on further negotiations, thus strengthening Iran's position in the region.

At a time like this, with so much human loss and suffering, it seems trite to consider the impact of the crisis on the markets and economy. However, there are potential implications that must be considered. One point to note is that past geopolitical events, after the initial market reaction (which often is a sharp decline and flight to safety), have led to more buying opportunities than persistent selloffs. One implication of war in the Middle East is rising oil prices. The effects of the war on the markets and economy will largely depend on whether the conflict spreads throughout the region and its impact on global energy prices. Crude oil is trading up about 4% as of this writing.

How this impacts Fed policy is another variable. The Fed has already hiked rates by 525 basis points and has messaged higher for longer and the potential for additional rate hikes. A flight to safety trade would provide a bid to U.S. Treasuries and therefore send interest rates lower. This may conflict with what the Fed desires, but given the rising geopolitical risk this poses to the global economy, the Fed will likely tolerate lower rates.

The risks of war could ultimately become a downside driver for the U.S. economy via a drop in consumer confidence or a disruption in the global economy. Thus, in our opinion, the potential drop in interest rates is not something that necessarily would make the Fed become more hawkish. We think the larger macro picture will continue to drive the markets. The economy remains more resilient than many expected this far into the rate hike cycle. Recession expectations keep getting pushed further into the future, and third-quarter GDP is expected to come in around 3.0%.

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The markets are now oversold, investor pessimism is setting in, and as we move into the fourth quarter, seasonal headwinds should turn into tailwinds for the market. As always, we believe it is imperative for investors to stay focused on their long-term goals and not let short-term swings in the market derail them from their longer-term objectives.

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