16 June 2025, 11:29 UTC
Chief Investment Office GWM
Investment Research

Israel-Iran conflict brings geopolitical risks into focus

Weekly Global

Mark Haefele, Global Wealth Management Chief Investment Officer, UBS Switzerland AG

What happened?
Iran launched another wave of missiles at Haifa and Tel Aviv in the early hours of Monday, Reuters reports, damaging residential buildings, power facilities, and port infrastructure. The strikes follow a weekend marked by reciprocal missile attacks. Following its Friday strike, Israel broadened its targeting of Iranian military and energy assets, including the South Pars gas field and key government sites in Tehran.

Repeated missile exchanges, damage to infrastructure, and the resulting interruptions to shipping routes have intensified worries about the Strait of Hormuz, a critical artery for global oil shipments.

Market sentiment showed signs of stabilizing on Monday. Brent crude is trading around 0.4% lower at the time of writing after a sharp rise on Friday. Gold is down 0.5%, holding near USD 3,413/oz, below its Monday peak. S&P 500 futures are currently up 0.4%, suggesting a rise after Friday's 1.1% decline.

Hopes remain for de-escalation, though the rhetoric has been heated. President Trump suggested Israel and Iran "may have to fight it out," but expressed hope for a negotiated outcome. G7 leaders have said they will take up the issue in a leaders' summit in Canada. Separately, Reuters reported Trump had dissuaded Israel's Netanyahu from a plan to target Iran's supreme leader directly in the initial strike. Both Iran and Israel's governments have warned each other of further escalation.

What do we think?
The conflict marks a significant escalation in regional tensions and comes after US-led negotiations to curb Iran's nuclear program hit an apparent deadlock. Military exchanges last year between Israel and Iran were not followed by wider escalation. But in this instance, the intensity of the strikes, the severity of reciprocal response, and the potential involvement of the United States are crucial factors in assessing the risk of escalation into a wider regional conflict.

Near-term market volatility is likely. The Strait of Hormuz is a key artery for the global energy trade, with more than 20 million barrels of hydrocarbons passing the narrow shipping corridor each day, and the sharp spike in crude oil prices is a clear indication that market participants are concerned about

From the studio
Podcast: **Monday latest on Iran-Israel escalation, Fed/SNB, and trade talks** (4:16)
Video: **CIO's Thomas Wacker on whether US fiscal policy is at a breaking point** (8:03)

Questions for the week ahead

What comes next after Israel's strike against Iran? We will be looking to see if the conflict remains contained mostly to Israel and Iran, whether there are any signs that the dispute will compromise global energy supplies, and whether the conflict will swiftly de-escalate (as was the case when the two nations exchanged strikes last year) or spiral.

With rate decisions from the Fed and Swiss National Bank, is the global easing cycle on track? The Fed's rate-cutting pause in 2025 is set to continue, with a strong consensus that they will stay on hold again this week. Rather than the decision itself, markets will be looking for guidance on when easing might resume—based on the Fed's perspective on the fast-moving trade conflict, the state of the labor market, and inflation developments prior to higher US tariffs. By contrast, we do expect the SNB to ease—taking rates to zero—in response to a stronger franc and signs of cooling growth.

Will US trade deals live up to expectations? US President Trump last heralded progress in improving trade relations with China, saying that the supply losses. A risk premium in oil prices will likely persist in the near term. If there are no supply disruptions, oil prices should fall again.

Below, we outline three potential scenarios, and how we would expect them to impact the global economy and financial markets. We highlight that these scenarios do not cover all eventualities, given the fluidity of the situation and the potential for miscalculations by the parties involved.

Scenario 1: Conflict remains contained mostly to Israel and Iran
In this scenario, further military exchanges between Israel and Iran continue in the coming days and weeks, and Israel’s allies help contain the threat from Iranian missile and drone attacks. However, energy infrastructure in the wider region remains largely intact and maritime routes undisrupted —with any potential output loss from Iran made up for by bringing spare capacity elsewhere in the region back online. Renewed talks over the remains of the Iranian nuclear program may emerge, and markets will soon turn their attention back to trade policies and growth inflation dynamics. In this scenario, the rise in oil prices would likely be temporary and short-lived enough not to affect global inflation dynamics meaningfully. Risk assets may experience some additional near-term downside, but would also likely recover quickly once it becomes clear that the conflict remains contained.

Scenario 2: Prolonged disruption to energy supplies
The most damaging scenario for the global outlook would be a prolonged disruption of energy supplies from the region. This could involve Iranian energy infrastructure being targeted, or Iran retaliating against US assets in the region and potentially energy infrastructure in the gulf. This, in turn, could also trigger US strikes on Iran. Global economic activity would suffer in such a scenario, though the ultimate impact would depend strongly on the duration of the energy supply disruption. The oil price may also see bigger swings if OECD countries decide to tap strategic reserves. Equity markets would likely see a rapid sell-off in this scenario as market participants price higher uncertainty and a weaker economic outlook. Assets seen as safe havens like gold, the Swiss franc as well as highly rated bonds would likely perform well.

Scenario 3: Rapid escalation, quick recovery
A scenario of rapid escalation, which also draws in the United States, may lead to combined US and Israeli strikes on Iran’s nuclear and military capabilities. Energy supplies may be temporarily disrupted, some damage to the wider Gulf energy infrastructure may occur, and such strikes could potentially result in the military defeat of the Iranian regime. Risk assets would likely sell off more strongly in this scenario than the immediate reaction we've seen so far, especially if and when the first disruptions to energy supplies are reported. However, a quick depletion of Iranian military capabilities would likely be followed by a strong focus on re-establishing energy supplies from the region, and risk asset markets may be quickly reassured by subsequent lower risks to regional oil supplies and trade.

How to invest?
The escalating conflict between Israel and Iran poses the risk of renewed cross-asset volatility. But past incidents suggest that if the conflict remains relatively contained and does not disrupt global energy flows, the market

deal was “done” and the “relationship is excellent.” Meanwhile, Commerce Secretary Lutnick said there would be “deal after deal” in coming weeks. But this week, investors are hoping that more details will emerge to support such upbeat statements.

impact should fade fairly quickly as attention returns to underlying macroeconomic and policy fundamentals.

For investors, the key is to stay focused on long-term objectives and use market swings to build or rebalance risk positions where appropriate:

Navigate political risks: Gold's reaction to the attack highlights the metal's role as a long-term portfolio diversifier. While some geopolitical risk premium was already priced before Israel's attack, speculative positioning appeared relatively light, suggesting the potential for further upside if negative headlines persist.

We continue to believe that gold remains a highly effective hedge against geopolitical risks. Ongoing US policy uncertainty is undermining the greenback's ability to perform well when uncertainty is on the rise. This also applies to some degree to long-dated US government bonds, considering fiscal concerns. Lastly, the decline in crypto prices after the initial strike is a reminder that they do not trade as classic "safe-haven" assets.

Phase into equities: Equities have performed well in 2025, and a lot of positive news on trade policy and economic growth appears to already be reflected in prices. So far, the Iran-Israel escalation has not significantly impacted equity market sentiment. However, increased near-term volatility could enable investors to gradually add to global equities or balanced portfolios. We focus on select US sectors including technology and health care; mainland China's tech sector, India, and Taiwan in Asia; and on European quality stocks and our "Six ways to invest in Europe" theme.

We continue to see high grade and investment grade bonds as offering an attractive balance of risk and reward. Yields on quality bonds in most major markets remain compelling, and we expect the ongoing global rate-cutting cycle to support further investor inflows. Investment grade bonds are also appealing from a portfolio risk management perspective.

Key Messages

Israel-Iran hostilities intensify Middle East risks
The risk of wider conflict in the Middle East escalated last week after Israel launched strikes on Iran, targeting nuclear facilities, military sites, and senior commanders. Israel described the campaign as pre-emptive, claiming Iran had enough material to make multiple nuclear bombs within days.

Over the weekend, Israel expanded its operations, while Iran retaliated by striking Israeli cities. Explosions in Tehran and damage to energy facilities raised concerns over the Strait of Hormuz, a critical global oil route, resulting in Brent crude briefly spiking above USD 75 a barrel, from below USD 70 a week before. US President Trump told Israeli Prime Minister Netanyahu not to target Iran’s supreme leader, according to Reuters, but warned both sides may have to “fight it out.”

While past flare-ups did not spark broader conflict, this time the intensity and US involvement have added to worries. With the Strait of Hormuz managing over 20 million barrels per day, volatility is likely to persist, as reflected in oil’s spike.

Against this backdrop, we’ve outlined three scenarios: First, the conflict remains contained to Israel and Iran, causing limited infrastructure damage, allowing markets to stabilize and oil prices to retreat. Second, the most damaging scenario involves prolonged energy disruptions from regional strikes, driving oil toward USD 90/bbl. In this case, inflation risks increase, forcing central banks into difficult trade-offs, while equities sell off and gold and safe-haven assets outperform. The third scenario entails rapid escalation followed by a swift recovery driven by joint US-Israel strikes, with markets initially falling but rebounding as energy risks quickly ease.

Takeaway: Gold’s reaction to the attack highlights the metal's role as a long-term portfolio diversifier. While some geopolitical risk premium was already priced before Israel’s attack, speculative positioning appeared relatively light, suggesting potential for further upside if negative headlines persist.

Phasing into markets amid trade volatility
US President Trump last week heralded progress in improving trade relations with China, saying that the deal was “done” and the “relationship is excellent.” Meanwhile, Commerce Secretary Lutnick said there would be “deal after deal” in coming weeks.

Optimism that the worst of the conflict is over had helped push the S&P 500 to within 2% of the record high struck in February, ahead of Friday's decline. Our base case remains that pragmatism will prevail in trade talks, allowing US stocks to advance further over the coming 12 months. But recent developments have also been consistent with our view that the journey is unlikely to be a smooth one. The potential for setbacks remains high.

Trump told reporters he would send letters outlining higher tariffs as the end of a 90-day pause approaches in July. China has put a six-month limit on licenses to export rare earths to the US, according to the Wall Street

Journal, allowing it to exert pressure in the event relations deteriorate again. Shipments of the most advanced AI chips from the US are still likely to be restricted.

A successful outcome to talks with the European Union can't be guaranteed, given fundamental disagreements over issues such as digital taxes. Finally, tariffs imposed under the International Emergency Economic Powers Act (IEEPA) will remain in place while challenges to the government's authority work their way through the courts—a process that is expected to take months.

Takeaway: Against such an uncertain backdrop, investors should prepare for continued volatility. We think phasing into equities can be an effective way to overcome the challenges of market timing, while structured strategies can help manage volatility.

Seek resilience in Eurozone stocks as headwinds intensify
Eurozone shares faced headwinds last week, with the Euro Stoxx 500 falling 2.6% on concerns that the European Union may not secure a trade deal with the US before the Trump administration's tariff pause ends on 8 July. We see further challenges for the region moving into the second half of the year.

The focus on US trade and fiscal policy uncertainties has tempered enthusiasm for Europe following optimism for higher German infrastructure, enhanced EU defense spending, and hope of progress in Russia/Ukraine peace talks early in 2025. Eurozone growth momentum looks set to slow, while the prospect of an imminent end to the European Central Bank's rate-cutting cycle may cloud the outlook for lending and domestic demand.

Against this backdrop, we are Neutral on the region's equites and believe investors should increasingly seek resilience in their European equity allocations. This could include adding to "quality" European stocks—those offering high profitability, robust balance sheets, and sustainable competitive advantages. Over the past 35 years, the MSCI Europe Quality index has outperformed the broader MSCI Europe index by an average of 2% per year, with lower volatility.

In addition, a period of recent underperformance now offers an attractive entry point, in our view. Quality has lagged the region by 9% over the last 12 months and by 15% since October 2020. As a result, the forward price to earnings premium for quality stocks has fallen from over 40% at the start of 2024 to below 30% by May 2025, slightly under the 10-year average.

Takeaway: We advise investors to consider an allocation to quality European stocks. We have also closed our preference for Eurozone small- and mid-cap equities after a period of strong outperformance—these stocks are up 21% year to date versus 14% for large caps (based on MSCI EMU SMID and MSCI EMU Large Index data). The drivers that supported this segment, such as improving lending conditions and ECB rate cuts, are waning. We still like our "Six ways to invest in Europe" theme for its diversification across investment drivers.

Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, “junk bonds,” derivatives, distressed securities, non-U.S. securities and illiquid investments.
- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer’s “home” currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

Appendix

Risk information

UBS Chief Investment Office's ("CIO") investment views are prepared and published by the Global Wealth Management business of UBS Switzerland AG (regulated by FINMA in Switzerland) or its affiliates ("UBS"), part of UBS Group AG ("UBS Group"). UBS Group includes former Credit Suisse AG, its subsidiaries, branches and affiliates. Additional disclaimer relevant to Credit Suisse Wealth Management follows at the end of this section.

The investment views have been prepared in accordance with legal requirements designed to promote the **independence of investment research**.

Generic investment research – Risk information:

This publication is **for your information only** and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. The analysis contained herein does not constitute a personal recommendation or take into account the particular investment objectives, investment strategies, financial situation and needs of any specific recipient. It is based on numerous assumptions. Different assumptions could result in materially different results. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness (other than disclosures relating to UBS). All information and opinions as well as any forecasts, estimates and market prices indicated are current as of the date of this report, and are subject to change without notice. Opinions expressed herein may differ or be contrary to those expressed by other business areas or divisions of UBS as a result of using different assumptions and/or criteria. UBS may utilise artificial intelligence tools (“AI Tools”) in the preparation of this document. Notwithstanding any such use of AI Tools, this document has undergone human review.

In no circumstances may this document or any of the information (including any forecast, value, index or other calculated amount ("Values")) be used for any of the following purposes (i) valuation or accounting purposes; (ii) to determine the amounts due or payable, the price or the value of any financial instrument or financial contract; or (iii) to measure the performance of any financial instrument including, without limitation, for the purpose of tracking the return or performance of any Value or of defining the asset allocation of portfolio or of computing performance fees. By receiving this document and the information you will be deemed to represent and warrant to UBS that you will not use this document or otherwise rely on any of the information for any of the above purposes. UBS and any of its directors or employees may be entitled at any time to hold long or short positions in investment instruments referred to herein, carry out transactions involving relevant investment instruments in the capacity of principal or agent, or provide any other services or have officers, who serve as directors, either to/for the issuer, the investment instrument itself or to/for any company commercially or financially affiliated to such issuers. At any time, investment decisions (including whether to buy, sell or hold securities) made by UBS and its employees may differ from or be contrary to the opinions expressed in UBS research publications. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, divisions or affiliates of UBS. Futures and options trading is not suitable for every investor as there is a substantial risk of loss, and losses in excess of an initial investment may occur. Past performance of an investment is no guarantee for its future performance. Additional information will be made available upon request. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information.

Different areas, groups, and personnel within UBS Group may produce and distribute separate research products **independently of each other**. For example, research publications from **CIO** are produced by UBS Global Wealth Management. **UBS Global Research** is produced by UBS Investment Bank. **Research methodologies and rating systems of each separate research organization may differ**, for example, in terms of investment recommendations, investment horizon, model assumptions, and valuation methods. As a consequence, except for certain economic forecasts (for which UBS CIO and UBS Global Research may collaborate), investment recommendations, ratings, price targets, and valuations provided by each of the separate research organizations may be different, or inconsistent. You should refer to each relevant research product for the details as to their methodologies and rating system. Not all clients may have access to all products from every organization. Each research product is subject to the policies and procedures of the organization that produces it.

The compensation of the analyst(s) who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking, sales and trading or principal trading revenues, however, compensation may relate to the revenues of UBS Group as a whole, of which investment banking, sales and trading and principal trading are a part.

Tax treatment depends on the individual circumstances and may be subject to change in the future. UBS does not provide legal or tax advice and makes no representations as to the tax treatment of assets or the investment returns thereon both in