

A Difficult Week on Many Fronts

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Israel, Hamas, and the Middle East remain front and center in our geopolitical engagements. They have dominated our in-person conversations, our calls, and video conferences. Things are evolving rapidly, and we are doing our best to give you our understanding of the situation and how it is likely to evolve (along with other less likely, but plausible outcomes).

We understand that our clients have many (and often varying) opinions on the war. For many, including those at Academy Securities, this hits us on a very personal level.

I apologize in advance if anything we say or write comes off as condescending, one-sided, or even superficial. That is not our intent. Our intent is to take our decades of service in the region and our connections at the political and military levels (both domestic and foreign) and provide you with our educated views on the situation. On the “macro” side of things, we have the luxury of talking to so many clients that we feel we can offer insights into how to think about the war in terms of market risk. That is the goal, and any failure to come across the right way in doing that is a failure on my part. We have limited space and are acting on the best available information that we have. Please bear with us and feel free to respond to our work. Hopefully, it helps you navigate yet another treacherous geopolitical situation.

The Middle East

Yes, this is a war between Israel and Hamas, but the conflict (and what this potentially means for the global economy) goes well beyond that.

We have published multiple SITREPs on the subject that can be found [here](#). We also recently produced a [podcast](#) where, in addition to General (ret.) Robeson, we were able to introduce our latest team member, Maria Donnelly. Academy has also had the opportunity to discuss this on multiple radio and TV programs.

The consensus view right now (amongst the Geopolitical Intelligence Group) is that **Israel’s response will be one of controlled, but total victory**. This means that Israel will eradicate Hamas as an enemy that is capable of inflicting damage to Israel. There will not be “half” measures (or room for any other conclusion from the Israeli standpoint) other than the elimination of Hamas as a threat to its citizens and borders. They have the military strength and support to accomplish this. At the same time, the destruction of Hamas will be as “precise” as possible. Significant efforts will be made to avoid civilian casualties. Given the nature of the defensive positions, the type of fighting that is likely to occur, the need to minimize risk to their soldiers, and the additional complications posed by the taking of hostages, this is a difficult task and will not be 100% successful. That is the tightrope Israel is walking as they plan their battle strategies to eliminate this threat. As this war evolves, our views on the most likely scenarios will evolve with it, but that is the current overall view.

The first big wildcard (with respect to potential escalation) is **Iran**. I do not say this lightly, but given the frequency in which it comes up, it needs to be said. “There is almost no way that Hamas organized this attack without the help of Iran.” That is not a direct quote from any particular GIG member, but it encapsulates the strong consensus view that at some level, Iran helped Hamas engineer this attack. That is my working principle based on what our GIG is telling me. **Given this, how things evolve with respect to Iran will be critical.**

So far there is no “official” intelligence or claim of direct involvement. That is allowing the “status quo” to continue. The world is still “looking the other way” as Iran sells sanctioned oil, since it keeps global

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oil prices lower than they would be otherwise. Again, you are unlikely to see “official” reports of turning a blind eye to this, but given the conversations here, I am convinced that this is occurring. There is theoretically some chance that Iran will denounce Hamas and signal that they will withdraw support for Hezbollah and other radical groups in the region, but that seems highly unlikely. **So, the risk remains that Iran could take a more prominent role in escalating the conflict.** That would be bad for the safety of the region and for oil prices, as we would then need to “really” enforce the sanctions. Oil prices would rise due to more serious enforcement of sanctions and because of the increased risk of destruction in the region.

My assessment is that while this is not yet the “likely” case, it is pretty darn close, which means the markets might be underpricing the risk. If you see headlines indicating a more direct involvement of Iran, expect oil prices to surge, Treasury yields to drop (flight to safety will overwhelm oil price increases), and risky assets (credit spreads and equities) to wobble again.

Saudi Arabia is the next most important nation to watch. Again, this is coming from the GIG members, and their years of experience and connections. They believe that the timing of the attack was likely designed to slow down or derail Saudi Arabia’s “normalization” of its relationship with Israel. The Abraham Accords have the potential to change the landscape of the Middle East (for the better, from a “Western” perspective). The Saudis, while at odds with Iran, had historically not been as close to Israel as they have become more recently. Is this a step to disrupt that progression? Just as many believe that Putin had hoped to fracture NATO (he failed miserably, and arguably has strengthened it), was this attack a final attempt to stifle that shift in politics in the Middle East? Will it also fail, like Putin’s attempts with NATO?

This is a huge potential wildcard. On the positive side, the Saudis had been making encouraging progress (from an Israeli standpoint). Our GIG members who have been to the region talk about the amazing shifts in the Kingdom as they attempt to modernize. The Saudis have been developing a post-oil economy for decades and continue to make progress on that front. While they still have many policies that would be viewed as “restrictive” by the West, they have been reducing those restrictions at an astonishing pace. They did increase oil production, initially, when asked by the U.S. to help battle inflation. **There are reasons to be optimistic.** On the negative side, they have cut back on oil production of late. They also just began diplomatic discussions with Iran (China apparently played a key role in this). **Ultimately, much of Saudi Arabia’s reaction over time could be shaped not just by Israel’s response, but also by how that response is received by the media (and, more importantly, social media) in the Kingdom and the region.** Our working assumption is that the Saudis want to continue on the “progressive” path, and it will take a lot of backlash from Israel’s response to deter them from that path. This is likely one of the key reasons why Israel is being careful in planning and executing their full military response. **It would be very positive for the West and the region if the Saudis do not waver.** There is even an outside chance that the Saudis could increase oil production to take advantage of the rise in prices, and to show support (indirectly) for the West and Israel’s allies. That might be a step too far for the Saudis, at least right now, but they could eventually play a key role here.

China has been more critical of Hamas than it is of Putin. There is a chance that China could play a positive role in the region. China, unlike the U.S., is communicating with all sides. They have been taking on a more active role in global hotspots. While the GIG was not a fan (to say the least) of their proposed peace plan for Russia and Ukraine, it is undeniable that they are having a greater influence in geopolitics than before. There is a chance that China enables all sides to do something that is “positive” for the region and the globe. They don’t seem to have any incentive to make things worse, so we view their

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involvement in the region as being potentially positive right now.

Russia. This attack almost makes me want to **revisit the recent spate of coups in Africa**. The U.S. is not officially recognizing some of the coups, as that would require (by law) pulling out of those countries, at least on the diplomatic front. This action would not further our agenda of helping those countries and protecting our interests in Africa. The timing of higher oil prices certainly doesn't hurt Russia's position in the world, as Europe is already bracing for winter. Russia is not a direct actor in the current events in the Middle East, but it is certainly a beneficiary.

The Middle East – Bottom Line

Given the scope of the attacks and the bloodshed, the developments of the week went about as well as they could from a market perspective.

- Watch Israel's response. A thorough, but cautious response is likely best for the global economy and markets.
- If Iran is identified as being directly involved, or the West aggressively ties Iran to the events in the region, watch out for escalation.
- The Saudis could help with oil production, which would be great for prices (and on the "signaling" front). The risk is that they could start to reverse some of the pro-Western/pro-Israel steps that they have been taking lately.

Oil will rise with escalation and decline with the "status quo" despite how awful that status quo is.

Yields will drop with escalation, and hold steady, unless something surprising happens in the region that causes them to rise. The strong link between oil and yields is quite weak right now and will likely mean that they will move in opposite directions rather than in the same direction.

Risk assets will struggle to rally, as the downside risk does not seem to be fully priced in.

A Difficult Week on the Inflation Front

Inflation data indicated risks that the slowdown has stopped or even reversed. Inflation expectations popped in the University of Michigan [CONsumer CONfidence](#) survey. Inflation expectations in that survey are highly correlated to gas prices, and future expectations of the economy are correlated to recent stock market performance – so take the data with a grain of salt.

We will address this more next week, as we wanted to focus our attention this week on the conflict in the Middle East. Academy brings a degree of expertise in the region that we feel is second to none.

Take care, and I apologize if anything that I have said or written recently is offensive, disturbing, or otherwise problematic. We are just trying to do our best to help you navigate through another awful crisis.

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