Increasing the Market Risk Assessment Due to the Middle East

On Saturday we discussed in detail what we're looking at in the Middle East, in terms of risks, threats, and even opportunities. See a Difficult Week.

As we continue to have discussions with a variety of our Geopolitical Intelligence Group ("GIG") members, I feel obligated to increase our risk assessment on three key elements of our analysis:

- **If Iran's goal is to disrupt the progress that has been made in the Middle East with the Abraham Accords**, then they will likely escalate (as they have not yet achieved their desired effect). Yes, this requires a belief that Iran is responsible (in large part) for the Hamas attack. While that is not the "official" view, our GIG would find it inconceivable if they weren't. I have the privilege of working with 18 retired Generals and Admirals here at Academy Securities. I think that this group provides a unique perspective that is highly relevant now, so I will focus on the Middle East today. **The risk of escalation by Iran (directly or via proxy) is medium-high to high.** For the people of Israel, it won't make a difference where the attack comes from, but it seems like the rest of the world will cling to the "hope" (for lack of a better word) that Iran isn't behind it if a proxy is used. It seems like a transparent "turn a blind eye" approach that allows Iran to continue to sell oil despite sanctions (if you believe that this is occurring, which is highly likely) and to diminish the risk of much larger energy production and transportation issues.
- **The Saudis are unlikely to increase oil production at this time.** The Saudis may eventually increase production, likely at a much higher price point (over $100 a barrel), but only after they have seen how the Israeli response develops. There is simply too much pressure from others in the region (and a portion of their own population) to step up at the moment to reduce the pressure on oil prices.
- **The difficulty that the Israeli military faces.** Eliminating the ability of Hamas to harm Israel and its citizens is already a difficult task. Hamas will be prepared for a counterattack and will likely have positioned themselves in and around civilians to make it more difficult for Israel. A plan for Israel to defeat Hamas, while limiting civilian casualties and protecting the lives of their own soldiers, is going to be incredibly difficult to execute. **The risk of something "bad" occurring during the ground operation is higher than I'd like to admit**. That risk was already there when I penned this weekend's piece. Our GIG has repeatedly reminded us of how difficult this task is and how we need to be prepared for the risk of some "event" that creates a new uproar of anger towards Israel. **The market is somewhat aware of this, but I continue to believe that we are all downplaying this risk.**

Updated Bottom Line

If the Middle East was the only thing shaping markets (it isn't, and we have a second macro-focused T-Report coming later today), I would recommend:

- Reducing risk (a little) as the market has shifted to being a tad complacent on the risks to the region and the ramifications for the markets and global economy.
- Buying hedges in the rate market. I think that rates are already too high (see follow-up piece), so this is an easy one.
- I would not use the oil market here to hedge (you could convince me to short it), since:

- Oil was in free-fall before the attacks.
- The Saudi's may well provide a ceiling to how high oil can go, at least under "moderate" escalation.

It is depressing and a bit scary that this war in the Middle East is what we need to analyze, but sadly it is, and we are trying to bring all of our resources to bear to help navigate this.

Disclaimer