

Implications from the Middle East Conflict

Markets have been rattled by the US–Israel conflict with Iran, but the bigger story is what comes after the headlines: a potential reshaping of global power, energy supply chains, and inflation dynamics. In this note, we step back from the day-to-day volatility to outline three medium- to long-term consequences we believe could become permanent features of the investment landscape, and what they mean for emerging markets investors.

The volatility in news flow, and its impact on capital markets, stemming from the US–Israel conflict with Iran makes investing highly challenging in the short term. However, below we outline some of the longer-term trends that we believe will become permanent features of the investment landscape in the years ahead as a result of this conflict.

After over a month of hostilities, at the time of writing it appears that a two-week ceasefire has been enacted, with the Iranian Supreme National Security Council reportedly agreeing to reopen the Strait of Hormuz. US President Donald Trump said he would suspend his plans to bomb Iran for another two weeks, sharing a post on Truth Social stating that he had received a 10-point proposal from Iran (which if accepted would represent a major strategic victory for Iran) and was willing to negotiate.

This followed a widely condemned threat from the President that “a whole civilization will die tonight” as the deadline he had set for Iran to agree to a deal - including reopening the Strait of Hormuz - approached. Trump’s remarks drew heavy criticism from fellow American conservatives, including several Republican senators.

If the ceasefire holds (a big **if**) and leads to de-escalation, this would clearly be positive news. However, given President Trump’s unpredictability, by

the time our investors read this report the situation may have changed considerably.

In this highly volatile, news driven environment, equity investors are facing increasing short-term uncertainty. That said, we do see several likely longer-term consequences of the war that could fundamentally alter the investment environment. It is these medium to long term impacts that are informing the Northcape EM team’s investment decision making. Specifically, we see three major impacts, which we discuss in turn:

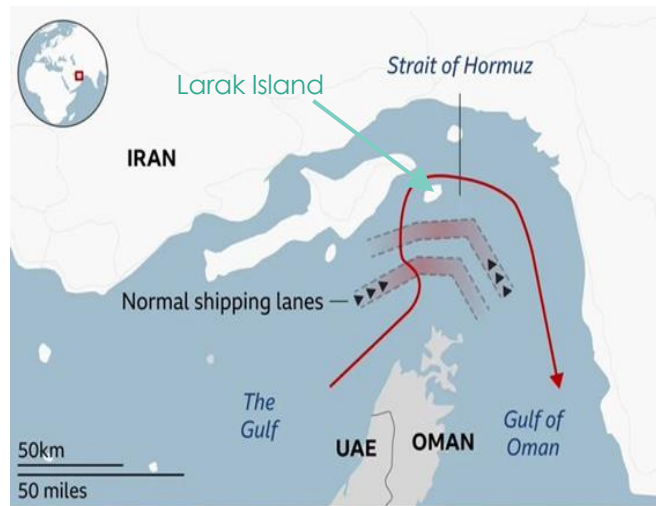
1. Major Strategic Loss of US Geopolitical Power

It has proven remarkably easy for Iran to shut the Strait of Hormuz. The firepower of the US Navy has so far been unable to prevent Iran from using maritime and aerial drones, as well as precision missiles, to strike shipping. Iran appears intent on maximising this leverage by demanding sovereign control over the Strait of Hormuz. Iran’s Parliamentary National Security and Foreign Policy Committee recently approved an 8-point “Strait of Hormuz Management Plan”, which included the levying of passage fees through the strait. This process appears to have already begun.

According to *Lloyd’s List*, ships from multiple countries are avoiding the main shipping lanes in the Strait of Hormuz and instead transiting through Iranian territorial waters around the island of Larak (see Exhibit 1), apparently with Iran’s prior approval. *Lloyd’s List*

reported that “one tanker is so far understood to have made a payment, said to be in the region of US\$2 million, as part of an agreement to transit the strait.” Governments including India, Pakistan, Iraq, Malaysia, and China are reportedly negotiating with Iran for access under this tolling agreement.

Exhibit 1: Route taken by Pakistani oil tanker through Strait of Hormuz, March 2026 (Source: BBC)



With over one hundred ships passing through the Strait of Hormuz each day, such a fee could generate approximately US\$90 billion per year, effectively making Iran one of the richest Gulf states. This would provide substantial resources to continue developing nuclear weapons — arguably an even higher priority for the Iranian regime following what it views as an unprovoked US attack under the Trump administration.

If Iran succeeds in imposing sovereignty over the strait and charging transit fees it would undermine the very foundation of international maritime law. Freedom of navigation is a cornerstone principle of international law, codified primarily in the 1982 United Nations Convention on the Law of the Sea (UNCLOS). This convention explicitly states signatories cannot charge such transit fees as being proposed by Iran.

If Iran is permitted to charge transit fees, why would Oman, on the other side of the passage, not also demand fees? Or the Houthis in Yemen require fees

for passage through the Bab el-Mandeb strait in the Red Sea? Or why wouldn't China impose customs charges on vessels entering Taiwan?

Freedom of navigation underpins the US led, rules based, global trading system, which has in turn been fundamental to the globalised world we live in today. Just as President Trump's tariffs have undermined global trade rules and the WTO, his war against Iran risks weakening another crucial pillar of globalisation: international maritime law.

The dismantling of this rules-based system would likely lead to a “might is right” geopolitical order, restricting trade and long-term economic development.

2. Global Oil and Gas Supplies May Be Impacted for Months, If Not Years

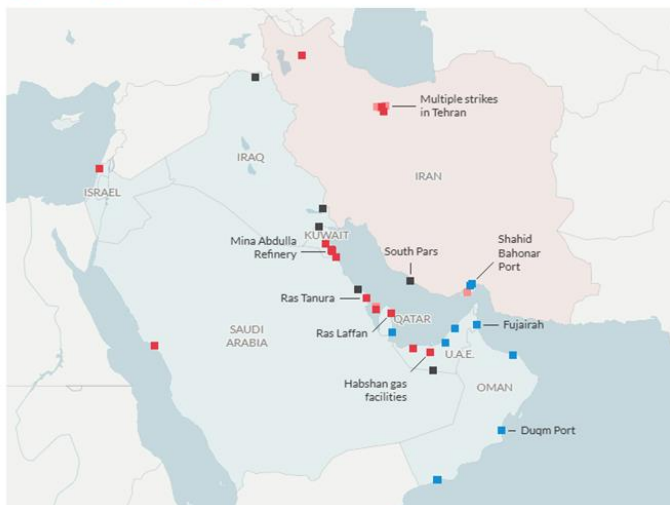
Approximately twenty million barrels per day - around 20% of the world's oil exports - flow through the Strait of Hormuz, which is currently closed. It is estimated that roughly 50% of this oil cannot be exported through alternative routes such as the East-West Pipeline across the Arabian Peninsula. Natural gas is another critical export, with a significant proportion of global supply originating from the Persian Gulf. Even if the strait were reopened, this does not imply an immediate return to normality in energy markets.

More than forty energy sites - including oil refineries, natural gas fields, and export infrastructure have reportedly been damaged across nine Middle Eastern countries since the US and Israel began bombing Iran (see Exhibit 2). Some sites have been struck multiple times by Iranian drones and missiles.

Damage to processing plants, pipelines, and ports in the Gulf could take months or even years to fully repair. A prominent example is Qatar's Ras Laffan LNG facility, which reportedly suffered extensive damage from Iranian missile attacks on March 19. Two of its fourteen liquefaction trains were severely affected, potentially keeping them offline for three to five years. These two trains alone accounted for roughly 4% of global LNG exports.

Exhibit 2: Damaged Oil and Gas Infrastructure across the Middle East (Source: GIS)

■ Plant ■ Storage ■ Port ■ Field



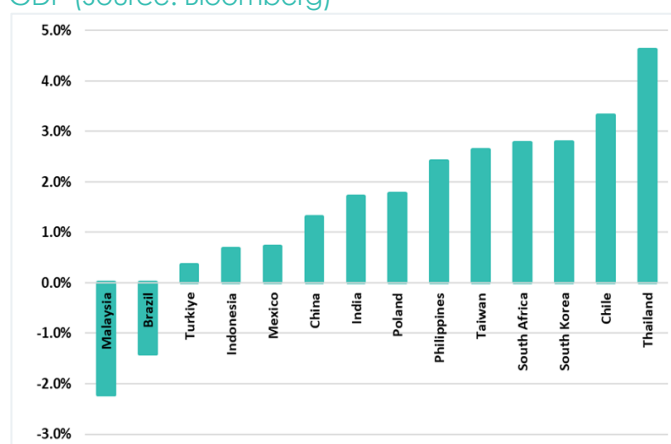
The inability to export oil has also forced producers to curtail output as storage capacity has been exhausted. Restarting production is not as simple as turning on a tap - pressure build ups, water ingress, and wax accumulation in wells can require specialised equipment and lengthy remediation. This process can take anywhere from days to months, with the longer the shutdown the more remediation required. Refineries also need to shut down without feedstock, and restarting them is costly and complex, often taking weeks.

Therefore, even if the strait were reopened tomorrow, we would expect several months of constrained supply, with oil and gas prices remaining elevated for some time. The longer the conflict persists, the greater and more prolonged the damage to global supply chains. Nonetheless, if crude prices remain at current elevated levels, alternative supply, most notably US shale, should gradually come online while demand destruction helps moderate prices over the medium term. The pivot to renewables would also accelerate.

This would leave the Middle East facing the double challenge of ongoing geopolitical instability and declining oil revenues, further deterring investment in the region. Within emerging markets, the impact of higher energy prices varies widely.

As shown in Exhibit 3, Brazil and Malaysia are net exporters of oil and gas respectively, while North Asian economies (including Taiwan and South Korea), Thailand, Chile, and South Africa are large net importers of both oil and gas and therefore most exposed to sustained energy shocks. The Northcape Emerging Markets Strategy remains underweight those markets that are most vulnerable to high energy import costs.

Exhibit 3: Net oil and gas imports as a percentage of GDP (Source: Bloomberg)



3. Higher Inflation and Detrimental Economic Impacts

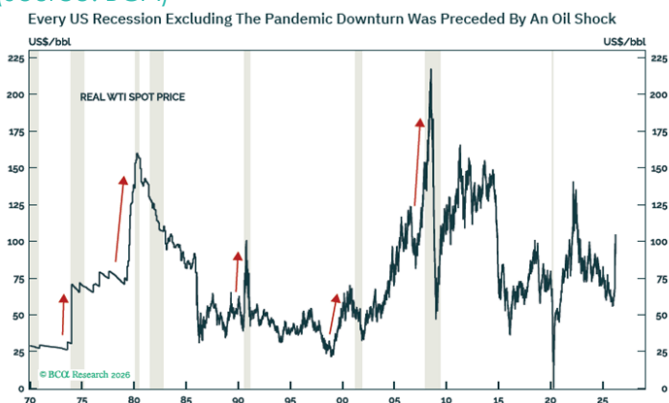
Higher energy costs are already being reflected in rising inflation expectations (see Exhibit 4). These expectations are being driven not only by energy prices but also by reduced supply of other goods produced in the Gulf, most notably fertiliser (specifically urea, a by-product from natural gas). About 30% of internationally traded fertilisers pass through the Strait of Hormuz. The resulting impact on food production, particularly given the US crop planting season from April to June, is likely to push food prices higher in the second half of the year.

Exhibit 4: US 2026 Inflation Expectations (Source: Bloomberg)



If the conflict continues, we expect inflation expectations to rise further, placing sustained pressure on central banks to raise interest rates even as economic conditions weaken. Historically, oil supply shocks have had severe consequences for the global economy. Every US recession, excluding the COVID 19 pandemic, has been preceded by such an oil shock, as shown in Exhibit 5.

Exhibit 5: WTI Spot Price versus US Recessions (Source: BCA)



What Does the Conflict Mean for Stocks?

In the short term, we expect equity market volatility to remain very elevated given large swings in news flow regarding the conflict's trajectory each day. Over the medium term, however, we believe the damage caused is likely to weigh most heavily on US equities.

The past eighteen months have seen a continued decline in the US dollar, a trend that began in 2022.

The US Dollar Index has fallen around 10% since the start of 2025, as shown in Exhibit 6. In this context, the recent 'flight to safety' supporting the US dollar since the beginning of hostilities in late February has been relatively muted given the scale of the global shock.

Exhibit 6: US Dollar Index (Source: Bloomberg)



The weakening US dollar signals growing concern among global investors about holding US assets, reflecting political dysfunction (for example, uncertainty around how President Trump might respond to a financial crisis), rising inflation, and deteriorating economic momentum.

Even if the Middle East conflict were to de-escalate quickly, we believe it would accelerate the erosion of confidence in the US, leading to further declines in the US dollar, and US equity valuations which are currently near 20-year highs, (see Exhibit 7).

Exhibit 7: S&P 500 12 Month Forward PE Ratio (Source: Bloomberg)



Summary

Unless 'boots on the ground' are committed, we do not foresee regime change in Iran. In any case, committing massive amounts of troops to hand-to-hand combat in the vast country of Iran, with over 90 million people, is both physically and politically very risky. We believe the US has no appetite for this type of war.

This leaves Iran to play the long game and potentially remain a disruptive threat within the Middle East for many years into the future, even if its military infrastructure is badly impaired today. This will lead to a structural derating in asset values across the Middle East in the years ahead. Accordingly, we see no reason to commit capital to these markets, even with the temporary sugar hit of the higher oil price.

Clearly, the oil price is a concern. At the time of writing, Brent crude has shot up 40% in March to over US\$90/bbl. The best strategy to deal with this highly volatile environment, with rising risks of higher inflation and interest rates, and elevated equity risk premia, is to stick to our process and focus on what we can

control. That is owning market leading companies with strong pricing power – an inherent characteristic of the Northcape Emerging Markets Strategy. This enables the entities we own to pass on the higher input costs from energy and thus help protect profit margins and cashflows.

However, we do believe if crude prices stay at these current high levels for a sustained period, alternate supplies will manifest (US shale for one), and demand will also reduce, leading to a gradual decline in oil prices over the long term. Hence many oil stocks that are doing well today could be facing even tougher headwinds long-term as the energy crisis reduces long-term reliance on fossil fuels.

We also continue to focus on emerging market companies with robust balance sheets, and low leverage, allowing them to fully fund their businesses, and indeed use the current volatile, uncertain market conditions to grow market share against their weaker competitors. Rivals with thin margins, weak cash flows, and high leverage are likely to under invest, thus lose market share to the leaders we own.

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