

EXECUTIVE SUMMARY

- Recent Middle East military activity has triggered a sharp but familiar bout of volatility, led by higher energy prices and stagflation concerns, consistent with a classic terms-of-trade shock rather than a global downturn.
- Strong political, economic and strategic incentives on both the US and Iran, reinforced by the 7 April ceasefire and slowly improving energy flows, support our central assumption that the conflict will prove short lived.
- Structural economic differences when compared to prior oil shocks, including lower energy intensity, anchored inflation expectations, modest wage growth and already restrictive policy rates, materially limit the risk of persistent stagflation.
- Regional outcomes are diverging, with energy-import-dependent Europe and Asia facing greater headwinds, whilst the US remains more resilient due to domestic energy production, consumer strength and earnings momentum.
- Recent equity market weakness has been valuation-driven rather than earnings-led, improving the long-term opportunity set as prices adjust lower whilst global earnings expectations remain broadly intact.
- As uncertainty fades, diversification benefits are expected to re-emerge, allowing portfolios to gain from more balanced market leadership and a refocus on fundamentals rather than narrow, geopolitically driven market reactions.
- Against this backdrop, staying the course through volatility and rebalancing selectively towards quality and disciplined value exposures remains the most effective way to compound long-term returns.

INTRODUCTION

Military activity in the Middle East over the past seven weeks has driven a sharp but familiar bout of market volatility, centred on higher energy prices and renewed stagflation concerns. Disruption to commodity transit through the Strait of Hormuz has become a key focus, affecting around 20% of global oil consumption and 25–30% of Liquefied Natural Gas (LNG) trade ([chart 1](#)¹).

Recent market moves have been dominated by energy markets, with oil and gas prices rising sharply ([chart 2](#)²) and the impact spreading into wider commodity inputs such as fertilisers, reflecting concentrated Gulf production. This has fed quickly into other asset classes: bond yields have risen across the US, UK and Europe as markets delay expectations for rate cuts amid higher inflation risk. Equity markets have also corrected, though unevenly. Energy-import-dependent regions, notably Europe and Asia, have underperformed, with Asia particularly exposed due to its reliance on supplies transiting the Strait of Hormuz. By contrast, US equities have proved more resilient, supported by domestic energy production, a services-led economy and stronger earnings momentum, whilst the dollar has strengthened as a safe haven. Together, these moves point to a classic energy-driven terms-of-trade shock, rather than a broad-based global downturn.

Chart 1: The Strait of Hormuz is a critical chokepoint

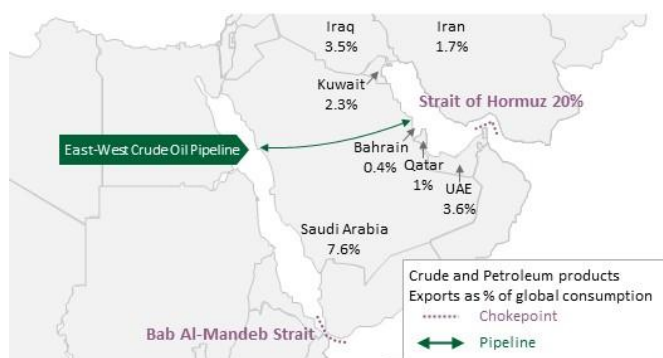
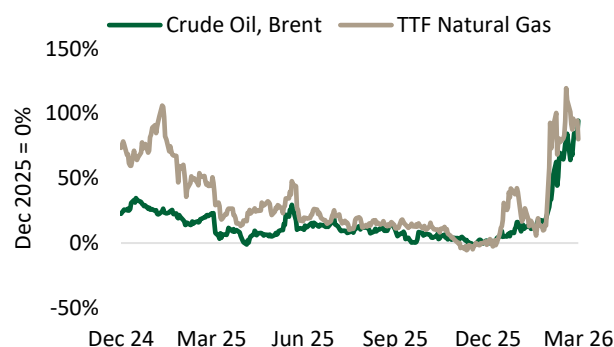


Chart 2: Supply shock has caused surging energy prices



The central assumption underpinning our investment strategy throughout has been that meaningful constraints and incentives would ultimately assert themselves on both the US and Iran, limiting the duration and economic fallout of the conflict. These incentives, political, economic and strategic, have now begun to crystallise, reinforced by the ceasefire announcement on 7 April and early signs of improved energy flows. Whilst talks are yet to provide meaningful steps towards a resolution, it is likely that negotiations will continue, despite threats of escalation from both sides.

Importantly, earnings expectations have remained resilient throughout the conflict, with valuations adjusting lower, improving the long-term opportunity set. As the conflict and related disruption eases, markets are likely to refocus on fundamentals, allowing equity returns to realign with underlying earnings momentum.

Against this backdrop, our core message remains unchanged: maintain discipline, stay the course through volatility, and rely on diversified, valuation-aware portfolio construction to compound long-term returns.

¹ Source: BCA Global Research, March 2026

² Source: Bloomberg, March 2026

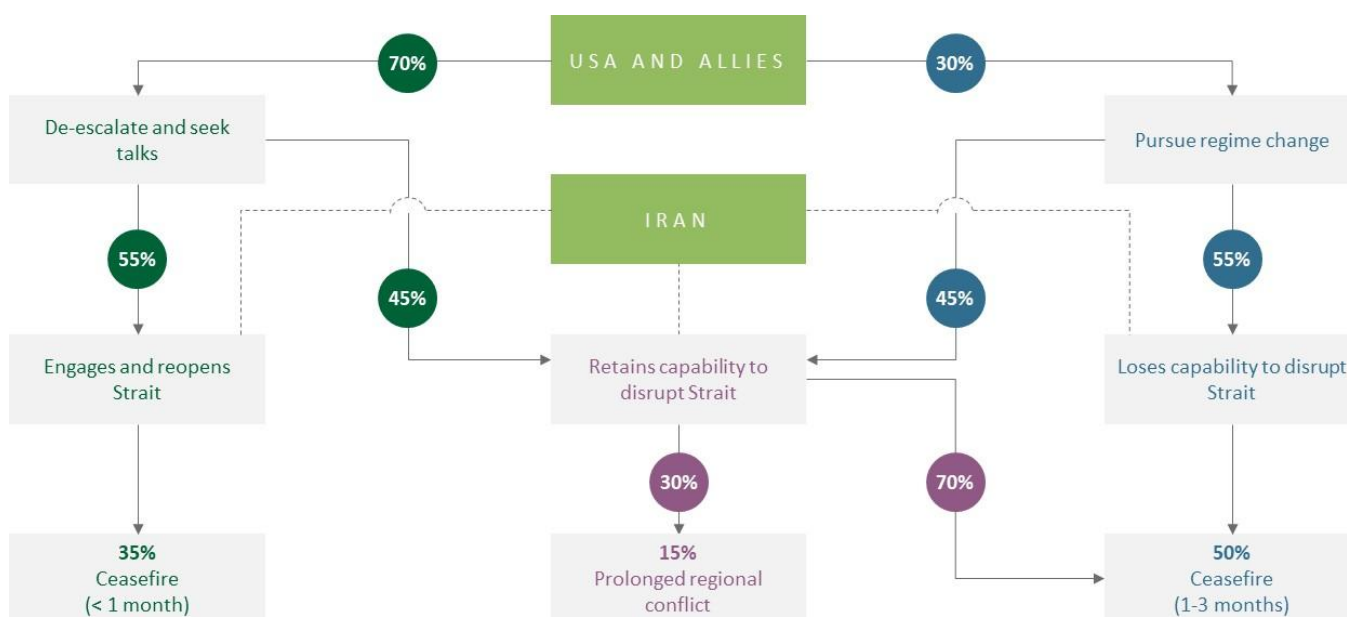
MIDDLE EAST CONFLICT: ECONOMIC IMPACT AND HISTORICAL CONTEXT

Ceasefire: Incentives to de-escalate are strong

The US-Iran conflict has driven heightened market volatility by creating two principal risks for investors. The first is the potential of a stagflationary shock akin to the 1970s oil embargo or the 2022 Russian invasion of Ukraine, driven by the closure of the Strait of Hormuz and the associated surge in energy prices. Even if the conflict does prove short-lived, persistent supply-chain disruption and elevated commodity prices could result in a meaningful repricing of global capital markets. The second concern is the risk of wider military escalation, leading to a more prolonged conflict should negotiations fail and the US and its allies pivot towards broader regime change in Iran, alongside the targeting of industrial and civilian infrastructure.

Our approach remains anchored in long-term investment principles, grounded in rational and probabilistic scenario analysis to guide portfolio strategy and capital allocation over time. Throughout this conflict, we have adhered closely to this discipline, working with a central assumption that a near-term ceasefire (around an 85% probability) would limit both the duration and severity of the economic impact (see [diagram 1³](#)). As we noted in our client update on 9 March, “We have high confidence in our central assumption that the conflict proves relatively short lived, allowing economic and market conditions to stabilise in the weeks ahead, but we also recognise it is an evolving situation.”

Diagram 1: Uncertainty remains high, yet ceasefire announcement supports near-term resolution



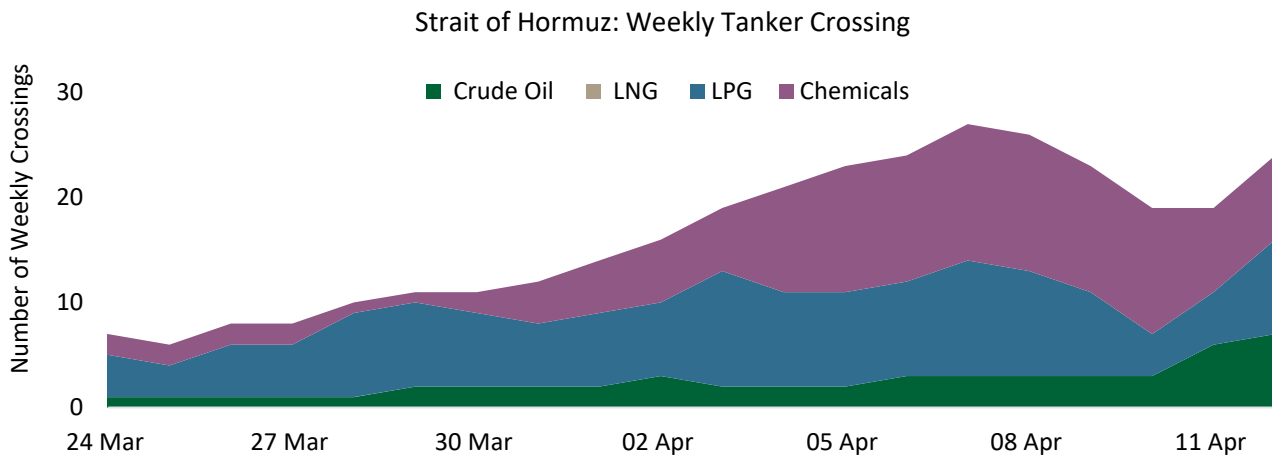
Rhetorical and military evidence in the past three weeks has supported this view. For the US, economic and political considerations are increasingly acute. Higher oil prices feed directly into inflation expectations, consumer sentiment and financial conditions, all of which carry political consequences ahead of Congressional midterms later this year. As public statements from US leadership have increasingly emphasised the achievement of key military objectives, culminating in the announcement of a two-week ceasefire on the 7 April, tanker passage through the Strait of Hormuz is also gradually improving ([chart 3⁴](#)).

³ Source: SFIM Assumptions, April 2026. Probabilities are estimated and subjective

⁴ Source: Bloomberg, 13 April 2026



Chart 3: Tanker traffic in the Strait of Hormuz is gradually improving



For Iran, regime survival remains the overriding priority. While there is undoubtedly a willingness and ability to disrupt energy flows in order to apply economic pressure, a prolonged closure of the Strait of Hormuz is likely to provoke a broader international response and risk undermining Iran’s strategic position. Retaining the option to threaten future disruption provides greater leverage than exhausting it through permanent closure.

Bottom line: Near-term uncertainty remains elevated, but political and economic incentives strongly favour de-escalation rather than a prolonged and economically destructive conflict. The ceasefire announcement and subsequent resolution talks signal that we have likely moved past the point of ‘peak uncertainty’, supporting the longer-term trajectory of the market cycle.

Economic consequences: 2026 energy shock differs from prior episodes

Rising energy prices inevitably invite comparisons with previous oil shocks (chart 4⁵), most notably the 1970s oil embargo that ushered in a prolonged period of stagflation, and more recently the Russian invasion of Ukraine in 2022, which triggered a sharp inflation surge and aggressive monetary tightening. While the current episode exhibits short-term stagflationary characteristics, the structure of today’s global economy is fundamentally different, materially reducing the risk of a repeat of those outcomes.

Chart 4: Inflation-adjusted oil prices remain below historic shock episodes

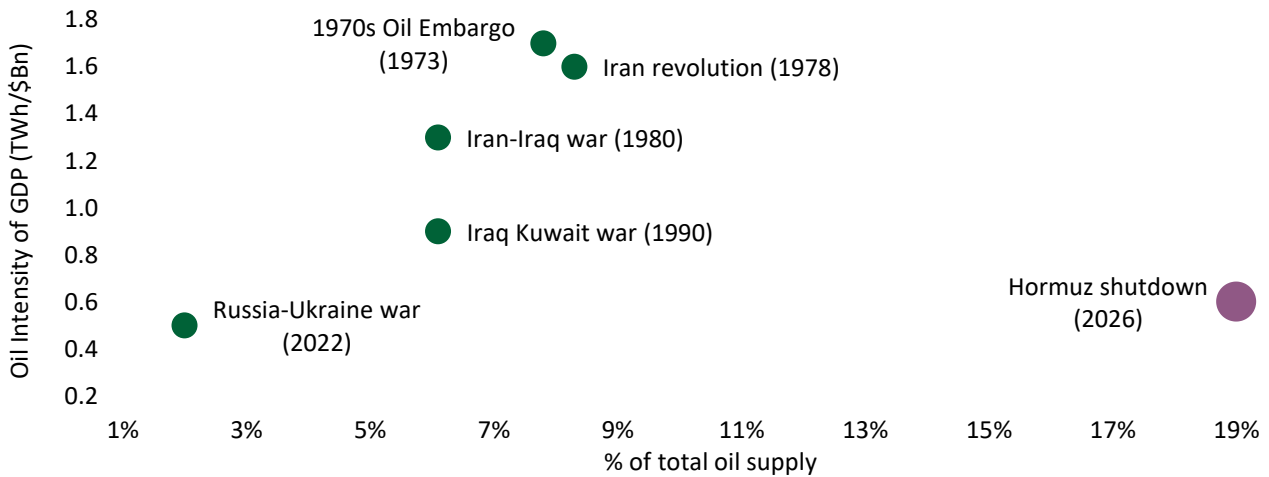


⁵ Source: Factset, March 2026.



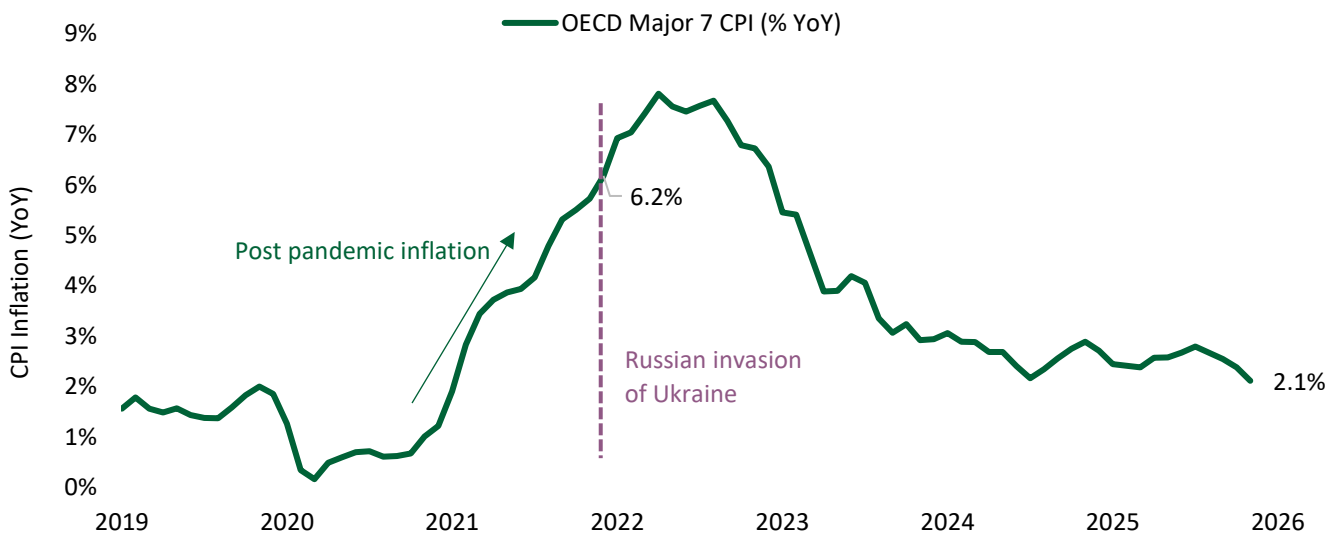
Energy shocks have occurred repeatedly over recent decades, yet developed economies have become far less sensitive to them. US oil intensity, the amount of oil required per unit of economic output, has declined substantially, reflecting the growing dominance of services within US GDP and reducing the direct exposure of employment and consumption to energy price moves (chart 5⁶). Energy supply has also become more flexible, supported by US shale production and the expansion of global LNG markets, allowing part of the adjustment to occur through supply rather than demand alone.

Chart 5: Declining US oil intensity has reduced the economic impact of energy disruption



While recent market behaviour has echoed aspects of 2022, with higher energy prices prompting a rise in short-dated bond yields on concerns over policy tightening, it is important to recognise that the broader inflation impulse is materially weaker today. In early 2022, inflation was already high and accelerating (chart 6⁷), supply chains were impaired following the pandemic, labour markets were overheated and policy rates sat near zero. By contrast, inflation today is much lower, supply pressures outside energy have largely eased, and policy rates are already restrictive. Wage growth remains modest, limiting the risk of second-round inflation dynamics becoming entrenched.

Chart 6: Global inflation pressures are materially lower than in 2022



⁶ Source: TS Lombard, March 2026

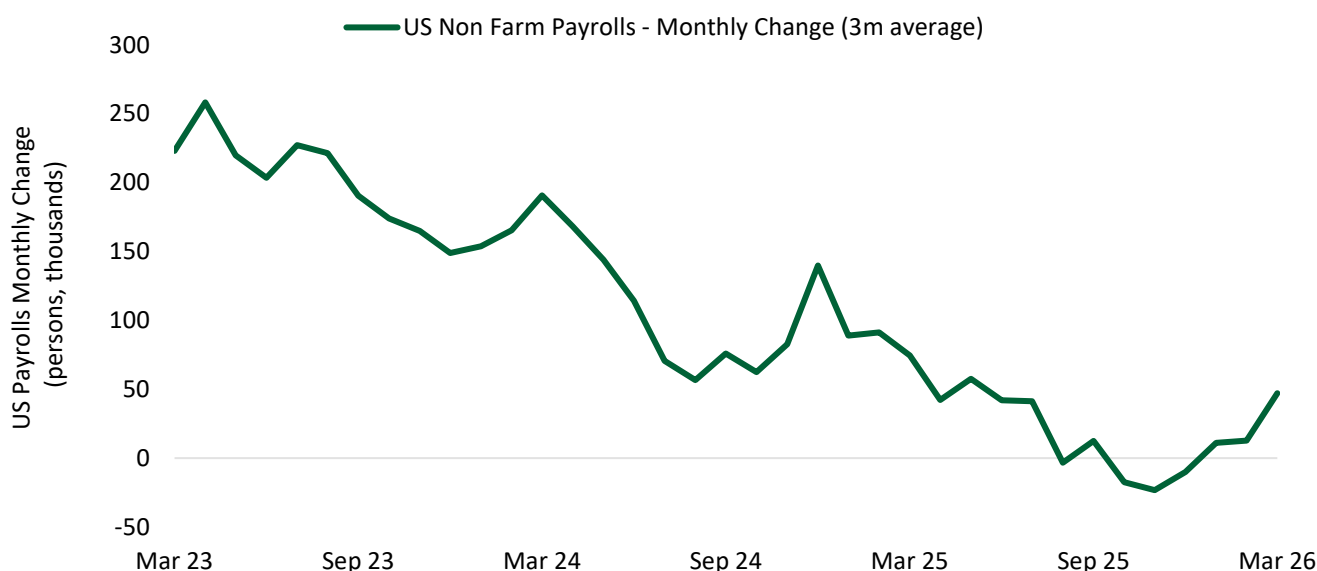
⁷ Source: Bloomberg, March 2026



Perhaps most importantly, inflation expectations remain well anchored. Central banks have built significant credibility over decades of inflation targeting, and current policy settings already restrain demand. This provides an important buffer against energy-driven price shocks feeding through into wages and broader pricing behaviour. In this context, policymakers are better placed to look through a temporary rise in headline inflation, particularly if tighter financial conditions and elevated uncertainty begin to weigh on growth and employment. Historically, central banks have tolerated higher headline inflation during energy shocks when underlying inflation dynamics remain contained.

Consumption will face a near-term headwind from higher energy and food prices, but is likely to prove resilient. This is especially the case in the US, where household balance sheets have been supported by prior fiscal measures, including federal tax refunds under the One Big Beautiful Bill Act and tariff reductions following recent Supreme Court rulings. Recent data continue to point to underlying strength, with improving job creation following tariff-related uncertainty in 2025 and solid growth in core retail sales (chart 7⁸). By contrast, Europe and parts of Asia face a more pronounced shock, given their reliance on imported energy, reinforcing regional divergence in economic and market outcomes.

Chart 7: Recovering US employment growth supports ongoing consumer resilience



Bottom line: This energy shock represents a manageable and temporary headwind rather than a turning point for the economic cycle. Assuming a continued path towards military de-escalation and improving energy transit, lower oil intensity, subdued wage pressures and anchored inflation expectations materially limit the risk of persistent damage. In this environment, consumer-led economies, most notably the US, are well placed to demonstrate renewed leadership, supported by resilient household balance sheets and policy flexibility. This gives central banks scope to look through near-term inflation pressures, avoiding the growth-damaging tightening that undermined confidence in 2022.

Portfolio strategy: staying the course amid market volatility

Periods of military conflict are often accompanied by sharp market swings, heightened uncertainty and calls for caution. However, history consistently shows that volatility driven by geopolitical events rarely alters the longer-term trajectory of equity markets (chart 8⁹). While headlines dominate short-term sentiment, equity returns over time remain anchored to earnings growth and valuation, rather than political or military developments.

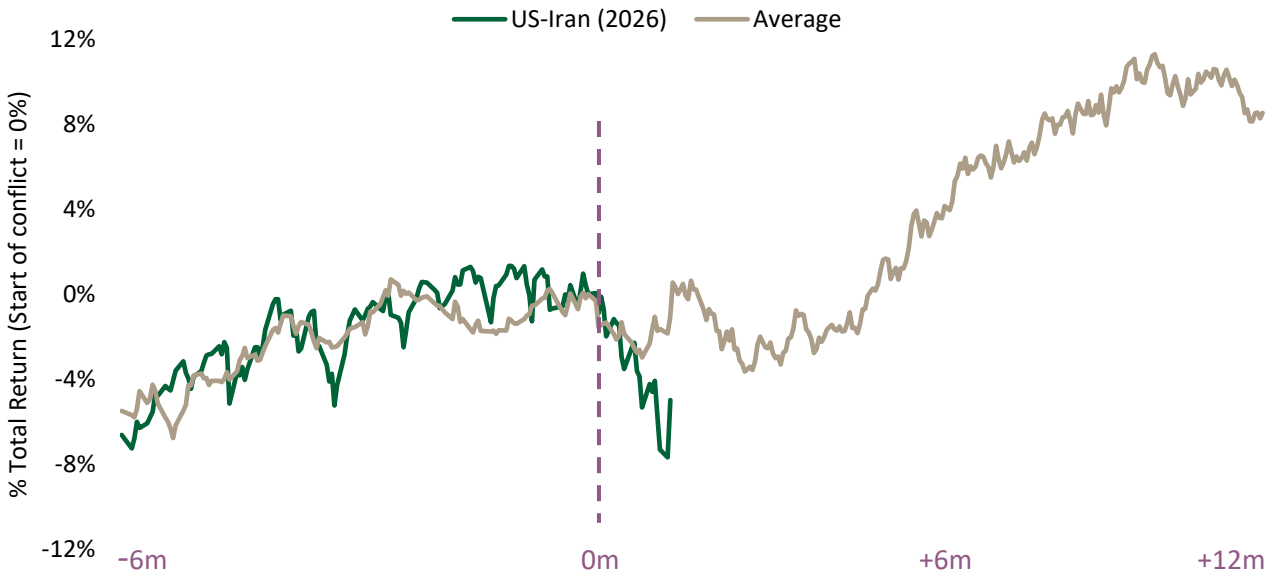
⁸ Source: Bloomberg, March 2026

⁹ Source: Bloomberg, March 2026



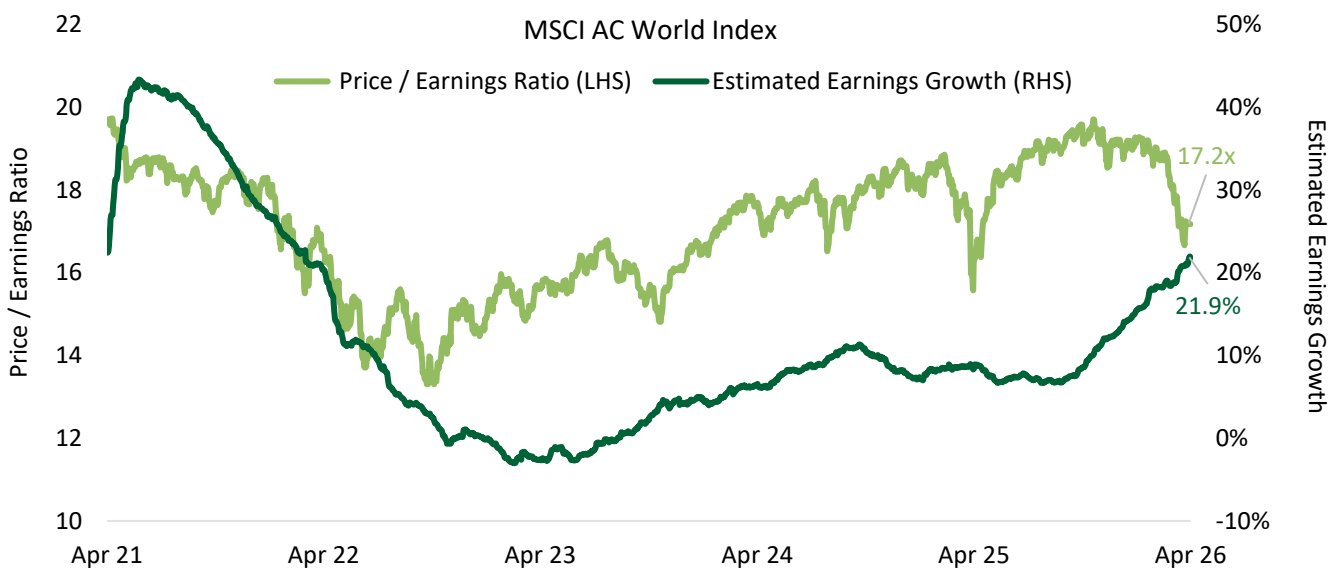
This underpins our long-standing commitment to staying the course. Attempts to aggressively de-risk and subsequently re-risk portfolios around bouts of conflict-driven volatility have a poor track record, frequently locking in losses and missing the recovery that follows once uncertainty peaks. By contrast, periods of volatility often improve the opportunity set for long-term investors, creating more attractive entry points and enabling disciplined rebalancing rather than reactive decision-making.

Chart 8: Equities often prove resilient following military conflicts



Importantly, the recent correction has been largely valuation-driven rather than earnings-driven (chart 9¹⁰). Global earnings expectations remain robust, with consensus forecasts pointing to around 22% annual growth in earnings per share for the MSCI AC World Index over the next 12 months. As prices have adjusted lower while earnings expectations have continued to rise, global equity valuations have reset meaningfully. The MSCI AC World Index now trades on approximately 17.2x forward earnings, a notably more attractive level than earlier in the year.

Chart 9: Earnings resilience combines with lower valuations, supporting the outlook for long term returns



¹⁰ Source: Bloomberg, MSCI AC World Index, April 2026



In this environment, our focus is not on reducing equity exposure, but on refining it. Portfolios are focused on high-quality and growth franchises with strong balance sheets, durable competitive advantages and visibility of earnings growth, alongside selective exposure to value where valuations provide an appropriate margin of safety. This approach allows portfolios to remain aligned with long-term growth drivers while benefiting from improved valuation discipline.

Bottom line: Conflict-driven volatility reinforces, rather than undermines, the case for staying the course. With equity valuations lower and earnings expectations resilient, particularly in US-led growth themes such as AI adoption and quality growth, selective rebalancing offers an opportunity to strengthen long-term return potential without compromising discipline.

Quality and value: complementary strengths in a higher-rate world

Quality remains a central pillar of our equity strategy. As set out in our Annual Investment Outlook, we broadened our exposure last year across a range of high-conviction global active managers, deliberately reinforcing resilience within equity portfolios at a time when market leadership had become increasingly concentrated. Quality companies are characterised by robust balance sheets, strong and durable cash generation, high returns on capital and prudent capital allocation. These attributes matter, particularly in an environment of greater macro uncertainty and structurally higher interest rates, when earnings durability is increasingly in demand by investors.

That logic has been reinforced over the past quarter. Recent weakness across areas such as software and professional services reflected broad, indiscriminate selling driven by disruption concerns rather than a deterioration in fundamentals. Feedback from our active managers suggests limited evidence of structural damage. As one of our global quality managers observed, *“we have, to date, seen limited evidence that the fundamentals have deteriorated for the affected companies. Indeed, in several cases, the technology is accelerating innovation and providing an opportunity for the company to further strengthen its competitive advantage¹¹”*.

In many cases, quality companies are adapting well to the integration of AI, using it to enhance productivity, accelerate innovation and deepen competitive advantage. In a world of moderate growth, it is precisely these characteristics, pricing power, operational efficiency and balance sheet strength, that support consistent earnings delivery and downside resilience.

Quality exposure is intentionally complemented by a disciplined allocation to value. Value investing, as we define it, is not a blunt bet on cyclicalities, but a focus on businesses trading at attractive valuations relative to underlying cash flows, asset bases and normalised earnings. In an environment where interest rates remain higher than in the decade following the 2008 Global Financial Crisis, valuation discipline matters more. Higher discount rates penalise distant and uncertain cash flows, whilst favouring companies with tangible assets, strong free-cash-flow generation and clear return on capital frameworks.

In this context, we have introduced a new global value-oriented active manager, selected for its emphasis on balance sheet resilience, conservative assumptions and disciplined capital allocation. We expect this strategy to perform well in periods of geopolitical uncertainty and uneven inflation pressures, providing diversification relative to growth-oriented styles while retaining upside participation as valuations normalise.

Together, quality and value offer complementary sources of return. Quality provides resilience and consistent compounding through the cycle, whilst value introduces valuation discipline and potential re-rating opportunities in an environment where asset prices have adjusted and dispersion has increased.

Bottom line: In an environment of moderate growth and structurally higher interest rates, the combination of quality and value is particularly powerful. Strong balance sheets, durable cash flows and disciplined valuation matter more than in prior cycles, reinforcing our conviction in a balanced quality–value core supported by selective, high-conviction active managers.

¹¹ Source: Franchise Partners Quarterly Letter, April 2026



Market disruption: the potential for further market volatility

Recent market conditions highlight several areas with the potential to generate renewed volatility or short-term disruption, even as our central assumption remains that the broader market cycle stays intact. The most immediate source of uncertainty relates to the trajectory of the US-Iran conflict. While the ceasefire has reduced near-term pressure, a renewed escalation or more persistent disruption to energy flows could reintroduce stagflationary dynamics later in the year. In particular, repeated supply-chain interruptions or a post-midterm repeat of geopolitical tensions could see higher energy and food prices constrain real incomes more forcefully, tipping parts of the global economy into a more traditional stagflationary environment.

This possibility warrants close monitoring, but it does not justify an overtly defensive portfolio stance. Structural differences compared with prior oil shocks remain important: lower energy intensity, more flexible supply, and better anchored inflation expectations materially limit the likelihood of lasting economic damage. In practice, this points toward careful calibration of duration and equity exposure rather than broad de-risking, ensuring portfolios remain positioned to absorb short-term volatility without forfeiting participation in longer-term earnings momentum.

The evolution of the AI investment theme represents another important driver of market behaviour. AI remains a central pillar of the growth outlook, but investor sentiment has clearly shifted. Markets have become far less tolerant of aggressive capital expenditure that undermines free-cash-flow generation, particularly where investment is debt-financed. This more discerning approach is constructive. It suggests that the excesses and euphoria typically associated with speculative bubbles are not present. At the same time, elevated growth assumptions embedded in parts of the AI ecosystem may be challenged if competition intensifies, pricing power erodes, or monetisation of large-scale infrastructure investment proves slower than anticipated. This environment favours selectivity and active management rather than abandonment of the theme itself.

Private credit is another area attracting attention. Here, the concern is twofold. First, sentiment has been affected by the liquidity profile of certain retail-oriented vehicles offering periodic redemption despite holding inherently illiquid assets. These liquidity gates, however, are a core design feature of the asset class, intended to protect investors by avoiding forced selling. It is also important to recognise that the majority of the approximately \$1.8 trillion private credit market is underpinned by long-term institutional capital, rather than short-term retail flows. Second, the maturity of pandemic-era loans written at high leverage and low rates has prompted renewed focus on credit quality. While isolated cases of distress and fraud, such as First Brands and Tricolor, have drawn attention, default rates remain low and there is limited evidence of broad-based stress. The asset class is undergoing a meaningful test, which we continue to observe closely, but current conditions do not resemble a systemic episode.

Taken together, these developments highlight the potential for periodic volatility rather than a fundamental deterioration in the outlook, reinforcing the importance of maintaining diversification and retaining flexibility within portfolios.

Bottom line: Periods of market volatility may be driven by renewed geopolitical tensions, shifts in the AI investment narrative or stress points within private credit, but these developments are best addressed through ongoing scenario analysis, diversification and selective rebalancing. Monitoring these drivers and reviewing portfolio positioning through a disciplined rebalancing framework remains a core and integral part of our investment approach, ensuring portfolios stay resilient, flexible and aligned with long-term objectives as conditions evolve.



Summary: Core Asset Class Views

The outlook for the remainder of 2026 remains constructive but uneven, shaped by heightened geopolitical volatility, the evolving path of Artificial Intelligence adoption, and an economic environment that has proved more resilient than many fear. The recent escalation in the Middle East has injected a short-term stagflationary shock through energy markets, tightening financial conditions and driving a sharp but differentiated market response. However, strong political and economic constraints on both the US and Iran, reinforced by the ceasefire announcement on 7 April, support our central assumption that the conflict remains short lived and does not derail the broader market cycle. Against this backdrop, improved valuations, resilient earnings growth and the prospect of diversification benefits re-emerging as uncertainty fades underpin a disciplined, long-term investment approach. Our updated asset class views are as follows:

Equities	Equity markets have responded to geopolitical uncertainty with increased volatility and a valuation reset, particularly in energy-import-dependent regions. Importantly, this has not been accompanied by a material downgrade to earnings expectations, with global earnings growth for 2026 remaining robust. The recent de-rating has therefore improved the long-term opportunity set rather than undermined it. As we move beyond peak uncertainty, equities should increasingly realign with underlying earnings momentum. The AI cycle continues to evolve constructively, with leadership broadening from capital-intensive infrastructure providers towards a wider range of adopters benefiting from productivity gains. This environment favours a selective, actively managed approach, anchored around high-quality companies and complemented by disciplined value exposure.
Fixed Income	Bond markets have repriced sharply in response to higher energy prices, with yields rising as investors delay expectations for rate cuts and draw comparisons with 2022. We believe these parallels are overstated. Inflation is lower, policy rates are already restrictive and wage growth remains modest, giving central banks greater flexibility to look through a temporary energy-driven inflation impulse. As geopolitical risks ease and uncertainty reduces, yield curves should stabilise and potentially steepen, improving prospective returns from high-quality fixed income, such as US Treasuries, UK Gilts and investment grade credit. In more adverse scenarios, where escalation persists and growth risks dominate, duration should re-assert its defensive properties.
Currencies	The US dollar has strengthened alongside higher oil prices and elevated geopolitical risk, reflecting its traditional role as a safe haven and the US's relative insulation from energy shocks. As uncertainty recedes and markets refocus on fundamentals, currency dynamics are likely to become more balanced. While shorter-term volatility is likely to persist, the absence of credible alternatives to the dollar's dominance in trade, settlement and liquidity continues to support a strategic preference for US assets within global portfolios.
Liquid Alternatives	Liquid alternatives remain an important source of diversification in an environment where traditional correlations can shift during periods of stress. Strategies designed to exploit dispersion, such as long/short hedge funds, are well placed as markets become more discerning around growth quality, balance sheets and AI winners versus losers. We also continue to favour diversifiers that are not closely linked to economic or geopolitical outcomes. Catastrophe bonds, in particular, offer attractive spreads above government bonds with returns driven by insured natural disaster risk rather than inflation, growth or conflict dynamics, reinforcing their role as portfolio stabilisers.

Private Capital

Private capital activity remains selective while managers are focusing on operational value creation. Exit activity has increased, though holding periods for assets are being extended. There remains strong competition for quality assets with significant amounts of uninvested capital available, highlighting the importance of partnering with the top managers who can access the best quality assets at reasonable valuations.

Overall portfolio message:

In the near term, volatility is likely to persist as markets digest ongoing events in the Middle East and potential economic consequences. However, our central assumption remains that constraints on escalation limit lasting economic damage, allowing fundamentals to reassert themselves. Improved valuations, resilient earnings growth and the gradual re-emergence of diversification benefits support a disciplined, stay-the-course approach, using periods of uncertainty to rebalance selectively rather than attempting to time risk aggressively.

Stonehage Fleming Investment Management
Chief Investment Officer Group
13 April 2026



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