MACRO CONFLICT UPDATE (PART 24)

I want to say I am surprised by the fact that I have to write part 24 of this macro conflict series, but I'm really not. Even though we drew down some cash recently to buy the dip on some of the commodity/material related equities in the protfolio that have been beaten down and are showing really solid value in my view (more details in last week's report on Thursday and the newsletter on Friday), the remaining 2/3rds of the cash position were kept in place exactly because ‘all was not well’ just yet on the macro front and this weekend once again showed that to be the case sadly. Also before anyone asks, I did indicate that I would be away from the desk this week, but I can't help myself and used this weekend and this morning for this update as I promised to keep you all as well informed as I can throughout this uncertainty. Now, let's have a look at what has happened and how asset classes across the board have reacted to it.

A few of the things were described in those aforementioned reports from last week as well, but for continuity sake, for the first time since April the strikes reached Iranian bridges, including a railway bridge in Golestan province and 2 bridges on the route into Mashhad itself. The diplomatic channel stayed alive underneath it all thankfully, with Araghchi working the phones with his Saudi, Turkish and Omani counterparts and with Pakistan's army chief and oil actually drifted lower into the weekend. All is well right? No, because then Saturday happened. Iran hit another commercial ship transiting the strait on Saturday, and Trump ordered fresh airstrikes in response. As a calander usually works, Sunday followed and by the time night rolled around the US was flying a wave of strikes that ran for hours against dozens of Iranian military targets, going after air defenses, coastal radar, missile and drone infrastructure, and IRGC small boats around the Strait of Hormuz, explicitly to degrade Tehran's ability to threaten commercial shipping. Iranian forces fired on commercial vessels in the middle of that operation, with American aircraft shooting down a cruise missile and an attack drone aimed at them. Tehran then declared the Strait of Hormuz closed, a claim Trump disputed within hours with his insistence that the waterway remains open to commercial traffic, and it lashed out at the American footprint across the entire Gulf, with attacks reported in Bahrain, Kuwait, Jordan, Qatar, the UAE and Oman (I think I got all of them here), and 3 people injured by falling shrapnel in Qatar.

Then this morning brought the second night of this exchange rather than any cooling off, even with market opening hours creeping closer and closer and the usual unspoken deal being that we don't fire at each other when the market is trading guys, come on now. The IRGC says it struck the Sheikh Isa air base in Bahrain, hitting helicopter maintenance facilities, a hangar housing a P-8 Poseidon (I don't know if firing drones at a Greek god will help this conflict in any way, but maybe he can help open the Strait, who knows) and a drone command center, Jordan intercepted 4 missiles crossing its airspace in the early morning, and the Guard promised that retaliation would continue and regional mediators are scrambling to save the memorandum of understanding. Now, I am not a lawyer in any way, but I am pretty sure that article 5 of the aforementioned MOU was supposed to reopen the trade route through the strait, but Iran has spent the past weeks diverting traffic away from the Omani-controlled waters and into the lane it controls, and the IRGC has been trying to charge a fee for passage, which Washington flatly rejects. Layer on top of that the fact that the framework was only ever designed to bridge into August and that the Treasury already revoked the waiver allowing Iranian oil sales, with transactions banned from later this week, and the picture that emerges is two sides building leverage ahead of the real negotiation rather than two sides stumbling into total war. Could that change? Sure, but I really hope that this is the case and that things calm down again into another round of negotations, otherwise this will get worse before it gets better this month.

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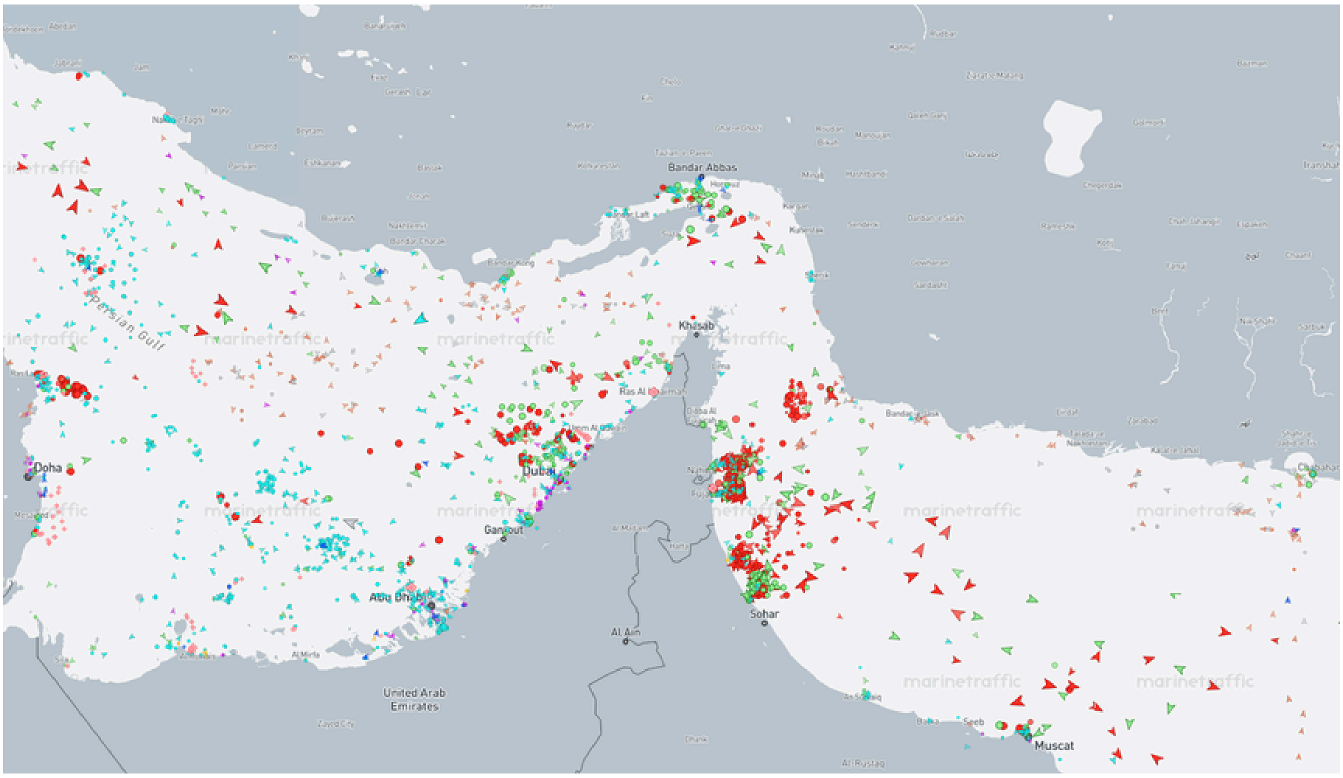
So, why is the market not reacting on what appears to be renewed escalation? Brent just under $79 with the strait nominally closed looks absurd on its face, but the way I see it, the market is pricing a rhythm of missile skirmishes punctuated by windows of calm that let tankers through rather than an actual sustained closure, at least that is my read on this situation. This morning's move was a 4% pop that merely snapped a 2-day losing streak. Traffic through Hormuz has slowed as the security picture deteriorated, but it has not stopped, and Iran's own lifeline runs through that same water, with roughly 90% of its oil exports passing through Kharg Island, so Tehran closing the strait for real would amount to sanctioning itself, as the US would likely resume their blockade as well.

As you all remember, Brent printed above $126 during the opening phase of this war and then gave the entire premium back, ripping off the faces of various leveraged entities/investors and traders, who carry that muscle memory, wanting proof of barrels actually going missing before they pay up a second time. The physical picture does not help the bulls either, with the UAE pumping at record levels last month and the IEA framing the risk as delayed inventory rebuilding rather than shortage, while the China factor is also still playing a part (more details on that in last week's report, which I recommend you read through carefully to get a better idea of their important role in this whole situation). The waiver revocation pulls Iranian barrels off the legal market and puts a floor under this thing, but a floor is not a breakout, at least not yet. Even when away from the desk, I will be watching these developments closely, as this week is likely to give us more clarity as to what the near term direction will be for not only this conflict, but the market (risk assets in particular) as a whole.



There is much more that can be said about this conflict or the market reaction, but much of that was covered last week as well and going all broken record once again won't make much of a difference, so let's leave it at this for now. If we see the market go risk-off, I have a clear shopping list ready to buy more quality companies, but for now I am happy to sit on my hands after buying more last week. Thank you for tuning into this update and I hope you have a good and healthy rest of your day and until soon, cheers! ~Mart

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