US-Iran conflict update: Conflict roadmap & market implications

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Andrija Vesic, Senior Research Analyst CEEMEA
Eric Morin, Global Head of Research

Key takeaways

- Periods of heightened volatility reinforce the importance of disciplined portfolio construction and a focus on long-term investment objectives.
- We continue to expect the middle east conflict to de-escalate over the next few weeks. Ultimately, the geopolitical risk premium is likely approaching its peak but the timing and trajectory of its decline remain highly uncertain. In the near-term, the balance of risks remains skewed to the downside (i.e. higher geopolitical risk premium) as the conflict could escalate. Although temporary spikes in oil and other commodity prices are certainly possible (even likely) we recommend that investors remain disciplined, focusing on their long-term investment objectives. Our outlook for returns over the next 12 months and in the longer term remains relatively constructive.
- Key indicators to monitor include further de-escalatory statements from the US regarding its military objectives & operation, any moderation in Iran's demands related to transit through the Strait of Hormuz, and whether Iranian proxies continue to refrain from direct involvement. These factors will play a critical role in shaping the path of the geopolitical risk premium's descent.

Updated conflict roadmap

In our updated assessment, we now see two paths in the next few months as potential outcomes from this conflict:

1. **Contained de-escalation**: We believe the US has a willingness to de-escalate its military operation and Iran is incentivized to negotiate a resolution that maintains transit through the Strait of Hormuz. A cumulative loss of 5 million barrels of crude oil over the next three months would likely keep oil prices in a $75–$95 per barrel range under our baseline. In our prior assessment, we expected the conflict to remain contained but for oil prices to return to lower levels.
2. **Prolonged Strait of Hormuz closure**: This risk scenario involves a sustained disruption in the Strait of Hormuz, resulting in at least a 75% reduction in shipping transits from the pre-conflict average of 38 tankers. In this scenario, oil prices could increase to the $140–$175 per barrel range. The trajectory of other important commodity prices would be similarly affected. Further, the probability of an escalation by the US, and other allies, would jump given the global economic pain caused by higher oil prices. This scenario has remained intact from our prior assessment.

Our scenario of a contained de-escalation is the likeliest outcome from this conflict due to the following reasons:

1. **US pain threshold crossed:** Last week's increase in oil prices to $120 per barrel prompted President Trump to soften his hardline stance and initiate efforts to de-escalate the conflict. Particularly, the softening of tone from the administration on military objectives and possible duration of war as well as restraining to engage in punitive military measures on Iranian civilian infrastructure suggests that President Trump has started to look for an off-ramp to de-escalate the war. The US has limited incentive to pursue a prolonged regional confrontation, given fiscal constraints and the approaching midterm elections. President Trump is already contending with an unpopular war that has driven gasoline prices & mortgage rates sharply higher while driving his popularity lower. This dynamic will continue to pressure the US to seek de-escalation.
2. **Weakened Iranian regime:** After 19 days of air strikes, Iran's military capabilities and political authority have been severely diminished. First, the frequency of retaliatory actions against Gulf neighbors has dropped markedly since March 9, suggesting a significant reduction in Iran's capacity for military disruption. Second, the selection of Mojtaba Khamenei—son of former Supreme Leader Ali Khamenei—as the new Supreme Leader breaks with the Islamic Republic's tradition of avoiding dynastic succession, suggesting power struggles among regime factions. Lastly, US and Israeli forces now effectively control the country's airspace, leaving Iran largely defenseless.

   Although the regime reportedly continues to export oil, the costs of a prolonged conflict could place the new leadership in a precarious fiscal and political position. As such, it is unlikely that the regime will be able to stabilize and regain full control without reaching a negotiated agreement with the US.

3. **Lack of proxy involvement**: A weakened Iranian regime, combined with sustained US military deterrence in the region, has so far discouraged Iranian-backed proxies from direct involvement. Notably, the Houthi rebels in Yemen have remained on the sidelines. Their significance stems from their capacity to disrupt the Bab el-Mandeb Strait, another critical shipping chokepoint leading into the Red Sea. With ongoing disruptions in the Strait of Hormuz, commercial vessels—including oil tankers—are increasingly rerouting through the Bab el-Mandeb Strait into Saudi Arabia oil export terminals in the Red Sea.
4. **Iran's constraints stemming from China**: Iran is constrained by Chinese vested interests in the region's oil assets. First, Gulf countries are larger exporting partners to China and have proven to be more reliable than Iran. Second, Chinese energy companies have vested ownership in Iraq's oil production, which is being negatively affected by Iranian retaliation against oil infrastructure. Lastly, a prolonged oil shock and supply disruption would also hurt China's growth outlook, which remains mired by structural imbalances.

Market implications

Contained growth impact: Our baseline outlook for oil over the next 12 months ($75–95 range, versus $60–65 previously) is compatible with a contained downward revision to our global growth outlook of -0.25% over the next 12 months, mechanically lowering our global GDP outlook to 3%. The negative growth impact is smaller for Canada and the US, where we see limited marginal spillovers to energy production and investment in the next 12 months. The situation does not warrant any increase in recessionary expectations; we continue to assign a probability of 30% to a global recession in the next 12 months.

Inflation and monetary policy: The oil shock is expected to temporarily increase headline inflation by approximately 0.3–0.4% in most countries over the next four quarters, on average. However, the impact on core inflation should be much smaller. This is not a repeat of 2022. Unlike the aftermath of Russia's invasion of Ukraine in 2022, the current supply shock in energy prices is not accompanied by the massive demand and inflationary shocks witnessed then, such as large fiscal and monetary stimuli amid a global reopening post-pandemic. As a result, we do not anticipate central banks in developed economies to react to this shock—and if they do, the response is likely to be delayed and relatively contained, given the net negative economic effects of higher energy prices.

Global wealth transfer to energy producers: The approximately US$20 increase in our oil outlook results in significant current account positive shocks for energy-producing countries. For example, our upward revision to the oil outlook is expected to increase Canada's current account balance by 0.6% of GDP.

Outlook for risk assets: Despite these headwinds, CIBC Asset Management's outlook remains broadly constructive. The balance of risks remains skewed to the downside, as the conflict could escalate in the near term; however, we continue to expect de-escalation over the next few weeks. Ultimately, the geopolitical risk premium is likely approaching its peak, but the timing and trajectory of its decline remain highly uncertain. Our outlook for returns over the next 12 months and in the longer term remains relatively constructive. If anything, the equity outlook is likely improved for energy-producing regions, including Canada.

Strategic asset allocation: Diversification and discipline

CIBC Asset Management's approach emphasizes the enduring value of diversification—across geographies, asset classes, and strategies. The managed solutions portfolios, totaling over $100 billion, are diversified across more than 20 countries in both developed and emerging markets, as well as across fixed income, equities, and alternative assets.

Rather than reacting impulsively to short-term uncertainty, CIBC Asset Management advocates for disciplined, long-term portfolio construction. Recent increases in volatility were expected as early as January 2025, with the return of President Trump's executive order-driven policy environment. In response, CIBC Asset Management increased allocations to Low Volatility, high-yield equity strategies using systematic ETFs in Canada, the US, and international markets. These have delivered particularly strong performance and have reduced overall portfolio risk in this environment.

Tactical asset allocation and portfolio adjustments

On a tactical level, CIBC Asset Management's Multi-Asset & Currency Management team has actively managed risk through hedging and option-based strategies. The focus has been on protecting downside risk while retaining the ability to participate in market rebounds. Derivative hedges have allowed for efficient risk management without excessive exposure to equity beta.

At the asset class level, fixed income teams have upgraded credit quality in portfolios and have added credit protection. Equity teams have maintained a long-term focus on themes such as central bank gold buying and diversified sector exposures. Daily cross-team investment meetings ensure that rigorous analysis of macroeconomic developments and scenario analyses inform all investment decisions.

Long-term outlook and enduring investment themes

Despite current uncertainties, CIBC Asset Management maintains a positive long-term outlook. Key structural tailwinds include expansionary fiscal policy, increased military spending, ongoing investment in artificial intelligence, and productivity gains—especially in the US. While demographic headwinds and immigration challenges persist, these are expected to be outweighed by positive forces supporting corporate earnings and margins.

Recent market breadth—such as the outperformance of equal-weighted and value indices—has been interrupted by the conflict, but CIBC Asset Management expects these trends to resume once stability returns. Investors are encouraged to remain diversified, stay invested and avoid overconcentration in narrow market segments.

Hedging: the offset or reduction of the risk associated with all or a portion of an existing investment or group of investments. Cross-hedging is permitted as long as there is a high degree of correlation between changes in the market value of the investment or group of investments to be hedged and the hedging instrument.

Creating effective exposures to certain markets: replication of equity, fixed income, money market, currency or other indices or securities, in order to reduce transaction costs and achieve greater liquidity. Facilitating the investment management process: increase the speed, flexibility and efficiency in the investment management operation of the client account. Enhancing returns: benefiting from a lower cost or locking-in of arbitrage profits, except for private client accounts.