

# Bulletproofing your portfolio against the Israel-Iran conflict

## When diplomacy fails, diversification prevails

The Sunday-morning sun was barely peeking over the horizon when the news of Iran launching an unprecedented missile and drone attack, firing ~300 projectiles on Israel overwhelmed our news feeds. This assault, which has been named Operation True Promise caused little physical damage and

hopefully avoided greater ego damage. The repercussions of this attack on Israel will definitely extend beyond the immediate conflict zone and will be felt by the Indian financial markets too.

Brace for a knee-jerk reaction.

### **WHY HAS THIS HAPPENED, AND WHAT ARE THE IMPLICATIONS?**

On 1st April 2024, Israel had carried out an airstrike that demolished Iran's consulate building in Damascus, Syria, killing 8 Iranian officers and a senior member of Iran's Islamic Revolutionary Guards. Following the consulate attack, there were rising tensions, with Iran threatening retaliation and even temporarily closing the strategic Strait of Hormuz shipping route.

Iran then seized a container ship off the UAE coast, claiming it was "related to the Zionist regime (Israel) in the Gulf." This escalating tit-for-tat dynamic appears to have culminated in Iran's large-scale missile and drone assault on Israel this morning.

This has prompted an urgent response from the G7 countries and the UN Security Council, with the U.S., UK and France intervening militarily to intercept some of the Iranian missiles, signaling a major escalation in the long-running "shadow war" between Iran and Israel, opening a new, more public and large-scale chapter in their conflict.

History has shown that such regional conflicts can create both risks and opportunities for investors. For example, the cyclical flare-ups between Israel and Hamas in Gaza have previously led to market volatility, but also presented buying opportunities for those able to look past the short-term uncertainty.

## NIFTY50 RETURNS ONE YEAR AFTER THE BREAKOUT OF A MAJOR WAR

EVENT	START DATE	NIFTY50 RETURNS AFTER 1 YEAR
Pakistan's invasion of Kargil	03-May-1999	36%
US invasion of Afghanistan	07-Oct-2001	04%
US invasion of Iraq	20-Mar-2003	68%
Russia's annexation of Crimea	18-Mar-2014	33%
Russia's invasion of Ukraine	24-Feb-2022	07%
Israel-Hamas Conflict*	07-Oct-2023	14.58%

\* Returns till date

Source: Dezerv Analysis

### WHAT SHOULD INVESTORS DO IN DIFFERENT SCENARIOS?

While the situation is still unfolding and under close watch by our investment teams, we've outlined a few scenarios to deepen your understanding of how we are preparing our investment strategy. This ensures your battle-tested portfolio remains resilient and opportunistic.

#### SCENARIO 1

##### Rapid de-escalation (3-4 Days)

If the conflict de-escalates in 3-4 days without further military actions, we anticipate a mild market correction of 3-5%. In this scenario, the markets might react nervously at first but are likely to stabilise quickly. Therefore, no major changes to the portfolio would be necessary. Our strategy would be to hold steady, maintaining our current allocations while closely monitoring market responses. This approach allows us to preserve capital while remaining poised to react swiftly should the situation change unexpectedly.

#### SCENARIO 2

##### Extended conflict (15-30 days)

If the conflict extends over 15-30 days, we expect a more pronounced market correction, potentially ranging from 5-10%. Such a scenario provides a strategic opportunity to deploy additional capital thoughtfully and to adjust exposures accordingly. Given that global powers like the US, UK, and France are likely to intervene, their involvement could stabilise the situation, thereby creating valuable market opportunities. We advise investors to consider capitalising on this correction by topping up their investments, as previous instances have shown that markets tend to recover once geopolitical tensions ease.

#### SCENARIO 3

##### Prolonged global impact (War breakout)

In the event of a prolonged, significant conflict with severe effects on global growth (potentially reducing GDP by 1-2%), we will need to reconsider our portfolio strategies and enhance diversification measures. This scenario, though currently less likely, would prompt significant market corrections exceeding 10%. In such cases, aggressive investment strategies may be necessary to leverage potential recoveries as well as tactical allocation to defense and other war-allied sectors.



## HOW IS OUR PORTFOLIO POSITIONED?

Our portfolios are carefully crafted to navigate through geo-political upheavals effectively, harnessing the advantages of active management through capitalising on opportunities such as these and mitigating risk of capital erosion.

While Gold has typically performed well in terms of geo-political uncertainty and we're keeping a keen eye on the asset class, here's our views on equity and fixed-income strategies.

### EQUITY

After addressing the volatility in the small and mid-cap sectors, we strategically adjusted our focus towards an overweight position in large-cap stocks. This shift bolsters our strategy's defenses against significant market downturns. Large-cap stocks typically show lower volatility and higher resilience in times of geopolitical uncertainty, thereby safeguarding our investment approach.

### FIXED INCOME

If the conflict escalates, involving the Middle East and potentially impacting OPEC, rising oil prices could drive inflation and subsequently, interest rates. In such a scenario, our fixed-income strategies aim to meticulously safeguarded against duration risk, ensuring stability and protection from these interest rate fluctuations. This proactive management of strategies positions us to likely maintain portfolio performance even under economic pressures caused by higher oil prices.

## CAPITAL MOVEMENT

In times of market uncertainty, investors often face a dilemma: to redeem their investments due to fear or to deploy fresh capital hoping to seize emerging opportunities. We focus on maintaining stability while positioning for potential growth.

### Current Investments

We advise against redeeming current investments. Our team is continuously evaluating the situation, and we will provide updates as necessary. Our current overweight position in large-cap stocks aims to enhance the defensive posture of the portfolio.

### Fresh money (New capital)

We recommend deploying new capital in a staggered manner to mitigate risks associated with market volatility. This approach allows us to take advantage of potential dips in the market incrementally, optimising entry points.

### Market corrections

Should the market experience a correction greater than 10%, we are prepared to invest aggressively. Historical data shows that markets often recover quickly from sharp declines, presenting opportunities for additional investment. We will keep you informed of any significant market changes that may create advantageous investment opportunities.

### Preparedness for opportunities

It's crucial to keep 'dry powder'—readily available funds—for emerging opportunities. This readiness allows us to act swiftly and capitalise on market conditions favourable to our investment strategy.

## **FURTHER ASSISTANCE AND NEXT STEPS**

At Dezerv we pride ourselves on not just active management but also on active communication. We understand the complexities involved in navigating these uncertain times. We encourage you to reach out to our team of experts to discuss any concerns or opportunities you might identify.

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