Lotos Asset Management

Quarterly Investment View

Lotos
Asset Management

From the Strait of Hormuz to Capitol Hill: War, Oil and the impact on the Midterms

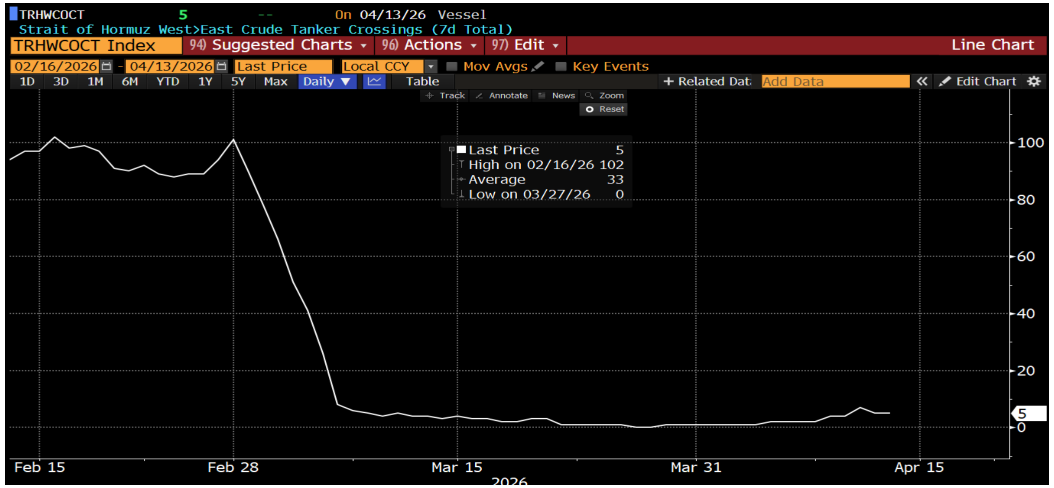
The United States entered a joint military campaign with Israel against Iran on February 28, 2026. Within days, the conflict had killed Supreme Leader Ali Khamenei, triggered Iranian retaliatory strikes across the Gulf, and drawn in most regional actors. After nearly 40 days of hostilities, Pakistan brokered a ceasefire — though the truce remains fragile.

The conflict's most immediate market consequence was a violent repricing of energy. After Iran closed the Strait of Hormuz, Brent crude surged past $120 per barrel and major producers declared force majeure on exports, sending shockwaves through global markets. At the pump, Americans were paying over $4 per gallon on average — up from roughly $3 before the conflict, a more than 30% jump that directly compressed household disposable income. The ceasefire and the announced reopening of the Strait have since pushed crude back to around $100.

The midterm environment presents a meaningful headwind for the Republican Party. Polling shows only around 25% of Americans approve of the decision to enter the conflict, with support among Republicans sitting at just 55% — a notable fracture within the coalition. Democrats are sharpening their cost-of-living messaging around pump prices, which remain among the most politically salient economic indicators for American households. Supply-side proposals from the White House are unlikely to move the needle quickly, reinforcing the administration's incentive to secure an extended and durable ceasefire rather sooner than later— one that would allow energy markets to normalize further.

Compounding the picture, the Trump administration has entered a period of notable institutional disruption. Within a single month, both Homeland Security Secretary Kristi Noem and Attorney General Pam Bondi departed — the first cabinet exits of his second term. Both had been appointed largely on the basis of political loyalty, and their relatively brief tenures point to a broader pattern: when officials lack the institutional depth required by their portfolios, the result tends to be policy inconsistency and organizational friction within the agencies they leave behind. Reshuffles of this kind are not directly market-moving, but they contribute to an erosion of policy predictability that investors are increasingly factoring into their assessment of U.S. institutional reliability.

Source: Bloomberg (WTI; Active future contract (Oil Price))



Source: Bloomberg (Strait of Hormuz Commercial Ship Vessel Crossings)

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These pressures — geopolitical shocks, domestic turbulence, and shifting global power dynamics — are converging at a moment of limited political capital for the administration, compressing its room to maneuver precisely when demands on it are greatest. The durability of the ceasefire remains the central variable for markets. A sustained truce that allows crude to continue retreating would ease inflationary pressures, stabilize the political environment, and provide a constructive backdrop for risk assets. A breakdown — particularly any renewed closure of the Strait of Hormuz — would reignite energy markets and reintroduce the tail risks that drove volatility through March and early April. Secondary variables include the trajectory of the federal deficit under wartime spending, the pace at which supply-chain inflation normalizes, and whether the intra-Republican split over the war hardens into an organized force capable of affecting turnout in competitive districts this November.

Emerging markets sit at the intersection of the pressures the conflict has generated but also offer selective opportunity. The energy shock widened current-account deficits across commodity-importing economies in South and Southeast Asia, compressed currencies, and forced central banks into defensive rate holds. Gulf exporters captured windfall revenues, though these face partial reversal as crude retreats. Capital flows followed the familiar pattern — outflows during peak hostilities, selective re-entry since the ceasefire. For investors willing to look through near-term uncertainty, the dislocation across emerging-market assets may be creating attractive entry points.

The upcoming earnings season takes on outsized importance in this context. Corporate results will provide the first hard data on how deeply the energy shock has penetrated margins and forward guidance. For emerging-market equities, earnings will help separate companies with pricing power from those forced to absorb the hit — a distinction index-level data has so far obscured. In developed markets, results from energy, defense, and consumer discretionary sectors will offer the clearest read on whether the conflict's effects are fading or becoming structural. If guidance confirms the damage was largely transitory and shows resilient margins and a stable outlook, conditions would be in place for a sustained upside re-rating in equities.

The two charts highlight the dramatic shift in US rate cut expectations following the outbreak of the Middle East conflict.

Before the war, markets were pricing in over 60 basis points of cuts by January 2027, whereas by 14 April 2026 this had collapsed to less than 10 basis points — reflecting the market's view that the resulting oil shock and inflationary pressures have effectively tied the Fed's hands.

Implied USD Rates, on the 26th of February

Region: United States »		Instrument: Overnight Index Swaps »	
Target Rate	3.75	Pricing Date	02/26/2026
Effective Rate	3.64	Cur. Imp. O/N Rate	3.640

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
03/18/2026	-0.049	-4.9%	-0.012	3.628	0.250
04/29/2026	-0.195	-14.6%	-0.049	3.591	0.250
06/17/2026	-0.572	-37.7%	-0.143	3.497	0.250
07/29/2026	-0.958	-38.6%	-0.239	3.401	0.250
09/16/2026	-1.495	-53.7%	-0.374	3.266	0.250
10/28/2026	-1.842	-34.7%	-0.460	3.180	0.250
12/09/2026	-2.258	-41.6%	-0.564	3.076	0.250
01/27/2027	-2.463	-20.5%	-0.616	3.024	0.250

Source: Bloomberg; USD implied interest rates, derived from Overnight Index Swaps

Implied USD Rates, on the 14th of April

Region: United States »		Instrument: Overnight Index Swaps »	
Target Rate	3.75	Pricing Date	04/14/2026
Effective Rate	3.64	Cur. Imp. O/N Rate	3.640

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate	A.R.M.
04/29/2026	+0.021	+2.1%	+0.005	3.645	0.250
06/17/2026	-0.015	-3.5%	-0.004	3.636	0.250
07/29/2026	-0.103	-8.9%	-0.026	3.614	0.250
09/16/2026	-0.177	-7.4%	-0.044	3.595	0.250
10/28/2026	-0.242	-6.5%	-0.061	3.579	0.250
12/09/2026	-0.408	-16.6%	-0.102	3.537	0.250
01/27/2027	-0.457	-4.9%	-0.114	3.525	0.250
03/17/2027	-0.495	-3.8%	-0.124	3.516	0.250

Source: Bloomberg; USD implied interest rates, derived from Overnight Index Swaps

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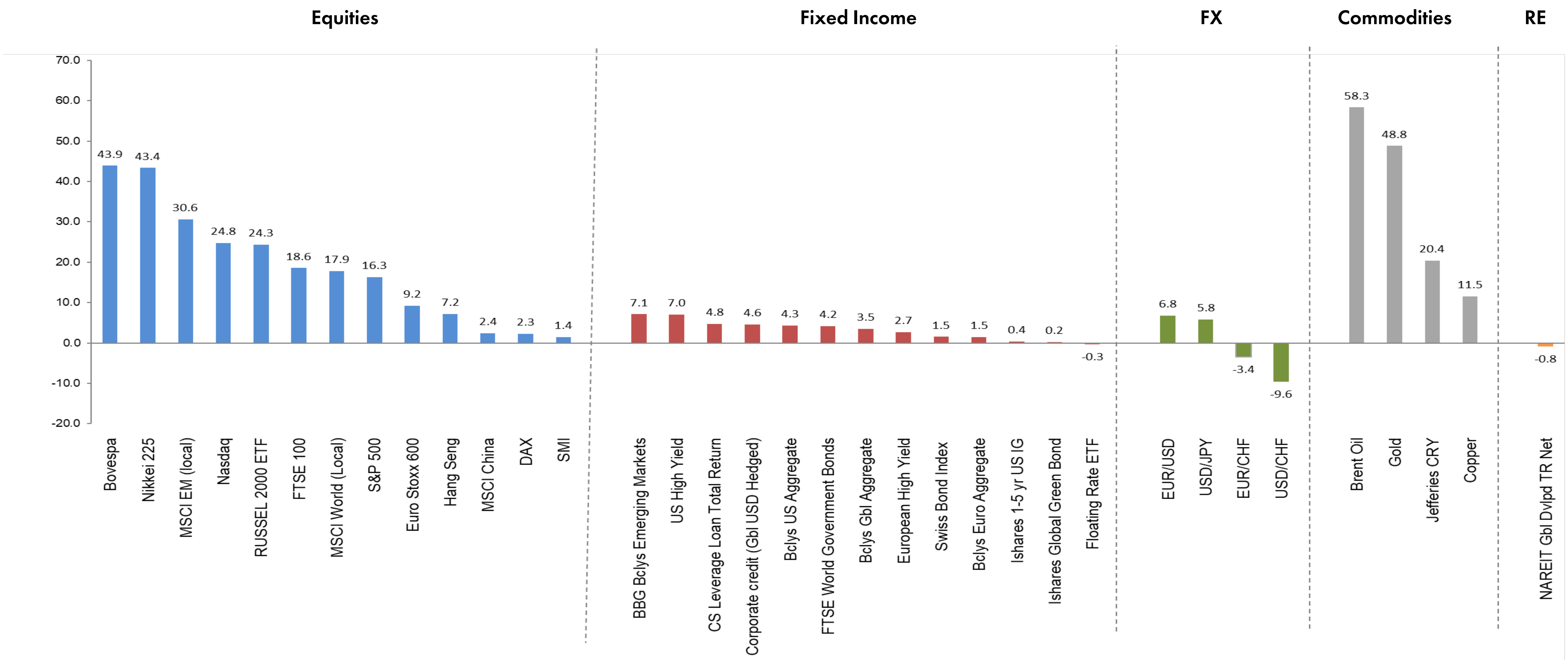
Conclusion:

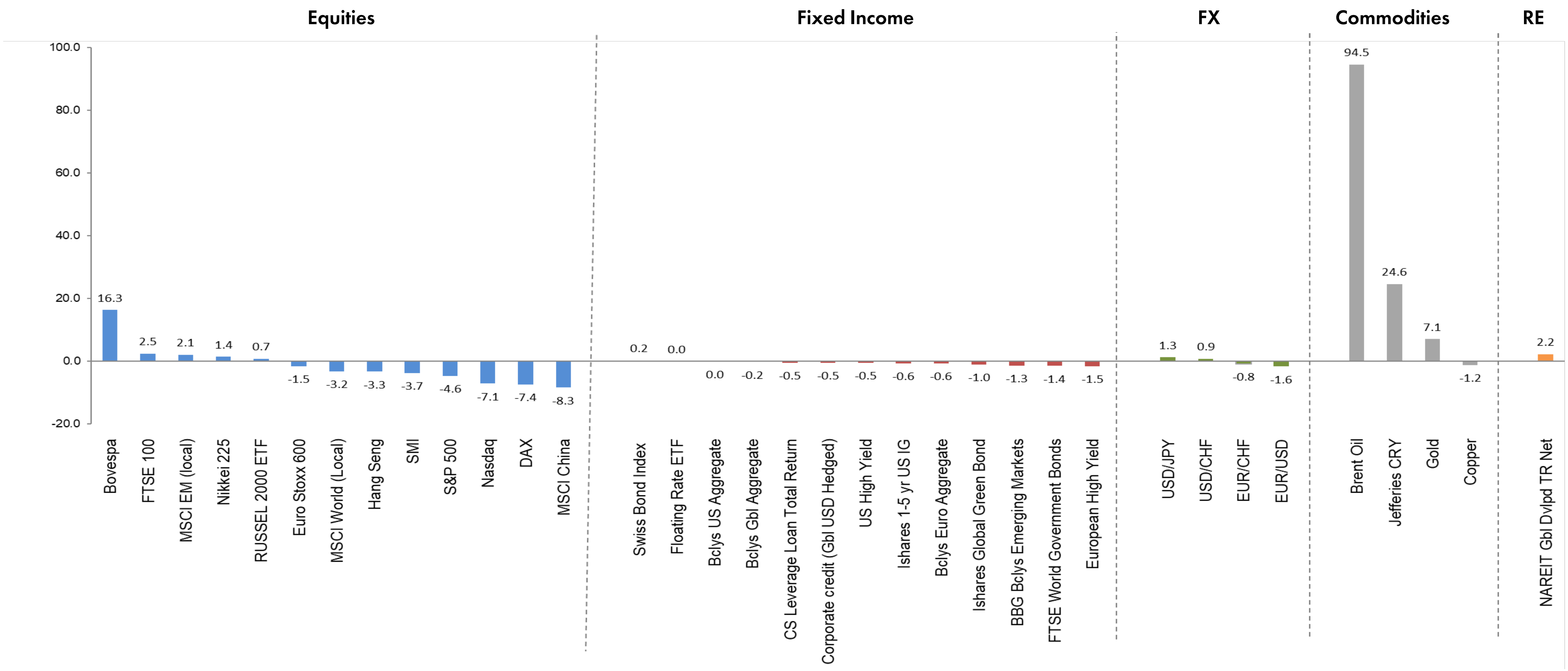
- Energy remains the dominant channel through which Middle East conflict reaches household balance sheets and electoral outcomes – the Strait of Hormuz can be a single point of failure for global price stability.
- The market itself is exerting pressure for a durable ceasefire extension. Further crude normalization would ease inflation, support consumer spending, and provide a constructive backdrop for risk assets.
- Early cabinet disruptions, driven in part by loyalty-based appointments, have now run their course. Whether the administration uses this reset to improve institutional depth and policy execution remains a key variable for markets to monitor.
- The upcoming earnings season is a potential inflection point. Should results confirm resilient margins and stable guidance, the conditions for a sustained equity re-rating to the upside would be in place.
- Cost-of-living dynamics – particularly pump prices – will impact the November midterms, with direct implications for the balance of power in Washington and the regulatory environment that follows.

Please refer to the section "How are we invested and why" for further details.

1-Year Performance of Major Asset Classes as of End-March 2026 (in Local Currencies)



Q1 2026 Performance of Major Asset Classes (in Local Currencies)



Performance major asset classes Q1 2026

- **Equities:** Equity markets broadly struggled this quarter, with most of the major indices ending in negative territory amid renewed concerns over higher oil prices, and consequently persistent inflation pressures, and elevated interest rate expectations. Brazil stood out as the notable exception, with the Bovespa posting a strong gain of +16.3%, buoyed by commodity-driven earnings and supportive domestic policy. A handful of other markets — including the FTSE 100, MSCI Emerging Markets, and the Nikkei 225 — managed modest positive returns in local currency terms. US equities faced meaningful headwinds, with the S&P 500 declining 4.6% and the Nasdaq falling 7.1%. European equities also gave back ground, with the DAX among the weakest performers, down 7.4%, reversing part of its earlier-year outperformance. In Asia, Hong Kong and Chinese equities underperformed, with MSCI China declining 8.3%, pressured by ongoing concerns around domestic demand and the competitive outlook for Chinese technology and EV manufacturers. Swiss equities slipped 3.7%, reflecting broader risk-off sentiment despite the franc's relatively stable footing.

- **Fixed Income:** Fixed income markets faced broad headwinds this quarter, as renewed geopolitical tensions and rising oil prices stoked inflation fears and pushed yields higher across the board. Nearly all benchmarks ended in negative territory, with longer-duration and rate-sensitive segments bearing the brunt of the sell-off — government bonds and European high yield falling as much as 1.5%. Shorter-duration and floating rate instruments proved more resilient, with the Swiss Bond Index the only outperformer, posting a marginal gain of +0.2%. Higher-yielding, carry-oriented instruments generally fared better than their investment-grade peers, as spread compression offered a partial offset to rising rates. Credit markets faced an additional headwind from mounting stress in the private debt sector, where rising defaults, collateral markdowns and a surge in investor redemption requests rattled sentiment, contributing to wider credit spreads particularly in sub-investment-grade segments. High-profile collapses in the auto sector and concerns over AI disruption to software borrowers amplified the risk-off tone, though the broader contagion to public credit markets remained contained.

- **Commodities:** Commodities were the standout asset class this quarter, driven overwhelmingly by the surge in energy prices. Brent crude soared +94.5% as geopolitical tensions and supply disruptions triggered a sharp repricing of the oil market, in turn pushing the broader Jefferies CRY commodity index up +24.6%. Gold advanced +7.1% over the quarter, though the move masked considerable volatility beneath the surface — safe-haven demand driven by geopolitical conflict provided a strong tailwind, while simultaneously rising yields acted as a countervailing force, as higher real rates increase the opportunity cost of holding non-yielding assets. The net result was a positive but turbulent quarter for the metal. Copper was the exception, slipping marginally as demand concerns offset the broader commodity tailwind.

- **Currencies:** Currency markets were shaped by diverging rate expectations and safe-haven flows. The US dollar strengthened broadly, gaining against both the Swiss franc and the Euro, with EUR/USD declining 1.6%. The yen weakened against the dollar, reflecting the continued policy divergence between the Federal Reserve and the Bank of Japan, and the surge in energy prices, given Japan's heavy dependence on energy imports.

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