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The May Outlook

Market Stance

OIL SHOCKS AND THE LESSONS OF THE 1970s

Lessons from the 1970s oil shocks

Commentary

- The war between the United States, Israel and Iran has delivered one of the sharpest oil price shocks in more than half a century.
- However, the structural differences between today's global economy and that of the 1970s dampen the adverse economic impact.
- The risk of a much longer drawn out conflict is real however, with further demand destruction the most likely balancing mechanism for energy prices.

Upshot

- The plausible outcome for 2026 probably sits somewhere between the crises of 1979 and 1990, depending almost entirely on how long the Strait of Hormuz remains closed and how central banks respond.

THE GLOBAL ECONOMY

Macroeconomic backdrop

Commentary

- The energy shock will reduce output in some parts of the global economy, but unlikely to result in a synchronised global downturn.
- Across the major economies, Europe and Asia are more exposed to higher energy prices, while the US economy is more insulated.
- Progress towards reaching target inflation rates has slowed, limiting central banks' ability to continue their easing cycles.

Upshot

- The balance of risks has shifted somewhat to the downside, but the risk of a global recession this year remains relatively low.

EQUITY MARKET LEADERSHIP

Exploring sub-plots in equity markets

Commentary

- Global equity markets have rebounded sharply from their March lows, led by US technology stocks once again.
- Despite the headline grabbing nature of the Middle East conflict, equity markets have once again been led higher by strong earnings growth, particularly within the IT sector.
- European and Asian equity markets have rebounded also, but lagged US equities – a sharp reversal from the months leading up to the conflict.

Upshot

- In the medium term we expect fundamentals to drive equity market returns, rather than short-term geopolitical risks.

SARANAC MULTI-ASSET POSITIONING

Finding the right balance

Commentary

- Middle East outcome too uncertain to commit with a high degree of conviction to a particular course of events.
- No obvious disorderly moves across asset classes, but remain vigilant if opportunities arise on dislocated asset pricing.
- Middle East is dominating headlines, but a wide range of other factors will drive asset prices beyond the short-term.

Upshot

- Multi-asset portfolios are already moderately risk-off, with a lower equity weight, short-duration fixed income and higher weight in alternatives.

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The Long Read

Oil shocks and the lessons of the 1970s

SNAPSHOT

Largest supply shock since the embargoes: In raw barrels off the market, the 2026 disruption through the Strait of Hormuz exceeds anything OPEC withheld in 1973, 1979 or 1990, and extends beyond crude to fertilizer, food and freight costs.

Today's economy is structurally better insulated: Energy intensity has roughly halved since 1973, services dominate output, the energy mix is more diverse, and the United States is now a net oil exporter rather than a large net importer.

The 1979 episode is the closest parallel: Panic-driven hoarding turned a moderate physical shortage into a near-doubling of prices. The risk for 2026 is not the oil price itself but a policy over-reaction layered on top.

The plausible outcome sits between 1979 and 1990: How long the Strait of Hormuz remains closed, and how central banks respond, will determine whether this becomes a serious but containable episode or something genuinely 1970s-style.

1. The supply shock in context

The war between the United States, Israel and Iran that erupted in late February 2026, and the closure of the Strait of Hormuz that followed, has delivered one of the sharpest oil price shocks in more than half a century. Brent crude, around $70 at the start of the year, briefly touched $125 and has since settled around $100 in early May, more than 40% above pre-war levels.

Of all the post-WW2 energy shocks, only the two oil crises of the 1970s share the essential ingredients of 2026: a Middle East conflict, a physical loss of regional supply, fear of Gulf contagion, and an inflationary shock. The 1990 invasion of Kuwait offers a useful third reference – another Middle East war, but one that dissipated quickly once the geopolitics resolved. While today's supply disruption is larger than 1973, the conditions that produced 1970s-style stagflation are largely absent today.

The Strait of Hormuz, through which roughly one-fifth of global crude and around 80 million tonnes of LNG normally pass, has been effectively closed since early March, with daily transits down by more than 90%. The World Bank estimates an initial supply reduction of about 10 million b/d; the IEA's figure is even as high as 13 million b/d at the peak. The 1973 Arab embargo removed roughly 4 million b/d of oil supply, the 1979 Iranian revolution about 5 million b/d, and the 1990 invasion of Kuwait roughly 4 million. In raw barrels off the market, 2026 therefore dwarfs each of the previous supply shocks.

The disruption extends beyond crude. Around 35% of global urea exports, used in agricultural fertilizer as well as plastics, transit Hormuz, and the World Bank expects fertilizer prices to jump over 30% this year. Container freight rates have climbed as much as 40%, with Cape of Good Hope reroutes adding roughly 14 days per voyage. This is therefore not just an oil shock but extends to the cost of food and transport more broadly, making it a more complex transmission mechanism than either of the 1970s episodes.

The Long Read

2. Lessons from previous oil crises

Taking a closer look at the 1973 OPEC embargo, imposed in retaliation for Western support of Israel during the Yom Kippur War, oil prices quadrupled from around $3 to nearly $12 by March 1974. US output fell roughly 2.5% over the course of the 1973-75 recession and inflation accelerated from 3.2% to 11.0%.

Yet the embargo did not occur in isolation, and this is the crucial point for any analogy with 2026. By 1973, Bretton Woods had collapsed, the dollar had been devalued, US wage-price controls were unwinding, and inflation was already running hot. Today's backdrop is different - inflation across many economies was on a downward trajectory and closer to target, central banks have established credibility over the past few recessions, and currencies are free-floating. A further contrast: the 1973 shock was deliberate, oil withheld as a political weapon, whereas today's shock is collateral.

The second oil crisis offers the closer parallel because, like today, it was triggered not by cartel action but by political upheaval inside a major Middle Eastern producer. Strikes in Iran's oil fields in late 1978 cut crude production by 5 million b/d. Saudi Arabia and others made up much of the volume, leaving a net loss of about only 5%. Yet prices nearly tripled, from $13 in mid-1979 to $34 in mid-1980. The reason was panic: buyers feared the upheaval would spread across the Gulf, hoarded inventory, and turned a minor physical shortage into a doubling of prices.

This is the most direct parallel to 2026. Markets today are pricing not only the disruption already observed at Hormuz but the tail risk of escalation - including the threat that Iran's allies could close the Bab al-Mandeb, in the event potentially blocking a quarter of the world's energy supply.

The policy response to the late 1970's oil disruption is what ultimately made matters worse. By the time Volcker's Fed sought to bring inflation down at all costs, US inflation had exceeded 14% and expectations had become unanchored. The federal funds rate was raised to nearly 20% by mid-1981, producing a deep double-dip recession with US unemployment peaking at 10.8%. Crucially, the Volcker recession was not directly caused by oil but by the response to the inflationary regime the oil shock had aggravated. The danger for 2026 is therefore not the oil price itself but a policy over-reaction layered on top of the income loss the shock has already imposed.

The Iraqi invasion of Kuwait in 1990 offers a more reassuring parallel. Brent rose from roughly $15 in early July to $41 by mid-October - a 90% increase in two months. About 4 million b/d of Iraqi and Kuwaiti supply was withdrawn. The shock contributed to the early-1990s US recession but lasted only nine months: by spring 1991, with the war over and Saudi spare capacity deployed, prices were back near pre-war levels.

3. Why today's economy is better insulated

The differences between today's global economy and that of 1973 or 1979 should mean that the adverse impact should be considerably less severe than was the case in the past. There are a number of structural themes that dampen the impact.

The first is the fall in energy intensity. According to the World Bank, the oil required to produce a unit of GDP has fallen from around 0.12 tonnes of oil equivalent per $1,000 of GDP in 1970 to about 0.05 by 2022. This was not an accident; it was the direct legacy of the 1970s shocks themselves. Tighter fuel economy standards roughly doubled new-vehicle fuel economy by the late 1980s, building regulation mandated insulation, and industrial processes became more efficient. The same percentage rise in oil prices today delivers roughly half the GDP impact it would have inflicted fifty years ago.

The Long Read

The second theme is the shift from manufacturing to services. In 1970 the advanced economies were dominated by heavy, energy-intensive industry – steel, chemicals, cement, autos. Today, services account for around 70-80% of GDP in most OECD economies, and services are far less energy-intensive per dollar of output. Much of the residual heavy industry has migrated to emerging Asia, leaving the US, EU and Japan with economies whose value-add is dominated by finance, software, healthcare, professional services and intangible goods that consume relatively little oil.

The third theme is the diversification of the energy mix. In 1973 oil supplied around half of world energy; today it supplies about a third, with gas, nuclear, hydro and renewables making up a far larger share. In electricity generation specifically, oil has been almost entirely displaced. Renewables in particular are insulated by definition: a solar farm or wind turbine, once built, is indifferent to events in the Strait of Hormuz. Heating has followed a similar pattern, with gas and electric heat pumps replacing oil-fired boilers. Oil's role has narrowed mainly to transport and petrochemicals, and even there, electrification is eroding its dominance: EVs accounted for around one in five new cars sold globally in 2025.

The fourth theme is a transformed supply structure. In 1973, OPEC controlled the marginal barrel, and the US was a large net importer with no domestic spare capacity. In 2026, the US is a net oil exporter, and US shale provides a supply response measured in months rather than years. Strategic petroleum reserves, which barely existed in 1973, now hold roughly 1.2 billion barrels across IEA members. None of this prevents a price spike, but it should shorten its duration and soften its peak.

Differences in policy matter at least as much. The 1970s featured powerful unions and widespread cost-of-living indexation; today's labour markets are far less indexed, and the wage-price spiral that made 1973 and 1979 persistent is much harder to ignite. Central banks in 1973 and 1979 had no formal inflation target and a record of accommodating fiscal demands. Today's have explicit targets, independence and broadly intact credibility, reducing the risk of policy error in response to transitory price spikes.

4. Implications and outlook

Of course, there is the risk that the conflict drags on much longer than most expect, in which case prices must do the work diplomacy cannot. Demand destruction operates in two phases: households consume less and industry idles energy-intensive processes in the short run; high prices accelerate substitution towards heat pumps, EVs and renewables in the longer run. The 1979-86 cycle is the textbook case – world oil demand fell about 10% between 1979 and 1983 while non-OPEC supply rose 5.6 million b/d, driving crude prices significantly lower by 1986. From a macroeconomic perspective, this would likely be the most adverse outcome of the current crisis.

In supply terms, the 2026 shock is larger than 1973, 1979 or 1990: the volume at risk through Hormuz exceeds anything OPEC withheld during the embargo. The 1979 parallel - panic-driven hoarding amplifying a moderate physical shortage into a price spike - is perhaps more directly applicable. Yet the modern economy is structurally far better insulated, and central banks have learned the lessons from past supply shocks.

The plausible outcome for 2026 probably sits somewhere between the crises of 1979 and 1990, depending almost entirely on how long the Strait of Hormuz remains closed and how central banks respond. The 1970s taught us that the worst outcomes come not from the oil price itself but from the loss of monetary and inflationary anchors that follow. Avoiding that mistake is what separates a serious but containable episode from a genuinely 1970s-style outcome.

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