



Beware of Unintended Consequences

President Trump has a habit of shooting first and reacting to consequences later. His fundamental aim is “to make America great again.” His populist approach and surrounding himself with likeminded, but pliable colleagues is resulting in unfettered decision making which in the case of Venezuela has resulted in an initial political gain. However, while his attack on Iran has created military momentum there, the markets await the impact of unintended consequences. The major conundrum at present is the oil price, where even a heavily damaged Iran has the ability to influence matters. Previously the Iran backed and relatively unsophisticated Houthis were able to create major uncertainty in the Strait of Hormuz; it is too early to discount even a weapons degraded Iran from disrupting tanker traffic in this critical area, despite US assurances.

Geopolitical events tend to be of short duration in market terms and diversification does give balance to portfolios. In fact, looking at all major geopolitical events since 1956, the S&P 500 has on average ended the following 3 months, 6 months, and 12 months in positive territory, despite initial double-digit losses. At this point we are watching for signs of duration of disruption and take some comfort that despite Russia’s shadow fleet of tankers already representing a significant amount of oil production out of circulation, energy prices were stable prior to US military action.

The key focus must be on potential inflation. At present a relatively short interruption to oil flow through the Persian Gulf could add 0.3% to the UK inflation headline rate. Given that we are still a distance away from the Bank of England target rate of 2% this is a point of concern. However, President Trump is confident enough to reject a request for talks with the Iranians which suggests confidence in his prediction of a cessation of hostilities by Easter. Presumably the Israeli Defence Force has given him encouragement through their intelligence network that the Iranian threat can be contained.

We are relatively comfortable that prior action taken to maintain a meaningful, but underweight, exposure to the US and a moderate overweight exposure to the UK, with its significant overseas earnings, is helpful looking forward. Japan and Gold are overweight, but even the latter moderate trimming of position pre current military action protects portfolios should interest rates rise.

Recent moves have not changed our strategic allocation, but we are actively looking for opportunities in the current climate. One factor we prioritise is to screen stocks and sectors that will still look attractive should the political situation stabilise relatively quickly. One area under review for example is markets that would benefit from a rise in commodity prices which were already on the move before the attack on Iran. Additionally, we are looking at UK direct stocks where momentum/sentiment has decoupled from fundamentals and provides opportunities.

On the fixed interest part of portfolios, largely held for defensive reasons, we have maintained relatively short duration positions should future interest rate reductions take longer than expected to occur. This is in fact an area where we are looking at tax efficiencies and note that by investing in short dated low coupon Gilts we can improve the net returns for our clients compared to retaining funds in cash deposits.

We will likely write again shortly should matters change abruptly. It seems that most parties have some incentive to resolve the Strait of Hormuz situation with Trump facing elections and Iran heavily dependent on energy exports given the dire straits of their economy - but the Houthis remind us that nothing can be taken for granted at present.

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5 March 2026

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