Yardeni Research

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Morning Briefing

Another Regime Alteration

Check out the accompanying chart collection.

Executive Summary: Saturday's military attack on Iran by the US and Israel that killed Iran's leader and 40 top officials is likely to push oil prices higher this week. However, in our short-war scenario, oil prices should fall in the coming weeks after a ceasefire. In any event, the attack also incapacitated Iran's navy, so the threat of a blocked Strait of Hormuz has been greatly reduced. This is potentially a positive development from economic and investment perspectives, greatly reducing geopolitical risk in the Middle East once the war ends. If oil prices drop in the coming weeks following a ceasefire, US inflation and gasoline prices will decline, boosting US consumer spending and benefiting global economies and stock markets. The weekend's Middle East developments make us even more confident in our Roaring 2020s scenario. ... Also: Dr Ed reviews "Mercy" (+).

YRI Weekly Webcast. Join Dr Ed's live webcast with Q&A on Mondays at 11 a.m., EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

Geopolitics I: Happy Purim! Today is Purim, a Jewish holiday that commemorates the saving of the Jewish people by Persia's Queen Esther from annihilation at the hands of a Persian Empire official named "Haman," as the story is told in the Book of Esther. Haman was the royal vizier to the Persian King Ahasuerus (likely a.k.a. "Xerxes The Great"). When the Queen was informed of the plot, she told the King, who ordered that Haman be hanged.

What was Persia then is now Iran. And now, some 2,500 years later, Iran's Supreme Leader Ali Khamenei, a modern-day Haman, was killed on Saturday along with 40 other top Iranian leaders when the US and Israel launched a military campaign against Iran's Mullah regime.

In a February 28 post on *The Free Press*, historian Naill Ferguson observed that President Donald Trump's approach to dealing with America's adversaries in Latin America and the Middle East isn't regime change but regime alteration: "Indeed, regime alteration is the practical consequence of the approach laid out in Trump's *National Security Strategy*

published late last year. The strategy rules out the deployment of American ground forces other than special forces. It requires a short time frame for military operations. It will disappoint those who want to fast-track Venezuela and Iran to democracy. But the lesson of Iraq has not been lost on Trump." So no boots on the ground.

In Venezuela at the beginning of the year, Trump snatched President Nicolás Maduro and replaced him with Delcy Rodríguez, leaving the structure of the regime in place but requiring her to follow commands from Washington, including on the country's oil production and exports (*Fig. 1*).

Trump seems to be angling for a regime alteration in Cuba, by cutting off the country's access to oil from Venezuela. In Iran, Trump's goal is to force the next regime to end the previous regime's ambitions of building nuclear weapons, destroying Israel, and dominating the Middle East by supporting terrorist organizations around the region.

Now that the "Axis of Evil" has lost Iran and Venezuela, what will be the impact and reaction of its other three members, China, North Korea, and Russia? Losing Iran is a big blow to Russia, which received military equipment, especially drones, from Iran. China imports lots of oil from Iran. In North Korea, Little Kim is probably scrambling to fortify his bunker. China has seen America's military might in action twice in Iran and once in Venezuela since the start of Trump's second term. China's leaders might now consider postponing any planned invasion of Taiwan.

In the Middle East, the terrorist proxies of Iran's Mullahs in Gaza (Hamas), Lebanon (Hezbollah), and Yemen (Houthis) have already been decapitated once by the Israelis. Now they've lost their puppet master in Tehran. The Abraham Accords are likely to be expanded to include more Arab countries. The Israeli stock market has been discounting this scenario for the past two years (*Fig. 2*).

For the financial markets, the immediate issue is whether Iran's decapitated regime will block the Strait of Hormuz. We are not military experts, but it seems to us that if that were going to happen, it would have happened by now. The probable reason it hasn't is that the US and Israel have incapacitated Iran's navy. At the same time, it is very unlikely that the two allies would have done any damage to Iran's oil production and export facilities (*Fig. 3*). As in Venezuela, Trump probably expects to be running Iran's oil business from the White House soon.

Of course, in the next few days, oil prices could spike higher. Indeed, Reuters reported that

Brent crude jumped 10% to about $80 a barrel over the counter on Sunday, according to oil traders, while analysts predicted that prices could climb as high as $100 (*Fig. 4*). Most tanker owners, major oil companies, and trading houses have suspended crude oil, fuel, and liquefied natural gas shipments via the Strait of Hormuz, trade sources said, after Tehran warned ships against moving through the waterway. More than 20% of global oil is moved through the Strait of Hormuz.

Meanwhile, on Sunday, Iranian Foreign Minister Abbas Araghchi said that a new supreme leader could be chosen within days. He also said that Iran has no intention of closing the critical shipping lane at present nor any plans to do "anything that would disrupt navigation at this stage." That might be because reports indicate that a total of nine Iranian naval ships have been destroyed and sunk since the operation began on Saturday. Some of these are described as relatively large and important vessels. Trump also announced that the Iranian Naval Headquarters has been "largely destroyed" in a targeted strike.

In any event, oil prices are likely to fall in the coming months assuming this war is short, as it's bound to be. That should help to bring US headline inflation down to the Fed's 2.0% y/y target. Lower gasoline prices will boost consumers' purchasing power in the US and around the world (*Fig. 5*). Both US and global economic growth should benefit from lower oil prices. Stock markets around the world should continue to set record highs, especially in oil-importing countries throughout Asia (*Fig. 6*). So most emerging economies' stock markets should continue to outperform (*Fig. 7*).

We've held back on overweighting the S&P 500 Energy sector because we expect ample global supplies to offset near-term jitters about the outcome with Iran (*Fig. 8*). Events over the weekend suggest that the recent weeks' energy stock rally might continue for a few more days and then fizzle in our short-war scenario.

Geopolitics II: What About Interest Rates? On Friday, despite mounting evidence that another conflict in the Middle East was imminent, the 10-year Treasury bond yield fell below 4.00% (*Fig. 9*). That happened even though January's PPI inflation rate was hotter than expected (*Fig. 10*). Furthermore, the January 27-28 FOMC *minutes*, released on February 18, were relatively hawkish, with some members of the monetary-policy committee explicitly raising the possibility of rate hikes assuming that there are no clear indications that disinflation is firmly on track. At the time of the meeting, the bond yield was at 4.25%.

Despite the decline in the yield since then, it remains at the bottom of a relatively tight range that has persisted for the past three years (*Fig. 11*). In the happy-go-lucky scenario we

outlined for the Middle East and oil prices, the yield may continue to fall, as it has often tracked oil prices in the past, except for the past few weeks (*Fig. 12*). A faster decline in inflation because of falling oil prices might help incoming Fed Chair Kevin Warsh (assuming he is approved by the Senate) convince FOMC members to lower the federal funds rate (*Fig. 13*). We think that would increase the likelihood of bubbles inflating in financial asset markets.

However, the US Treasury bond market may be signaling that the clear and present danger of financial bubbles lies in the private credit markets, as evidenced by the falling prices of ETFs that invest in private credit lenders. FOMC officials might be persuaded to lower the federal funds rate to avert a financial crisis starting in that market.

Of course, if something significant breaks in the private credit market, the Fed will rapidly create an emergency liquidity facility and lower the federal funds rate. The Fed has lots of experience doing so from its previous Whac-A-Mole play during the Great Financial Crisis, the Great Virus Crisis, and the Mini-Banking Crisis (*Fig. 14*).

Geopolitics III: What About the Price of Gold? Of course, the US Treasury bond yield may also be falling because of safe-haven demand. The price of gold is likely to rise this week for the same reason, especially if the price of oil spikes. However, the latest developments in the Middle East over the weekend suggest that geopolitical risks in the Middle East are likely to decrease rather than increase as discussed above. That's assuming that the Iranian regime doesn't rise from the dead. But that's not very likely now that so many of its top leaders have been martyred and presumably having lots of fun in the afterlife.

For now, we are still targeting $6,000 per ounce for the price of gold by year-end and $10,000 by the end of the decade (*Fig. 15*). But we would be inclined to book some trading profits in the event of a big jump to the upside in the prices of gold and oil, especially in the latter since we don't believe a jump would be sustainable.

Geopolitics IV: The Roaring 2020s & Beyond. We've been thinking about whether to change our subjective probabilities for our three economic and stock market scenarios for the rest of this year. We've decided to leave them as is notwithstanding the latest developments in the Middle East. In fact, these developments, and the happy outcome we discussed above gives us more confidence in them:

(1) *Our Roaring 2020s base-case scenario remains at 60%*. If the postwar outcome of our-

short-war scenario plays out, oil prices will be lower. Consumer confidence, purchasing power, and spending will get a boost from lower oil prices and greater stability in the Middle East. The odds of a recession and a bear market would remain low. Corporate earnings would continue to rise as both the US and global economies benefit from lower oil prices (*Fig. 16*). Our Roaring 2020s targets for the S&P 500 remain intact at 7,700 by the end of this year and 10,000 by the end of 2029 (*Fig. 17*). The Roaring 2020s would be followed by the Roaring 2030s.

(2) *Our Meltup scenario remains at 20%*. We have been thinking about lowering the odds of our Meltup scenario given the weakness in the stock market so far this year, as the air is coming out of the AI bubble. However, we are encouraged to see that the decline in the forward P/Es of the Magnificent-7 has been mostly offset by rising valuation multiples among the Impressive-493 (*Fig. 18* and *Fig. 19*). A happy outcome of the latest turmoil in the Middle East could certainly drive stock prices higher around the world.

Arguably, there was a stock market meltup last year in the S&P 500 Information Technology and Communication sectors, particularly the Magnificent-7. The stock market action so far this year shows that this excess is being cured by investors rebalancing to other sectors and to overseas stock markets (*Fig. 20*). A meltup doesn't have to set the stage for a meltdown, and certainly not one that triggers an economic recession.

(3) *Our Meltdown scenario remains at 20%*. We have previously identified the two biggest risks to the two bullish scenarios above as a geopolitical crisis, particularly in the Middle East, and a financial crisis, particularly in the US private credit market. Now we are thinking that the risks of the former are declining (in a short-war scenario) and that the risks of troubles in the private credit markets are increasing.

If the private credit market seizes up, the Fed will most likely respond rapidly with an emergency liquidity facility and cuts in the federal funds rate, as mentioned above. In other words, a meltdown scenario is likely to offer lots of good buying opportunities as the Roaring 2020s roar into the Roaring 2030s!

Movie. "Mercy" (+) is a 2026 science-fiction thriller that attempts to tackle the "AI in the courtroom" concept but largely gets bogged down in the gimmicks of its own format. Directed by Timur Bekmambetov and starring Chris Pratt and Rebecca Ferguson, the film follows a detective (Pratt) who wakes up strapped into a "Mercy Chair," accused of murdering his wife. He has 90 minutes to prove his innocence to an AI judge (Ferguson) by scouring digital data. (See our movie reviews *archive*.)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index fell 0.5% during the February 27 week to 1.7% below its January 12 record high. The AC World ex-US outperformed with a 1.7% gain for the week to a new record high. The AC World ex-US has been outperforming the US MSCI since December 24, 2024 and hitting new record highs since May 14—the first time it's had such a long streak of successive record highs since June 15, 2021.

EM Asia was the best performing region last week, with a gain of 3.3%, followed by EM (2.8%) and the AC World ex-US. EM Latin America was the worst regional performer, with a decline of 0.8%, followed by EMU (0.4), Europe (0.7), EAFE (1.2), and EMEA (1.4). The Korea MSCI index, with a gain of 9.6%, performed the best among country indexes, ahead of South Africa (6.8), Taiwan (6.1), Hong Kong (3.3), and Japan (2.6). The Brazil MSCI index was the worst performer w/w, with a decline of 1.4%, followed by India (-0.9), China (-0.8), Mexico (0.3), and Germany (0.4).

In terms of ytd performance rankings, the 0.2% gain for the US MSCI index ranks as the third worst performer among the 18 MSCI countries that we follow and trails the 11.1% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EM Latin America leads with a gain of 19.5%, followed by EM Asia (14.9), EM (14.7), and the AC World ex-US. EMU is the worst ytd performer, albeit with a gain of 6.9%, followed by Europe (7.7), EAFE (9.9), and EMEA (10.5). Korea is the best ytd performer among the country indexes, with a gain of 56.0%, followed by Taiwan (25.3), Brazil (21.1), South Africa (18.6), Mexico (17.1). The worst performing countries ytd: India (-3.9), China (-1.4), the USA (0.2), Germany (4.3), and Spain (5.9).

US Stock Indexes (*link*): Fourteen of the 48 major US stock indexes that we follow rose during the week ended February 27, compared to 47 rising a week earlier. The Dow Jones 15 Utilities index was the best performer for the week, with a gain of 2.4%, ahead of Nasdaq Industrials (1.4), S&P 500 LargeCap Value (0.4), S&P 400 MidCap Pure Growth (0.4), S&P 500 LargeCap Equal Weighted (0.4), and Russell MidCap Growth (0.4). The S&P 600 SmallCap Pure Value index was the worst performer, with a decline of 3.1%, followed by S&P 400 MidCap Pure Value (-2.9), S&P 600 SmallCap Value (-2.4), S&P 400 MidCap Value (-1.8), and Russell 2000 Value (-1.8).

SMidCaps, a.k.a. the SmallCaps and MidCaps, still dominate the top of the ytd gainers list

of 48 indexes, but fewer indexes are higher ytd now—39 now versus 45 at the end of January.

With a gain of 13.4%, the Dow Jones 20 Transports index has moved into the top spot as the best performer so far in 2026, ahead of S&P MidCap 400 Pure Growth (11.7), Dow Jones 15 Utilities (11.4), S&P 400 MidCap Growth (9.9), and S&P 600 SmallCap Pure Value (9.6). The worst performing major US stock indexes ytd: Russell 1000 Growth (-5.1), Russell 3000 Growth (-4.7), S&P 500 LargeCap Growth (-3.0), S&P SuperCap 100 (-2.5), and Nasdaq Composite (-2.5).

S&P 500 Sectors Performance (*link*): Seven of the 11 S&P 500 sectors rose during the week ended February 20, and eight were ahead of the S&P 500's 0.4% decline. That compares to six sectors rising week earlier when seven were ahead of the S&P 500's 1.1% gain. During the latest week, the top five performing sectors all ended at record highs despite the S&P 500's decline. Among last week's three worst performers, Information Technology joined Real Estate as the only two S&P 500 sectors in a correction. Tech is now down 11.5% from its October 29 record high.

The outperformers last week: Utilities (5.9%), Consumer Staples (2.7), Health Care (2.1), Energy (2.0), Materials (1.3), Real Estate (0.7), Communication Services (0.5), and Industrials (-0.1). The underperformers last week: Information Technology (-2.2), Financials (-2.0), and Consumer Discretionary (-0.5).

Seven of the 11 sectors are positive ytd, and the same seven are ahead of the S&P 500. Their average gain is 13.7%, well above the 0.5% gain for the index.

Energy continues to pull away as the best ytd performer, now with a gain of 24.4%, followed by Materials (17.6), Consumer Staples (16.0), Industrials (14.0), Utilities (11.3), Real Estate (9.3), and Health Care (3.2). These four sectors are lagging the S&P 500 so far in 2026: Financials (-6.3), Information Technology (-5.6), Consumer Discretionary (-3.8), and Communication Services (0.3).

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