Yardeni Research

March 9, 2026

Morning Briefing

Between Iran & A Hard Place

Check out the accompanying chart collection.

Executive Summary: With the US suddenly thick in the fog of war, Dr Ed discusses the collateral effects on the US economy and stock market. Spiking oil prices may precipitate a stock market correction rather than a bear market, but the latter is possible. The Roaring 2020s remains Dr Ed's base-case outlook for the rest of this year with subjective odds unchanged at 60%. But there's now much less chance of a Meltup (with odds of just 5%) and greater odds of a Meltdown (35%). For the rest of the decade, he sees either a continuation of the Roaring 2020s (85%) or a new scenario, the Stagflating 1970s Redux (15%). If investors start expecting stagflation, a bear market is more likely. Markets should stabilize once the Strait of Hormuz reopens to safe navigation. … Also: Dr Ed reviews "Dead Man's Wire" (+).

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US Strategy I: Roaring 2020s Vs Stagflating 1970s Redux. In last Tuesday's *QuickTakes*, reacting to the latest Middle East war, we wrote: "We've been expecting a pullback due to excessive bullish sentiment, but now we expect a 10% correction from the high. It's hard to imagine that the IRGC [the Islamic Revolutionary Guard Corps] won't use drones and speed boats to maintain their effective blockade of the Strait [of Hormuz]. If they are successful in doing so, the correction could be closer to 15%." The day before, a senior adviser to the IRGC's commander-in-chief warned, "If anyone tries to pass … the navy will set those ships ablaze."

Since then, the Iranian navy has been largely destroyed. However, as long as the IRGC can fly drones, the Strait will remain straitjacketed. President Donald Trump has authorized the US Navy to escort ships through the Strait, but that operation may take a while to implement and may not completely succeed at thwarting Iranian drone attacks. Meanwhile, on Saturday, the *New York Post* *reported*, "A commercial oil tanker was set ablaze in the Strait of Hormuz after it was struck by an Iranian suicide drone, the country's Islamic

Revolutionary Guard Corps said Saturday, with a US Navy mission to safeguard ships through the region possibly still weeks away."

Military historians have debated whether air power alone can decisively win a war. Most have concluded that it is rarely sufficient on its own to achieve total victory and lasting political change. Air power is exceptional at destroying things—infrastructure, supply lines, and concentrated armor. However, it cannot "hold" a street corner, search a basement for insurgents, or administer a local government. It also can't eliminate drones.

On Saturday, the President refused to rule out boots on the ground, though he did rule out using Kurdish forces as a proxy for a ground invasion of Tehran, calling the war "complicated enough" without them. He said that ground forces would only face an adversary "so decimated that they wouldn't be able to fight at the ground level."

Meanwhile, here on the home front, Friday's employment report for February was much weaker than widely expected. Also on Friday, January's retail sales report was weak. As a result, the Atlanta Fed's *GDPNow* model lowered the projected Q1 real GDP growth rate to 2.1% (saar), down from 3.0%. The US economy and stock market are stuck between Iran and a hard place currently. So is the Fed. If the oil shock persists, the Fed's dual mandate would be stuck between the increasing risk of higher inflation and rising unemployment.

Here are a few of the consequences of the war for our economic and financial market outlooks:

(1) These are fast-moving times. We are moving fast to update the subjective probabilities for our three economic and stock market scenarios. Our base-case scenario remains the Roaring 2020s, with our subjective probability unchanged at 60%. We are lowering the Meltup scenario from 20% to 5% and increasing the Meltdown scenario (which now includes a 1970s-style stagflation) from 20% to 35%. The timeframe is over the rest of this year. Over the rest of the decade, we would narrow the scenarios to two: the Roaring 2020s at 85% and the Stagflating 1970s Redux at 15%.

(2) As we've previously observed, oil price spikes have coincided with recessions and bear markets (*Fig. 1* and *Fig. 2*). The one exception was the 2022 spike following Russia's invasion of Ukraine. There was no recession, but there was a bear market. That experience confirmed the resilience of the US economy and the limited impact of oil prices on it. The same should hold today with the latest oil price spike, though we are more inclined to expect a 10%-15% correction in the stock market than a bear market, which we can't rule

out under the circumstances.

(3) Our relatively optimistic view assumes that the war will last a few more weeks and that the US economy and corporate earnings will prove resilient once again. The US economy's energy intensity—total energy consumption per unit of real GDP—has dropped sharply over the years (*Fig. 3*). It is down 70% from 1950 through 2024 and 62% from 1979 through 2024.

The US economy has transitioned from dependence mostly on energy-intensive manufacturing industries to services industries (*Fig. 4*). Also contributing to the decline in America's energy intensity have been corporate average fuel economy (CAFE) standards and technological improvements in internal combustion engines (*Fig. 5*). On the other hand, the digital economy is boosting electricity demand (*Fig. 6*). However, increased use of natural gas and renewables in electricity generation and in industrial processes that previously relied on oil should continue.

(4) US crude oil production, including natural gas plant liquids and renewable fuels/oxygenates, is at a record 24mbd, well above US usage of 21 million barrels per day (mbd) (*Fig. 7* and *Fig. 8*). As a result, the US is a net exporter of around 3.0 mbd (*Fig. 9*). That's quite a reversal from 2007, when the US was a net importer of about 12mbd.

(5) We can't rule out a bear market if investors start to anticipate a Stagflating 1970s Redux scenario. There were two oil shocks back then. In October 1973, Arab members of OPEC imposed an embargo against the US and other nations supporting Israel during the Yom Kippur War. Crude oil prices quadrupled, jumping from approximately $3 to nearly $12 per barrel in just a few months. The result was "stagflation"—the rare and painful combination of stagnant economic growth with high unemployment and rising inflation (*Fig. 10*). It brought long lines at gas stations, fuel rationing, and the first major realization of US vulnerability to foreign energy dependence.

The second crisis followed the 1979 Iranian Revolution, which severely disrupted global oil supplies. Prices more than doubled. This shock pushed an already fragile economy further into stagflation. Both crises triggered two recessions during the 1970s.

According to Polymarket.com, the odds of a recession this year jumped to a three-month high of 34% on Friday from 21% on Wednesday, February 25 just before the war started (*Fig. 11*).

US Strategy II: Strait Talk About the IRGC. When the war started over a week ago on Saturday, February 28, our initial reaction was that it would be a short one. By Tuesday, we had second thoughts and wrote about them in that day's *QuickTakes*. Our major concern is that by decapitating the Iranian regime during the first hour of the war, the US and Israel unleashed the regime's pitbulls, i.e., the IRGC. They are essentially a "terrorist state within a terrorist state." The IRGC controls an estimated 20% to 40% of the Iranian economy, including major construction firms, telecommunications, and oil engineering companies. This wealth allows them to fund operations even under heavy sanctions.

The US designated the IRGC as a Foreign Terrorist Organization (FTO) in April 2019—the first time the US had made such a designation against a government entity. These terrorists are likely to be hard to eradicate with just air power. They can continue to do lots of damage with their suicide drones.

President Trump first issued his formal demand for "unconditional surrender" by Iran on Friday, March 6. The next day, he explained that unconditional surrender is essentially "where they cry uncle, or when they can't fight any longer and there's nobody around to cry uncle." On Sunday morning, Trump warned that any new Supreme Leader chosen by Iran's Assembly of Experts "won't last long" without his explicit approval, effectively asserting a US veto over the Iranian succession process following the death of Ayatollah Khamenei.

A leaderless Iran means that no one has the power to accept unconditional surrender in Iran. Indeed, on Saturday, Iranian President Masoud Pezeshkian issued a public apology for Iran's "fire at will" strikes on its neighbors, only to be immediately undercut by the IRGC, which launched a fresh wave of attacks just hours later. This sequence of events highlights a massive breakdown in command and control within the Iranian regime following the death of Supreme Leader Ayatollah Khamenei on February 28. Despite the loss of the "head of the snake," the IRGC was designed with a decentralized structure. Local commanders have already begun acting independently, launching retaliatory drone and missile barrages against US assets and allies in the Gulf.

A key goal of the current air strikes is to degrade the IRGC's ability to repress its own people. By targeting the Basij (the IRGC's domestic paramilitary wing), the US aims to create an opening for a domestic revolt against the regime. However, for financial markets, the war won't be over until ships can pass through the Strait of Hormuz without being attacked by the IRGC. When that happens, the bull market in stocks should resume.

US Economy: On the Home Front. In the US, January and February economic data are

prewar and a mixed bag. March data will likely show that the initial impact of the war started to boost inflation and weaken the labor market. On the inflation front, gasoline prices are soaring along with the price of crude oil (*Fig. 12*).

Food prices may not rise immediately, but a shortage of fertilizer is likely to push them higher in coming months. Approximately 25%-33% of the world's nitrogen fertilizer market (specifically, urea and anhydrous ammonia) passes through the Strait of Hormuz. On March 2, an Iranian drone strike hit the Ras Laffan industrial complex in Qatar—the world's largest export hub for liquefied natural gas. Natural gas is the primary "feedstock" for nitrogen-based fertilizers. Saudi Arabia, Oman, and the UAE are among the top 10 global exporters of urea. All are currently experiencing logistical or production disruptions due to the surrounding air war.

If the blockade isn't broken by early April, farmers may be forced to switch from corn-based fertilizer (which requires heavy nitrogen) to soybean-based substitutes or simply to apply less fertilizer. Lower fertilizer application typically leads to lower yields, which could trigger a secondary "food price shock" in late 2026.

The war is the latest stress test of the US economy's resilience since the start of the decade. It is also the latest challenge to our Roaring 2020s thesis. As noted above, we are sticking with this as our base-case with a 60% subjective probability. But we have upped the odds of the Stagflating 1970s Redux to 35% by reducing the odds of a Meltup to 5% over the remainder of 2026.

The latest batch of economic indicators showed that the labor market was weak in February and that retail sales were weak in January. On the other hand, productivity was very strong in recent quarters. If that continues to be the case, productivity should help to moderate the stagflationary consequences of the war.

(1) *Employment.* January's employment report was much better than expected, while February's was much worse than expected. Bad weather and a strike weighed on February's report. Nonfarm payrolls fell 92,000 last month. January's count was revised down by 4,000 to 126,000, and December's was revised from a gain of 48,000 to a loss of 17,000 (*Fig. 13*). The unemployment rate edged up last month to 4.4% from 4.3% in January.

The good news is that average hourly earnings rose 0.4% m/m in February, while the workweek was unchanged. As a result, our Earned Income Proxy for wages and salaries in

personal income rose 0.3% to a record high in February (*Fig. 14*).
The Fed is now caught between a weakening labor market (supporting a federal funds rate cut) and rising energy/fertilizer prices from the Iran conflict (supporting a hold or hike).

(2) *Retail sales*. During January, retail sales fell 0.2% m/m, while December's data—which previously had been reported as a moderate gain—were revised lower to be unchanged m/m. Nonstore retailers had a 1.9% m/m jump, while motor vehicle & part dealers saw a 0.9% drop (*Fig. 15*). Gasoline stations sales fell 2.9%. A bright spot was a 0.3% m/m increase in the core group of retail sales.

The implementation of last year's One Big Beautiful Bill Act is expected to provide a tailwind in the coming weeks. There should be a "February rebound" as record-high tax refunds (averaging 20% higher than last year) hit bank accounts.

(3) *Productivity*. Labor productivity—measured as output per hour worked—grew at a 2.8% annualized rate in Q4-2025. That's the third quarter in a row in which the growth rate exceeded the 2.1% average since the start of the data in the late 1940s (*Fig. 16*). Unit labor costs rose just 1.3% y/y during Q4-2025, helping to keep inflation down (*Fig. 17*).

(4) *GDPNow*. As mentioned above, the latest batch of data caused the Atlanta Fed's GDPNow model to reduce the projection for Q1-2026 growth from 3.0% to 2.1% (*Fig. 18*).

Movie. "Dead Man's Wire" (+) is a 2025 film based on the 1977 Minneapolis standoff. The film follows a desperate man, convincingly played by Bill Skarsgård. He storms a mortgage lending office, seizes an executive, and rigs a shotgun to the hostage with a dead-man trigger. It's a wacky true story about a wacko, with a weird ending. (See our movie reviews *archive*.)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index fell 2.0% during the March 6 week to 3.6% below its January 12 record high. Despite the decline, the US MSCI was the week's best-performing country and ahead of 6.5% decline for the AC World ex-US index from its record high. The AC World ex-US index 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.

In an unusual twist, all MSCI regional indexes trailed the 6.5% decline for the AC World ex-US during the latest week. EM Asia was the best performing region last week, albeit with a decline of 6.6%, followed by EAFE (-6.8%), EM (-6.9), Europe (-7.3), EM Latin America (-7.9), EMEA (-7.9), and EMU (-8.3). The USA MSCI index, with a decline of 2.0%, performed the best among country indexes, ahead of Hong Kong (-2.7), China (-3.0), Canada (-3.0), and India (-3.6). The South Africa MSCI index was the worst performer w/w, with a decline of 14.6%, followed by Korea (-13.5), Mexico (-9.0), Germany (-8.7), and France (-8.6).

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*): All of the 48 major US stock indexes that we follow fell during the week ended March 6, compared to 14 rising a week earlier. The Russell 1000 Growth index was the best performer for the week, albeit with a decline of 0.7%, ahead of Russell 3000 Growth (-0.8%), Nasdaq Industrials (-1.0), S&P 100 MegaCap (-1.2), and Nasdaq Composite (-1.2). The Dow Jones 20 Transports index was the worst performer, with a decline of 6.2%, followed by S&P 500 LargeCap Transportation (-5.7), S&P 400 MidCap Pure Growth (-5.7), S&P 400 MidCap Growth (-4.9), and S&P 500 LargeCap Pure Growth (-4.7).

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—30 now versus 45 at the end of January.

With a gain of 9.4%, the Dow Jones 15 Utilities index has moved into the top spot as the best performer so far in 2026, ahead of Dow Jones 20 Transports (6.4), S&P 600 SmallCap Pure Value (5.7), S&P MidCap 400 Pure Growth (5.4), S&P 500 MidCap Pure Value (5.2). The worst performing major US stock indexes ytd: Russell 1000 Growth (-5.7), Russell 3000 Growth (-5.5), S&P 500 LargeCap Growth (-4.3), Nasdaq Composite (-3.7), and S&P SuperCap 100 (-3.6).

S&P 500 Sectors Performance (*link*): One of the 11 S&P 500 sectors rose during the week ended March 6, and four were ahead of the S&P 500's 2.0% decline. That compares to seven sectors rising week earlier when eight were ahead of the S&P 500's 0.4% decline. A week earlier, the top five performing sectors all ended at record highs despite the S&P 500's decline. Financials fell into a correction last week, joining Information Technology and Real Estate as the only three S&P 500 sectors in a correction.

The outperformers last week: Energy (1.0%), Information Technology (-0.4), Consumer Discretionary (-1.4), and Financials (-1.8). The underperformers last week: Materials (-7.2), Consumer Staples (-0.5), Health Care (-4.6), Industrials (-4.1), Real Estate (-2.3), Utilities (-2.1), and Communication Services (-2.1).

Six of the 11 sectors are positive ytd, and the same six are ahead of the S&P 500. Their average gain is 11.7%, well above the 1.5% decline for the index.

Energy continues to pull away as the best ytd performer, now a gain of 25.6%, followed by Consumer Staples (10.3), Industrials (9.4), Materials (9.2), Utilities (8.9), Real Estate (6.6). These five sectors are lagging the S&P 500 so far in 2026: Financials (-8.0), Information Technology (-5.9), Consumer Discretionary (-5.2), Communication Services (-1.8), and Health Care (-1.6).

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