



Crude

The escalating conflict between the United States, Israel and Iran has sent crude oil prices surging past one hundred dollars a barrel for the first time since 2022. With the Strait of Hormuz effectively shut down and roughly twenty percent of global oil supply disrupted, energy markets are experiencing their most severe shock in decades. For investors, the consequences extend far beyond the commodity itself: inflation expectations are rising, bond markets are selling off and central banks face an agonising dilemma between supporting growth and containing prices.

The oil shock: what happened and why it matters

On 28 February, the United States and Israel launched Operation Epic Fury, a coordinated military campaign targeting Iranian leadership, nuclear infrastructure and air defences. Iran retaliated by threatening tanker traffic through the Strait of Hormuz, the narrow waterway through which roughly one-fifth of global oil and liquefied natural gas shipments pass. Tanker transits collapsed from an average of 24 per day to fewer than 4 within seventy-two hours. Brent crude, which had been trading around 60 USD a barrel at the start of the year, surged past 100 USD on 9 March, briefly touching 119 USD intraday. The disruption is estimated to be roughly twice the scale of the Suez Crisis of 1956, making it the largest supply interruption in modern energy history.

Iraq, Kuwait and the United Arab Emirates have been forced to curtail production as storage capacity fills and export routes remain blocked. Analysts warn that if the strait remains closed for more than a few weeks, prices could reach 135 to 150 USD a barrel, levels not seen since the aftermath of the Russian invasion of Ukraine.

Inflation: the transmission mechanism from barrel to basket

The most immediate consequence of sustained high oil prices is a renewed spike in inflation. The International Monetary Fund estimates that every sustained ten percent rise in oil prices adds approximately 0.4 percentage points to global inflation and reduces world economic output by 0.15 percent. With oil having risen roughly fifty percent since late February, the arithmetic is sobering: headline inflation across developed economies could increase by 1.5 to

2 percentage points if prices remain elevated through the second quarter.

The transmission runs through several channels. Transport and logistics costs rise immediately, followed by petrochemical and manufacturing input costs. Food prices are particularly sensitive given the energy intensity of modern agriculture. For Europe, which imports nearly all of its oil and a significant share of its gas, the shock is compounded by the simultaneous disruption to liquefied natural gas flows through the same waterway. European natural gas prices nearly doubled in the days following the onset of hostilities before partially retracing on reports of diplomatic contacts.

Bonds under pressure: yields rise as rate cut expectations fade

The bond market reaction has been swift and telling. The benchmark US ten-year Treasury yield spiked to 4.21 percent on 9 March before partially retracing to around 4.14 percent by 13 March, as the White House signalled the conflict may be nearing its end and the IEA proposed the largest coordinated release of strategic oil reserves in history. The yield had been steadily declining through February amid expectations of further rate cuts. In Europe, sovereign bond yields have risen across all major economies as inflation fears outweigh traditional flight-to-quality demand.

The sell-off reflects a fundamental repricing of the interest rate outlook. Before the conflict, markets were pricing in multiple rate cuts from the Federal Reserve and the European Central Bank in 2026. The oil shock has dramatically altered that calculus. Traders are now positioning for a later start to monetary easing, with



some pricing out rate cuts entirely for the first half of the year. For bond portfolios, the implications are significant: rising yields mean falling prices, and the longer the duration of a holding, the greater the capital loss. Investment-grade and sovereign bond funds, which had rallied through late 2025 and early 2026, face a sharp reversal if the conflict persists.

Interest rates: the central bank dilemma

Central banks now face a classic stagflationary dilemma. Higher energy prices simultaneously push up inflation and weigh on economic growth. The Federal Reserve, which had been expected to resume cutting rates in the second quarter, is now likely to hold steady until the inflation picture clarifies. The European Central Bank finds itself in what economists have described as a genuine dilemma, balancing an oil-driven inflation spike against a growth outlook already weakened by trade tensions. In Asia, several central banks including those in Malaysia, Australia and Singapore are now expected to tighten policy rather than ease, while others are delaying planned cuts. The critical variable is duration. If the disruption proves short-lived and oil prices retreat to the 70 to 80 dollar range within weeks, the inflationary impulse will be transient and central banks can largely look through it. However, if the strait remains closed or fighting

escalates further, the world faces a sustained energy shock that could tip vulnerable economies into recession while simultaneously pushing prices higher. This is the scenario markets fear most: a supply-driven inflation surge that monetary policy is ill-equipped to address without inflicting further economic pain.

Conclusion

The oil price shock triggered by the Iran conflict continues to challenge global financial markets. Although prices have pulled back from their peak above 100 USD to around 88 USD as diplomatic signals emerge and the IEA has proposed its largest-ever reserve release, inflation expectations remain elevated, bond yields are still well above pre-conflict levels and central banks are being forced to reconsider their easing trajectories. For investors, the immediate priority is to assess duration risk in fixed-income portfolios, consider inflation-protected securities and maintain diversification across energy-sensitive and energy-insulated sectors. The coming weeks will be decisive: either a diplomatic resolution restores oil flows and markets normalise, or a prolonged disruption ushers in a new period of stagflationary pressure that fundamentally reshapes the investment landscape for the remainder of 2026.

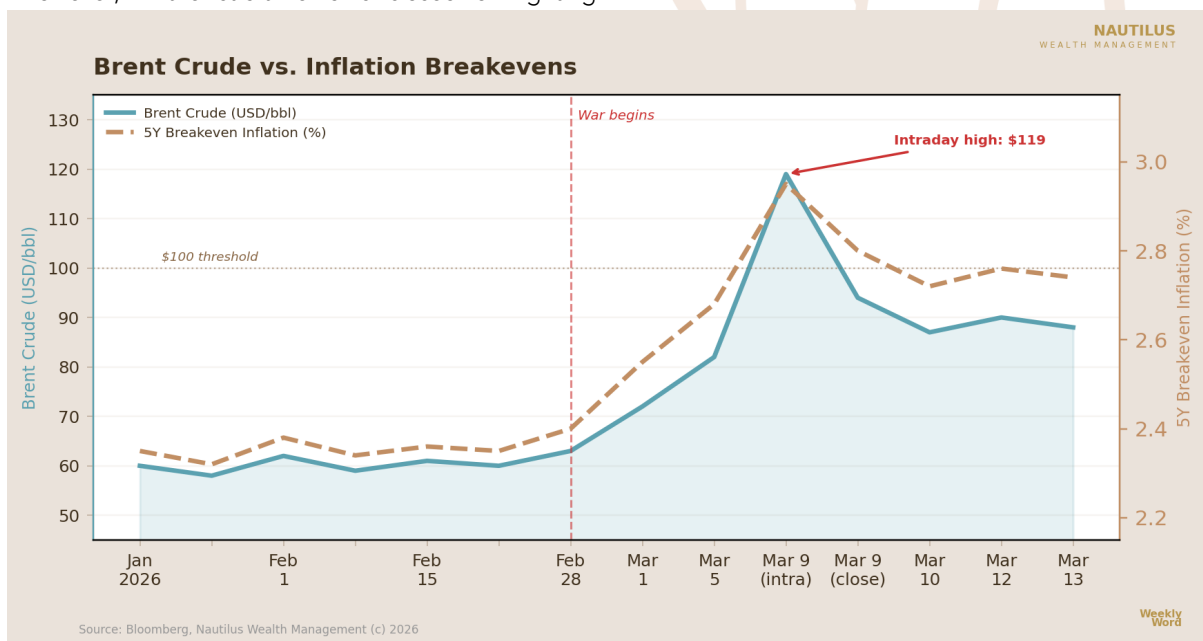


Chart 1: The oil price shock has driven a sharp divergence between energy costs and bond market expectations. As Brent crude surged past one hundred dollars, inflation breakevens widened and nominal yields rose, reflecting the market repricing the probability of near-term rate cuts from major central banks.

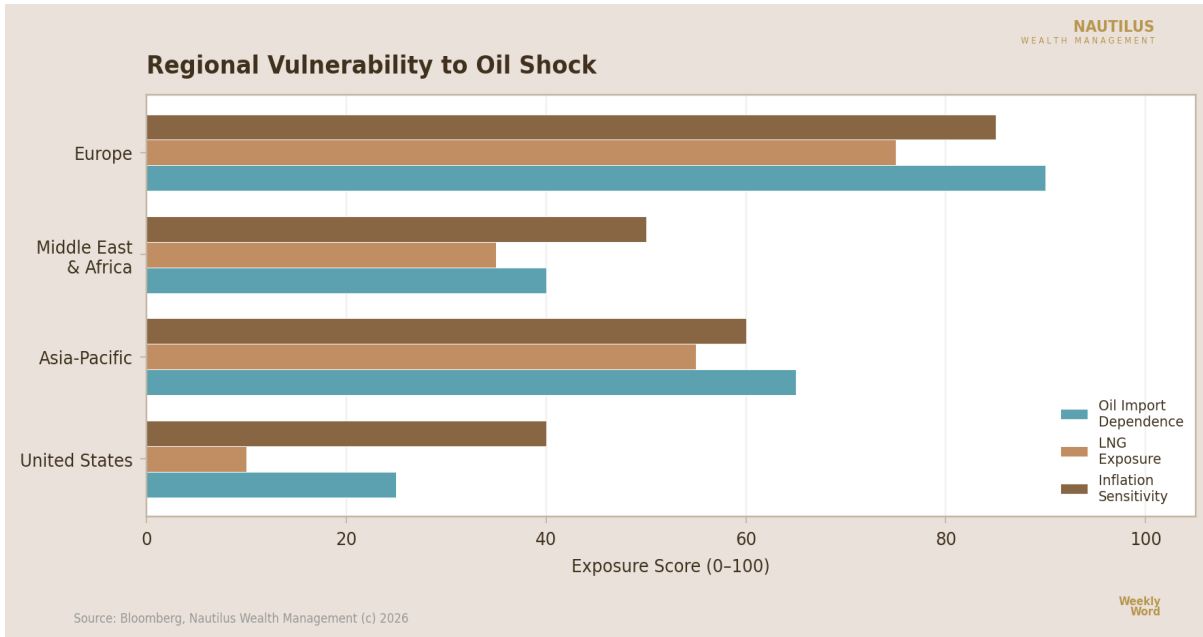


Chart 2: The impact of the oil shock varies significantly by region. Europe faces the greatest vulnerability due to its near-total dependence on imported energy, while the United States benefits from substantial domestic production. Asia-Pacific economies are exposed through both oil and liquefied natural gas import channels.

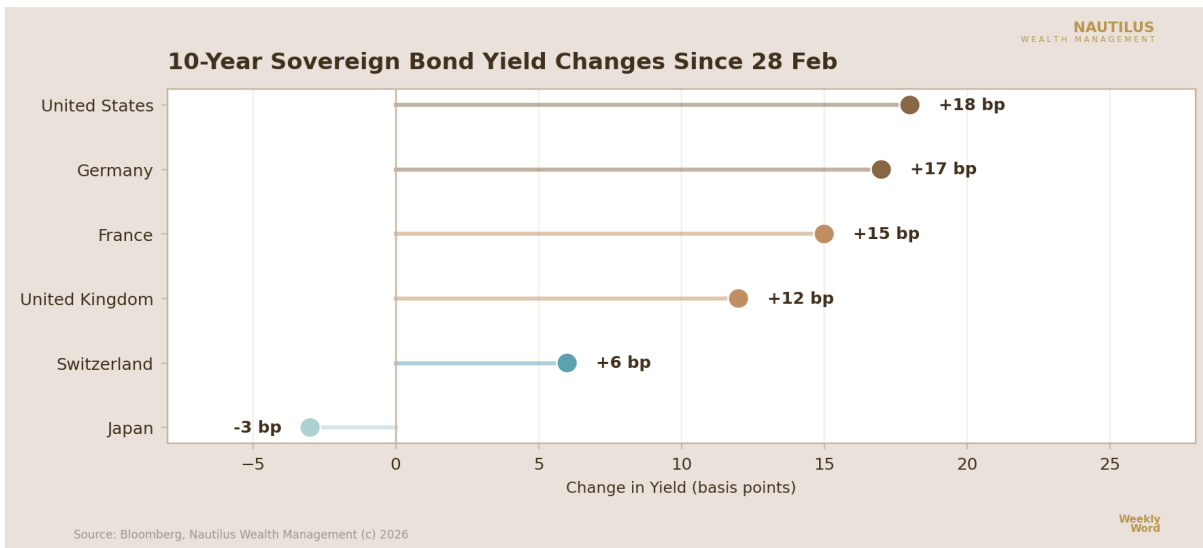


Chart 3: Bond yields have risen across all major economies since the onset of hostilities, reflecting higher inflation expectations and a repricing of central bank rate cut timelines. The sell-off has been most pronounced in longer-duration sovereign debt.

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