



Global Investment Office | March 12, 2026

# US Policy Pulse

## America, Iran and the Midterm Elections

In this report we dive into the economic and market impacts of the war in Iran.

### Key Insights:

- Oil prices have surged over 40% for the year to date as the conflict in the Middle East has effectively closed the Strait of Hormuz, through which 20% of global oil supply travels.
- Historically, geopolitically driven market declines are short-lived: The S&P 500 Index has gained an average of 8.4% in the 12 months following major geopolitical risk events that we analyzed.
- US equities have remained resilient compared with international stocks, which are down 6% since the onset of the war in Iran.
- The US dollar has strengthened while the 10-year US Treasury yield has jumped 27 basis points, reflecting potential for renewed inflation pressures.
- Higher oil prices could push headline Consumer Price Index (CPI) inflation up 70 basis points, with a minor impact on core CPI, though the oil shock's duration matters.
- Although the wallet share of energy in consumer spending has declined from 7% to 2% since the 1970s, US consumers remain sensitive to higher oil prices, with affordability a top voter concern.
- Republicans are likely to lose the majority in the House of Representatives and keep the Senate, although the margin between Democrats and Republicans in the Senate could tighten with a prolonged energy shock.
- The war could also catalyze further defense spending and add to debt and deficit pressures, while supporting defense sector performance.

The global political landscape is entering a period of heightened complexity as geopolitical tensions intersect with the US electoral cycle. The increasingly multipolar world is being shaped by resource competition, shifting alliances and persistent regional conflicts, as Washington seeks to assert its economic and military influence across key regions including the Middle East, and most recently Iran. Foreign policy decisions are likely to carry implications for markets, energy prices and the economy.

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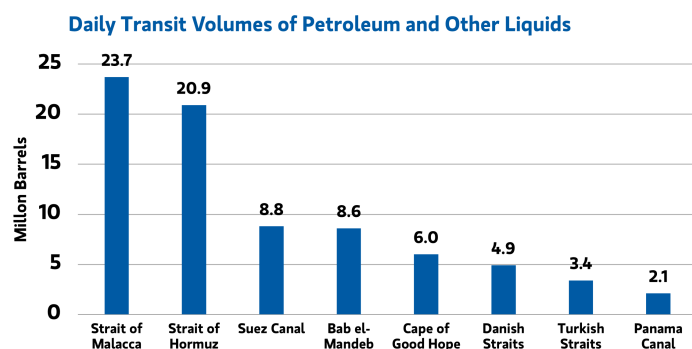
## US POLICY PULSE

Domestic political considerations are growing in importance as policymakers begin to orient themselves toward the approaching midterm elections. Historically, midterm cycles have introduced added policy uncertainty, with markets often underperforming in the second year of a presidential term as congressional momentum has shifted to campaign season and legislative activity has stalled. The sitting president's party often faces pressure in the midterms as voters assess their priorities under a new or evolved policy regime. That said, policy decisions impacting energy prices, defense spending and geopolitics could influence domestic policy responses, as well as future election outcomes. With these dynamics in mind, we discuss some of the most important investor considerations of the Iran war, highlighting its potential impact on the markets, the economy and the midterm elections.

### Evolving State of Play

On Feb 28, the US and Israel launched coordinated missile strikes across Iran, targeting nuclear facilities, military infrastructure and senior leadership. Iran responded with attacks against Israel, US bases and allies across the Middle East, rapidly escalating the regional conflict. Ongoing military action has catalyzed an energy supply shock as global oil shipping through the Strait of Hormuz ground to a halt. About 20% of global oil supply travels through the strait, with transit volumes of approximately 21 million barrels per day, making it the second-most-active global shipping chokepoint (see Exhibit 1). The effective closure pushed crude prices above \$100 per barrel late last week, contributing to higher gas prices, inflation concerns and renewed volatility across financial markets.

### Exhibit 1: Critical Energy Supply Chains Are Under Pressure



Source: EIA, Vortexa, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2023

While the US has signaled a desire to end the conflict, long-term implications of the shock are important to consider. Energy-importing economies in Europe and Asia likely face the greatest pressure from rising fuel costs, while major exporters benefit from higher prices. The conflict underscores the central role of the Middle East in global energy security and how regional instability can quickly translate into broader market and economic disruptions. That said, we emphasize that the duration and breadth of the conflict are critical when considering the magnitude of these impacts.

### How Have Markets Reacted to the Conflict?

Historically, significant market corrections have typically been catalyzed by one of three primary drivers: 1) structural inflation and higher interest rates leading to unexpectedly hawkish monetary policy; 2) higher unemployment; and 3) exogenous shocks such as wars, pandemics, trade disruptions and energy crises. Of the three, exogenous shocks are often short-lived, resulting in limited long-term market implications despite initial volatility. In fact, over the past 75 years, the S&P 500 Index has risen 8.4%, on average, in the 12 months following major geopolitical risk events that we analyzed (see Exhibit 2). This highlights the importance of staying focused on long-term investing objectives amid short-term price volatility.

### Exhibit 2: Geopolitically Driven Volatility Is Typically Short-Lived

Event	Start Date	S&P 500 Return				
		+1W	+1M	+3M	+6M	+12M
Korean War	June 1950	-7.6%	-10.0%	1.5%	4.9%	11.2%
Vietnam War	November 1955	4.4%	7.3%	4.1%	13.9%	10.0%
Suez Crisis	October 1956	2.6%	-4.4%	-3.6%	-1.4%	-12.3%
1958 Lebanon Crisis	July 1958	2.9%	5.3%	12.1%	23.8%	32.1%
Cuban Missile Crisis	October 1962	-6.3%	5.4%	13.3%	21.1%	27.8%
Indo-Pakistani War	August 1965	0.7%	2.6%	7.7%	8.7%	-2.1%
Six-Day War	June 1967	4.1%	3.3%	6.5%	7.7%	13.0%
Yom Kippur War	October 1973	14.4%	-4.5%	-10.0%	-15.3%	-43.2%
Fall/Liberation of Saigon	April 1975	2.0%	4.4%	1.8%	2.3%	16.4%
Iran Hostage Crisis	November 1979	-1.0%	4.2%	11.6%	3.0%	25.9%
Soviet-Afghan War	December 1979	0.3%	5.6%	-7.8%	6.9%	26.2%
Iran-Iraq War	September 1980	-5.3%	1.2%	4.1%	2.8%	-10.5%
Multinational Force in Lebanon	August 1982	0.6%	4.9%	13.9%	27.6%	36.8%
US Action in Libya	April 1986	2.0%	-1.4%	-1.7%	0.5%	19.6%
US Action in Panama	December 1989	1.7%	-1.1%	-0.4%	4.7%	-3.7%
Gulf War	August 1990	-3.3%	-8.2%	-11.3%	-2.4%	10.2%
Croatian War	March 1991	0.0%	0.0%	-1.1%	3.4%	7.6%
Bosnian War	April 1992	0.1%	2.8%	2.0%	0.4%	8.8%
Kosovo War	February 1998	0.6%	4.4%	4.6%	-2.1%	18.0%
War in Afghanistan	October 2001	1.9%	4.1%	8.7%	4.8%	-26.7%
Iraq War	March 2003	-0.8%	2.0%	13.7%	18.3%	26.7%
Russia/Ukraine	February 2022	1.7%	5.4%	-8.1%	-3.4%	-7.4%
<b>Average</b>		<b>0.1%</b>	<b>1.5%</b>	<b>2.8%</b>	<b>5.9%</b>	<b>8.4%</b>
<b>Median</b>		<b>0.7%</b>	<b>3.1%</b>	<b>3.1%</b>	<b>4.1%</b>	<b>10.7%</b>

Note: S&P 500 returns reflect index price changes; stated Vietnam War start date corresponds to beginning of US military assistance to South Vietnam.

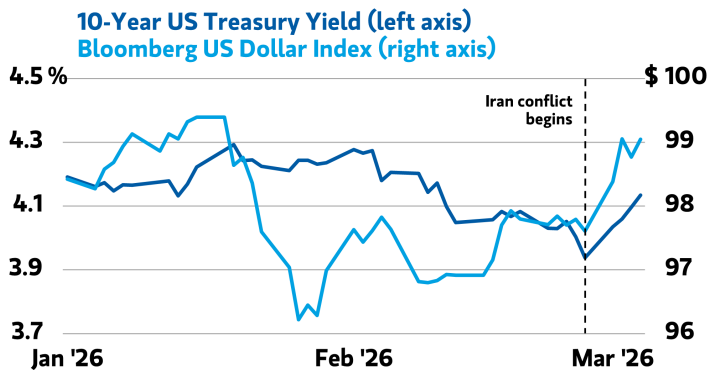
Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 5, 2026

US equity markets have remained relatively resilient in the face of the current conflict, with the S&P 500 flat since its onset, amid strong energy sector performance and a global rotation into US equities. Weakness in international equity markets, as illustrated by the MSCI World ex US Index's 6% decline, suggests investors view European and Asian stocks as more exposed to the energy shock than counterparts in the US, which benefits from increased energy independence and domestic oil supplies.

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The 10-year US Treasury yield has risen by 27 basis points given the combination of renewed inflation worries due to higher oil prices and growing concerns around deficit spending. At the same time, the US dollar has strengthened, highlighting the relationship between rising US interest rates and the attraction of global capital flows. Such flows are a function of increased demand for dollar-denominated assets and reinforce dollar strength during periods of geopolitical uncertainty (see Exhibit 3).

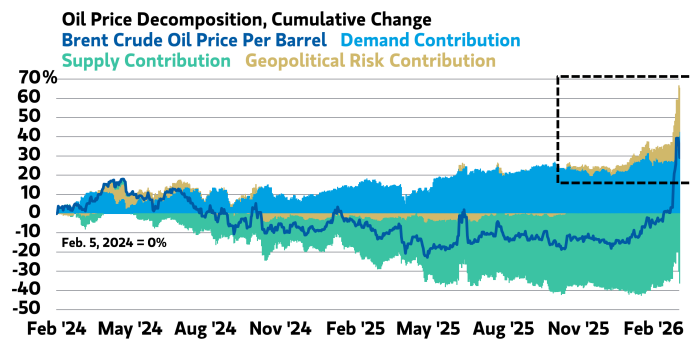
### Exhibit 3: US Dollar Strengthened as Geopolitical Risk Rose, While Yields Jumped



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 10, 2026

While near-term US equity pressures may be limited, energy constraints could persist even if the US disengages from the conflict as geopolitical risk has increased in the Middle East. As we noted in last month's *US Policy Pulse*, "[Pricing the Politics of Power](#)," oil markets have been reflecting a higher geopolitical risk premium since the start of 2026, with prices up 51% this year and over 30% since Feb. 27 (see Exhibit 4).

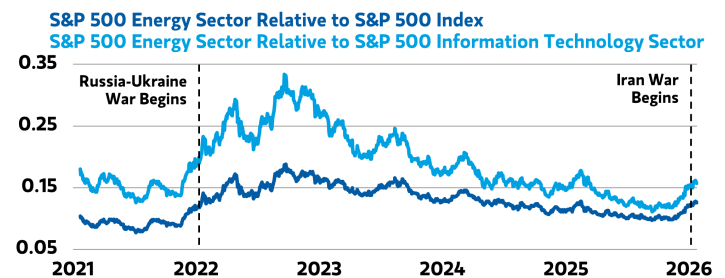
### Exhibit 4: Geopolitics Has Been a Primary Driver of Oil Prices in 2026



Source: Bloomberg Economics, Morgan Stanley Wealth Management Global Investment Office as of March 10, 2026

The risk premium dynamic can also be seen in the price action of large-cap energy stocks, with market reaction to the Iran conflict so far comparable to that of other recent energy shocks. For example, following the Russian invasion of Ukraine in February 2022, the S&P 500 energy sector outperformed both the broader market and the tech sector (see Exhibit 5). This suggests that energy and energy infrastructure may have higher exposure to geopolitical risk and we encourage investors to consider energy infrastructure carefully when leveraging as an inflation hedge, keeping long-term investing goals in mind as they seek diversification.

### Exhibit 5: Energy Stocks Have Outperformed the S&P 500 During Periods of Geopolitical Risk

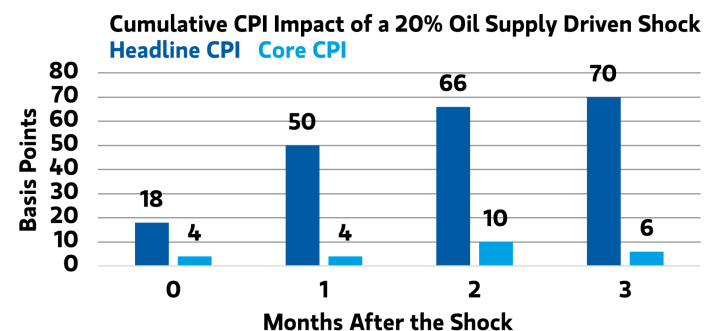


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 10, 2026

## Oil Shocks and the Economy

Supply-driven oil shocks have historically tended to have a mixed economic impact. According to Morgan Stanley & Co.'s economists, oil shocks of a 20% magnitude have resulted in a cumulative 70-basis-point short-run boost to headline CPI after three months but have had a far more limited 6-basis-point impact on core CPI (see Exhibit 6). If the oil shock remains contained, we would expect a more modest impact on core inflation, which would suggest that the Federal Reserve could look through the short-term inflation pressures. However, if higher oil prices persist, the Fed's reaction function could be complicated, supporting a higher fed funds rate for longer.

### Exhibit 6: Oil Shocks Tend to Boost Headline CPI

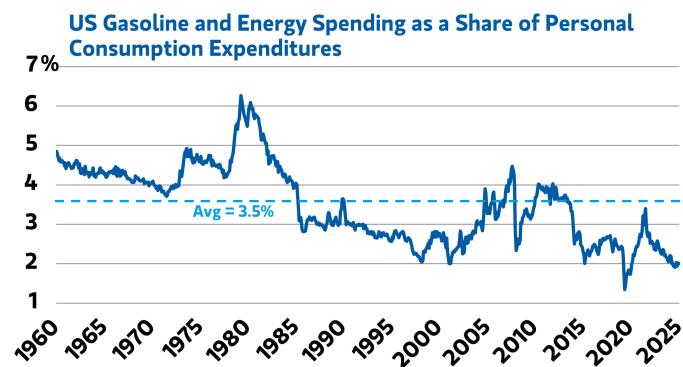


Source: BLS, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of March 4, 2026

### Oil Prices and the Consumer

While higher oil prices from supply shocks tend to erode consumer spending power, it is worth noting that the US economy is more insulated from supply shocks than in previous decades. The US has become a net energy exporter and the top oil-producing country in the world, reducing the need for vast energy imports, though not eliminating it. Partly due to a more diverse mix of energy sources and the introduction of renewables, the US is also less dependent on oil to conduct business than it used to be. US oil consumption per unit of GDP has fallen by almost 70% since 1980, suggesting that today, it takes 70% less oil to produce the same amount of GDP. For consumers, spending on gasoline and other energy as a share of total consumption is one-third of what it was in the late-1970s, falling to almost 2% from a peak of 6%, and below the historical average (see Exhibit 7). That said, higher oil and gas prices at the pump often serve as a proxy for voters' assessment of economic conditions ahead of the midterm election cycle.

### Exhibit 7: The Wallet Share of Energy in Consumer Spending Has Declined



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of December 31, 2025

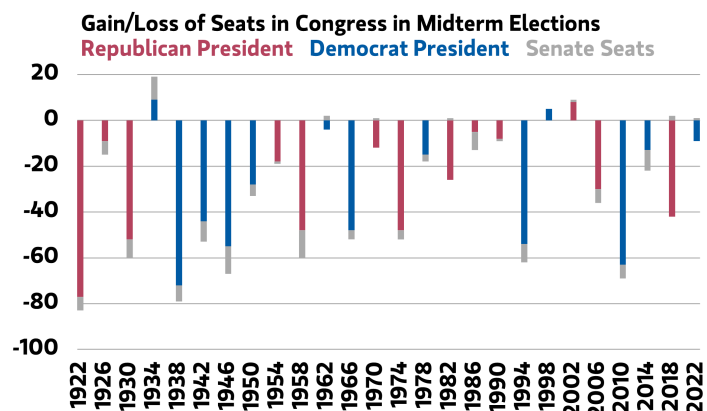
### US Politics: Affordability and the Midterms

The oil shock of 2022 underscored voter and consumer sensitivity to higher prices associated with cost of living, perceived wealth and affordability—factors we believe ultimately defined the 2024 election. For most of President Trump's second term, oil and gas prices have been a major point of relief for households, businesses and consumers, as prices have fallen. Rising prices at the pump, one of the most visible signs of daily affordability for most voters, could pressure low-income consumers, with the bottom 20% of consumers spending four times more on energy than the top 20%.

The political sensitivity of rising prices could further pressure the GOP's 2026 midterm election prospects. The sitting president's party has lost an average of 30 seats in the House in midterm elections since 1922. In the Senate, the sitting

president's party has lost an average of four, thereby also pressuring Republicans, given their narrow 53–47 majority (see Exhibit 8). We expect the GOP to lose the House and keep the Senate, although the margin in the Senate could tighten with a prolonged energy shock.

### Exhibit 8: The Sitting President's Party Has Historically Lost Seats During Midterms



Source: Morgan Stanley Wealth Management Global Investment Office as of March 10, 2026

### What Options Does the Trump Administration Have to Address Rising Oil Prices?

Beyond a cessation of conflict through military or diplomatic means, President Trump has suggested several options to address rising oil and gas costs. More broadly, the Trump administration has pursued a deregulatory strategy aimed at boosting the domestic supply and production of energy, which we highlighted in our March 12, 2025, report, "[Deregulation Risks and Opportunities](#)." The administration may also seek to pressure domestic oil producers to boost production. However, US oil and gas rig counts have fallen to 2021 levels, suggesting that while the surge in prices is a positive production signal, they may only be able to increase production at the margin due to limited capacity. Producers have previously signaled that WTI crude prices above \$75 per barrel typically incentivize a substantial increase in drilling, though we note that this could take months, and prices would need to remain above that level for a sustained period.

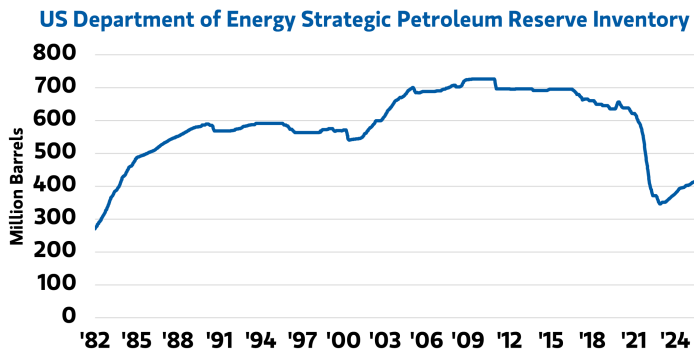
Other policies announced include US ship insurance, through the US Development Finance Corporation, for all nonsanctioned tankers transiting the Strait of Hormuz, along with a US Navy escort for tankers. The administration also granted India a 30-day waiver to resume purchases of Russian oil, which could then be refined and sold on the global market.

The administration may also have other creative, short-term options ahead of the midterms: The president may be inclined to tap the Strategic Petroleum Reserve (SPR), currently at

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415 million barrels and rising, but stockpiles are close to their lowest since the 1980s (see Exhibit 9). The administration could also grant a temporary domestic holiday on gasoline taxes. However, there is no guarantee that refiners and gas stations would pass through lower costs to consumers. While oil prices have been highly sensitive to announcements by the president, policy action's impact may be fairly limited.

### Exhibit 9: The SPR Could Be Tapped, But Stockpiles Are Near Their Lowest Since the 1980s

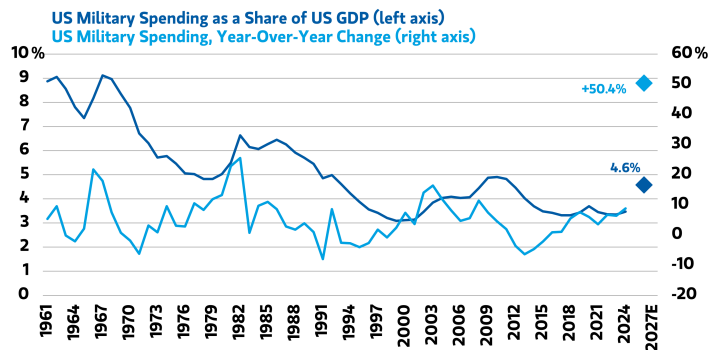


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 10, 2026

### Defense and Fiscal Spending

In addition to the implications for oil prices and the midterms, the conflict supports President Trump's \$1.5 trillion defense spending request for fiscal year 2027. This increase would raise military spending as a share of GDP to 4.6% in 2027 and represent an approximately 50% upsurge from 2024, the highest annual increase in at least 60 years (see Exhibit 10). While it's unclear if Congress will approve the increase in the near term, reports have suggested that the US spent \$5.6 billion on munitions during the opening 48 hours of the war, catalyzing momentum for \$50 billion in supplemental defense spending from Congress. Though the potential duration of US involvement remains a key unknown, military conflicts have historically required supplemental and emergency defense funding. Over time, we believe that fiscal policy and elevated government spending related to the conflict could modestly weigh on debt and deficits and support higher US Treasury term premiums—the amount of additional compensation investors demand for holding longer-maturity US Treasuries.

### Exhibit 10: US Military Expenditures Are Expected to Grow Drastically



Note: GDP figures for 2025 to 2027 are projections; latest military expenditure data is as of 2024.

Source: World Bank, SIPRI, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of March 10, 2026

US global military involvement, and subsequent defense spending, are also likely to support defense stock performance. We expect prime defense contractors to continue to benefit, along with companies specializing in drones, satellite technologies and missile defense systems.

### Investment Conclusion

The US-Iran conflict has catalyzed a meaningful global supply shock via the effective closure of the Strait of Hormuz, through which 20% of the world's oil supply transits. If sustained, this could complicate the Fed's reaction function, potentially supporting a higher fed funds rate for longer. At the same time, history suggests that geopolitically driven equity volatility is often short-lived, with the S&P 500 gaining an average 8.4% in the 12 months following major geopolitical risk events, reinforcing the importance of staying anchored to long-term objectives.

Politically, although energy makes up a smaller share of overall consumer spending than it did in the 1970s, US consumers remain sensitive to higher prices, with affordability a top voter concern ahead of the midterms. Meanwhile, history suggests that the sitting party tends to lose seats in the midterm elections: Republicans are likely to lose the House and keep the Senate in 2026, although the margins in the Senate could tighten with a prolonged energy shock. The war could also catalyze further defense spending and add to debt and deficit pressures, while supporting defense sector performance.

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**S&P 500 Energy Sector Index** is a capitalization-weighted index. The index was developed with a base level of 10 for the 1941-43 base period. The parent index is SPXL1. This is a GICS Level 1 Sector group. Intraday values are calculated by Bloomberg and not supported by S&P DJI, however the close price in HP<GO> is the official close price calculated by S&P DJI.

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For index, indicator and survey definitions referenced in this report please visit the following: <https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions>

#### Glossary

**Real Gross Domestic Product (GDP)** is the GDP of the country measured at current market prices and adjusted for inflation or deflation.

**Risk premium** is the return in excess of the risk-free rate of return an investment is expected to yield.

**Volatility** This is a statistical measure of the dispersion of returns for a given security or market index. Volatility can either be measured by using the standard deviation or variance between returns from that same security or market index. Commonly, the higher the volatility, the riskier the security.

#### Risk Considerations

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rise, bond prices fall and vice versa. Longer-term bonds carry a longer or higher duration than shorter-term bonds; as such, they would be affected by changing interest rates for a greater period of time if interest rates were to increase. Consequently, the price of a long-term bond would drop significantly as compared to the price of a short-term bond.

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RSI1773322938342 03/2026