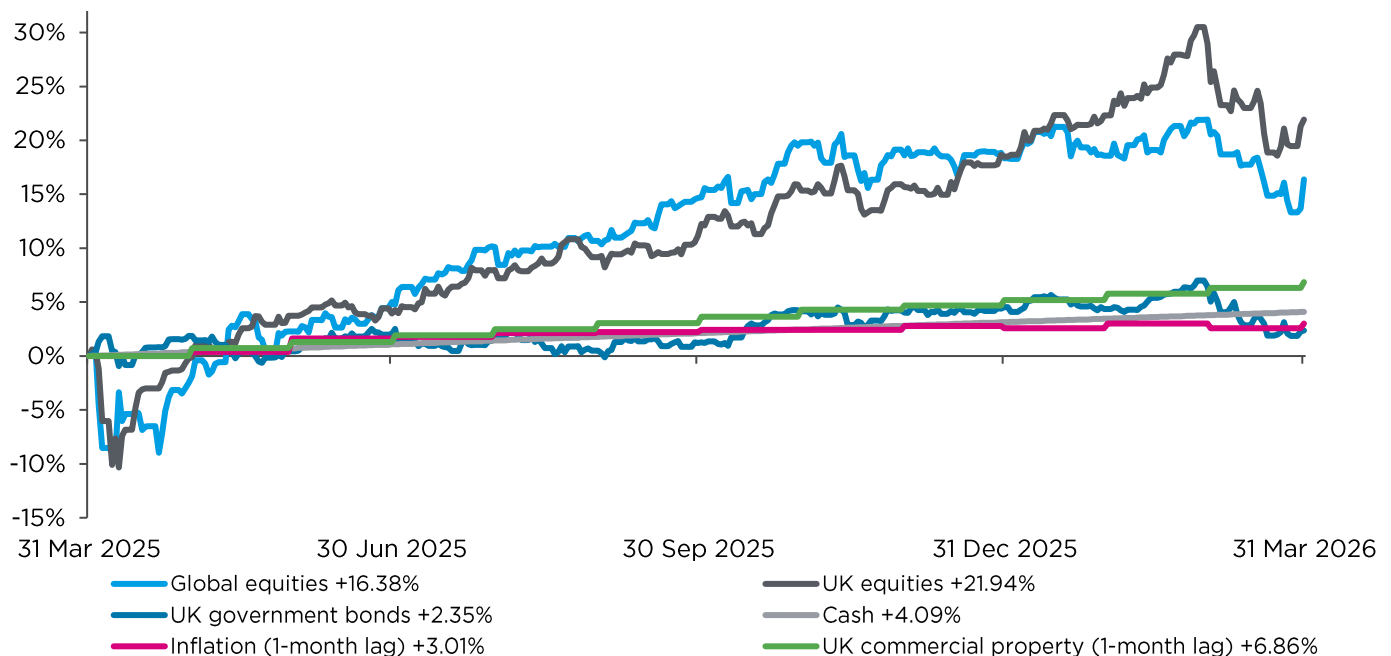


# Market review

## The headlines

- ▶ **The Middle East war was the principal and most publicised driver of share prices in March, but not the only one.**
- ▶ **Shares in energy-importing regions and those that started the month at high valuations suffered disproportionately.**
- ▶ **Central banks kept interest rates on hold during March, but bond yields rose significantly.**

### Market returns: the Middle East war led to a significant decline in share prices during March.



Sources: Bloomberg, returns in pound sterling as of 31 March 2026 (31 March 2025=0%). Daily data, except for inflation and UK commercial property, shown monthly. UK government bond returns as per Markit iBoxx £ Gilts Index. Inflation as per the Office of National Statistics' UK Consumer Prices Index, with a one-month lag. UK commercial property as per MSCI UK Monthly Property Index, estimated for the most recent month. Cash returns as per Sterling Overnight Index Average (SONIA). Global and UK equity returns as per MSCI World Index and MSCI UK IMI Index, respectively. **Past performance is not a reliable indicator of future results.**

## Economics and markets news

The war between the United States, Israel and Iran that started on the last day of February triggered a 6.4% decline in world share prices in March.<sup>(1)</sup> Prices fell 4.9% in the US, 6.6% in the UK and 8.4% in the eurozone, in local currency.

But the US dollar strengthened somewhat during March, relative to the pound sterling. That cushioned losses on US dollar-denominated assets for UK investors.

The oil price rose from \$72 per barrel on 27 February to \$105 at the end of March, but the gold price fell 13% over that time, from \$5,248 to \$4,678 per troy ounce.

Rising energy prices raised fears that inflation might increase and that government budgets might come under pressure. Central banks took a wait-and-see approach during March. Nevertheless, short-term and long-term bond yields rose significantly during the month.

## United States

The Middle East war was the principal driver of world share prices in March.

But share prices in the US didn't move much right after the war started. That's probably because investors had anticipated the conflict and, after last June's conflict, thought that it might be over soon.

Instead, share prices declined gradually, as the conflict implicated Iran's neighbours across the Persian Gulf, with more severe consequences than anticipated, and took longer than investors had expected.

First, Iran's counterattacks on the UAE, Kuwait and other Gulf states caused unprecedented disruption across the Gulf region. At the end of the month, attacks by Iran-allied Houthi rebels in Yemen even endangered the entrance to the Red Sea.

Secondly, Iran's blockade of the Strait of Hormuz was more severe than anticipated. Large oil importers in Asia, such as China and India, even rationed some fuels.

Lastly, President Trump's repeated assurances that the war had been 'won' or would be over 'very soon' only settled nerves for short periods of time, usually followed by further share price declines.

By the end of March, therefore, US share prices had fallen 4.9%, led by industrial firms, health care providers and consumer staples companies. Because the US is a net oil exporter, only some of that fall related directly to the Middle East conflict.

Share prices of industrial firms such as Southwest Airlines and taser producer Axon suffered the most direct effects from events in the Middle East. The war threatens to increase these energy-intensive businesses' costs, while also causing an economic slowdown that may reduce demand for their products.

Shares of managed care firms such as Centene led the decline in health care. These companies deliver government programmes such as Medicaid. The expiry of Covid-era subsidies has seen these companies' membership shrink, with less profitable members remaining and health care costs rising.

In the consumer staples sector, investors reacted negatively to merger news about beauty firm Estee Lauder and condiments producer McCormick & Co.

Energy was the only stock market segment in which average US share prices rose during March. Higher oil prices boosted bellwethers such as Occidental Petroleum. Some smaller firms, such as APA, benefited disproportionately from the fact that they have little exposure to the Persian Gulf.

On the economic front, core personal consumption expenditure (PCE) inflation, the preferred inflation gauge of America's central bank, the Federal Reserve (the Fed), had risen from 2.8%, year on year (yoy) in November 2025 to 3.0% in December. It rose again in January, to 3.1%, but headline consumer price (CPI) inflation remained steady in February, at 2.4% yoy.

February's US jobs report showed an unexpected loss of 92,000 jobs, versus the 60,000 gain expected. But the Fed held its main policy interest rate steady during March. Its outgoing chairman, Jay Powell, said that the US 'economy is doing pretty well' but that inflation 'remains somewhat elevated'. The Fed, he said, would take into account 'financial and international developments' before its next move.

Overall, higher energy prices have made it less likely that the Fed will cut interest rates twice this year, as investors had been expecting. Much will depend on the Fed's incoming chair, Kevin Warsh, who joins in May.

The about-turn in expected inflation and in interest rates had a marked impact on bond yields as well. The yield on two-year US Treasuries (government bonds) rose from 3.38% at the end of February to 3.79% at the end of March.<sup>(2)</sup> Ten-year US Treasury yields rose from 3.97% to 4.30% over that time.

## United Kingdom

The Middle East war is significant for the UK economy because we are net energy importers. UK CPI inflation held steady in February, at 3.0% yoy, but could rise significantly if energy prices remain at current levels.

Higher inflation, in turn, makes it less likely that the Bank of England (BoE) will continue to cut interest rates in 2026, as analysts had expected before the war. Instead, analysts now expect the BoE to raise interest rates twice in 2026. In March, however, the BoE kept rates on hold, while it 'assesses how events unfold'.

Yields on two-year UK government bonds ('gilts') shot up from 3.53% at the end of February to 4.28% at the end of March, and 10-year gilt yields from 4.23% to 4.94%. Debt interest payments are a significant portion of the UK government's spending, so observers are closely monitoring the impact that higher interest rates may have on the government's budget.

UK share prices fell 6.6% in March. Notable losers included housebuilders Persimmon and Taylor Wimpey, on fears of higher interest rates, and firms such as aerospace-to-nuclear concern Rolls-Royce and airline easyJet, because of higher energy prices.

Share prices of mining firms Antofagasta and Fresnillo also fell. Precious metals prices slid as investors took profit after recent highs, with higher interest rates offering suitable alternative investments. Industrial metals such as copper sold off after recent highs, because higher energy prices raise the possibility of a global economic slowdown.

Unsurprisingly, oil firms British Petroleum and Shell led the section of the UK stock market that performed well during the month, benefiting from higher oil prices.

## Other markets

**Eurozone** share prices fell 8.4% in March. That decline was led by mining firms such as Sweden's Boliden, and industrial firms like Schneider Electric, but share prices in sectors like technology also fell.

Europe's central bank, the ECB, kept interest rates on hold during March, but raised its inflation projection for 2026. Eurozone inflation data, which is available more quickly than that in other regions, sharply increased, from 1.9% yoy in February to 2.5% in March. That was its steepest monthly increase since October 2022.

**Japanese** shares prices fell 10.8% during March, mainly because Japan is highly dependent on Middle East oil.

The Bank of Japan held its policy interest rate at 0.75% in March. It continues to monitor the yen and inflation and aims to resume its gradual rate hikes later this year.

**Chinese** shares fell 7.4% during March, because China also depends strongly on Middle East oil. In addition, the slump in China's property prices and consumption continued during the month.

The Chinese government set a growth target of 4.5%-5% at its five-yearly meeting in early March, signalling a shift from rapid growth to higher-quality development, including technological self-reliance and environmental sustainability.

<sup>①</sup> Source: MSCI (total return, net of withholding tax, in local currency), except where stated

<sup>②</sup> Sources: US Fed, Bank of England, European Central Bank

## Looking ahead

In addition to its direct human cost, the Middle East war will have significant effects on the world economy in 2026. That's not only because prices for oil and gas are critical for transport, heating and industry. Across our economy, by-products of oil and gas exploration are important, including – for example – helium in medicine and micro-chips, or fertilisers in agriculture.

Higher energy prices have the potential to cause **stagflation** across the economy.

- **Inflation** is the first of stagflation's two components. If the oil price remains at c. \$100 per barrel, UK CPI inflation could be a full percentage point higher over the next 12 months than currently forecast.

The US is more insulated from this effect, as it is a net energy exporter. But there, too, higher energy prices

could halt the recent downtrend in inflation. Asia is a significant importer of Middle East oil and gas. Apart from the direct impact on consumer prices there, higher producer prices in Asian manufacturing could, indirectly, raise inflation in the rest of the world.

- Economic **stagnation** is a second possible consequence of this war. Analysis suggests that, at current levels, the share of consumption spent on oil would rise by 0.6 percentage points, holding back other spending.

That is a modest rise, compared to the 3.0-3.5 percentage point rise during the two 1973 and 1979 oil shocks. To repeat that effect, oil prices would have to rise to \$170 per barrel and stay there for a year.

The situation in the Middle East clearly has the potential to derail the economy. But upcoming US mid-term elections on 3 November will, in our analysis, spur President Trump to find a solution to this crisis.

The war has not yet impacted the outlook for corporate profits, apart from modest downgrades in the UK, Europe and Japan. In fact, the expected growth in US companies' profits for the 12 months ahead has accelerated from 13% before the war to 16% now, mainly due to energy shares and the AI sector.

Lower share prices and stable to growing corporate earnings make for more attractive price-earnings ratios. Given our focus on earnings and valuations, we have therefore maintained our allocations to equities.

## Glossary

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