Morgan Stanley
INVESTMENT MANAGEMENT

Global Equity Observer

Energy price spike, geopolitical conflict and shifting narratives

INVESTMENT INSIGHT | INTERNATIONAL EQUITY TEAM | April 2026

The first quarter of 2026 started in positive territory for broad global equity markets, but sentiment reversed following the U.S. and Israel strikes on Iran at the end of February. By March end, the MSCI World Index had fallen 6.4% in the month, leaving it down 4% for the quarter. Investors are now assessing the implications of a potential severe energy shock, which could lead to rising inflation expectations and even an increasing risk of stagflation.

Brent crude rose 63% in March—the largest monthly increase on record.[1] The Strait of Hormuz carries around a fifth[2] of global oil supply, alongside critical flows of liquefied natural gas, helium, petrochemicals and fertilisers. The disruption is widely considered the largest supply shock since the 1970s.

Equity market volatility increased, with daily index moves often dictated by escalation or de-escalation news from the White House. Despite this, overall index levels suggest a fairly complacent reaction so far, with The Economist[3] calling out "staggering optimism about a bad situation that could get an awful lot worse" and warning that equity investors are the ones that will end up looking "flat-footed".

However, the current crisis has not yet behaved like a typical growth scare. Energy, which we don't hold, was the only sector to deliver positive returns in March, rising +12%, while defensive sectors, such as consumer staples and health care, down -9% and -8%, respectively, underperformed the overall index as a result of the oil shock and the market's focus on inflation, supply chain disruption and the reduced likelihood of near-term interest rate cuts. As at the time of writing (10 April), markets have recovered the bulk of the March losses on the back of a ceasefire, but the outlook remains very uncertain.

[1] Source: Wall Street Journal. Brent Crude Price Notches Record Monthly Jump

[2] Source: U.S. Energy Information Administration (EIA) estimates, total global oil supply. The Strait is also estimated to carry 25% of global *seaborne* oil.

[3] Source: The Economist: 'Markets are gripped by an alarming cognitive dissonance', 24 March 2025

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"Oil shocks, geopolitical tensions and shifting AI narratives are rattling markets, testing investor confidence in an increasingly volatile environment."

Intangibles out of favour

The quarter brought more than war. Anthropic's milestone launch in early February of its Claude productivity tools reinforced a narrative that has built over nine months: that AI may accelerate disruption in software and data-related business models. With fears amplified by speculative commentary[4] around the future of white-collar work, we have seen a sharp rotation in equity markets. Investors have sought shelter in "HALO"[5] stocks, companies with heavy physical assets and perceived lower risk of technological obsolescence.

Here, we would voice caution: while intangible business models may be under scrutiny, reallocating towards more capital-intensive and cyclical sectors introduces a different set of risks. These businesses are often more exposed to economic volatility, input cost pressures and supply chain disruption—factors that are becoming increasingly relevant in the current environment. As ever, we believe a selective approach is key.

Adaptability and dispassion

The market rotation has created a challenging backdrop for our long-standing focus on capital-light compounders with durable competitive advantages. Importantly, the earnings growth of our portfolio companies has generally remained robust. However, many stocks have faced sharp derating.

Our response has been disciplined and analytical. We have assessed AI-related risks at both the company and industry level, and engaged with management teams. For key holdings, we have supplemented this work by bringing a fresh perspective to the debate through bull and bear analysis conducted by independent team members, not the primary research coverage, ensuring a balanced and unsentimental evaluation of potential scenarios. Where we judge visibility and predictability of earnings—core components of our investment framework—to have weakened, we have taken action, adjusting position sizes or selling positions accordingly. The broad-brushed sell-off has also created opportunities to add to oversold names, where we think the moat is more durable.

Throughout our team's history as quality investors, we have been open-minded where we find reliable compounders. The evolution of the portfolio over the past nine months reflects this. We have reduced exposure to software and data-exposed stocks in the information technology and financials sectors while increasing allocations to high quality businesses in communication services, consumer discretionary and industrials. Businesses can themselves also evolve. Amazon's transformation of its retail business is an example of a company that now meets our quality criteria, supported by improved economics and a more compelling valuation. At a time when elevated stock dispersion creates a richer opportunity set for stock pickers, we are also alert to idea generation beyond our traditional hunting grounds, while of course retaining our quality focus.

Looking ahead

We face two unfolding narratives which are arguably not reflected in current high valuations: a fast-paced, unpredictable technological revolution that is reshaping entire industries, and a fast-paced, unpredictable conflict that is reshaping a world already reeling from the decline of the rules-based order.

- In AI, so far the market has targeted the more obvious areas, but disruption is likely to extend elsewhere—bringing potential deflation risk to a broader set of industries. Meanwhile, Anthropic and OpenAI's partnership announcements in late February with some of the world's major companies have given credence to Nvidia CEO Jensen Huang's view that hedge funds may have been overzealous in their SAAS (software-as-a-service) short.
- In terms of the war in the Gulf, markets are currently uncertain about its duration. Scenarios range from de-escalation and oil price normalisation to a prolonged disruption and regional escalation driving stratospheric energy prices and economic pain.

The latter might be the trigger that finally tips expensive markets into a broad market drawdown, where quality has typically prevailed. We believe the portfolios' low cyclicality and stronger top-line growth expectations than the index should provide a degree of resilience. Their valuations, measured on a price to free cash flow basis, are now at an unusual discount to the index, which we believe does not reflect the underlying quality and healthy expected top-line growth of the businesses we own.

Source for data cited, unless otherwise stated: MSIM, FactSet, as of March 31, 2026.

[4] Reports including Citrini Research's The Global Intelligence Crisis, 22 February 2026

[5] Heavy assets, low obsolescence: acronym attributed to Ritzhotz Wealth Management CEO Josh Brown

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RO 5400781 Exp. 04/30/2028 26Q20112_KC_0426 Lit-Link: GLBQOBV-0426 LTR