

Research @ Citi Markets Edition: The Iran Playbook

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Transcript:

Opening Teaser: (00:00)

Research @ Citi Markets Edition.

Dirk Willer (00:04)

Welcome to Research at Citi Markets Edition, where we break down Global Macro in 10 minutes or less. I'm your host, Dirk Willer, Citi's Global Head of Macro, and with me today is Adam Pickett, our London macro head.

Welcome to the show, Adam.

Adam Pickett (00:15)

Thank you, Dirk. What a week to be doing this!

Dirk Willer (00:18)

Yes! We are recording this podcast at 9 a.m. on Monday, March 9, 2026. And as Adam is hinting at, probably the most important time for us to really specify when exactly we are recording this, given how fast things are moving, especially in the oil pitch.

So markets have been derailed by a big war shock that originated from Iran. And let's dissect a little bit how markets are taking it and what we're thinking.

Starting with the big picture, the Iran strike, geopolitics comes back as a key market driver. The main transmission channel, as always, for geopolitics is the oil price. And the obvious reason for that is, of course, the inflationary impact that is felt globally. But also, the activity impact is here to consider, and oil has been blamed in the past for contributing to recessions in various countries, including the U.S. So it's clearly important on both sides of the equation.

Studying the five largest more recent geopolitical shocks — i.e. the two Iraq wars, Arab Spring, Russia-Ukraine, and the 2025 Iran attack — suggests that oil goes up around 20% into the start of the war, then moves sharply higher for a few days, before stabilizing, at least in the median case.

And this time around, again, oil was up 20% going into it. Since then, it has moved more than 50%, at the time of recording, with WTI above 100. This is similar but worse than Russia-Ukraine, where oil spiked around 25% over seven days before peaking.

Also, interestingly, the option-implied volatility of oil, OVX, has reached levels of above 100, higher than during Russia-Ukraine. And this is actually usually only happening in bear markets for oil. So it's quite rare to reach these type of volatility levels. And it cannot stay there for long — or at least it hasn't stayed there for long in the past. And whenever it peaked, oil often peaks in a coincident fashion.

So that is interesting. And at the very least, it suggests a lot of fear has been priced. But the fat tails on both sides ... our energy strategists believe the disruption at the Strait of Hormuz is worth around 11 to 16 million barrels a day of crude and products.

The current prices imply a disruption lasting for around four to six weeks. They think clearly it could end faster for various reasons, including the U.S. deciding that it has achieved its war goals, the U.S. finding a way to safeguard the Strait of Hormuz, or the release of inventory by the IEA, given that they have capacity for more than 90 days of imports.

But importantly, there are also fat tails on the other side of the distribution. Essentially, our commodities strategists are worried that the risks of a tax on the regional energy infrastructure is still there, and that could put 10 million barrels a day at risk of longer supply losses than just for the time while the Strait is closed. So extremely high volatility, fat tails on either side, makes for very volatile and difficult trading.

A starting point, as I mentioned, in these five events: The S&P usually sells off sharply, but it's short-lived and actually as short-lived as the oil spikes — or, in oil peaks, S&P bottoms. In the 2022 Russia-Ukraine conflict, for example, the S&P of course had a rough year, but that was mostly due to the general post-COVID inflation and pending Fed hiking cycle. Initially, actually, the S&P rallied by 12% when oil had peaked, seven days after that attack, before the post-COVID story took over.

Treasuries actually do somewhat poorly for a time, on average for a month or so, as inflation fears typically dominate recession fears at first and Treasuries find it hard to decouple from oil. Even the oil spike in the first half of 2008, in the middle of the GFC, led to higher U.S. rates before that reverted aggressively.

So currently, Treasuries also under pressure, and on average, that continues for a bit. And on the dollar, there's actually no very strong takeaway — a lot seems to depend on positioning. So in summary, impact of geopolitics very sharp, but also reverses fairly quickly.

Now, sifting through the wreckage, Adam, what do you make of all the moves that we've seen in the first week of the conflict?

Adam Pickett (04:07)

I think it's important to distinguish between the idea of a VAR shock and the idea of a terms-of-trade shock. Now both of those things can be true, of course, but what we did in our recent work was look through the post-Iran moves within asset classes, across asset classes, to try to find a common thread.

For the VAR shock, we just looked at the pre-Iran positioning or performance and compared the post-Iran moves. Strong versal and decent R-squared would tell us it's a VAR shock.

On the terms-of-trade angle, Citi has terms-of-trade indices, CTOT, plus the three-letter currency code. And we use them to try and see whether there was a clear commodity terms-of-trade filter, for the asset-class dispersion moves.

We found better results from the VAR shock. I think in particular, when you look at stuff like gold going down a lot, it tells you that it isn't just energy dynamics. While Korea is a big energy importer, I'm not sure DRAM prices are massively affected by energy dynamics as well. And more broadly within equities, we found a very strong relationship with the Nasdaq — which had underperformed this year — holding up as a safe haven with a lot of Asia indices — which had outperformed — performing particularly poorly.

So for now we're thinking more VAR shock than terms-of-trade shock — obviously, with the risk that the longer this goes on, it morphs from VAR to terms of trade. But given there's been a repricing of front-end rates — but it's been across the board, again — that adds to our conviction.

Across asset classes, we see the most pain — understanding deviation basis — in rates, front-end rates, and then FX, with equities holding up reasonably better. Which broadly aligns with how Dirk described the relative resiliencies to some of these geopolitical shocks.

Dirk Willer (05:49)

Thanks, Adam. I mean, given how big these moves were, is there anything interesting to fade where valuation shows up, or are there any interesting hedges if this continues?

Adam Pickett (06:00)

On the fading side, one thing that we took a look at was equity indices that had large drawdowns, but also that had triggered our volatility risk-premia framework. As a reminder, that's just looking at the differences between implied volatility and realized volatility across equity indices, and using that as a way to gauge whether there was excess risk premia baked into a particular place.

Nikkei screened well across both the fundamentals as well as the large drawdowns and VRPs, so that could be an opportunity. Similarly, looking at front-end rates where a lot of hikes have been baked in, in general, we tried to screen for places that maybe

had less energy exposure, but also a central bank that generally was on the more dovish side. In particular, Switzerland stood out as a potential opportunity.

Lastly, on hedges, things that are co-moving with energy prices, but perhaps don't have as much risk premia baked into the vol curves as the oil market or the front-end rates market could be attractive. And in that case, European inflation and that vol market in general perhaps provides more opportunities.

Dirk Willer (07:08)

Thanks, Adam. Another interesting question, especially as you mentioned the context of front-end rates, is, of course, what it all means for the various central banks and maybe especially for the Fed. So far rate cuts for '26 have been reduced to just below two cuts for 2027.

Maybe one more is priced, but certainly we reduced the number of cuts during the Iran attack. And it would have been much worse if it hadn't been for very weak payrolls and maybe also in the background for deteriorating news flow on private credit.

In general, if you think about it going forward, either oil prices come off, and that would reduce inflation fears and support fixed income; or as long as oil prices at least stop rising, even if they remain quite elevated, at some stage the negative impact on demand might come back into the picture, not just the inflation story — especially in this context of rising credit worries and maybe a weaker labor market in the U.S.

So we therefore think, yes, rate cuts can be pushed forward as long as oil is rising, but they won't be fully priced out. And the tail is still for more cuts rather than for fewer cuts, in our view.

With that, in summary, developments in Iran create much volatility. In the past, geopolitical shocks were somewhat short-lived and risk assets as well as Treasuries eventually recovered. But it did take a peak in oil prices for that recovery. and currently there are fat tails on other side, even though a lot of fear has already been priced in.

Thank you for joining us today. This episode was recorded on March 9, 2026 at 9 am, and I'm your host, Dirk Willer. For more details, Citi clients can check out our report on Citi Velocity.

Next week's Research @ Citi Markets Edition will be hosted by Scott Chronert, Citi's head of U.S. Equity Strategy. And be sure to watch for our Research @ Citi podcast, which can view on the same channel.

The Macro Strategy Team will be back in two weeks' time. Stay sharp!

Disclaimer (09:03)

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