

Equity Portfolio Risk Management *Framework.*

Protecting Growth Portfolios Against a
Lingering Middle East Conflict

FOLLOW-ON FROM

Strait & Narrow — our Q2 2026 outlook, in which we flagged inflation as a key risk for portfolios and identified the Middle East conflict as the most likely transmission channel. This note operationalises that view into a defined risk management framework.

THE RISK THE MARKET IS ONLY BEGINNING TO PRICE

Equity markets have spent most of the year priced for a clean resolution to the Iran conflict, with the S&P 500 reaching fresh record highs and the Nasdaq enjoying its longest winning streak since 1992. Over the last two trading sessions, however, that confidence has begun to wobble. President Trump's warning that the ceasefire is on "massive life support," a hotter-than-expected CPI print, and the US 10-year yield pushing above 4.6% have triggered a coordinated pullback in both equities and bonds. The damage to Qatar's Ras Laffan LNG complex still requires three to five years to repair, and roughly one billion barrels of supply will be permanently lost as a result of the conflict, according to Vitol. The market is no longer fully complacent — but it is also not yet priced for the scenario where the ceasefire genuinely fails.

The transmission to growth equities is mechanistic: Hormuz disruption → oil shock → inflation re-accelerates → central banks boxed in → long-end yields reprice higher → multiples compress on the long-duration tech and growth names that have driven YTD performance. ECB President Lagarde has explicitly signalled that the next move is more likely to be a hike than a cut, with markets now pricing three hikes in 2026. In the US, Fed funds futures have crossed the 50% threshold for a hike by year-end — the first time markets have seriously priced a hike in years. **Inflation remains the most underappreciated risk for growth-tilted portfolios.**

Critically, energy continues to work even if peace ultimately holds. Permanent supply destruction means oil stabilises well above pre-war levels, and at \$90+ Brent against marginal extraction costs near \$50/bbl, the majors generate exceptional economic profit. The base case pays you to wait; the tail case pays explosively.

OUR FRAMEWORK: A FOUR-PRONGED RISK MANAGEMENT TOOLKIT

We remain constructive on growth equities over the long term. The structural tailwinds driving AI infrastructure, the productivity unlock from large language models, and the compounding power of the highest-quality global franchises remain intact. However, the current setup is one where **managing risk needs to be kept very clearly in mind** — portfolios that have run hard year-to-date are sitting on meaningful unrealised gains that warrant active protection. Our framework is built on one principle: **the best risk management tools cost little to hold, earn positively in the base case, and deliver explosive convexity if the risk we are managing actually surfaces.** Generic index puts are expensive insurance that bleeds premium in benign environments. We prefer to construct protection using positions that are fundamentally linked to the specific risk transmission channel — so that we are paid to wait, and paid disproportionately if we are right. Each prong below targets a distinct transmission channel and is negatively correlated with our core growth book in the scenario we are managing for.

#	PRONG / NAMES	RATIONALE
1	Energy & Fertilizers XLE, XOM, OXY, CF, NTR, UAN	Direct beneficiary of oil and natural gas supply disruption. Energy majors earn exceptional profits at sustained \$80+ Brent given \$50/bbl marginal costs — Occidental in particular offers high-beta exposure to crude prices given its Permian-heavy production base. Fertilizer producers — particularly North American nitrogen names anchored to cheap Henry Hub gas — capture massive margin expansion as global urea reprices off disrupted Middle East supply (50% of global urea exports transit Hormuz). Positive carry via dividends and earnings.
2	Tanker Shipping FRO, INSW	Highest-convexity prong. Hormuz disruption forces oil and LNG to reroute around the Cape of Good Hope, multiplying tonne-mile demand. VLEC supply is structurally constrained — shipyards booked through 2028 — creating a multi-year window of elevated charter rates. Variable dividends linked to spot earnings deliver extraordinary distributions in escalation scenarios. We stay with the quality operators — Frontline as the largest publicly listed tanker fleet and International Seaways for diversified, well-capitalised exposure. Size for binary outcomes.
3	Defence LMT, RTX, GE, BA/ LN, RR/ LN, HEI, SHLD	Structurally sticky tailwind independent of Iran-specific resolution. Munitions stockpiles are drawn down, US and European budgets ratcheted higher, and the European rearmament cycle is multi-year. Our preferred exposures span the US primes (Lockheed, RTX), engine and propulsion (GE Aerospace, BAE Systems, Rolls-Royce), and aerospace components (HEICO), complemented by the Global X Defense Tech ETF (SHLD) for thematic, internationally diversified exposure to the broader defence technology buildout. These names benefit from order backlogs measured in years, not quarters, providing earnings visibility regardless of how the Middle East situation evolves.
4	Rates Hedge (ITM TLT Puts) TLT ITM puts	The precision instrument. Directly hedges the duration risk in our growth book — if oil reignites inflation, the long end reprices higher and growth multiples compress. We prefer in-the-money puts on TLT rather than OTM strikes. The logic: ITM puts have higher deltas (closer to -1), so they appreciate materially as TLT moves lower, delivering the convexity we need if we are right. Equally important, on an annualised basis ITM puts are cheaper in terms of the extrinsic value being paid — the bulk of the premium is intrinsic value, which is preserved if yields are sticky and TLT does not rally sharply. If we are wrong, we do not bleed premium the way OTM protection would.

WHY THIS WORKS: NEGATIVE CORRELATION, POSITIVE CARRY

Three properties make this framework superior to generic index hedging. **First**, negative correlation — each prong actively offsets a specific damage vector to our growth book rather than relying on broad-market beta. **Second**, positive carry — three of the four prongs generate dividends and earnings in any scenario, so the cost of protection approaches zero net of yield. **Third**, convexity — shipping and TLT puts deliver explosive payoffs in the precise scenario that hurts the core book the most. The framework lets us stay long the growth equities we believe in over the long term, while actively managing the near-term risk that the market is only just beginning to price.

Risk management discipline: monitor correlation behaviour during stress (correlations can converge in true liquidity panics), maintain clear exit triggers — discipline lies in monetising hedges when the thesis plays out, not holding through the reversal — and scale out of the binary prongs (shipping in particular) into strength rather than holding through a Hormuz reopening.

The best time to build hedges is before the market fully prices the risk. *That window is now closing.*

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