Between Two Chokepoints

How Middle East Conflict Is Choking Oil, Bonds and Equities

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Strategy Report

KEY INVESTMENT HIGHLIGHTS

- The US-Iran conflict is likely to remain intermittent but prolonged.
- Disruptions around Hormuz and Bab el-Mandeb threaten both oil availability and delivery, keeping freight, insurance and crude prices elevated.
- Sustained oil prices above USD100 could broaden inflation, reinforce Federal Reserve tightening expectations and maintain upward pressure on UST and MGS yields.
- Strategic petroleum reserves can cushion temporary shortages but cannot replace disrupted daily flows indefinitely.
- US Treasury buybacks support bond-market liquidity but cannot overcome inflation, fiscal deficits and heavy issuance.
- Equities face higher operating costs and lower valuations as discount rates rise.
- We favour a barbell strategy combining tactical exposure to energy, marine services and plantations with domestic utilities, healthcare and essential-consumption stocks.
- A broader market rotation requires normalised shipping, lower oil and peaks in UST and MGS yields
- Stocks mentioned in this report: Bumi Armada (BUY, TP: RM0.42), MMHE (BUY, TP: RM0.59), Deleum Berhad (BUY, TP: RM1.22), MISC (BUY, TP: RM9.22), Dialog (BUY, TP:RM2.57), SD Guthrie (BUY, TP: RM7.65), Genting Plant. (BUY, TP: RM6.94), Sarawak Plant. (BUY, TP: RM5.36), Johor Plant. (BUY, TP: RM2.21), Ta Ann (BUY, TP: RM6.72), TNB (BUY, TP: RM16.31) and YTL Power (BUY, TP: RM5.98).

REHEATING THE CONFLICT

The conflict returns to the sea.

Active hostilities between the US and Iran resumed in early September after earlier ceasefire arrangements failed to produce a comprehensive political settlement. Tankers and naval assets around the Strait of Hormuz have again become instruments of military and economic pressure, leaving commercial shipping in a continuing security stalemate. The broader conflict has lasted considerably longer than initially expected. However, rather than uninterrupted high-intensity warfare, the likely pattern is a stop-start confrontation: short kinetic exchanges interspersed with tactical restraint, economic coercion and negotiations conducted under pressure.

From one chokepoint to two.

The renewed exchanges coincide with the Houthis' advance through Yemen. Control of Mocha, Perim Island and other positions along the Red Sea coastline improves the group's ability to threaten vessels around Bab el-Mandeb. However, the Houthis have not announced an indiscriminate closure. Direct communication with the US also reduces the immediate probability of an uncontrolled US-Houthi confrontation. Nevertheless, selective pressure on Saudi-linked shipping preserves leverage and weakens the reliability of the Red Sea as an alternative route.

Hormuz constrains supply; Bab el-Mandeb constrains delivery.

The Strait of Hormuz normally carries approximately 20mn barrels per day of crude oil and petroleum products, representing about 25% of global seaborne oil trade. Following the outbreak of the conflict, export flows through Hormuz reportedly fell to less than 10% of their pre-conflict level, forcing regional producers to curtail output and seek alternative routes.

Saudi Arabia's East-West pipeline provides a partial bypass by moving crude towards Yanbu on the Red Sea. However, attacks on infrastructure and heightened risks around Bab el-Mandeb have reduced the reliability of that route. Oil arriving at the Red Sea still requires secure onward passage, whether north towards Suez or south through Bab el-Mandeb. A serious disruption would force more vessels around the Cape of Good Hope, increasing voyage duration, fuel use, freight rates, war-risk insurance and the time each tanker remains occupied. Even if production does not fall further, the effective delivered cost of oil rises and usable tanker capacity declines.

The Saudi bypass is only valuable if onward passage remains secure.

We opine that the strategic asymmetry is important. Iran and the Houthis do not need to maintain a complete blockade. Persistent uncertainty alone can cause precautionary rerouting, higher insurance and slower cargo movements. The economic effect can therefore be disproportionate to the military resources required to sustain the threat.

A complete closure is not required.

IMPACT OF RENEWED HOSTILITIES ON OIL PRICES

Brent exceeded USD100pb because the market is confronting an actual impairment of physical flows rather than merely a geopolitical fear premium. Hormuz exports have been sharply reduced, regional production has been curtailed, and the principal Saudi bypass has become less reliable. Higher freight, insurance and rerouting costs further raise the delivered price of crude. Commercial shippers may reduce exposure before attacks become widespread, meaning the economic effect can precede a complete physical interruption.

Not merely a geopolitical fear premium.

Approximately 20mn barrels per day moved through Hormuz in 2025. Pipelines can bypass part of the strait, but their capacity is limited and cannot fully replace normal tanker flows. Production may also need to be curtailed if storage fills and export routes remain unavailable.

Severe disruption to Hormuz flows.

The Houthi advance places a second maritime corridor under pressure. Even without a formal closure, the greater ability to threaten vessels increases the probability of rerouting, delays and higher war-risk costs. This also weakens the strategic value of Yanbu and the East-West pipeline.

Bab el-Mandeb threatens the alternative route.

Higher crude prices do not reflect only the value of oil at the production point. Buyers must also pay to load, insure and transport each cargo. Longer voyages keep tankers occupied for longer and reduce effective fleet availability, magnifying the physical shortage.

Freight and insurance amplify the supply shock.

The March coordinated emergency release was historically large, but it could only buy time. We must note that strategic reserves are finite stocks, while impaired maritime routes represent a continuing daily-flow problem. If withdrawals are smaller than the lost flow, inventories merely slow the tightening.

Emergency reserves can bridge disruption, not replace continuous supply.

As reserves decline, governments become more reluctant to authorise further releases because the remaining barrels must protect against other emergencies. Future replenishment also shifts demand forward, potentially supporting longer-dated oil prices after the immediate crisis subsides.

HIGHER OIL IS PUSHING GOVERNMENT-BOND YIELDS HIGHER

From energy shock to inflation expectations.

Ordinarily, war triggers safe-haven demand for government bonds. This conflict has produced the opposite response because it directly threatens a systemically important input into global production and consumption. The inflation effect has outweighed part of the conventional flight to quality.

The transmission runs from higher oil into petrol and transport costs, then into headline inflation, broader input prices and inflation expectations. Markets subsequently price a higher and longer policy-rate path, raising government-bond yields.

Oil was the catalyst, not the only cause.

Oil and the US 10-year Treasury yield have moved unusually closely. The 10-year yield breached 5% intraday as higher energy prices accelerated an already fragile bond-market backdrop. Oil explains the timing and speed of the move, but not the entire level. Sticky inflation and resilient labour data raised the probability of Federal Reserve tightening. Persistent fiscal deficits, heavy Treasury issuance, competition for global capital and an elevated term premium amplified the sell-off.

Duration converts volatility into inflation risk.

For long-duration bonds, persistence matters more than the first price shock. If oil falls quickly, headline inflation and policy expectations can retrace. If energy remains expensive for months, investors demand greater compensation before the second-round effects are fully visible in official data.

US Treasury buybacks - supporting market liquidity but not changing the equilibrium yield.

The US Treasury department expanded its buyback programme to improve liquidity in older, less actively traded securities. By providing a buyer for off-the-run bonds, the programme helps dealers release balance-sheet capacity, improves market functioning and supports participation in new auctions. The programme is debt management rather than quantitative easing. Treasury repurchases one group of securities while continuing to issue other obligations to finance the government. It changes the composition of debt at the margin but does not eliminate the underlying borrowing requirement.

Operationally helpful, macroeconomically insufficient.

The buybacks appear operationally useful: participation has been strong and the risk of disorderly market functioning has been reduced. However, benchmark yields have continued to rise because the programme cannot lower oil prices, reverse inflation or resolve the fiscal deficit. The intervention is also small relative to the Treasury market, upcoming maturities and continued issuance. It may moderate the speed of a sell-off without changing the direction set by inflation, policy expectations and fiscal supply.

US Fed has no choice but to hike.

The US Federal Reserve raised the federal funds target range by 25 basis points to 3.75%-4.00% on 16 September, its first-rate hike since July 2023. The unanimous decision reflected the Fed's assessment that economic activity, domestic spending, employment and capital investment remained sufficiently resilient to absorb tighter policy, while inflation continued to exceed its 2% objective. The increase should help contain the second-round effects of higher energy prices by moderating demand and anchoring inflation expectations, but it cannot directly lower oil prices or restore shipping through Hormuz and Bab el-Mandeb. The near-term impact is therefore likely to be tighter financial conditions, higher short-term yields and continued pressure on rate-sensitive equities. However, updated Fed projections indicating the possibility of another increase in 2026 suggest that a sustained decline in longer-

dated Treasury yields will require lower oil prices and clearer evidence that underlying inflation is moderating.

A DUAL IMPACT ON EQUITIES

Earnings and valuations are compressed together.

The shock affects equities through two channels. Higher oil raises fuel, freight, electricity and raw-material costs while reducing household purchasing power. Higher UST and MGS yields simultaneously increase financing costs and the discount rate applied to future earnings. This explains why broad indices can weaken even as energy shares rise. The Nasdaq is particularly exposed because a larger share of its valuation rests on profits expected further into the future. The same mechanism raises the hurdle rate for data centres, semiconductor facilities and other capital-intensive AI investment.

Commodity support is only a partial hedge for the KLCI.

For Malaysia, higher petroleum-related income and commodity earnings provide an offset, but the FBM KLCI is not a pure energy index. Banks, utilities, telecommunications, consumer companies, property and REITs remain exposed to higher yields, tighter liquidity and weaker demand. Meanwhile, MGS cannot fully decouple from UST because global investors compare sovereign returns after allowing for currency and emerging-market risk. Higher MGS yields then compete with dividend equities and place additional pressure on refinancing costs and valuation multiples.

HOW LONG COULD THE CONFLICT LAST?

Short kinetic episodes can coexist with a prolonged conflict.

We believe that the US munitions position may limit the duration of individual high-intensity episodes without necessarily shortening the wider confrontation. Operational constraints may encourage selective strikes, maritime enforcement, sanctions and periodic retaliation rather than a continuous large-scale campaign. In our view, this reinforces the likelihood that intermittent kinetic escalation becomes the defining pattern: sharp military exchanges followed by pauses that lower immediate intensity but do not resolve the underlying dispute.

The midterms are an inflection point, not a guaranteed end date.

We opine that the 3 November 2026 US midterm election creates both an incentive to contain escalation and a reason to delay a final settlement. High petrol prices, inflation and mortgage costs are politically damaging, encouraging a temporary ceasefire or safe-passage arrangement. Yet the concessions required for a comprehensive settlement may be difficult before polling day. It is also possible that Iran may also see the electoral calendar as leverage. Maintaining controlled pressure on energy prices without triggering an overwhelming response could raise the economic and political cost to President Trump and his party. Operational accidents, however, could still override electoral preferences.

Our working scenario assessment.

Our base case remains a prolonged Tension Case: intermittent strikes, impaired but not fully closed shipping, fragile ceasefires, direct negotiations alongside military pressure, and elevated oil-price volatility. The Houthi advance and the vulnerability of Saudi infrastructure have raised the tail risk of a wider maritime disruption.

A credible de-escalation is the cleanest route to lower long-term yields because it would reduce oil, freight and insurance costs at source. Verifiable safe passage through both Hormuz and Bab el-Mandeb would moderate inflation expectations and reduce the number of Federal Reserve hikes priced by the market. We opine that a US Fed rate hike could eventually lower bond yields if it credibly prevents energy inflation from becoming embedded in core prices and wages. Initially, however, it would lift short-end yields and may add to equity volatility. Monetary policy can contain second-round effects but unfortunately cannot create oil or reopen shipping lanes.

De-escalation removes the shock; policy controls the consequences.

A durable bond rally would also require better inflation data, a lower term premium, stable Treasury auction demand and credible improvement in the fiscal path. Nevertheless, there is also a less favourable route to lower yields: if expensive energy and restrictive rates damage consumption, housing, employment or credit, recession fears could eventually overwhelm inflation concerns.

Not every decline in yields would be positive for equities.

EQUITY STRATEGY

Our strategy should not be built around one perfect geopolitical outcome. We favour a barbell portfolio: a measured tactical allocation to commodity-linked beneficiaries, balanced by domestically anchored companies with recurring demand, visible local order books, regulated or defensive cash flows and strong balance sheets. The tactical sleeve should remain separate from the long-term core given that commodity stocks can reprice sharply during escalation but reverse quickly when negotiations improve.

Combine tactical commodities with domestic resilience.

During escalation, we prefer upstream oil and gas producers with low gearing, visible production and direct crude-price sensitivity. Selected oilfield services and marine-support companies may benefit from higher utilisation and charter rates, but preference should be given to operators with contract repricing ability and manageable leverage. Fixed-price contractors exposed to rising labour, fuel and equipment costs may not convert higher oil into stronger free cash flow. We like; **Bumi Armada (BUY, TP: RM0.42)** as high oil prices improve the commercial viability of deepwater projects globally, accelerating new FPSO tenders (particularly in West Africa, South America, and Southeast Asia) and the group's strong operational cash flows allow rapid deleveraging, improving its capacity to bid for major capital-intensive field developments; **MMHE (BUY, TP: RM0.59)** as MMHE benefits directly from a surge in heavy engineering orderbook replenishment; and **Deleum Berhad (BUY, TP: RM1.22)** as Deleum's core segments will likely see increased utilization and high upstream activity underpins its multi-billion Ringgit order book.

Upstream oil and gas: POSITIVE, Tactical.

Our other top picks for the O&G sectors are **MISC (BUY, TP: RM9.22)** and **Dialog (BUY, TP:RM2.57).** We like MISC as the group offers a combination of defensive balance sheet strength and visible long-term cash flows, anchored by its core shipping divisions. One of the key highlights of MISC is its expanding order book of modern dual-fuel LNGC vessels, providing high revenue visibility and resilient cash generation. While near-term global freight rates face intermittent volatility, MISC's disciplined capital expenditure plan supports its earnings growth and dividend stability, offering an attractive yield profile. Meanwhile, Dialog stands out as a premier midstream energy infrastructure provider, driven by its high-margin tank terminal storage assets. The highlight of the group is on the recovery and expansion of long-term dedicated storage demand, complemented by recurring income from plant maintenance

Other top picks for the O&G sectors.

services and upstream production assets. Dialog's fortress balance sheet and strong cash-flow generation position it well to capture long-term growth across both traditional oil & gas logistics and emerging sustainable energy initiatives.

Plantations and commodity exporters: POSITIVE, Tactical.

Plantations offer a secondary commodity hedge as higher mineral-oil prices support the relative value of vegetable oils and biofuel feedstocks. We prefer efficient upstream producers with manageable costs and disciplined capital allocation. Selected metals and commodity exporters may also benefit, although gains could be capped if expensive energy weakens global industrial demand. We have a **BUY** calls are **SD Guthrie (TP: RM7.65), Genting Plant. (TP: RM6.94), Sarawak Plant. (TP: RM5.36), Johor Plant. (TP: RM2.21) and Ta Ann (TP: RM6.72)**.

TNB and YTL Power: structural demand with rate sensitivity.

For the domestic core, **TNB (BUY, TP: RM16.31)** and **YTL Power (BUY, TP: RM5.98)** offer exposure to regulated and structurally rising electricity demand, including data-centre growth. Elevated MGS yields may constrain near-term valuation expansion, but the underlying investment cycle provides earnings visibility. We would retain core exposure and add more aggressively after domestic yields show a convincing peak.

Healthcare and essential consumption strengthen the core.

Healthcare, selected insurers and essential consumption provide recurring domestic demand. **IHH Healthcare (BUY, TP: RM10.18)** offers defensive earnings if the oil and rates shock weakens growth, while **99 Speed Mart (BUY, TP: RM4.37)** provides visible essential-consumption cash flow. Telecommunications also offer recurring revenue, although leverage and bond-yield sensitivity should be monitored.

Avoid sectors facing the double earnings and valuation squeeze.

We remain cautious on aviation, transportation users, discretionary consumer, energy-intensive manufacturers, leveraged property companies and long-duration technology. These sectors face some combination of higher fuel costs, weaker purchasing power, rising discount rates and refinancing pressure.

Rotate in stages after de-escalation.

Following credible de-escalation, the first rotation should favour lower-oil beneficiaries such as aviation, transportation, and construction. The second rotation should begin only when lower oil is accompanied by a convincing peak in UST and MGS yields, bringing property, selected technology, REITs, utilities and telecommunications back into favour. We opine that defensive sectors should be accumulated subsequently if the earlier oil and rates shock begins to weaken growth.

Watch physical flows and yields, not only headlines.

We would reduce the commodity linked exposure when physical evidence confirms normalisation: verifiable safe passage through both chokepoints, restoration of Saudi export infrastructure, falling war-risk insurance, normalising tanker routes and a sustained decline in Brent. Ceasefire headlines alone are insufficient. Our overall stance remains cautiously constructive on Malaysian equities, but increasingly selective. Tactical commodity exposure provides near-term participation, while domestic and defensive holdings preserve flexibility for the eventual rotation.

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STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	The stock price is expected to rise by >10% within 3 months after a Trading Buy rating has been assigned due to positive news flow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	The stock price is expected to fall by >10% within 3 months after a Trading Sell rating has been assigned due to negative news flow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.

ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell

☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology