



First analysis of issues or topics that may affect investor portfolios

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## The U.S. strikes a blow against Iran

### What's moving markets

- The U.S. military used air and submarine assets to strike Iran's three, main nuclear processing and production facilities, but financial market reaction has been limited, so far.
- The sudden escalation in the Middle East war since June 13 joins other policy issues that were already orbiting as likely sources of capital market volatility this summer.

### Implications for investors

- In portfolios that have long-term investment goals, we favor incrementally adding exposure on down days to high-quality U.S. equity asset classes and sectors and staying selective in fixed income.

For "Operation Midnight Hammer," the U.S. used 125 aircraft, featuring the largest-ever deployment of B-2 bombers (including decoys and supporting fighter aircraft), to drop 14 30,000-pound bunker busting bombs on Iranian underground nuclear facilities. Over two dozen Tomahawk missiles from a U.S. guided missile submarine struck the facilities' supporting structures.<sup>1</sup>

The war's escalation sparked a cautious but muted overnight response across global financial and commodity markets. International equity indices mostly declined marginally in Europe and Asia, while the European Brent crude oil futures contract price edged higher. U.S. futures markets moved higher in equities but lower for West Texas Intermediate crude oil ahead of Monday. The move that most caught our eye was the (spot) U.S. dollar, which gained as much as 0.50% on the euro and 1.15% on gold overnight. The generally small but more favorable U.S. price changes suggest to us that investors are waiting for an Iranian response but one that is limited in scope. We discuss some scenarios below.

### Our perspective

Three prominent issues are likely to restrain the market responses. First, initial estimates suggest significant facility damage, but not necessarily complete destruction.<sup>2</sup> Iran has many nuclear facilities, but if the three targeted in the U.S. strike were completely destroyed, Iran's program may have been crippled. If those sites are only damaged, Iran may manage to make repairs and continue work toward a nuclear bomb. Second, as we pointed out

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<sup>1</sup> Tony Capaccio, "US attack against Iran hinged on misdirection and decoys", Bloomberg, June 22, 2025.

<sup>2</sup> See Institute for the Study of War, "Iran Update: Special Report", June 22, 2025.

in our June 16 *Institute Alert*, International Atomic Energy Agency (IAEA) inspectors found 409kg of 60% enriched uranium in Iran in late May, enough for up to nine nuclear warheads once they complete the relatively small step to weapons-grade (90% enriched).<sup>3</sup> It is not clear where Iran's inventory of 60% enriched uranium is now.<sup>4</sup>

Finally, Iran appears to have various ways to retaliate. In years past, Iranian proxies executed terror attacks across the Middle East and even in the Western Hemisphere, including cyberattacks on U.S. water and wastewater systems. The FBI and the U.S. Cybersecurity & Infrastructure Security Agency now are ramping up monitoring.<sup>5</sup>

Iran might make a makeshift nuclear bomb, but that is now more challenging, especially because Israel has killed many of Iran's top nuclear scientists and the U.S. has just damaged (if not smashed) the equipment and processes. Neither is it clear whether the Iranian regime could survive the U.S. or Israeli punishment if Iran were to attack with a nuclear device. Even non-nuclear strikes on regional U.S. bases likely would trigger severe U.S. retaliation.

On a smaller but still significant scale, Iran could try to destroy its neighbors' oil facilities, or to block the Strait of Hormuz, the narrow waterway through which about 20% of global daily oil consumption passes.<sup>6</sup> If Iran attacks Saudi Arabian oil production, the U.S. and other nations might destroy Iranian production. Alternatively, Iran has previously used naval patrol boats to commandeer shipping in the Strait, and now has anti-ship cruise missiles and drones. Iran even used GPS recently to interfere with navigation, and two tankers collided.<sup>7</sup> But, here, too, the U.S. can deliver an even larger response: One U.S. aircraft carrier group already is in the Red Sea and another is en route to the Indian Ocean.

We note that Yemen's Houthis largely succeeded in threatening Red Sea shipping. Shippers headed for Europe or the U.S. from Asia avoided the Suez Canal and, instead, sailed around the Cape of Good Hope. But the U.S. still used military resources to suppress the insurgency. We conclude that the U.S. would have even more incentive to prevent Iran from blocking the Strait, which is the only passage between the Persian Gulf and the open ocean.

More plausibly, Iran may continue its missile volleys into Israel, in an attempt to exhaust Israel's supply of air defense missiles. The volleys last week were small because Israel's strikes have destroyed roughly two-thirds of Iran's missile launchers.<sup>8</sup> Still, Iran could continue steady but smaller volleys until Israel needs more U.S. missiles. At that point, Iran may seek to pause the barrages in exchange for negotiating to keep some of its nuclear program.

Parties in war don't necessarily make the most logical choices, and Iran's leaders may yet grow desperate enough to block global oil supplies. A prolonged war could potentially bring desperation closer, but the recent, modest premium in oil prices over their springtime levels likely reflects cautious market optimism.

## What to do now

Our *2025 Midyear Outlook* report, released June 10, anticipated further geopolitical conflict, but the uncertain timing of the latest round (or rounds) may extend the market volatility.<sup>9</sup> The end of President Donald Trump's 90-

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<sup>3</sup> Regarding enrichment, see "Geopolitics shake market complacency," Wells Fargo Investment Institute, June 16, 2025.

<sup>4</sup> For more on Iran's stockpile of enriched uranium, see Institute for the Study of War, "Iran Update: Special Report," June 22, 2025.

<sup>5</sup> Iran's ties to Hezbollah (Lebanon), Hamas (Gaza Strip), and various groups in Syria and Iraq are well documented in the press. Argentina accused Hamas of a July 18, 1994, attack on a Jewish community center in Buenos Aires. For more on FBI and CISA monitoring, see Myles Miller, "New York to LA Ramp Up Security After US Airstrikes on Iran," Bloomberg, June 22, 2025; and CISA, "IRGC-affiliated Cyber Actors Exploit PLCs in Multiple Sectors, Including US Water and Wastewater Systems Facilities," December 18, 2024.

<sup>6</sup> Global daily oil consumption is roughly 100 million barrels, and daily traffic through the Strait is about 20 million barrels. For more information, see U. S. Energy Information Administration, "Amid regional conflict, the Strait of Hormuz remains critical oil chokepoint," June 16, 2025.

<sup>7</sup> "Goldman on Risk Premium; Shell on Hormuz Closure," Bloomberg, June 19, 2025.

<sup>8</sup> Mansi Arora, "Israel has hit two-thirds of Iran's missile launchers - How many are left now," June 20, 2025

<sup>9</sup> Wells Fargo Investment Institute, "2025 Midyear Outlook: Opportunities amid uneven terrain," June 10, 2025.

day pause on reciprocal tariffs comes on July 9, and the president just this week mentioned increasing the levy on automobiles.<sup>10</sup> The 90-day pause on China's reciprocal tariffs ends on August 12. Between those two dates, we expect Congress to complete a politically contentious budget bill whose negotiations may add uncertainty. New fighting in the Middle East now should bring forward and ultimately lengthen what may be a challenging summer for capital markets.

For investors who have a long-term focus and value caution here, we think it makes sense to hold a cash buffer, from which to add to investments incrementally. Money market rates are higher than they were the last time major uncertainty landed on financial markets, at the beginning of the COVID lockdowns. We believe rates above 3% may be one option. Legging back into financial markets, especially if underweight to strategic targets, remains a priority in our guidance as markets finally settle again, as we expect.

For investors who have cash and are seeking investment opportunities, our equity guidance prioritizes quality, and our fixed-income guidance emphasizes selectivity. We expect the U.S. economy will avoid a recession in 2025 and gain momentum in 2026, but near-term policy uncertainty could create increased market volatility, which may push financial market prices sharply higher on one day's (or month's) good news but lower on bad news the next.

We continue to expect positive (albeit slowing) economic growth in 2025, and a faster pace through next year. To avoid becoming overly defensive, we prefer quality and selectivity. In fixed income, our selectivity guidance favors investment-grade fixed income and focuses on corporate bonds and essential-service municipal securities. In our view, the middle range (3 to 7 years) of maturities offers comparatively better value than longer or shorter maturities.

In equities, quality at the regional and sector level includes strong profit margins, limited balance-sheet leverage, and high earnings stability. During market downturns, we expect these companies to benefit from solid defensive characteristics. We also believe they have the size and earnings potential to outperform ("playing offense") as economic conditions improve.

At the level of regional equity markets, our view is that quality is closely related to less dependence on trade and imported oil. The emerging economies (for example, China, Brazil, and India) depend more on trade than the developed economies of Europe and Japan, and the developed markets rely more on trade than the U.S. economy does.<sup>11</sup> Meanwhile, in late 2024, the U.S. was on pace to hit a record low in oil imports from the Middle East.<sup>12</sup> So, our quality emphasis favors U.S. Large Cap and Mid Cap Equities over U.S. Small Cap Equities. Likewise, we favor Developed Market ex-U.S. Equities over Emerging Market Equities. Among the U.S. large-cap sectors, we prefer Information Technology, Communication Services, Financials, Utilities, and Energy.

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10. Keith Laing and Mario Parker, "Trump Floats Higher Auto Tariff, Repeals California Gas-Car Ban," Bloomberg, June 12, 2025.

11. According to World Bank data, in 2023 (latest data available) exports made up 50% of the European Union economy, but the U.S. economy counted on exports for only 11%.

12. Ken Roberts, "2024 US Oil Imports From Middle East Hit New Record Low," Forbes, August 16, 2024.

### Risk Considerations

Forecasts and targets are based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **Municipal bonds** offer interest payments exempt from federal taxes, and potentially state and local income taxes. Municipal bonds are subject to credit risk and potentially the Alternative Minimum Tax (AMT). Quality varies widely depending on the specific issuer. Municipal securities are also subject to legislative and regulatory risk which is the risk that a change in the tax code could affect the value of taxable or tax-exempt interest income. The **commodities markets** are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility. **Currency risk** is the risk that foreign currencies will decline in value relative to that of the U.S. dollar. Exchange rate movement between the U.S. dollar and foreign currencies may cause the value of a portfolio's investments to decline. **Sector investing** can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility.

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