

What the Iran Conflict Could Mean for Stocks, Bonds & Inflation

What are some of the economic ripple effects stemming from the war in Iran?

April 3, 2026

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COLLIN MARTIN: I'm Collin Martin

LIZ ANN SONDEERS: And I'm Liz Ann Sonders.

COLLIN: And this is *On Investing*, an original podcast from Charles Schwab. Every week we analyze what's happening in the markets and discuss how it might affect your investments.

LIZ ANN: Well, hi Collin. Here we sit recording this in a new month after a month that felt like a year, but it is the beginning of April. And that also means not just a new month, but a new quarter yet the topic du jour really or du month, du moi, has not changed, given that we are still talking about the war in Iran and oil prices and the Strait of Hormuz and supply routes for oil and ripple effects into the economy.

And I shared this on my X feed this morning and it's gotten a lot of attention. I don't know whether you saw it, Collin, but I had an interesting conversation in LaGuardia airport yesterday and I was just sitting at the gate with my typical iPad open and market stuff and Bloomberg and charts galore. You know how when you get a sense

that somebody's sitting next to you and they're kind of looking at your screen to see what you're doing? I kind of got a sense of that. And then they announced that they were going to board soon, so I closed my thing. And he asked me about, "I see you're looking at a chart of oil prices." And I said "Yes," and told him what I did.

Long story short, we got to the discussion of the war and he said, "But, this doesn't impact the United States at all. Why are we so concerned about this? We're a net exporter of oil." And I said, "OK, but oil is, even domestically, is still priced based on global forces."

And as you and I sit here today, Collin, West Texas Intermediate, which is the domestic benchmark, is actually trading at a loftier level than Brent crude, which is the global benchmark. And we don't we don't sell ourselves oil at a domestic discount. Like, our economy is at the mercy of higher energy prices.

So, you know, even if however we or the powers-that-be define an end to this conflict, I think the ripple effects are still significantly, not just via the channel of higher energy prices, but the whole ripple through supply chains and the fact that we don't turn things back on very quickly, even when the Strait of Hormuz opens back up because so many of the storage facilities have gotten full. Production has been shut down.

Some of what has been destroyed, particularly part of an LNG field or liquid natural gas field in Qatar that has taken out, I think, about 17% of production. And they've already come out and said that that's going to take three to five years to build that production back. So even if the war ends, again, whatever that looks like, we're not at the end of the economic implications, but last thing I'll say and then I want to turn it over to you to get your thoughts on your side of the world, but clearly our equity market is still very much at the mercy of headlines, big swings in oil prices, of narrative shifts, of social media posts, and we've we had a two, you know phenomenally strong days in the market this week and as you and I are recording this now, things have turned on a dime and we still have that inverse relationship between oil prices and the U.S. stock market.

And I don't think that that changes anytime soon. So I think the volatility at the index level, what's happening under the surface in terms of where leadership resides or where it doesn't, I think that will continue to be very much at the mercy of global oil prices.

What about you? How are you thinking about this in terms of some of the fluctuations in yields, maybe, I would ask you to start with in particular?

COLLIN: Yeah, well, I have a very similar story to build on what you mentioned. This is probably two weeks ago now, early, you know, early-ish stages of the war. And I

was at my gym and chatting with a guy I know really well and very, very smart guy, but admittedly not in the financial services markets. And we were talking about the price of oil, and he had a similar question that you just posed from the person at LaGuardia. You know, "Why are oil prices that we're producing going up so much if this is over in the Middle East?" And I said, "Well, you know, it's a global market right now and things get priced globally. We export our oil." And you know, it just shows that there's a lot of uncertainty about everything that's going on right now.

So to your question about how I'm looking at this and what's going on, I want to frame it two ways because on the one hand, things are moving very quickly. It's very uncertain. And we're trying to balance the fundamentals that tend to drive markets and the Treasury market and Truth Social posts, comments from the administration, comments from other foreign governments about what a potential outcome is here, how long it's going to last.

So I wanted to start with what our views were and then how all these things play into it. So what we've seen so far is Treasury yields rise. And over the course of March, they rose pretty sharply, where the range of the 10-year Treasury yield was about 40 basis points from its trough to its peak. That's actually not that wide, though. And I was looking into this just yesterday to see how does that compare to the past few years. And it's actually way less than what we saw in 2022 and 2023 when there was a lot of volatility about Fed rate-hike expectations and given the surge of inflation. So, in the grand scheme of things, the movements that we've seen recently haven't been that out of the ordinary.

And also it's in line with what we were expecting coming into the year. So coming into the year, if we talk specifically about the 10-year Treasury yield, we thought it would probably hover in a range above 4%. We saw upside around 4.5% and maybe downside in the 3.75% area. And there were really three reasons that drove that view. And given everything that's going on right now, I'd say that's very much still our view and everything we're seeing is supporting kind of that that higher range above 4% for the time being. The first is sticky inflation. You know, we saw some progress on inflation, obviously, from the peaks of 2022 and 2023, but it was kind of stuck in that 2.5% to 3% range. That's not going away anytime soon. And we're probably going to start to see a big jump in the next month or two, given the rise in oil prices.

A second is fiscal and debt concerns. We're issuing more and more debt each year. That wasn't going away before everything that's happened. And then wars can be expensive. And we need to fund that. So that's, even if it's marginal, it's more issuance than was likely expected to fund that. And then finally, we saw kind of diverging paths of global yields where we started to see European yields even before the war start to rise a little bit. We saw Japanese yields rise. And when you

start to see higher yields kind of across the globe, that can put some sort of a floor underneath ours, as investors potentially see different opportunities elsewhere. And we're seeing that continue.

And if we look at Europe, for example, the European Central Bank is expected to hike rates, given the inflationary impact from the war. They're much more dependent on oil imports than we are here. We're a little bit more insulated there, and they're expected to hike. We don't expect the Fed to hike. We think that the next move will likely be lower, but they'll probably be on pause for a little bit. So we had these three factors and they're all still very much here. So I'd expect us to continue to bounce around between 4% and 4.5%. I'd say 4% is probably the near-term floor. It's a little bit higher than what we thought coming into the year. I think to get below that, we'd need to probably see a recession. And even though there's risks to everything that's going on, there's negative economic consequences, it seems like the economy was on pretty solid footing coming into this.

So the hope is that with tax refund season happening right now, maybe there's some sort of a buffer that can offset those negative consequences. Liz Ann, I have a question for you, and this is something that's stumping me a little bit. So we have all these risks right now. There's concerns out there, and yet it looks like earnings estimates have been increasing. So walk me through that a little bit, because listen, I'm a bond guy. I listen to you for stock market guidance and I know a lot of our investors and clients do. So help me understand how we're seeing an increase in earnings estimates with so much uncertainty right now and potential negative consequences.

LIZ ANN: I think you have to disaggregate what's been happening with earnings estimates. You're absolutely right. And that has been a surprise. I'm getting an increasing number of questions about why estimates have been going up in light of the obvious. The estimate increases have been largely concentrated in just two sectors. So this is not an across-the-board re-rating up for earnings estimates. Maybe the ultimate "Duh" would be that energy sector estimates have been going up.

Actually, there's three sectors that account for it. You've had also a little bit of upward revisions to the estimates for the materials sector. Also, maybe a lowercase "duh," because there you do when you see commodity prices move higher that can often accrue to the benefit of the materials company. So there's a little bit of that tie-in to the impact of the war on materials, but the bulk of it has been driven by increased estimates within the technology sector. And even there, it's not really a broad story where analysts are just saying, you know, that this sector is immune or there's other things going on or this is an AI story. Two particular stocks... and a big caveat here, I'm not a stock analyst. I don't cover these stocks. I'm mentioning them

simply because there's been a concentration in earnings estimate revisions, and it's Micron and Nvidia, have accounted for a fairly high percentage of that increase to tech estimates.

The other thing, too, I think that is happening, and we're at an interesting time here right now, is I'm not sure analysts know exactly what to do with estimates as it relates to the war and oil prices. And maybe because we're on the cusp of starting first quarter earnings reporting season, there isn't necessarily a reason at this stage for analysts to make a big, bold call on calendar year 2026 numbers when they haven't yet directly heard from companies in that kind of public setting, which, you know, we've got earnings reporting season starting in about a week or two. And I think that'll be the opportunity when companies report the first quarter to talk about so far what the impacts have been, of course, as it relates to the first quarter.

It was only the third month of the first quarter that had the war ongoing. But there's no question that companies will talk about the impact it's going to have. It'll be interesting to see whether you get certain companies that maybe have energy costs as a very high input cost, what they do with guidance. I don't know whether we're going to see a rash of companies just withdraw guidance altogether like we saw last year, which, as you remember, when we started first quarter reporting season last year, it was right at the beginning of the April 2 so-called Liberation Day, the April 9 announcement of delays. And a lot of companies just said, "You know what, we can't provide guidance in this environment of unstable policymaking."

And certainly, I don't think if there are some withdrawals of guidance, it'll be anything like what we saw back in 2020 when the pandemic erupted and companies just said, "We have no ability to give forward-looking guidance." But I think we'll have more, you know, meat put on the bones of this. And then you might start to see analysts make some adjustments to 2026 numbers. So I think that's the backdrop.

But, meanwhile, I think one of the late-night comics does a section called "Meanwhile...." There are other things going on in our world besides the war and energy prices. And, you know, I think about that in the context, "Boy, you know, before this war erupted, all we were talking about in my world was sort of AI and AI disruption." And in both of our worlds, you know, strains in the credit markets, tariffs, and the impact. So, we're now, as I mentioned earlier, when we talked about how companies were in this sort of state of uncertainty a year ago because of the initiation of the tariff regime in which we're still living right now. But given that, we are at the one-year anniversary of that period, and we've got broader inflation and the labor market in focus for obvious reasons.

Talk about your thinking now as it relates to the inflation backdrop. I know you already commented on what you think the Fed is going to do, but maybe just take a

step back from the oil price piece of this and maybe broader thoughts on inflation and maybe tie in the impact of tariffs.

COLLIN: Yeah, there's two ways that I usually look at inflation. I know you do and Kevin Gordon does, but I like to break it out in goods and services. And if we focus first on goods, you know, that's usually where you see a lot of the tariff impact. And Fed Chair Powell talked about this at his March press conference at the Federal Open Market Committee meeting where he was kind of talking about the potential roll off of it, knowing that, you know, we're recording this right now, it's April 2, so the one-year anniversary of the tariff announcement. And over time, assuming it was a one-time boost, you can see those effects roll off a little bit.

We hear a lot about the idea that there hasn't been much inflation from tariffs, and at a headline-level maybe. But if you look specifically at goods prices, we were leading into the tariff announcements, goods prices were falling in aggregate, core goods prices by 1% to 2% on a year-over-year basis. And then they rose 1 to 2% in the months to follow. So we saw it, but you have to figure out what's our percentage of imports that were affected by tariffs, what the consumption basket is. So it was in there, just not at a headline level. I think there's, maybe there's good news and bad news here. The good news is if there was that one time increase that could just start to roll off.

I'm a bond guy, so I tend to be negative, Liz Ann. So maybe the bad news is that maybe that, you know, we have a new tariff plan since IEEPA, or the International Emergency Economic Powers Act, was ruled down that they might be here to stay in some form and maybe businesses who were a little bit unsure about how this is going to play out, maybe didn't pass them along at all or in full, maybe we start to see that. So, pros and cons, but I think there's still, for me, is some uncertainty.

Now we also have to look at the services level, and I think that with a... not a weak labor market, but not as strong as we've seen, I think we can continue to see services inflation come down and that's a good thing. But just to add to the uncertainty theme, there's so much uncertainty right now and as it's translating to driving Treasury yields, the markets, the Fed, even if we saw some good news where maybe tariff impact was rolling off, you have the oil prices that are offsetting that. So inflation, unfortunately, probably isn't going to go down anytime soon based on our outlook. And it's probably going to hover north of 2.5%. You also mentioned AI. And let me use that to talk a little bit about the credit markets and building on what you were talking about regarding stocks.

So far this year, and even in the month of March, credit markets generally held in there. We saw spreads rise a little bit, spreads, that's the extra yields that corporate bonds offer above comparable Treasuries. And we saw relatively, somewhat big

moves in both investment-grade (IG) and high yield. When I say big, relative to each index. So high yield spreads rose a lot more than IG spreads, but relative to the starting point, we saw some decent moves and they've already since come down a little bit. And I think that's a good thing. That shows that investors and market participants are relatively comfortable lending to corporations right now, even in an uncertain economic environment. So that's a good thing.

And then one little fun fact. I was looking at issuance trends and with the U.S. dollar investment grade market, March of this year was the fourth largest month of issuance on record. So there's a couple kind of angles there for me. One is that's good in that there's demand. If there was no demand, companies likely would be a little bit more hesitant to issue because one, with less demand, maybe it results in higher yields and higher borrowing costs. Maybe the issuers need to issue at a higher coupon rate to attract those buyers. Also, if there's not a lot of buyers there, if you're an investment grade issue, and it doesn't look like there's a lot of demand, you might not issue because that's kind of a bad sign and it sends signals. So they might just pull it if it looks like there's not enough demand out there.

You could also say it's a sign of uncertainty for businesses, because I said it was the fourth largest monthly issuance and it followed, I think March, April and May of 2020, which is after we got good news from the Federal Reserve back when they had new facilities to buy corporate bonds and corporate ETFs, we saw this huge few months of corporate bond issuance because companies wanted to take advantage of relatively attractive borrowing costs and kind of make sure they were OK for the years to come.

And that could be one way to look at it, that businesses are saying, "We're very uncertain right now yields are still somewhat attractive or we can handle these borrowing costs. So maybe we want to issue debt, kind of boost up our liquidity, cash on our balance sheets to maybe prepare for a bumpy ride." That's a possibility, but there are pros and cons to everything, Liz Ann. But I thought it was interesting that we saw such a big month in issuance given all the uncertainty that we saw.

Let's, you know, if we're talking about credit, let me pivot to the stock markets again, and I've seen this in the news a lot lately, but maybe our listeners might not be as familiar. What does it mean if we hear that the market is oversold?

LIZ ANN: Yeah, so obviously it typically means the markets had a fairly sharp decline and not just the magnitude on the downside, but fast enough that, in general, selling pressure is considered excessive relative to what might be limited change to the underlying fundamentals. And there's a lot of technical indicators that are used to judge a market being either oversold, and the market could be overbought, too, things like relative strength indicators, indicators called stochastics which look at

the speed and magnitude of price moves rather than sort of fundamental value, but you know, a lot of people look at those technical indicators getting overbought and oversold as some sort of signal that the opposite move is set to happen, but a really important sort of caveat when looking at any technical indicators, but certainly oversold, overbought indicators is that they're conditions, they're not signals.

A market can get overbought and stay overbought for really extended periods of time, especially when you have... if you've got strong fundamentals, you can have markets stay overbought for a long period of time. If you've got deteriorating fundamentals, you can see markets stay oversold for an extended period of time. So what it really just does is tell you when the combination of momentum in the market itself, but also sentiment, investor sentiment, gets stretched. It doesn't tell you when the snapback or the reversion to the mean is going to happen. And I wrote about this quite a bit a year ago when we were dealing with the Liberation Day, the April 9 announcement of delays, and the inability to try to gauge and anticipate some of these policy-related announcements.

But what we could do is assess the market landscape, assess things like sentiment, assess positioning. You know, did you have crowded trades in certain part of the market, as it said, so much money because of enthusiasm or fear of missing out? And that allows you to think about segments of the market that maybe are more vulnerable, to the extent you then get some sort of negative catalyst. So as opposed to trying to anticipate what the positive or negative catalyst is going to be, which these days can literally turn on a dime, understand the technical conditions of the market, understand parts of the market that might be oversold or overbought or where sentiment is stretched in one direction or another. And that's just one way to provide a little bit of a knowledge edge, absent being able to forecast what these announcements are likely to be.

COLLIN: Alright, Liz Ann, well, it's time to look ahead as we always do, so what is on your radar next week?

LIZ ANN: Well, what's probably undoubtedly on our radar is the monthly jobs report, which unfortunately, as it relates to the timing of taping these podcasts, is after you and I are doing this right now, but before this episode will air. So I just want our listeners to know if anybody's wondering why the heck we said absolutely nothing about the jobs report, that's just the unfortunate timing of the release of the report being wedged in between our taping and its release. But as we all are going to digest the labor market report, I think a lot of the details under the surface of just the headlines of payrolls and the unemployment rate are important. So we'll dig into that in more detail. And I would say follow both of us. Shameless plug: Collin's brand new on X, because that's one of the things we do is real-time react to a lot of this economic data.

We did this week get the ISM, Institute for Supply Management Manufacturing, Index. Next week we'll also get the Services Index. And what's been interesting there is that you've actually seen a bit of an improvement over the last three months to the manufacturing side of the economy. Yet over the prior two months, because we don't have this third month with services not yet released, we've seen a little bit of a rolling over on the services side of the economy. So I'll keep an eye on the differential there.

We get the all-important Personal Consumption Expenditures price index, which even though I think a measure like Consumer Price Index, or CPI, tends to get more of the focus by the general population and even investors as a reminder, the PCE index is the Fed's preferred measure. Claims, you know, initial unemployment claims on a weekly basis, I think that's important to keep an eye on.

And then, later in the week next week, we do get the consumer price index. So we'll have a couple of measures. I think, Collin, we're also getting some Fed minutes and I know in your world that's something that you tend to pour over. But aside from that, what is on your radar?

COLLIN: Yeah, I'll kick it off with the Fed minutes because that gives us more insights than what the statement and Powell's press conference provides because it gives us an idea of not a precise number of tilts and thoughts of the various participants, but we'll see things about "Several participants thought that...", "a few," "a majority." And it's kind of silly, but we look at those qualitative terms to get an idea of what that means.

There's actually... there's a report on the Federal Reserve Board of Governors website that attempts to give us an idea of what "a few," "some," "several," "a majority," what that means. So I'll be looking to that to see what the wide range of views, what was discussed, and what it means going forward. And building on the Fed theme, you mentioned it, but we get the PCE, Personal Consumption Expenditures report. It is for February. So this is pre-Middle East conflict, but I think that can be really important to see what the trend was looking like before this happened, especially on the core level.

So Core PCE, which excludes volatile food and energy prices, in January it rose by 3.1%, back above 3%, the wrong direction. So even though we... you know, we're going to likely see the oil and gas related spike. We can try to look through those, but you don't want to look through core inflation readings. And we're going to be paying very close attention to that to see if it is holding above 3% or worse, rising, because that's going to be very important for the Fed, because they can impact the demand side of the economy, inflation expectations, they can't really fix what's going on with the Strait of Hormuz right now.

And then finally, we get the final reading for fourth quarter GDP. For most of the components, I don't really pay too much of attention because we've gotten that already. But there's one little nugget in there that I like where we get corporate profits and we have to wait a few releases before we get that. And I like looking at the corporate profits in that release from the Bureau of Economic Analysis because it gives us a very comprehensive view of the corporate landscape, not just what's in the S&P 500® or various stock indexes. It includes all companies, large, mid-sized, small, public, private. So it's a very comprehensive look. So we look there to see what earnings and revenue trends look like to see how companies are positioned right now.

LIZ ANN: Yeah, Collin, I'm glad you mentioned that. So that comes out of the National Income and Product Accounts (NIPA). And you're right, we'll get the read when we get GDP for the NIPA-based profits in the fourth quarter. And for what it's worth, and I've been pointing this out a lot, we often think of corporate profits as the S&P 500® because it is the benchmark for the US equity market. But that's just 500 companies, all publicly traded companies generally on the larger end of the spectrum.

The reason why this is important in this environment is in all of last year S&P profits were up around 14% year-over-year. Now we only have through three quarters for the NIPA-based profits because once we get the release it'll be for the fourth quarter. But the first two quarter of NIPA-based profits were negative. And then we had a little bit of an improvement in the third quarter. But that is a perfect example of some of the K-shaped nature of this. You've got, you know, an index like the S&P where corporate profits has been strong, but when you look at the vast majority of companies, to your point, large, small, private sector, publicly traded companies, you see a different picture. So we'll have to see whether that lift in the third quarter persisted in the fourth quarter. Maybe we can see a bit of a closing of the gap between those two.

So thanks for listening, everybody. As a reminder, you can always keep up with us in real time on social media. I'm @LizAnnSonders on X and LinkedIn. My imposter problem is a little less severe than it's been in the past. Kudos and credit to the wonderful folks at Schwab who play whack-a-mole with this stuff. And Collin, remind everybody where you are.

COLLIN: Yeah, I'm @CollinMartinCS on both X and LinkedIn. So you can follow me there. That's Collin with two Ls and then CS for Charles Schwab. As you mentioned, Liz Ann, I'm still trying to grow my follower count. I just started posting on X a couple of weeks ago. So if you're listening here, I'd love a follow.

LIZ ANN: Give him a follow. And you can always read all of our written reports, they always have lots of charts and graphs, and they're on schwab.com/learn. And if you've enjoyed the show, please consider leaving us a review on Apple Podcasts, a rating on Spotify, or feedback wherever you listen. And please tell a friend or two or more about the show, and we will be back with a new episode next week.

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