

MARKET REACTION TO OIL SUPPLY SHOCKS

The current conflict in the Middle East is eliciting strong feelings of déjà vu from investors: yet another war in an oil-rich region is constraining supply and boosting energy prices while raising the prospect of higher inflation and, consequently, restrictive monetary policy. However, this conflict doesn't exist in a vacuum; while materially higher energy prices—particularly if sustained—would have a net negative impact on the global economy, there are many other economic tailwinds acting as counterweights.

If the oil shock persists, one might reasonably expect that global economic growth will stagnate amid higher inflation and potentially higher global interest rates. Assuming the worst-case scenario materializes, how might we expect global risk assets to perform? Perhaps the best way to gauge future performance is to analyze how markets behaved during four prior oil shocks¹: 1) the Arab Oil Embargo, 2) the Iranian Revolution, 3) the Gulf War, and 4) Russia's invasion of Ukraine. **In each of these prior oil shocks, the initial drawdown of the cheapest quintile* of stocks' was either comparable or less severe than that of the most expensive quintile* of stocks, and their recovery was decidedly more powerful.**

Exhibit 1: Drawdown Comparison Between Four Prior Oil Shock Periods

		Drawdown Duration (Months)	Drawdown Severity (%)	Recovery Duration (Months)
Arab Oil Embargo†	Cheap*	22	-35%	30
	Expensive*	22	-58%	84
Iranian Revolution	Cheap	2	-8%	4
	Expensive	1	-7%	10
Gulf War	Cheap	3	-21%	18
	Expensive	2	-23%	37
Ukraine Invasion	Cheap	8	-23%	12
	Expensive	9	-34%	32
Average	Cheap	8.75	-22%	16
	Expensive	8.5	-31%	40.75

Source: Sanford C. Bernstein & Co., Pzena analysis
Universe is the MSCI ACWI Index. Cumulative total return data, in U.S. dollars, from 1972 through 2022
†Only U.S. data was available; universe is the 1,000 largest stocks in the U.S.

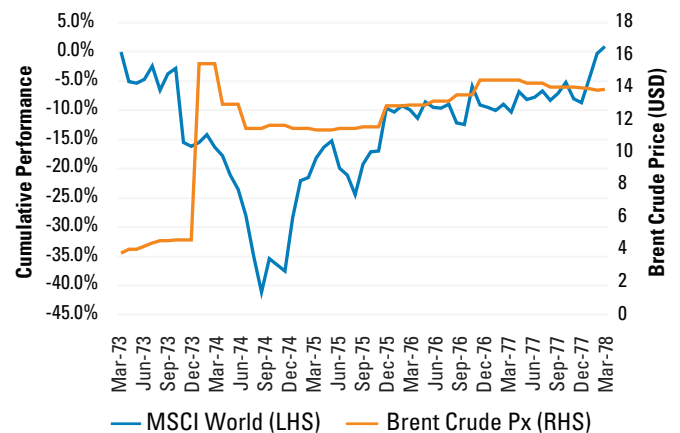
*Cheap = stocks within the cheapest quintile measured on an equally weighted basis based on price/book of the relevant universe. Expensive = most expensive quintile. See respective chart details for specific universe.

1. Performance periods begin at the prior peak

ARAB OIL EMBARGO

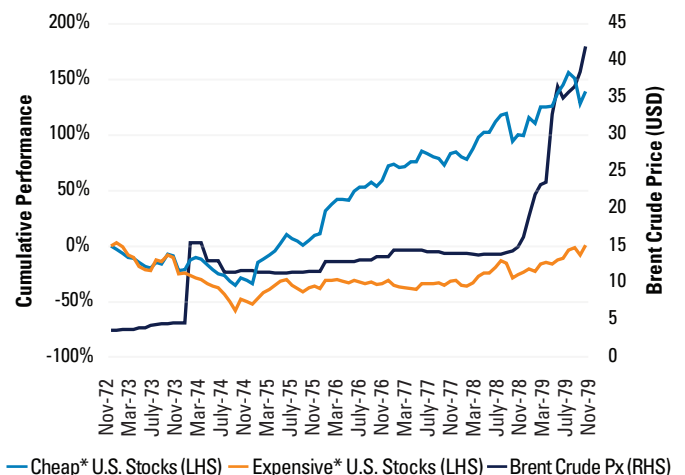
The U.S. economy was already on dangerous footing heading into the 1970s, as a result of years of expansionary fiscal policy that sent inflation from less than 2% to more than 6% by the turn of the decade². By the time the oil shock occurred, the U.S. economy was improving but not strong enough to absorb higher energy prices. Cheap stocks went on to materially outperform expensive stocks, as the expensive and longer-duration “Nifty Fifty” cohort fizzled out in the face of higher inflation and interest rates.

Exhibit 2: The Arab Oil Embargo (Global)



Source: FactSet, Sanford C. Bernstein & Co., Pzena analysis

Exhibit 3: The Arab Oil Embargo (U.S.)



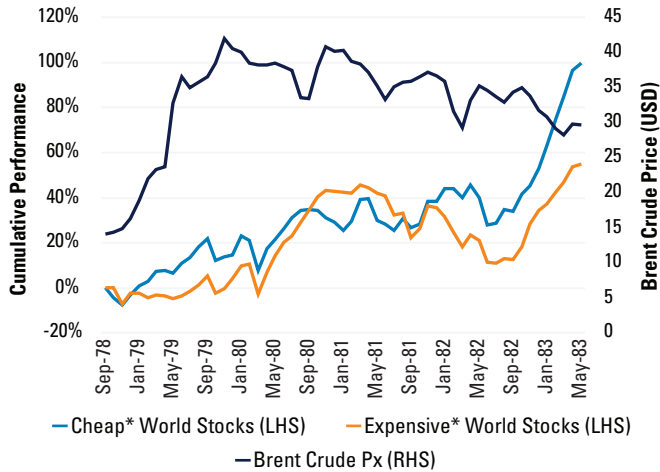
Source: FactSet, Sanford C. Bernstein & Co., Pzena analysis
Universe is the top 1,000 U.S. stocks by market capitalization

2. Factset

IRANIAN REVOLUTION

Despite a spike in crude prices of approximately 200%, the drawdown in global stocks was short-lived, as corporate earnings (at least for the S&P) managed to grow over this period, along with both nominal and real GDP.

Exhibit 4: The Iranian Revolution

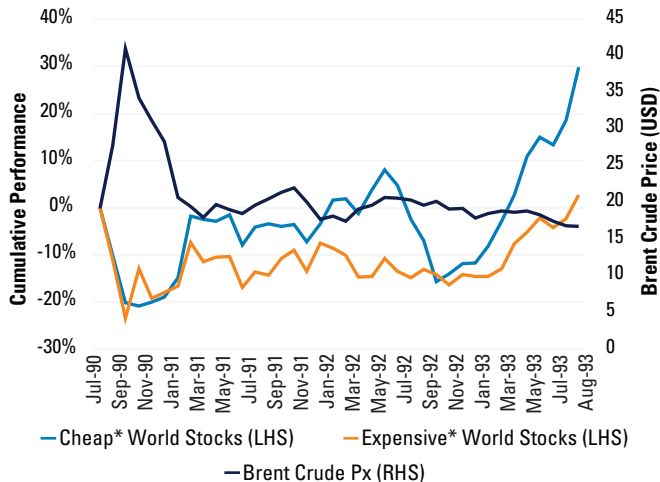


Source: FactSet, Sanford C. Bernstein & Co., Pzena analysis
Universe is the MSCI World Index

THE GULF WAR

Because rates were already high when Iraq invaded Kuwait in August 1990, there was room for the Fed to cut, which helped declining corporate profits. The transitory oil price spike, coupled with accommodative monetary policy, laid the foundation for an equity rally once crude prices peaked.

Exhibit 5: The Gulf War

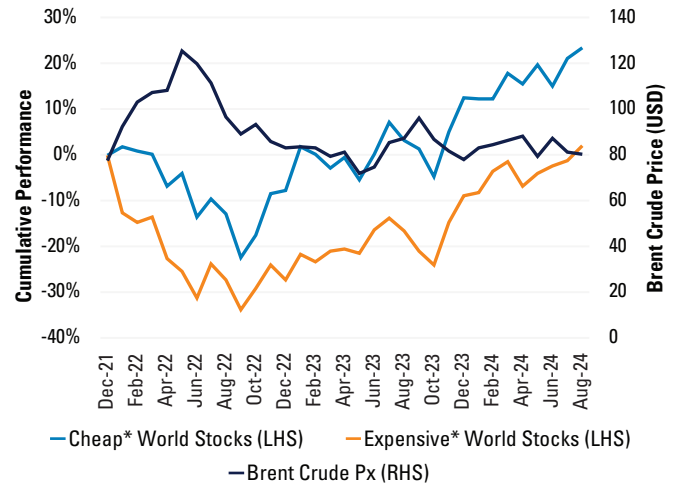


Source: FactSet, Sanford C. Bernstein & Co., Pzena analysis
Universe is the MSCI World Index

THE INVASION OF UKRAINE

Similar to what happened in the early 1970s, a surge in inflation hit longer-duration, expensive stocks the hardest after Russia's invasion of Ukraine in 2022, while cheap stocks held up relatively well. Inflation was already elevated before the oil price spike due to massive fiscal stimulus following the COVID-19 pandemic.

Exhibit 6: The Invasion of Ukraine



Source: FactSet, Sanford C. Bernstein & Co., Pzena analysis
Universe is the MSCI World Index

*Cheap = stocks within the cheapest quintile measured on an equally weighted basis based on price/book of the relevant universe. Expensive = most expensive quintile. See respective details for specific universe.

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