



Special Report
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Strategist's Note

Our thoughts on the recent
terrorist attack on Israel.

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We Are at War

“We are at war”. These were the words spoken by Israel’s Prime Minister, Benjamin Netanyahu, after the unprecedented and brutal attack perpetrated on Israel by Hamas in the early hours of Saturday morning. Estimates indicate that close to 1,000 Hamas fighters and between three and five thousand rockets descended upon southern Israel that day, in an intricately coordinated assault from the air, land, and sea. As of this writing, approximately 900 Israelis had lost their lives, including 11 Americans, as well as close to 700 Palestinians. According to the Israeli Ministry of Defense, more people have perished in Israel over the past four days, than over the past 15 years combined. Additionally, it is estimated that between 100 and 150 people have been taken hostage into Gaza, including many women, children, and elderly individuals. In response, Israel has launched a counteroffensive into Gaza, codenamed Iron Swords, and it is preparing for a “long and difficult war”. The political divisions plaguing the country just last week have been put aside, as the country coalesced behind a common cause. Opposing political factions are looking to form a temporary coalition government, while 300,000 reservists are called to service, and a new military base that could accommodate over 10,000 soldiers is being built very close to the Gaza Strip. The next stages of the conflict are up for speculation, but Israel has vowed to destroy Hamas as a military organization.

With a population of approximately 2.5 million people living in an area of 141 square miles (365 square kilometers), the Gaza Strip is one of the most densely populated regions in the world. Complicating matters is the fact that Hamas is embedded in the everyday fabric of this region, blending in and disappearing into the dense populace as they see fit. As a U.S. general recently described it, there could be a coffee shop in one stand in a bazaar, while the next stand may house Hamas leadership. Additionally, many of its fighters move about through a maze of interconnected tunnels throughout the region. This poses a tremendous problem for the Israeli military, as flushing out these fighters, who have the support of much of the local population, will prove difficult. Whatever shape the conflict takes, it is likely to be protracted and come at a high cost of human lives.

The sheer brutality of the attacks was shocking, and the fact that it was able to be carried out is alarming. Equipped with some of the best soldiers, training and technology, the Israeli Defense Force, or IDF, is one of the premier fighting forces on the planet. This begs the question; how could such an extreme attack take place? Theories abound, and investigations will surely ensue. However, there is a saying that Afghan fighters would tell coalition forces during the war in Afghanistan: "You have the watches, but we have the time". This was a low-tech attack, which likely took months, if not years, to plan. It would appear as if Hamas used Israel's reliance on high-tech against them. There are indications that cell phones were not even used to coordinate the attacks. Electronic intelligence gathering systems would have yielded limited results. Hamas might have even taken advantage

of the approximately 100,000 Gaza residents that were allowed to come into Israel for work, as a trojan horse, to strategically smuggle weapons and assets into the country over a period of years, seizing on the opportunity presented by Israel's refocusing of its troops to deal with unrest on another front, the West Bank. The presence of numerous terrorist groups in the region also complicates matters, as the removal of weapons thought to be of Hamas, could have actually been of another competing group. In any case, heavy reliance on superior technology for its intelligence operations might have lulled Israel into a false sense of security. The need for human intelligence, particularly in a region as densely woven as the Gaza Strip is imperative, complemented not supplanted, by technology.

However, it would be naïve to think that Hamas could have relied solely on low-tech. It would have also needed a certain amount of equipment and training in order to carry out an operation of this size and scope. This is where Iran may have played a role. Iran has a long history of supporting multiple terrorist organizations in the middle east. The Israeli Ministry of Strategic Affairs estimates that close to 90% of Hamas' funding comes from Iran. A former Director of Israeli Military Intelligence recently told Bloomberg that he believes that Iran finances Hamas with approximately \$100 million per year and Hezbollah with as much as \$1 billion. Much of this funding comes in the form of the training, tools, and capabilities needed to operate across the region. Iran has been very vocal in supporting Saturday's attack, although it denies any direct involvement in it. The United States and Israel have also stated that they have not yet found any direct involvement of

Iran. However, the Soviet Union rarely claimed any “direct” involvement in conflicts in Latin America during the Cold War, yet its hand was present across the region. Although on a relatively smaller scale, Iran now operates much like the Soviet Union did back in the ‘70s and ‘80s, carrying out its foreign policy goals through surrogate organizations and proxy-wars across the region. This affords it plausible deniability, while allowing it to be a constant thorn on the side of the West. Just as the Soviets did during the Cold War, and as Saddam Hussein attempted to do in 1990 during the Gulf War, Iran could try to draw other regional players into a broader conflict, as it has little incentive to ease pressures in the Middle East. In fact, other Iranian proxies in the region, particularly Hezbollah in Lebanon, are feeling the pressure to join the conflict and have already been involved in some skirmishes in the north. With an arsenal of over 100,000 rockets in store, Hezbollah is a much larger foe than Hamas, although it has less support from the Palestinian population in Lebanon. In an effort to deter other players from joining the conflict, the United States has sent one of its newest aircraft carriers, the USS Gerald R. Ford, along with her carrier strike group, to the Eastern Mediterranean.

For a number of years, the United States and its allies had embarked on a campaign to increase rapprochement in the Middle East, fostering dialogue between Israel and many of its neighbors. In fact, the United States, Israel, and Saudi Arabia have been in talks to come to an agreement on what could potentially develop into a unique triumvirate in the region. This would serve to counterbalance a nuclear Iran, presumably backed

by Russia and China. Iran and Saudi Arabia do not see eye to eye and are already engaged in proxy wars between themselves. For Iran, and by default Hamas, an understanding between its three main rivals destabilizes its footing in the region. Many in the analyst community believe that this could be one of the main reasons, if not the main reason, for the attack on Israel. In fact, Hamas has publicly stated in no uncertain terms that the attacks should serve as a warning to any Muslim nation looking to ally with Israel.

Another dynamic at play in the region are the geopolitics of oil. Many on Wall Street have equated the current situation with the dynamics present during the Yom Kippur War in 1973 that led to a major spike in oil prices. Although there are some similarities, the current backdrop is different. In the 1970s the supply of oil lay mostly in the Middle East, so a major disruption of this supply would prove of grave consequence to the global markets. Nowadays, the United States is producing nearly 13 million barrels of oil per day. As a major producer itself, the country has become a net-exporter, not importer of oil. Additionally, unlike in 1973, the demand for oil is also more sustainable today. Earlier this week, OPEC released its oil demand forecast for the next two decades, stating that it foresaw demand climbing 16%, reaching 116 million barrels per day by 2045. This demand growth, although higher than expected, could be met by production increases and spare capacity cushions much higher than those available in 1973. OPEC, particularly Saudi Arabia and the United Arab Emirates, have exercised better discipline over supplies, leaving approximately 4 million barrels/day of spare capacity over the next couple of years.

This is not to say that we do not foresee oil prices climbing higher in the near future. For the better part of 2023, we have been in the camp that oil prices would climb higher throughout this year and next, breaking above \$100/barrel for Brent Crude. The current conflict could exacerbate this dynamic and keep oil prices higher for longer. One third of the world's oil supply passes through the Strait of Hormuz, over which Iran exercises limited control. A broader conflict directly involving Iran could cause oil to move meaningfully higher. What we are saying, however, is that barring the spillover of this conflict across the region, we do not see oil prices spiking higher as they did in 1973, as we do not think that the same dynamics are at play today.

We are often getting the question: "What is an investor to do in light of the current situation?". We believe that the answer is to keep a level head and stay diversified. Some on Wall Street are advocating a move to cash, given the high level of interest rates. Again, barring a spillover of the conflict into the rest of the region, geopolitical events tend to have transitory effects on the markets. Although holding a cash reserve is always prudent, a large move to cash would leave an

investor potentially underexposed to the markets, as these stabilize over time. Additionally, higher for longer oil prices could also potentially lead to more resilient inflation. Keeping a large amount of assets in cash would also erode an investor's purchasing power over time, as despite the currently high yields present in short-term securities, these might not be able to keep up with prolonged inflation. Hedging some of the geopolitical risk, whether it is through commodities like oil-related securities or gold could be prudent, but again, we believe that the key is to remain diversified, with a level head and an eye toward the long-term.

Our thoughts and prayers are with all those affected by this terrible tragedy.

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