(UBS)

What would an Iran resolution mean for markets?

11 May 2026, 14:40 UTC, written by UBS Editorial Team

Hopes of a lasting peace in the Middle East have been mounting, despite various setbacks. Our base case remains that a diplomatic solution will be reached, allowing investors to return their focus to solid earnings fundamentals. However, this will be a bumpy process.

With uncertainty remaining, we advise investors to use the recent strength of equity markets to rebalance portfolios and diversify.

Diplomatic efforts continue between the US and Iran, with investors encouraged by a continued ceasefire.

- US and global equities rallied to record highs again last week, reflecting a strong earnings season and hopes that diplomatic efforts will eventually yield a lasting peace.
- The ceasefire between the two nations, though fragile, has been holding.
- Both sides have a strong incentive to reach a deal in our view, with Iran eager to rebuild and the Trump administration under pressure to bring down elevated energy prices ahead of Congressional elections in November.

But hurdles remain to a sustainable peace, with the potential for renewed escalation.

- A final peace deal remains elusive, with President Trump saying Iran's latest response to US peace plans was "totally unacceptable."
- Points of disagreement appear to include the future of Iran’s nuclear program, the nation’s demand for reparations, and its ability to charge a fee for passage through the Strait.
- Even after an agreement is reached, a full reopening of the Strait of Hormuz will take time.

With uncertainty still elevated, investors can use the recent strength of equities to rebalance portfolios.

- The S&P 500 is up 8.1% so far this year, as of 8 May, and the MSCI All Country World index is up 9%.
- Since these gains have been led by big US tech firms, this has created an opportunity to rebalance portfolios from a position of strength.
- Investors can address this concentration risk by complementing exposure to market-cap-weighted indices with equal-weighted index approaches, or by adding exposure to our preferred markets such as Japan, emerging markets, China, and Switzerland.

Did you know?

- The Strait of Hormuz is the world's most important oil route, accounting for more than one quarter of global maritime oil trade, moving about 21 million barrels per day to global markets from Iran, Iraq, Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates.
- Iran's oil production (crude and natural gas liquids) was at nearly 4.8 million barrels per day in January—roughly 4.5% of global output—according to the International Energy Agency.

Investment view

We have continued to view equities as Attractive through the conflict in the Middle East. Our view remains that a diplomatic solution will eventually allow investors to focus fully on resilient fundamentals, leading to further upside for stocks. The current strength of markets provides an opportunity to rebalance portfolios, since much of the recent gains have been led by large US tech firms. Within AI, we favor broaden exposures to megacap tech across the enabling, intelligence, and application layers of the AI value chain. Investors can also lower concentration risks by adding equal-weighted index approaches. Broaden exposures to megacap tech across the enabling, intelligence, and application layers of the AI value chain, including semiconductors and chipmaking equipment, power and resources, and infrastructure.

Original report – **What would an Iran resolution mean for markets?, 11 May 2026.**

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