Macrovoices

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March 2026

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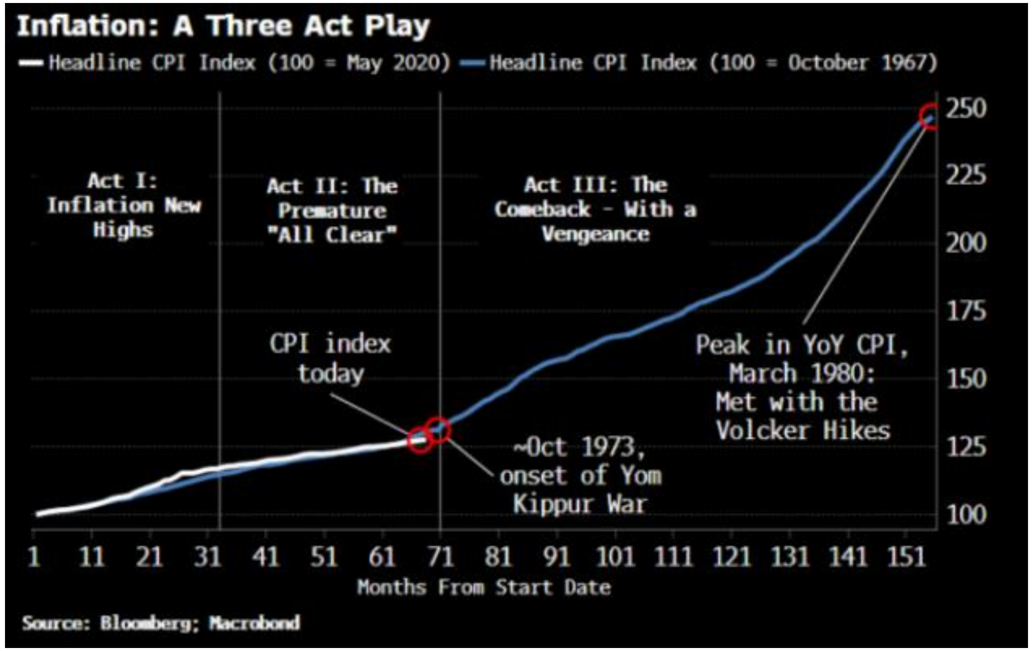
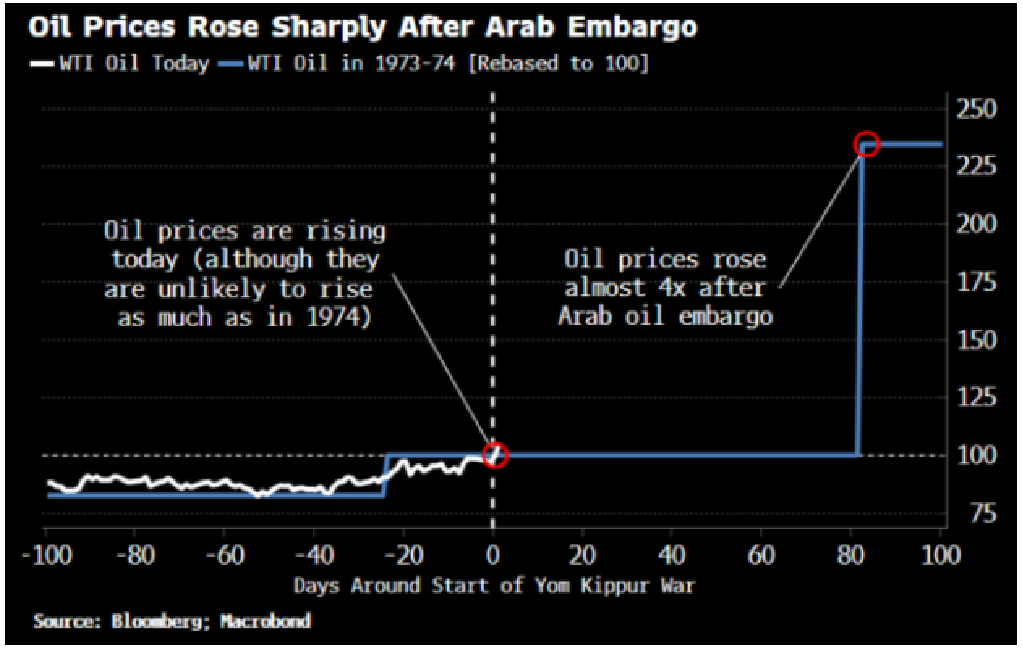
Inflation Is a Three Act Play

Some of the similarities between the 1973 Yom Kippur War between Israel and the Arab states merit it as a non-negligible tail risk today. Stocks sold off significantly over the following year, after the oil embargo led to a quadrupling in the oil price





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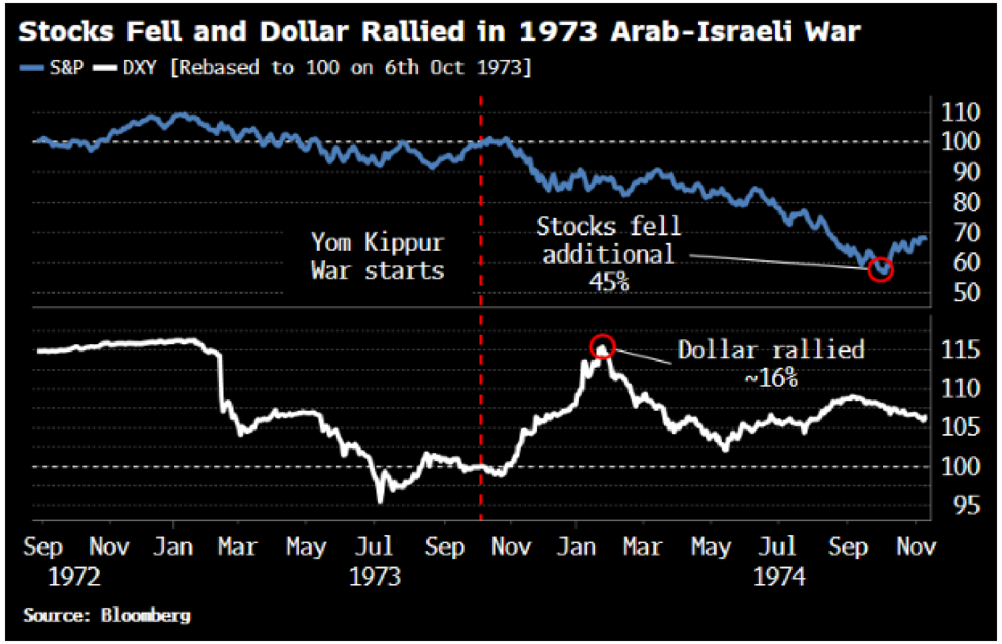
Yom Kippur War: A Bad Precedent

War struck in 1973 just as CPI was levelling off. Today is an uncanny repeat of that

The energy price shock met a stock market with as narrow leadership as today's - the era of the Nifty Fifty. Valuations are much higher today, yet then the market still went on to drop 45%



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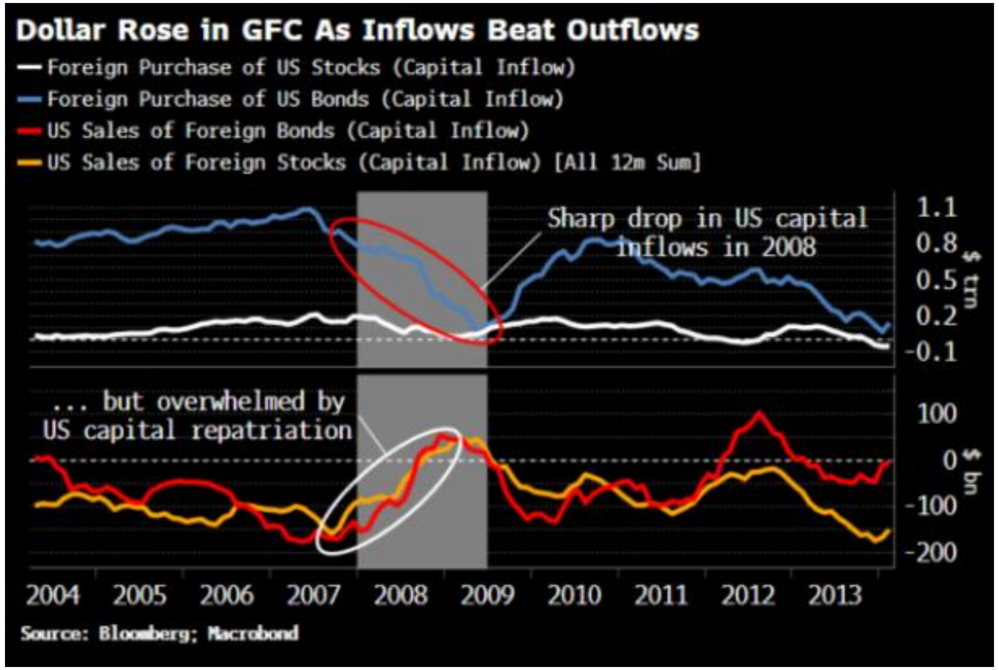
Rewriting the Risk-Off Playbook I

The dollar and Treasuries cannot be expected to behave as in prior risk-off periods



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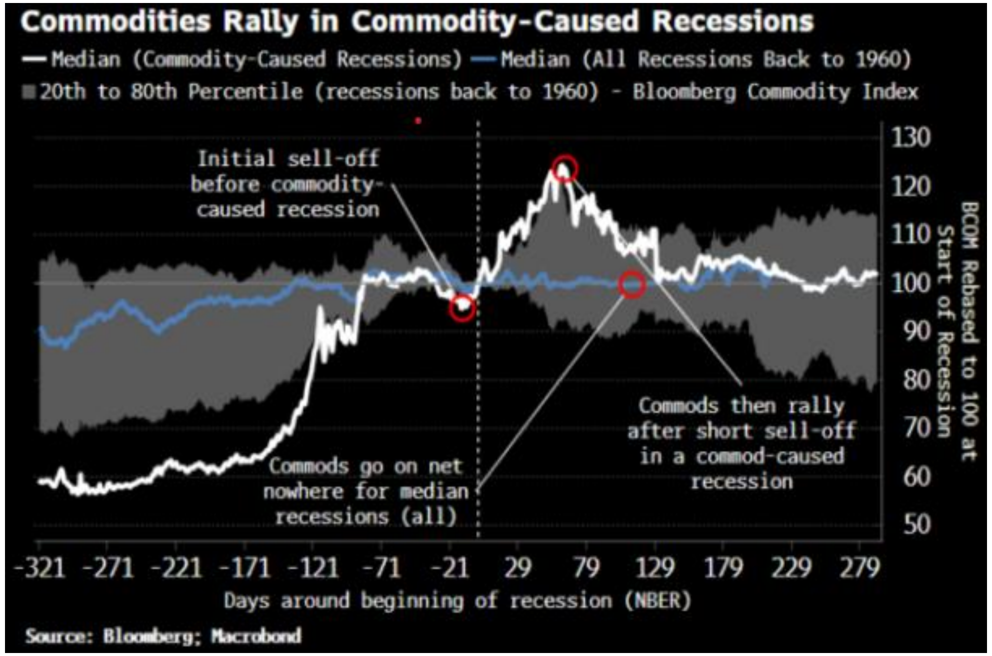
Rewriting the Risk-Off Playbook II

Commodities are expected to sell off in a recession, but they typically rally through it when they are the cause of the downturn



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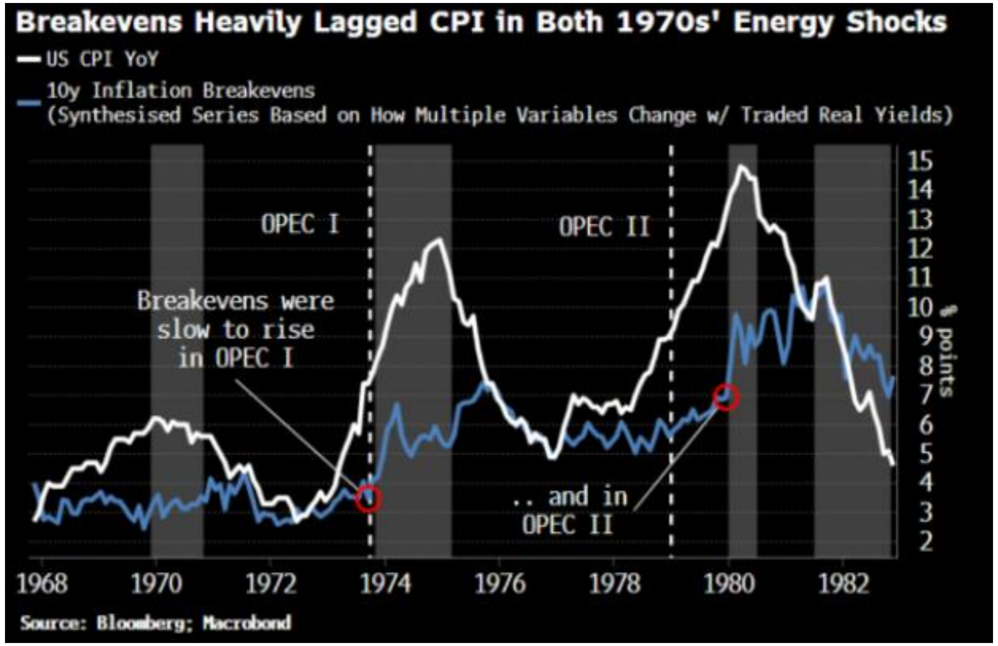
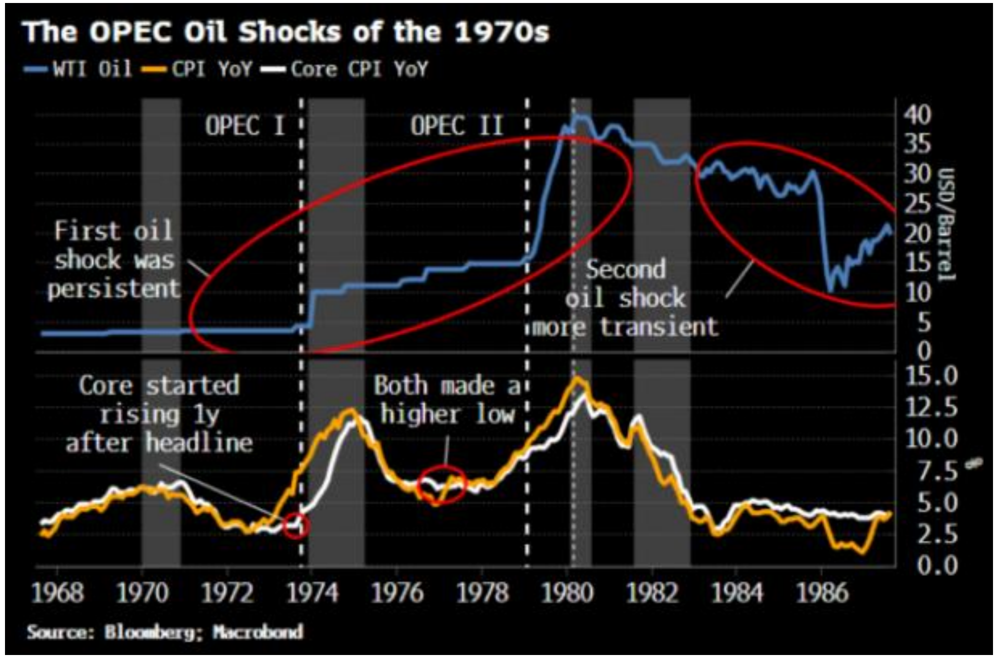
Yields Are Still Not Fully Pricing the Energy Shock

Breakevens heavily lagged CPI in both oil shocks of the 1970s, OPEC I and OPEC II

OPEC I led to permanently higher oil prices, while OPEC II's shock was more transient. But both shocks led to higher core and headline CPI as inflation became deeply entrenched





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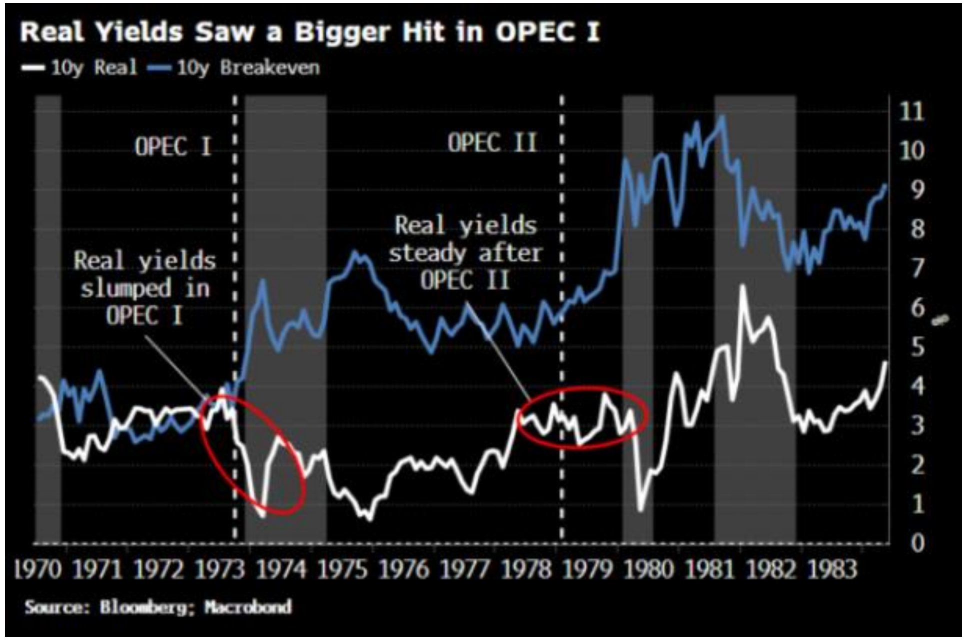
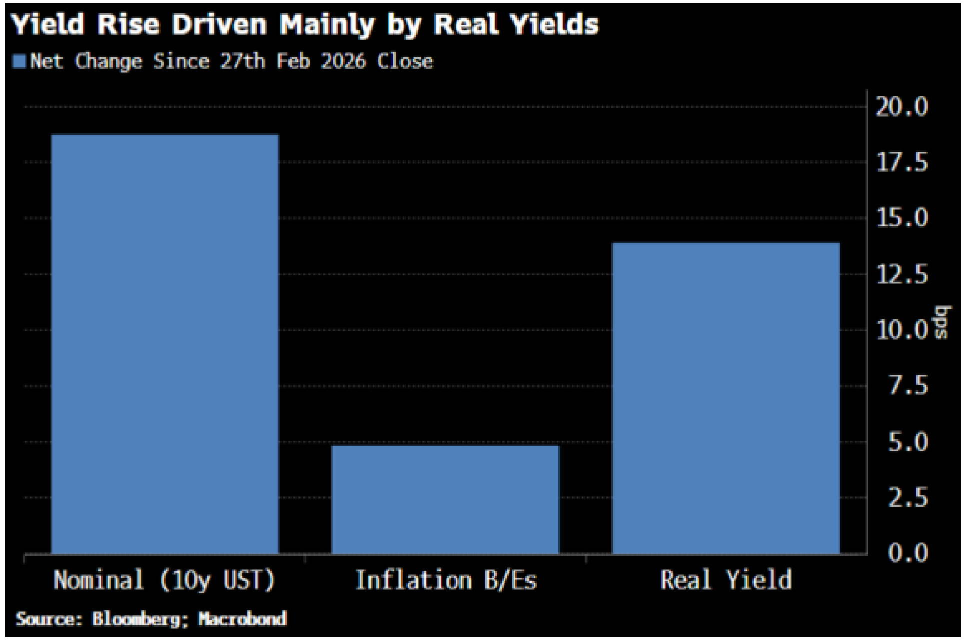
Energy Shock Should Lead to Curve Steepening

A growth shock – which is more likely energy prices stay elevated – will lead to lower real yields, and breakevens will rise.

Add in an incoming Fed chair who's more likely to resemble Arthur Burns (chair in OPEC I) than Paul Volcker (chair after OPEC II), the ingredients are there for a yield curve steepening

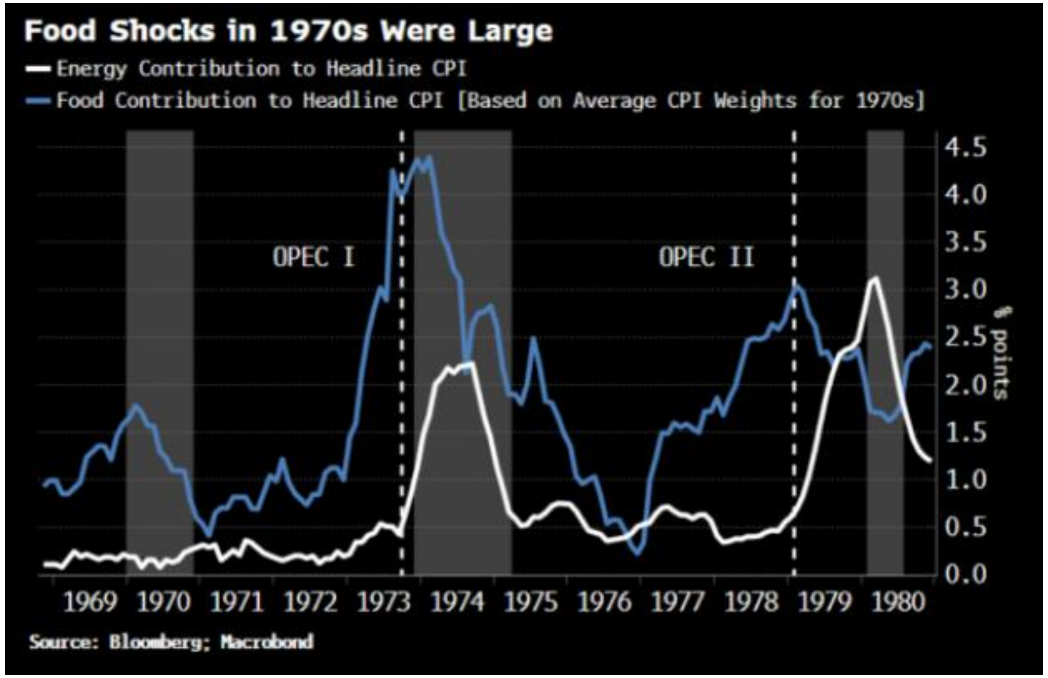




Food Prices Could Be More Troublesome Than Energy

It was underappreciated that food was a bigger price shock than energy in the 1970s

Food is currently contributing more to CPI than energy in the US, as it did in 2022 as well



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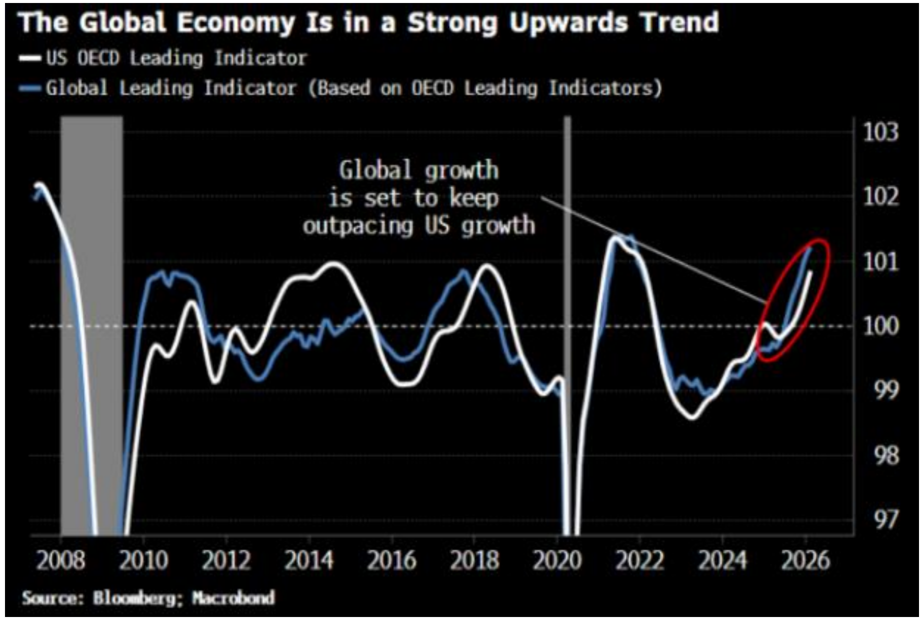
It Takes a War to Bring Down an Economy This Strong

The US economy is firing on all cylinders, with most of the main cycles – liquidity, business, inventory, housing and credit – in good shape

To dismantle such a wide base of economic resilience would take a protracted war



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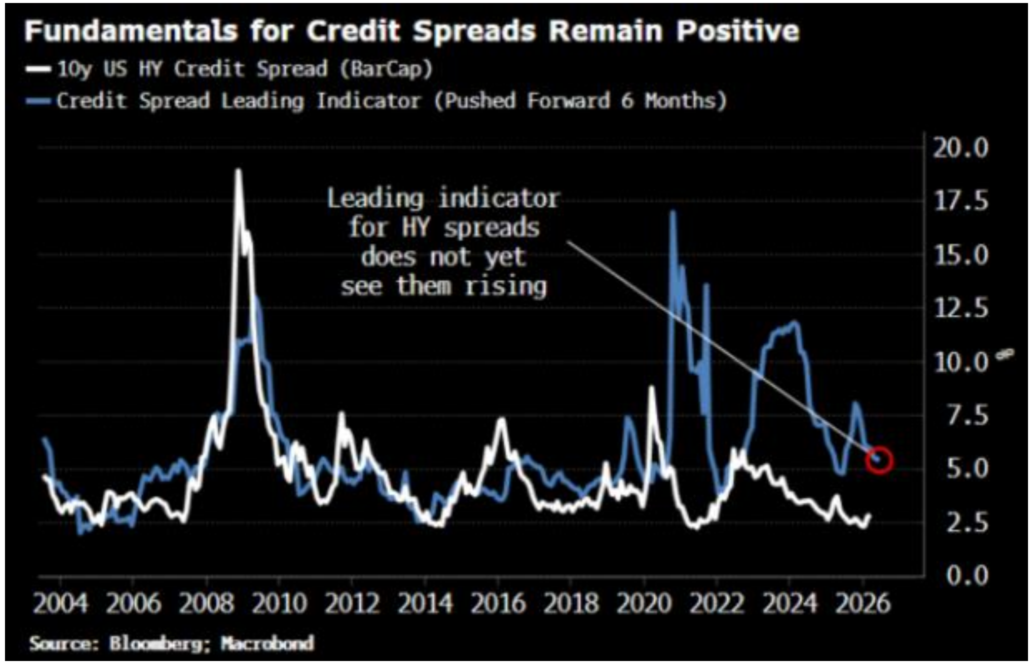
Private Credit Is the Weakest Link

The credit cycle as a whole has yet to turn down

But private credit is vulnerable to the disruptible software sector, and could be further put at risk from a prolonged war in the Middle East



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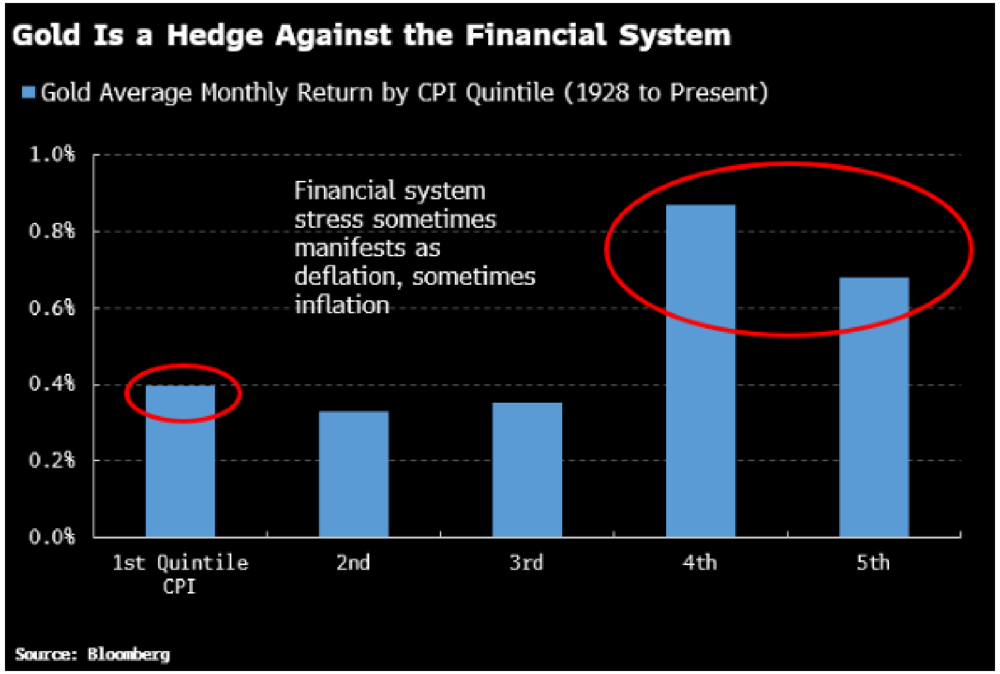
Gold Is a Hedge Against Both Tails

Gold is not just an inflation hedge, it is also a deflation hedge. This unique property makes it indispensable insurance for portfolios.

As the age of financialization reverts to a real asset world, gold is an unimpeachable source of high-quality collateral with no fully viable alternatives



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