



By Patrick Fearon-Hernandez, CFA

*April 20, 2026*

## **The War in Iran and the End of US Hegemony**

In a [\*Bi-Weekly Geopolitical Report\*](#) late last year, we argued that the 2025 trade dispute between the United States and China revealed just how dramatically Beijing has increased its comprehensive power — military, political, economic, and technological. We argued that China’s comprehensive power may now rival or even surpass that of the US, potentially ending the US’s traditional role as the global hegemon, i.e., the big, strong, dominant country that provides the world with security, order, and the reserve currency. Now that the US has launched a war against Iran — a key member of China’s geopolitical and economic bloc — the world has seen additional evidence that the US may not continue as a hegemonic power. In this report, we examine the evidence pointing to the US relinquishing its hegemonic role and what that means for investors.

### **A Longstanding Trend**

At Confluence, we have long tracked a growing shift in American voter sentiment away from the burdens of maintaining global hegemony. We have shown that as voters became angry at the social and economic costs of hegemony, US leaders adopted more populist, nationalist, and isolationist policies in realms ranging from foreign relations and trade to immigration and government spending.

In recent years, we’ve emphasized how the US pullback from global leadership has encouraged increasingly powerful adversary countries such as China, Russia, and Iran to assert themselves, prompting countries around the world to coalesce into relatively separate geopolitical and economic blocs. Our deep analysis indicated that this global fracturing would have multiple economic impacts, which called for specific investment strategy adjustments. Nevertheless, we showed that the evolving US bloc was generally attractive for investors, since it consisted mostly of today’s rich, highly industrialized, technologically advanced liberal democracies and a few closely related emerging markets.

### **Two New Omens**

Against the backdrop of a long US retreat from global leadership and the rising power of competitors such as China, Russia, and Iran, we believe two geopolitical and economic events over the last year were critical tipping points. These two events led to discoveries or learnings that help to confirm that the US may have lost its ability to exercise its hegemonic role. In this section, we examine each of those developments.

***China’s Control of Critical Minerals.*** The first of the great geopolitical learnings over the last year was how much power China has gained from its virtual monopoly over global supplies of rare earths and other critical minerals. As the world economy becomes more dependent on information technology and advanced materials, these

minerals have become essential supplies. Even though these minerals in some cases have a relatively low market value or are needed in relatively small amounts, any supply disruption can halt the output of key products such as semiconductors, electric motors, batteries, missiles, and military-grade ammunition. To retaliate for the US imposition of big tariffs on Chinese imports in 2025, the Chinese government activated an export licensing scheme that crimped world supplies of these minerals. Very quickly, influential manufacturers, including automakers, were warning the US administration that they were just weeks or even days from having to shut down their assembly lines. The White House then found that it had to back down from its tariffs and instead initiated trade talks and a trade truce with China. The Chinese government lifted most of its export restrictions, allowing supply chains for these minerals to mostly normalize, and the resulting trade truce remains in place to this day.

has been pursuing nuclear weapons to protect itself and assert its interests vis-à-vis the US and Israel. However, technological challenges and outside military and diplomatic pressure have apparently prevented Iran from successfully acquiring a nuke. [The major takeaway for Iran so far in this year's war was that it has gained enormous power versus the US and Israel simply from its ability to shut down shipping through the Strait of Hormuz](#), through which roughly 20-25% of the world's crude oil and natural gas supplies pass to market (see Figure 1). Large shares of other key global commodities also pass through the strait, such as refined petroleum products and fertilizers.

- Some observers now believe that Iran's nuclear program was always a feint, and that the Iranians always knew that their true leverage was their ability to shut down the strait.
- However, Iran's ability to close the waterway was quite uncertain until recently. Before the development of drones, any effort by Iran to shut down the strait probably would have required laying sea mines from naval vessels or firing anti-ship missiles from shore, both of which would have invited quick US attacks on the associated mine-laying or missile-launching assets. Now, Iran has plenty of drones that can be launched against ships from secret redoubts with little or no telltale signature, insulating them from attack. The war has also taught Iran that it only needs to attack a few ships to strike fear into the hearts of sea captains and the insurers who cover their ships. Even though Iran has only struck a small number of ships in the war so far, there are reportedly hundreds of tankers and other commercial vessels trapped in the Persian Gulf because their captains, owners, and/or insurers won't

Figure 1



*The Persian Gulf and the Strait of Hormuz (Source: Wikipedia Commons)*

**Iran's Control of the Strait.** The US-Israeli war against Iran has now revealed a second instance in which an adversarial country in China's bloc has been shown to have important leverage over the US. Of course, over recent decades, the Iranian leadership

risk being one of the few ships targeted. And of course, this says nothing about Iran's ability and willingness to attack the energy facilities and civilian infrastructure of other countries in the region.

- Of course, the true leverage from Iran's control of the strait is its ability to cause worldwide supply shortages and high prices for energy and other commodities around the world. Over the first month of the Iran war, the effective shutdown of the strait boosted Brent crude oil prices by about 50%. Diesel and jet fuel prices doubled in key markets from Asia to Europe and prompted many governments to impose rationing or other restrictions. The Iranians clearly understand that the political pain of such price hikes is a potent weapon against the US and other key countries. The US administration's decision to stop its attacks on the pretext of an Iranian peace proposal is evidence that Tehran can now bring the US to its knees if needed.

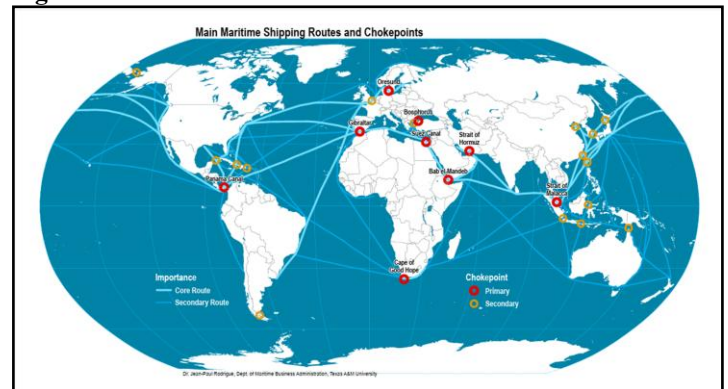
### Implications for the Global Economy

As of this moment, the US-Israeli war against Iran can only be considered a partial success. Two key war aims have been achieved: killing former Iranian Supreme Leader Ayatollah Khamenei, thereby "decapitating" the regime, and degrading Iran's conventional military power. However, the regime's militant Islamic Revolutionary Guard Corps (IRGC) and new Supreme Leader, Mojtaba Khamenei, retain a firm political grip on the country and are likely to be even more hardcore than the previous leader. While Iran's conventional armed forces have been degraded, [US and Israeli intelligence suggests the regime still has hundreds or even thousands of missiles and drones ready to launch](#). The regime also retains its ability to prevent a mass uprising and is likely to

rebuild its military once the shooting stops, potentially even restarting its nuclear program. Importantly, now that the regime recognizes the leverage it has by threatening to close the Strait of Hormuz, it is insisting that any peace deal gives it the right to charge a toll on shipping through the waterway, including a \$1-per-barrel charge for crude oil transits.

When we speak of a country as the global hegemon, one of its essential attributes must be the ability to protect the global sea lanes, including the many key maritime chokepoints around the world (as shown in Figure 2). This analysis shows that the US has now lost control over at least one of those chokepoints and maybe as many as three. This is a key reason why we think it is valid to question whether the US can still be seen as the global hegemon.

Figure 2



Major shipping chokepoints around the world.  
(Source: [Texas A&M University](#))

With the Iranian regime still in place and emboldened, world political officials and business leaders can likely never again assume free and unfettered shipping through the Strait of Hormuz. In the short term, we believe many countries and corporations will acquiesce in the payment of tolls to the Iranians, provided they aren't onerous. Over the longer term, however, we think foreign countries and companies will invest in

workarounds, including alternatives to shipping through the strait and redundant shipping routes. For example, we believe countries such as Saudi Arabia, Kuwait, and the United Arab Emirates will build pipelines to route their oil and gas to the Mediterranean Sea or Red Sea for passage through the Suez Canal or the Strait of Bab el-Mandab, bypassing the need to ship through the Strait of Hormuz.

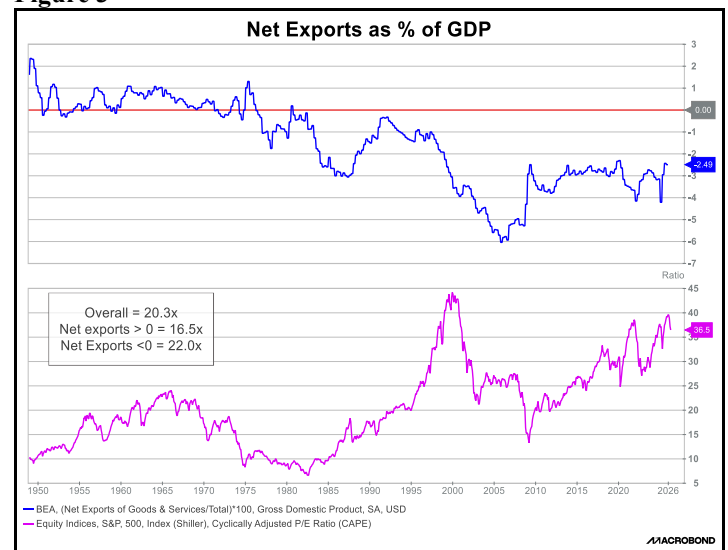
In broad terms, this big change to the world's energy and commodity markets will prompt economic changes similar to those of the 1970s. [We have already argued that one important shift will be for countries to put renewed focus on expanding or building their strategic petroleum reserves.](#) Similarly, companies will likely want to hold higher inventories of energy and other supplies than they did during the period of Globalization. The desire for redundancies may also prompt countries to emulate China's "all of the above" energy strategy, supporting the fullest range of energy sources from coal and gas to nuclear, solar, and wind. These high inventories and redundancies will result in a global economy that is less efficient than before, resulting in higher prices, volatile price inflation, and potentially higher and more volatile interest rates. In turn, that implies corporate profit margins will likely fall from their current historically high levels.

### Implications for Investment Strategy

For *US stocks*, we think the new, less efficient, more inflation-prone global economic environment is likely to push down valuations. After all, as shown in Figure 3, the free trade and trade deficits of the Globalization period correlated closely with rising price/earnings ratios. If policy and security considerations lead to lower US trade deficits, as we anticipate, the associated efficiency losses should make

investors less optimistic about future growth and more reluctant to pay up for every dollar of earnings. We think the current market rotation in favor of value sectors will continue, driven in part by a long-lasting boom in energy and commodity stocks. The advantage of value stocks will also reflect accelerating US reindustrialization as energy-intensive manufacturing continues to relocate from abroad to take advantage of our abundant energy resources. Reflecting the more fractious world and increased geopolitical tensions, we continue to favor defense stocks, in particular.

Figure 3



For *international stocks*, we caution investors not to be overly swayed by the broad economic pain facing Asia and Europe due to today's skyrocketing energy prices. While it is true that those price hikes are likely to cause much slower economic growth or outright recessions in Asia and Europe in the coming year, the high representation of value stocks in international markets will probably provide some cushion. Rather than abandoning foreign stocks, investors might consider rotating more into foreign energy and commodity stocks and foreign companies that can adroitly shift more production to

energy-rich North America or Latin America.

- As with US stocks, we continue to favor foreign defense stocks, in particular.
- Since Asia and Europe are more at risk of foreign energy supplies being cut off, we suspect they will be especially inclined to diversify their energy mix, boosting their alternative and green energy stocks.

We think the new environment of higher and more volatile inflation and interest rates will be challenging for *fixed income investments*, but for diversification

purposes, we see a stronger case for increasing exposure to *precious metals and other commodities* within a typical portfolio. We continue to evaluate the specific investments that are most attractive or should be avoided under these conditions, but as we refine our viewpoints, they will be reflected in vehicles such as Confluence’s Asset Allocation strategies and our Global Hard Assets strategy.

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April 20, 2026

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