



Aberdeen's Gilhooly Says Oil Could Quickly Reach \$175 Per Barrel

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Chuck Jaffe, in this episode of The NAVigator podcast interviews Robert Gilhooly, Senior Emerging Markets Economist at Aberdeen Investments. Robert says that the continuing war in Iran has put pressure on oil prices, but he expects them to stabilize short-term while the market determines what happens next. If the outlook becomes one where the Straits of Hormuz are closed off to shipments for a longer stretch of time, he says "If things get really bad, you could be talking \$175 for a barrel of oil." Gilhooly discusses the investment adage that the first shots of war signal a time to buy, and says that investors likely will see solid opportunities, but that they might want to wait a little longer for more clarity if they didn't jump in with the very first shots. He also discusses how tensions should be good for income-producing investments like closed-end funds.

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CHUCK JAFFE: There's an old investment adage that says that at the first sound of gunfire, it's time to buy, we're discussing that now with Robert Gilhooly, senior emerging markets economist at Aberdeen Investments, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, an industry organization that represents the entirety of the closed-end fund business, from investors and users up to fund managers, sponsors, and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. And today we're looking in the direction of Iran, and at market trajectories in the face of hostilities there, and we're doing it with Robert Gilhooly, he is senior emerging markets economist at Aberdeen Investments. You can learn about the firm at AberdeenInvestments.com, and you can follow the link in today's show notes to get directly to the research insights of Robert and his colleagues. And don't forget that if you want to know more generally about closed-end funds, interval funds, and business-development companies, you can get more at AICAlliance.org, the website for the Active Investment Company Alliance. Robert Gilhooly, welcome to The NAVigator.

ROBERT GILHOOLY: Thanks, Chuck.

CHUCK JAFFE: We have seen the outbreak of war in Iran, while people have been a little freaked out, markets have been ordinary levels of nervousness, and there is a feeling that war is good for markets and that's why you would buy on the first sound of gunfire, but is this that kind of a situation? Should investors be thinking, ah, fighting, that means I'm buying?

ROBERT GILHOOLY: It was definitely the right call when the metaphorical tariff bullets were flying during the trade war and we had that big market selloff in April, and I think generally I do have quite a lot of sympathy for that as a general strategy or a trading rule of thumb, it's always darkest before the dawn, and we just need to see that sliver of light and we can see markets really rebound and maybe lock in some very big gains while other people are losing their nerve. But part of the challenge to that, the moment as what you alluded to, Chuck, is the markets appear to be just pricing in a very short conflict, and it's just not that clear how much downside or the downside spiral they've really priced in, thereby limiting that opportunity to benefit from buying through the dip. Obviously we've recently had President Trump's statement, "The war will be over soon," and with midterms fast approaching, there's

a clear reason to want to wrap this up quickly, but a lot hinges on whether that's actually going to happen. Oil prices are likely to be a non-linear function, at the time, the Strait of Hormuz is shut down, and put kind of simply, we probably just won't see necessarily that much more price action in, say, oil for the next week or two. If you stretch that out further then releases from the strategic reserves just aren't likely to save you from a really big oil price. We think if things get really bad, you could be talking \$175 per barrel of oil. And who knows, of course, maybe by the time this pod goes out, a win could have been declared and hostilities might already be over, but on the other hand, it's not just a US war, game theory could suggest that this might not be the smartest choice for other players. You could certainly imagine a situation in which the Iranian regime concludes, any peace will be fragile, and the only way to show that there's a real cost to future aggression is to engineer a global oil shock. And sadly, that'd be quite easy to do, just slow walk any negotiations, fire a few drones at any ship trying to pass for a few more weeks, so we could really be talking about oil moving considerably higher. Now I certainly hope this won't happen, we're saying it's a tail risk here rather than maybe our best guess of what's going to happen, but I think it could suggest we're not in maybe yet the point where it's really time to put that adage into operation. As we record this, oil back up to almost \$100 per barrel, but the S&P's only down, what, 2% give or take since the end of Feb. level? So you might be questioning, how much risk do I really want to take, is there a good opportunity to buy into that dip? Because frankly there just isn't much of a dip at the moment.

CHUCK JAFFE: Not only not much of a dip, but if your tail risk is oil getting to \$175 a barrel, could we get to that level and not have a global economic recession? I understand we went through inverted yield curve will mean recession, and it didn't happen and other things, and this has been a Teflon economy that keeps going, but mathematically from everything I learned about economics when I was studying it in college, which admittedly was decades ago, \$175 oil means global recession in my mind.

ROBERT GILHOOLY: Yeah, it certainly could get us pretty close. I mean, the key bit there is just how long does any of this last? If we have a very short, sharp shock upwards, the [inaudible 0:05:15] and achieved, that would definitely reduce the risk of recession. But yeah, we're talking about some serious disruption at the moment. Even with the strategic reserves coming back online, being tapped is what we heard recently, we're still talking

about maybe eight million barrels of oil short coming out of the Gulf region, that's a very difficult number for the global economy to digest.

CHUCK JAFFE: And it's not just oil, fertilizer has been a big topic of discussion, but it's not even just that, is it? There are more impacts, what are the ones that you are most watching out for?

ROBERT GILHOOLY: Yeah, I think you're right to flag fertilizer as the first one, I think that's up around about 25%, maybe even 45% depending on the benchmarks you're looking at. Should those prices remain elevated, we definitely expect upward pressure on key food commodities, in particular, wheat, corn, soybeans, and coffee, those have all historically had some pretty strong correlations to fertilizer prices. Then the low-income emerging markets typically have the largest weightings of food within their inflation baskets, several major Asian countries stand out there, such as the Philippines and India, but even in major developed markets food prices obviously play a key role in shaping perceptions of inflation and political discontent, I think eggs have been a pretty good example of that in the past in the US. In terms of other commodities, I think we're also watching out for at the moment is what's going on with sulfur prices, I think they're up a bit over 15%, touching on \$670-ish per ton, that has a lot of knock-on impacts through chemical semiconductors which use sulfuric acid to clean wafers, metal processing too. [inaudible 0:06:59], for example, is very heavily reliant on sulfur to produce nickel, and Qatar supplies around about a third of the world's helium, which is used in various electronics manufacturing and other industrial processes, also within semiconductor manufacturing too, so there's a lot to watch out for. As you said, it's not just oil, the Gulf region as a whole accounts for a large share of global supply in the region of 25-45% for this kind of variety of industrial inputs.

CHUCK JAFFE: What that all translates to is higher prices for everything that gets touched by all those things that might wind up seeing supply shocks, and then that changes inflation, and then that could change what the Fed and other central bankers do in response. So what do you think they do in response?

ROBERT GILHOOLY: At the moment I think it's a very difficult time for economists and central bankers, I used to be a central banker myself, we've got to write down a price for oil even while it's so volatile and so uncertain as it is now, and a lot is going to just depend on how the nature of the shock unfolds. So if, for example, oil is very volatile over March, averaging

maybe \$90 per barrel, which allows for spot to remain pretty volatile in the second half of the month, if that's then falling down to a more like \$70-80 a barrel next month, so I guess that would implicitly embody a degree of lingering disruption, it takes time, of course, to get all of the ships out of the Strait of Hormuz, maybe even [inaudible 0:08:33] also lingering even after shipping comes back on. That sort of situation could be maybe adding 0.3-0.5 percentage points to inflation across some of the major economies, maybe a touch more given those second round effects we were just discussing. But even a sharper oil price jump, not necessarily massively inflationary, and given that would also embody a degree of demand destruction for consumers a little bit further down the road, that's probably a situation which the Fed, other major central banks, can still look through the shock. I think what we're thinking of though is this lightly delays the cuts that we were thinking were likely to come, so for example, we're now penciling in the next Fed move to be a cut in September, then followed up by another cut in March 2027, similarly we've also trimmed one cut off our baseline forecast for the Bank of England. For emerging markets, we thought already many central banks were pretty much done with their cutting cycles or getting very near their end, and a fairly busy electoral calendar is keeping politics and fiscal prudence, or more accurately, lack of fiscal prudence, pretty front and center. So this, initial inflationary spike, and probably some downward pressure and effects, and on top of this we're talking about more pressure to ramp up defense spending, we think all of that for the moment at least amplifies a wait and see approach. So central banks are going to want to see how bad the shock's going to be, then they can make a different judgment about what's going to dominate here, the price effects, or the demand destruction effects?

CHUCK JAFFE: While investors may also want to take a wait and see approach rather than saying, "Okay, I heard the shot, let's go," the things that they want to be using right now, you'd like to think that gold with the big run up has been comfortable, but most investors are saying the big run up means, look at how much we could give back. We've had interesting issues with the dollar as well, so where is somebody turning if they're nervous and they want a safe haven in all of this?

ROBERT GILHOOLY: Yeah, I think it's a really good question at the moment. Look, the US dollar strength I think makes sense, it has behaved as, we think of, as a more of a traditional safe haven asset, and partly that reflects relative structural features, the major economies,

the US is obviously a net oil exporter now, whereas say Europe is more exposed to both oil and also gas prices, suggesting a larger drag on GDP and all that I think fed into a stronger dollar, albeit only modestly. Gold, more of a puzzle. One view I guess is price fell in the initial stages because investors were raising cash from these previously well-performing positions, some need to deal with the shock or perhaps some of the run-up embodied conflict fears, and once this crystalized it was time to sell. I do think this here is a bit of a risk of market commentators being too good at explaining things after the facts, and I'm not sure I personally find either of these explanations particularly convincing. Some of the arguments for why gold was on a tear were maybe less than 24 karat, excuse the pun, central banks might have been reallocating some proportion of their holdings to gold, but buying a non-yielding asset wasn't going to go on forever. And why, if a motivation for other central banks around the world is diversify away from the US, would you buy an asset actually priced in US dollars, it's not 100% clear cut to me. So maybe instead if we view this as simply prior exuberance unwinding, I think it illustrates this good point, when an asset rises rapidly in price, it can become a source, not a diversifier of risk in times of stress. It's really not clear from here, if gold isn't jumping when US and Israel get into a conflict with Iran, when would it jump?

CHUCK JAFFE: You know The NAVigator is really about investing in closed-end funds and we haven't gotten at all really into investing in closed-end funds, we're just covering current events. But given what you were just talking about, if investors inherently at a time like this are looking for a safe haven, and it's not going to be gold necessarily, they're going to look potentially for income producing assets, they may want to be diversifying away from some of those government bonds with higher interest rates for longer and a spiraling deficit. Is this going to be the kind of thing where, again, not necessarily by intention, but does the closed-end fund space, where income is such a critical part of it, wind up being something where, hey, discerning buyers are going to turn here because income investments of all sorts should be popular in times like this?

ROBERT GILHOOLY: Yeah, I think that's probably true to a different extent. There's always going to be a case of try to buy at a good time, but we do see upper pressure on yields and we can think of some of these factors as being broadly supportive of that income story over

time, so potentially that is one you should definitely be thinking about as part of your portfolio.

CHUCK JAFFE: Robert, I have more questions, I just don't have more time. I hope you'll come back and chat with us again in the not too distant future.

ROBERT GILHOOLY: I'd love to. Thanks, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and yeah, I'm Chuck Jaffe, I'd love it if you'd check out my show on your favorite podcast app or by going to MoneyLifeShow.com. Now if you want to learn more about closed-end funds, interval funds, and business-development companies, go to AICAlliance.org, that's the website for the Active Investment Company Alliance. Thanks to my guest Robert Gilhooly, he is senior emerging markets economist at Aberdeen Investments, you can learn about the firm at AberdeenInvestments.com, and you can follow the link in today's show notes, the show description, to get directly to the research insights of Robert and his colleagues. The NAVigator podcast has something new for you every Friday, so make plans to join us again next week and follow along on your favorite podcast app to make sure you don't miss any of our closed-end fund fun. And until we're back next week, happy investing, everybody.

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