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The Market Commentary

April 2026 War Update II

1 Latest Developments

The US and Iranian teams met in Islamabad for negotiations mediated by Pakistan. The US team was led by Vance, the leading dove in the Administration, and included Witkoff and Kushner who are viewed by the Iranians as facilitators of the war. The Iranian team contained leadership elements from the *de jure* government, the Parliament and the IRGC junta - indicating that power is currently diffused throughout their structure in an ill defined manner. The Iranian distrust of the US was marked by their arrival in an unmarked aircraft while two decoy airplanes flew alternate routes.

The meeting appears to have served only to define the areas of disagreement. The US wants Iran to relinquish its tools of strategic import - the nuclear program, ballistic missiles, control of the Straits of Hormuz and support for foreign militias. The Iranians have no intention of disarming while under attack. They possibly softened their demands for security guarantees: a permanent ceasefire, withdrawal of US military bases, reparations and acknowledgment of their position vis-a-vie the Straits. Trump stated there were only three issues the two sides differ on. Really there is only one issue. The US seeks a fundamental change in Iran's military/diplomatic policy from belligerence to coexistence. The regime is not willing.

Talks ended after 18 hours. The mediator was surprised at the abrupt termination. It had expected talks to go on for several days. The Americans apparently took the decision to terminate. The Iranians probably came prepared to haggle for some time. And the mediator evidently expected a creative search for solutions. The Americans, however, seemingly prefer to alternate talks and bombing runs. They are, however, allowing for reconsideration and possible resumption of discussions.

The breakdown in talks is unsurprising. Each side arrived holding the view that it had prevailed on the field of battle and disinclined to make concessions. From an Iranian perspective they have successfully asserted control of the Straits which is a strategic move of the first importance. Additionally, they sense the extreme reluctance on the part of the US to incur substantial casualties. As a result they believe they can wait the US out and emerge strengthened by the war. From a US perspective it has established air dominance over Iran and can strike at will - effectively holding the country's leadership, national assets and industry at gunpoint. However, it has not yet translated that air power into a ground force advantage which could actually establish a new government.

The existing ceasefire is in place for ten days more. Trump announced the US

would begin clearing mines from the Straits. While not technically a ceasefire violation, it is a provocative act. Trump also announced the US would blockade the Strait and not permit access to the High Seas for ships from Iranian ports. This is, of course, what he should have done before entering in to negotiations. We identified this step in our monthly commentary as the correct move for the US at that time.

2 What Comes Next

As expected China is stepping in to rearm Iran. Their first step is a modest one - supplying MANPADS (man portable anti-air missile systems) though the cover of a third country. While modest it may cause the US problems - particularly if it moves to kinetic action to clear the Straits.

Iran will probably use the pause to consolidate power internally. We expect the IRGC junta to be the controlling element in the state. As long as it is able to block the Straits the government is likely to feel it won something and be unwilling to make peace on US terms.

On the US side the realization must be sinking in that the US is caught in a must win war which is likely to continue for several months at least. There will be no easy victory to crow about at the mid-terms. Belatedly the Administration is beginning to address its political deficits. It has put out the story of how the war policy was decided on. Initially it was agreed by Trump and Netanyahu. Caution/skepticism was express across the Administration initially, but after due deliberation the Administration unified behind the policy. This story identifies Trump as the leading hawk. His choice of Vance to lead the negotiating team can be seen partly as a mechanism for protecting himself against possible backlash from the anti-interventionists in MAGA. But the time to seek support is when you look like you are going to be a winner, not when you appear in danger of failing.

So the Administration has its work cut out for it. It needs to begin by replacing Hegseth. Hegseth was brought in to implement the Heritage Foundation's program of military reform. To that end he has built a hostile relationship with the professional military. That is not how a team is led to victory. Hegseth should be replaced by someone of undoubted competence and enjoying broad bipartisan support.

There is also a need to transfer the diplomatic job to professionals. The team of Witkoff and Kushner was deployed on the theory they could bring fresh thinking. Good enough. But they have not succeeded and instead we find ourselves in a serious war with repercussions literally around the globe and touching all our international relations. It is time for the professionals to take over. To give a modest example - scattered through the Pacific are a host of small but strategic island nations with

very limited petroleum reserves. China will shortly be out buying their friendship with access to its massive reserves. The US needs to be on the phone first assuring the relevant prime ministers that their needs are understood and will be taken care of.

Obviously the US has a great deal of diplomatic repair work to do with the US's European and Asian allies. They are likely to want more than mere acts of contrition and the US would be well advised to readily agree. It should anticipate that substantial changes in tariff and Ukrainian policies will be asked for and it should readily agree to them. The US also needs to repair its standing with India. Here tariffs and H1B visa policy changes could go part way to fixing relations.

Quite simply the Administration has tried to change too many things at once and it needs to jettison secondary projects to concentrate full strength behind the main initiative. Businessmen normally know how to be decisive when they find themselves overextended. This is Trump's moment to show he is a businessman and not a day-time television actor pretending to be a businessman.

3 The Issue of the Straits of Hormuz

We close this note with a review of the legal issues in the Straits of Hormuz. The world's ship traffic passes through a number of important Straits. These Straits are characterized by their breadth, by whether their land sides are controlled by one country or more than one and whether they are an exclusive passageway to a body of water or whether there exist viable detour routes in the event the Straits are blocked. Straits are natural features in distinction from canals and seaways which are man-made passage ways. Table 1 list a number of important straits. Use of a few straits is governed by specific international treaties. Most, however, are governed by international law.

From this table it can be seen that there are many maritime choke-points. The Straits of Hormuz are fairly typical - with the sides in more than one pair of hands and the narrows not especially narrow. Its most important quality is that there is no alternate route of navigation. This puts it in a more select group of straits, but even here it is not unusual.

Use of straits is governed by the "immemorial custom of the sea", the UN Convention on the Law of the Sea, and any superseding treaties or regulations. Historically nations asserted control over waters within 3 miles of the shore (basically a cannon shot.) Beyond that was the High Seas. In general the High Seas were open to use by all. In general that established free passage through straits wider than 10 km. The UN Convention served two purpose. First, to codify the immemorial customs

Table 1: Straits Important To Seaborne Commerce

Name	Narrows (km)	One Country	Exclusive Access	Treaty
Turkish Straits	0.75	Yes	Yes	Montreux Convention (1924)
Magellan	2	Yes	No	
Messina	3.1	Yes	No	
Kerch Strait	3.1	Note 1	Yes	
Danish Straits	4	No	Yes	Copenhagen Convention (1857)
Straits of Tiran	13	No	Yes	Egypt-Israeli Peace Treaty
Gibraltar	14.2	No	Yes	
Singapore Strait	19	No	Note 2	
Lombok Strait	20	Yes	No	
Sunda Strait	24	Yes	No	
Bab-el-Mandeb	26	No	Note 2	
La Perouse Strait	26	No	No	
Dover	33	No	No	
Hormuz	39	No	Yes	
Straits of Makassar	40	Yes	No	
Balabaq Strait	50	No	No	
Malta Channel	51	No	No	
Palk Strait	64	No	No	
Malacca	65	No	Note 2	
Otranto	72	No	Yes	
Windward Passage	80	No	No	
Bering Strait	82	No	Yes	
Mona Passage	130	No	No	
Sicilian Strait	145	No	Yes	
Florida Strait	150	No	No	
Taiwan Strait	180	Note 1	No	
Korea Strait	200	No	No	
Yucatan Channel	200	No	No	
Luzon Strait	250	No	No	
Denmark Strait	290	No	No	

Note 1: Currently Russia occupies both sides of the Kerch Strait, which previously was bordered by it and Ukraine. China claims control on both sides of the Taiwan Strait, but the Taiwan side is *de facto* not under Chinese control.

Note 2: Although an alternate route to the Straits of Malacca and Singapore exists it is not practically reasonable. The Bab-el-Mandab also has alternate access, but closing it very much damages Egypt's revenue from the Suez canal.

of the Sea. Second to modify them in part. In particular the Convention extended territorial waters to 12 miles (20km.) The Convention recognized a right of innocent passage whereby ships could use the extended territorial waters provided they complied with the regulations of the government controlling the territory. Further, the Convention recognized a right of Transit passage specific to Straits. This right allows free use by ships and airplanes exclusively for the purpose of expeditiously transiting the region. Almost all nations have adhered to the UN Convention and are entitled to the rights and obligations it confers. Further, the Convention is accepted as the definitive statement of customary law where the Convention addresses a matter and as such its law applies to all. Countries which do not adhere to the Convention are arguably not entitled to its privileges but they are required to respect its customs. As it happens both Iran and the US do not adhere to the Convention.

The Straits are further subject to a regulation issued by the International Maritime Organization (a UN agency) known as the Traffic Separation Scheme (TSS.) This regulation requires commercial maritime traffic to route through sea lanes designated for eastbound and westbound traffic. They route though the deep water off the Oman shore.

There are eight nations bordering the Persian Gulf (Iran, Iraq, Kuwait, Saudi Arabia, Bahrain, Qatar, the United Arab Emirates and Oman.) The United Arab Emirates is a confederation of seven Emirates all but one of which (Fujairah) border the Gulf. Thus these countries all have a vital interest in free navigation of the Gulf and Passage of the Straits. Indeed international law recognizes the free transit right in the approaches to the Strait and not just in the Strait proper.

In general the citizenship of a ship is determined by the flag it flies. For naval vessels this is of course the flag of their country. Most commercial vessels, however, are registered to one of just a few small countries - notably Panama and the Marshall Islands. In particular the legal status of a ship is not determined by its ownership, which may be a corporate group spread across several countries. By registering a “flag of convenience” a commercial vessel gains several advantages. First the registrar countries all adhere to the UN convention, so a clear legal structure is established. Second, they gain safety in numbers. From a ship’s perspective the most likely place for it to experience mistreatment is in ports. To give an example, a small Filipino port may see only one or two Norwegian ships in a year. It is cheap and easy for the port to declare Norwegian vessels especially burdensome visitors and impose special fees and procedures on them. But if it tries that game with Panamanian vessels it may find it suddenly has no ship visitors at all and might a well be landlocked.

For fifty years at least the Straits of Hormuz and the Persian Gulf have been open to free navigation. Very occasionally Iran has sought to interfere in use of the Straits,

but only on a case-by-case basis and usually with allegation of violations of the TSS. Legal opinion appears to be that Iran can attempt to fine ships for violations of innocent passage or of the TSS. But its recourse is limited to civil proceedings in maritime courts. It cannot deny ships their transit right by arresting them.

Iran's historical position is a little unclear. It claimed the right of transit was a Convention construct which it is not obligated to recognize given that it has not adhered to the Convention. But then its territorial waters are limited to the three mile limit of customary law and the ship traffic is further out in The Gulf where Iran would have no jurisdiction unless gained from the expanded notion of territorial waters granted by the Convention.

But Iran's current position goes much further. It asserts the right to grant or deny ships passage based on nationality of the owners. It categorically denies passage to ships it classifies as US or Israeli. Special treatment of belligerent nations is not unusual, however. But Iran goes much further. It asserts that neutral shipping must follow its maritime routing decisions and not the TSS. It further requires ships to pay tolls of \$ 2 million per ship for use of the Strait. In the process it asserts control over the oil exports of the other seven countries bordering the Gulf. These are assertions of rights of conquest with no shadow of justification in law, custom or contemporary practice in any other Straits. This assertion goes along with missile and other attacks it has made on the other seven gulf nations - even though none of them have engaged in belligerent acts towards Iran.

Iran is departing from a regulatory regime which it took nearly two centuries to put in place and which is followed by all the countries of the world. Destabilizing that regime could have enormous far flung consequences. The world's vested interest in maintaining the current order is very large. Basically Iran has gone to war with the world, and it is unlikely to prevail in the long term.

The US Administration finds itself in a curious position. Just a few months ago it issued a white paper stating its intent to disengage from the Middle East and its unwillingness to be the (unpaid) enforcer of international law. Now it finds itself deep mired in the Middle East and defending freedom of navigation in a waterway it makes little use of and from whose traffic it receives only indirect benefits. Naturally it feels the other countries of the world could share the burden with it. But rather unreasonably it feels that way after having spurned all the mechanisms for securing that support. As the rest of the world sees it, the US chose to kick this particular hornets nest on its own, the US can deal with getting the hornets back in the nest themselves and bystander are entitled to blame the US every time they happen to get stung. That view also is unreasonable. Iranians are not witless insects. But it is what you get if you do not do necessary preparatory work. US arrogance has bought

itself extra burdens rather than freedom of action.

4 About The Cover

The cover is a natural color photo taken by the NASA Terra satellite. It shows the Strait of Hormuz and its surround. The peninsula on the southern shore is the Musandandam Peninsula. It is a rugged mountainous region which drops directly into the sea with no beach to speak of. There is a small fishing village at the tip but otherwise no substantial habitations. The Iranian shore has a more substantial flat area before giving way to hilly and then mountainous terrain.

Directly opposite the tip of the Musandandam Peninsula is the Iranian city of Bandar Abbas. This is a modern city of about 500,000 souls. It is the headquarters of the Iranian Navy - now largely sunk. As a result its port area has been extensively bombed in the recent conflict. To the west is the long narrow Qeshm Island. Some armchair admirals have suggested US Marines could seize it as part of an operation to secure control of the Strait. The island is large and while not very elevated it is quite rugged. Taking control of it would require hard fighting and it will always be open to landings originating from the Iranian shore given its great length.

The TSS routes shipping through the Strait by following the Musandandam Peninsula from about two miles offshore. This is where the deepest water is. As such it is distant from the Iranian shore and only in range of drones, missiles and rocket propelled heavy artillery. The Iranians, however, are requiring shipping to follow close along the Iranian shore. This keeps it under the eye of shore batteries. It also probably keeps it away from mines the Iranians have placed in the usual sea lanes.

Normally the Strait sees a great deal of traffic. About 20% of seaborne crude oil passes through the Strait. Shipments of liquefied natural gas, fertilizer and helium also originate from the Gulf and are significant sources of world supply. A countervailing traffic of freighters brings in goods to be sold in the marts of the Gulf - preeminently Dubai.

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