Geopolitical escalation, resilient markets

- **US direct military involvement against Iran's nuclear facilities is a clear escalation**
- **Still, both countries have probably no interest in a longer and more severe conflict**
- **Markets seem to lean towards a "least worse" outcome, though the situation is fluid**

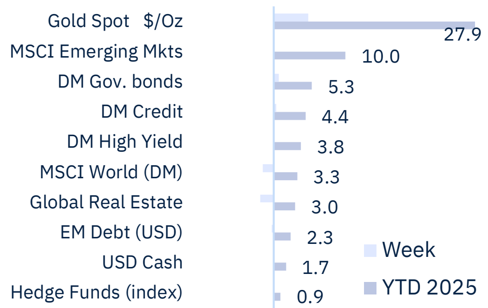
Last week's returns were overall unremarkable: oil prices rose and the dollar strengthened due to the conflict between Israel and Iran, gold gave back a bit of its previous gains, and the mood was overall a visible yet modest risk aversion.

With regards to macro data, we would simply highlight a positive surprise in China's retail sales and the opposite in the US. It was a heavy week for central banks with over 10 policy meetings, which mostly kept rates unchanged except for Norway, Sweden and Switzerland who decided a 25 basis points cut, which can be considered in relation to the impressive appreciation of their respective currencies in 2025. The Fed's June meeting was mostly a non-event: no rate cut, some mild "stagflation" in their economic projections but no change in their rate projections for 2025, as their dot plot maintains 50 bps of easing, but now only 25 in 2026.

Since we barely know what will happen this week, 2026 is certainly not our focus. Geopolitics are. US strikes on Iran's nuclear facilities were massive, involving more than 100 planes, including B2 bombers dropping "bunker busters". The US called it a complete success, claiming that Iran's nuclear threat is "obliterated", indicating an intention to stop there. Unpredictability is always material, as illustrated by President Trump's social media post mentioning a "regime change" only hours after his own administration said it was not on the agenda. Still, this could be another "Art of the Deal" rhetoric. We see no interest for both the US and Iran for a longer conflict. The latter could make a restrained, low damage "token" retaliation, opening the way for de-escalation. Markets are resilient so far, including the regional stock markets which were open on Sunday just after the strikes.

The situation remains extremely fluid, and we can only hope for peace. This will be the focus of the week ahead, together with a NATO summit, flash PMI reports, May US PCE inflation, China's economic forum and Powell's Congress testimony.

Asset Classes USD % total. Return, Week and YTD 2025



MAURICE GRAVIER
CGroup Chief Investment Officer
MauriceG@EmiratesNBD.com

GIORGIO BORELLI
Head of Asset Allocation
GiorgioB@EmitatesNBD.com

SATYAJIT SINGH, CFA
Head of Fixed Income Strategy
SatyajitSI@EmiratesNBD.com

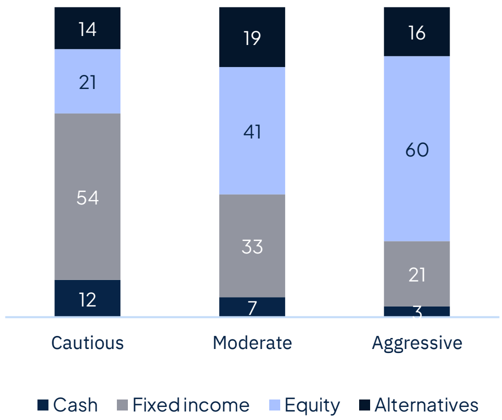
NAWAF ALNAQBI
Head of Equity Strategy
NawafALNA@EmiratesNBD.com

Cross-asset Update

Markets have once more failed to respond to the spiking geopolitical tensions as consensus had expected. Gold barely budged this morning and Brent crude is in retreat as of the time of writing. This is actually not unexpected on our side. As summarized in our daily note, no side currently has incentive to escalate. In particular, the Treasury market remains Trump's Achille's heel. Any miscalculation resulting in getting involved for long in the regional conflict would affect crude prices, in turn exerting upward pressure on Treasury yields. The Washington administration has got out of its way to cap the oil market via OPEC+ and given the debt burden in the United States it would be unwise to undo what was achieved. In early April Donald Trump buckled under the pressure of higher Treasury yields and a dysfunctional bond market when the tariff war came to ahead, and we tend to see his reaction function as being no different this time. It is likely that markets will continue to climb a wall of worry, rather than sell off badly on risks that so far have been more perceived than real, at least in the possibility that the conflict extends in space and time. Also, the blocking of the Strait of Hormuz repeatedly mentioned in the press would be a great way to make many enemies while trying to hit energy sources. We deem it as unlikely.

The recent Geneva agreement on a framework to scale down the tariff war between the US and China brings us back to Emerging Market equities, that would be the main beneficiaries of reduced trade tensions between the two superpowers. More Chinese stimulus could be on the way this summer. In China retail sales indeed surprised to the upside, yet on temporary rather than structural effects. Since the real estate market remains in the doldrums with falling prices and contracting sales, it should be a matter of time before the authorities step in with more supportive measures aimed at achieving the 5% growth target set for this year. Also, Fed easing expected in the second half would be one more positive factor. EM FX and bonds, that have been rallying with equities from their April lows, have already cleared their March highs, and it now seems the turn of stocks to be doing the same given the constructive outlook. Tactically, we are now more heavily weighted on EM versus DM stocks, as well as overweight Chinese equities in the EM space.

Tactical Asset Allocation: Simplified Positioning



TAA – Relative Positioning – Moderate Profile

UW/N/OW: Underweight/Neutral/Overweight

	UW	N	OW
Cash			>>
DM Gov.			>>
DM Credit		=	
DM H. Yield		=	
EM Debt		=	
DM Equity	<<		
EM Equity		=	
Gold			>
Hedge Funds	<<		
Real Estate		=	

Fixed Income Update

FOMC as expected did not change the policy rates. The policy statement mentioned that "Uncertainty about the economic outlook has diminished but remains elevated." Dot plots still showed two rate cuts for this year. Though it's notable that the distribution skewed more hawkishly than at the March meeting, as 9 of 19 participants see zero or one cut this year. Powell's press conference alluded to risks on both sides however, cautioned that it will take time for the impact of tariffs to pass through to inflation readings. The median FOMC participant's core PCE inflation forecast for 2025 rose 0.3pp to 3.1% and the median GDP growth forecast for 2025 fell by 0.3pp to 1.4%. The BoE MPC kept policy rates on hold. Declines in the pace of wage growth and services inflation leads us to believe that we may see three further rate cuts this year from BoE. We maintain our view that Gilt yields will decline more vs other major bond markets.

The long-end US Treasury yields continued to move down in the first half of the week. The US retail sales print for May was below expectations at -0.9% vs economist consensus of -0.6%. Industrial Production for May dropped -0.2%. The long-end yields moved up Wednesday late session onwards. The market may continue to fade upcoming rate cut expectations over the summer. Similarly, higher energy prices and the US involvement in the middle east conflict can raise inflation/deficit expectations leading to higher long-end yields. Overall, US yield curve could shift higher. Avoid long duration exposure at the moment.

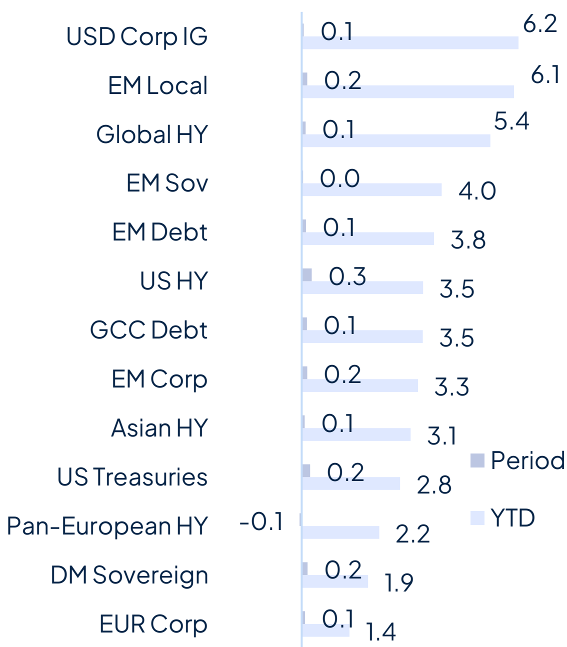
President Trump seems to have given a very limited authorization for strikes on Iran. For the US, there are domestic and macroeconomic considerations. President Trump would not want a prolonged conflict. There are different levels of hierarchy to escalation. If the escalation remains limited to Iraqi US bases, the US would not retaliate and that would provide an off-ramp to Iran. However, closure of the Strait of Hormuz would not be acceptable to the US and the retaliation could be massive. This is not the base case at the moment.

We expect credit spreads to widen this week. Under the first scenario, we don't expect the GCC spreads to blow out in an unruly fashion. However, the second scenario will likely be messy for regional credits. Bahrain long duration bonds could be the worst affected. We would avoid adding to High Yield real estate credits from the region as well. However, once the spreads have widened by at least 150 bps in the high yield space there could be selected opportunities to invest. We would look to go overweight high yield sovereign, GRE names as well as subordinate debt from banks from the region post spread widening. We expect the pipelines of deals to be pushed back for suitable environment. Price sensitive investors should book profit on vulnerable names as market seems priced for perfection.

Fixed Income Key Convictions (2025)

DEVELOPED MARKETS
Overall overweight DM FI
OW Government Bonds
Neutral corporate (IG & HY)
EMERGING MARKETS
Neutral EM Debt
Favor quality and selectivity
Including in GCC

Fixed Income Sub Asset Class Returns
(YTD, Last Week)



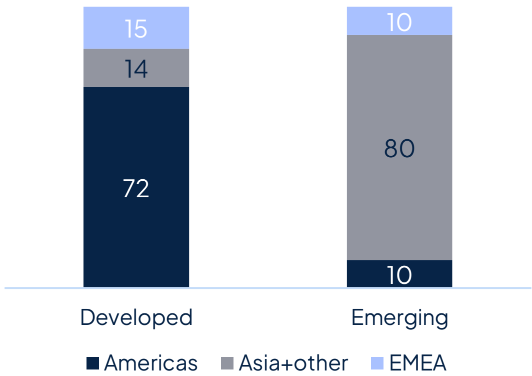
Equity Update

Global equity markets faced another turbulent week as geopolitical escalation, fragile macro signals, and policy uncertainty converged to unsettle sentiment. With the US now directly engaged in Middle East hostilities, the risk backdrop shifted from tension to consequence. The potential fallout of a broader conflict added a new dimension to markets already struggling to balance Fed hesitancy, tech sector fragility, and tariffs bound for resumption. Global equities fell 0.4%, with developed markets down 0.5% and emerging markets flat, a reflection of diverging exposures to policy and political volatility. In the US, the S&P 500 slipped 0.1% as participants wrestled with both regulatory and geopolitical crosscurrents. Semiconductor weakness was front and center after reports emerged that the Trump administration may further restrict advanced chip exports to China. Nvidia, ASML, and TSMC lost ground, dragging broader tech sentiment with them. Apple stirred debate after news broke of its discussions to acquire AI startup Perplexity, renewing questions around capital allocation in a hyper-competitive AI landscape. The financial sector also came under pressure as the Senate advanced the GENIUS Act, raising prospects of digital disruption in payment networks and weighing on Visa and Mastercard.

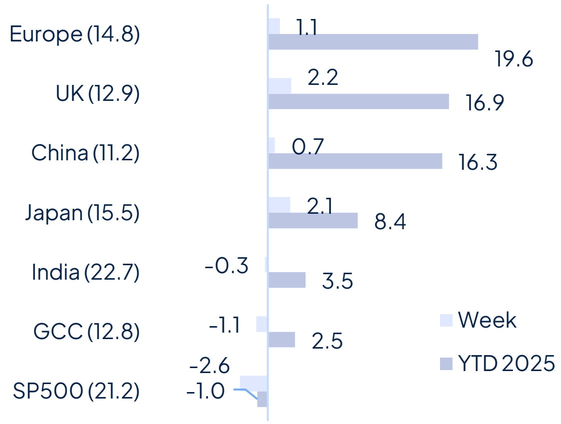
European equities were among the weakest performers, with the MSCI Europe index falling 1.6% and the Stoxx 600 logging its third weekly loss in four. Macroeconomic data continued to disappoint, particularly in Germany and the UK, where retail and sentiment indicators weakened. Industrials, autos, and chemicals saw sustained selling. Regulatory concerns resurfaced in the tech sector: Alphabet faced another potential EU antitrust blow, while Apple and Meta remained under investigation under the Digital Markets Act. Energy and utilities provided some cushion, but the broader tone was defensive. A modest Friday recovery followed President Trump's decision to delay further action on Iran, but the move failed to shift the underlying trajectory. China remained under pressure, with the MSCI China index down 1.3% as tech names struggled and policy clarity remained elusive. Hong Kong-listed shares saw volatile flows, particularly in semiconductors, after US regulatory threats toward China's chip sector re-emerged. Tencent Music and NetEase Cloud Music provided rare bright spots on strong subscription trends, though broader flows remained light. Japan stood out with resilience. The TOPIX rose 0.5%, supported by yen weakness, stable domestic data, and a late-week bounce in tech names tied to Taiwan's new chip export restrictions. Equipment makers such as Lasertec and Advantest gained, while financials and transport stocks advanced on solid earnings guidance. Foreign inflows continued, attracted by Japan's relative policy clarity, supportive FX dynamics, and a growing shareholder return narrative.

Middle Eastern equity markets added another layer to the week's complexity. With the US launching strikes on Iranian targets, the region became a central axis of market concern. Markets, including Saudi Arabia and the UAE, drifted lower, reflecting caution over trade disruption and external risk. Oil-sensitive sectors held up, while telecom and utilities in Qatar and Kuwait saw defensive inflows. Trading volumes picked up across the region, suggesting speculative hedging and rising short-term positioning around energy and security-linked outcomes.

Equity Recommended Regional Positioning

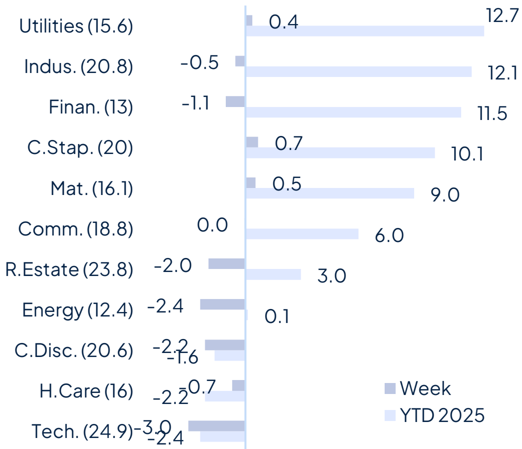


Major Indices Performance (TR, US$), P/E in brackets



Source: Bloomberg consensus. MSCI Indices unless specified.

Global Sector Performance (TR, US$), P/E in brackets



Source: Bloomberg consensus. MSCI All Country World sectors US$.

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