

Flash

De-escalation in the Middle East – More than temporary relief?

Key Messages

1. **A sigh of relief:** the markets are reacting with a clear risk-on move as the worst-case scenario has been avoided.
2. **Many uncertainties remain:** despite the immediate positive signals, a highly differentiated view is warranted, as the operational realities of the de-escalation rest on a fragile foundation as the US and Iran are divided on some key points.
3. **We confirm our key market calls:** lower risk of rate hikes should support longer dated European Core Government Bonds and Gold. We remain Neutral on equities but do not recommend to fade the rally.

The initial market reaction and geopolitical context

The announcement of a 2-week ceasefire between the US and Iran has triggered relief rally across global financial markets. The prospect of reopening the Strait of Hormuz has precipitously removed severe pressure from energy markets, resulting in a 16% correction in Brent crude and a corresponding 23% drop in diesel prices. Consequently, equity markets are responding with the strongest daily gains in nearly a year. This dramatic market dynamic primarily reflects the rapid unwinding of extreme geopolitical risk premia, as investors had been heavily pricing in a worst-case scenario involving the full destruction of Iranian oil infrastructure and an indefinite blockade of a vital maritime artery for global trade?. Moreover, negotiation positions between the US and the Iran are split on some key issues such as Iran's nuclear programme.

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Logistical realities and the shipping bottleneck

Despite the immediate positive signals, a highly differentiated view is warranted, as the operational realities of the de-escalation rest on a fragile foundation.

The physical reopening of the Strait of Hormuz is vastly more complex than a simple political declaration. Currently, a severe backlog of more than 800 vessels remain trapped or idle in the Persian Gulf region. The resolution of this bottleneck will require considerable time given the capacity constraints of this narrow waterway. Furthermore, international shipowners and maritime insurers remain highly cautious. A sustainable resumption of normalised transit flows would require real guarantees of safety, especially given emerging indications that Iran may attempt to leverage the situation to implement new, structural transit fees. Such measures would permanently alter the cost dynamics of global maritime trade in the region.

Structural energy deficits and downstream pressure

While the recent correction in energy prices provides short-term relief, a swift return to pre-crisis price levels appears highly improbable. Even following the sharp decline, crude oil continues to trade substantially above its starting levels for the year. With uncertainties persisting, we don't expect the risk premium to be fully priced out immediately. Even in the best-case scenario we would rather see a slow but constant decline towards our 12-month target range of USD 70-80 per barrel in the coming months, not a sudden drop. Consequently, energy levels should remain more elevated than pre-war levels for some time.



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In addition to the pricing environment, the physical supply chain has sustained long-term damage. An estimated 4% of the global liquefied natural gas (LNG) supply remains completely offline due to destroyed infrastructure, an impairment that is expected to persist for years rather than months. These elevated input costs are already embedded in certain downstream sectors. Industry assessments, including those from global aviation bodies, indicate that jet fuel prices and the cost of petroleum derivatives, such as plastics, will remain structurally high, inevitably filtering through to broader consumer inflation indices.

A fragile diplomatic framework

The geopolitical underpinning of the current market optimism is also inherently precarious. The agreed-upon ceasefire is strictly limited to a 14-day window, serving primarily as a necessary political and economic off-ramp to alleviate immediate global pressures. However, the core strategic conflicts remain entirely unresolved.

The underlying framework for future negotiations, ostensibly based on a 10-point proposal, involves highly contentious demands regarding the permanent control of maritime navigation, the future of the Iranian nuclear programme, and the comprehensive lifting of sanctions. The profound disparity between the strategic objectives of the involved parties suggests that navigating a permanent resolution will be exceedingly difficult, leaving the region highly susceptible to renewed volatility once the temporary truce period ends.

Strategic portfolio outlook

The recent diplomatic developments mark a crucial step away from a severe tail-risk event. The risks to a prolonged inflationary shock have declined in a meaningful way. This should ease the pressure for central banks to react with a significant tightening of monetary policies. Thus, **we confirm our recent upgrade of longer dated European Core Government Bonds (up to 10 years) to Positive.**

Moreover, falling rates and the prospect of a weaker dollar (our 12M target for EUR/USD remains at 1.20) should **support gold prices, on which we remain positive with a 12-month price target of USD 5.500/oz.**

Looking at equities, the picture remains less clear. The longer lasting impact on global growth and earnings still needs to be evaluated. While the world certainly became a more friendly place to carry risk, the underlying market environment remains characterised by elevated uncertainty. The global economy has transitioned from the immediate threat of an energy supply shock to a prolonged period of complex geopolitical manoeuvring.

Therefore, **we confirm our Neutral view on equities for the time being.** However, due to the decreased downside tail risks, **we would not fade the rally at this point in time.** We will be carefully monitoring the diplomatic developments over the coming weeks. Before taking on any additional risks, we need a higher degree of clarity about the durability of any (new) agreement because this will be decisive in shaping the medium-term risk landscape, the trajectory of global inflation, and the corresponding monetary policy outlook.

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