



White Smoke over the Middle East

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3 months and 17 days. That is how long it took for the United States and Iran to finally reach a preliminary agreement and put an end to the conflict that had pitted them against each other since February. The details of the agreement are not known, but in the eyes of investors, the only thing that matters is the reopening of the Strait of Hormuz, which is expected to take effect starting Friday, the day the agreement is officially signed in Geneva. While oil flows transiting unofficially have already picked up significantly in recent weeks, the reduced risk of attack should encourage more shipping companies to attempt the crossing, especially as insurance premiums are expected to gradually decline. Admittedly, it will likely take several months for the situation in the oil market to normalize, given the complete shutdown of production in several producing countries and the time required for tankers to make multiple trips to Asia or Europe. During this period, the market will remain in a supply deficit and continue to draw on global oil stocks, which are already at historically low levels, which is likely to keep energy prices at higher levels than before the war. Nevertheless, investors would do well to look beyond this and instead welcome the dissipation of geopolitical risk and, with it, the dire scenarios of a global recession or a sustained inflationary shock. The reaction in the markets illustrates this perfectly today, with a further drop in sovereign yields in the wake of the correction in Brent prices, a narrowing of credit spreads, a decline in volatility, and a sharp rise in equity indices. While one might have expected the resolution of the conflict in the Middle East to be the catalyst for a sectoral and geographic rotation in favor of the segments that have been hardest hit since late February, this has not been the case. European indices are even underperforming significantly this Monday compared to their U.S. and even Asian counterparts, which are once again being driven by the technology sector. The latter continues to be favored by investors, encouraged by valuations returning to less extreme levels following last week's correction—which had prompted us to adopt a positive view on equity indices once again, particularly US ones. The outperformance of the Momentum factor is certainly significant, but it is difficult to count on a trend reversal at this stage, as investments in AI infrastructure continue to be revised upward and optimism regarding the performance of future models remains intact.

It is worth noting, however, that cyclical sectors are regaining some momentum, such as consumer discretionary and construction, as are European small caps—particularly in Germany—which could fare well if the German stimulus plan accelerates at year-end, as promised by Berlin.

Furthermore, we remain positive on both investment grade and high yield credit, as well as on sovereign bonds, with a preference for the short end of the curve, as we believe expectations of policy rate hikes are overly pessimistic, both for the ECB and the Fed. In fact, inflation has likely peaked or will do so very soon, and even if energy prices do not return to their pre-crisis levels, their contribution to inflation should gradually diminish, while the latest statistics on both sides of the Atlantic show no signs of second-round effects at this stage. Unlike the shock of 2022, demand is not excessively strong and the labor market is far from being as tight, which should help prevent the triggering of the wage-price spiral. While in Europe, the slowdown in economic activity should at the very least prompt the ECB to hold off and maintain maximum flexibility regarding its next decision, in the United States, the arrival of Kevin Warsh should lead to slightly more accommodative communication, if only by indicating that a rate hike is far from a foregone conclusion despite the strength of the US economy.



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