

Strait Tension Portends a Short and Sharp Stagflationary Shock

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

The fate of the Strait of Hormuz remains the central variable for markets, with 20% of global energy flowing through it, and any prolonged disruption would have significant implications for oil, gas, inflation, and risk assets. The market is facing a complex configuration of military math, diplomatic developments, and nautical updates about vessel passage through the strait. What are the near-term and longer-lasting implications for markets?

Washington appears to be testing a narrow diplomatic window, while at the time of this writing, Tehran continues to reject current US terms. Yet the key question now is how much flow can resume, even if partial, and under what political conditions. Should partial flows resume, oil prices could retreat quickly, as the passage of even a handful of large tankers would materially ease supply constraints. Iran appears to be shifting its strategy to controlling the flow of vessels through the strait, as opposed to an effective blockade. This may be due an assessment that a full blockade will be unsustainable as global pressures rise, including from allies such as China. Tehran may judge that controlling and charging tolls for passage may be more advantageous, particularly if a deal with the US does not materialize. The legal status of the strait and the legality of charging said tolls will be contested by various parties. Our work suggests that there appear to be legal grounds for Iran to charge certain fees for services they provide (e.g., security and environmental precautions) rather than tolls simply for passage. We are already seeing signs that flows through the strait are beginning to rise. This reduces tail risks, yet it may already be too late to avoid an air pocket for many products.

As for near-term issues, unlike oil, gas markets remain regional and infrastructure-constrained, making it far harder to replace lost Qatari liquefied natural gas (LNG) shipments. Refined products like jet fuel look most vulnerable in the near term given depleted inventories. Pressures in refined products may ease sooner than in crude, but gas could remain under strain the longest if the conflict drags on. Our base case assumes elevated prices in the near term, followed by gradual moderation as selective flows increase and confidence grows that a full blockade will be avoided. Volatility is likely to remain high, but the balance of probabilities favors a constrained-flow regime rather than a prolonged shutdown.

Asia would likely feel the first shock through gas and refined products, followed by Europe via higher energy costs and supply disruption, given their relative dependence on the Middle East as energy source. Inflation would accelerate, growth would slow, and the longer the interruption lasts, the more damaging the spillovers would become: a stagflationary impulse mirroring that of the pandemic six years ago. The US is more insulated for these issues, due to its domestic production capacity.

In terms of macro implications, inflation is likely to edge higher in the second quarter as energy prices interact with seasonal effects. However, if the strait gradually reopens and oil stabilizes below \$100, the inflation impulse should fade later in the year. In that scenario, the broader backdrop could mirror prior geopolitical shocks: sharp but temporary market corrections rather than a lasting stagflation episode. This would support a return to lower volatility, steadier yields, and conditions more favorable to carry and risk-taking than current front-end pricing implies.

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About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

While central banks have become more hawkish, markets may be overstating the extent of their response. If growth cools and inflation pressures subside, the Fed could still cut rates in the second half of 2026. The European Central Bank faces a tougher balance given its direct exposure to gas and energy costs. This divergence suggests the Fed has more room to ease, underpinning a relatively stronger dollar versus the euro, even as risk sentiment improves.

Overall, while tail risks persist, a prolonged full closure now appears less likely. The more probable outcome is one where we have already seen the lows in flows through the strait, and gradual normalization will follow. Commodities are contemporaneous assets, while equities are anticipatory assets. As a result, we could see energy prices remain elevated due to near-term physical tightness, yet equities may start to look through that and begin climbing the wall of worry. The biggest near-term risk now is damage that may be done by both sides to energy infrastructure. While we're mindful of this tail risk, evidence increasingly points to a temporary energy shock rather than a structural one, offering a tactical opportunity to re-engage selectively with risk assets.

In terms of longer-lasting implications, we see the potential for a deal between the US and Iran that could finally bring some relative stability to the region by addressing the key nuclear issue. This seems more likely to us than the US simply "walking away" and leaving the nuclear issue and status of the strait unresolved. In any case, we would expect the relationship to remain volatile; however, the worst may be behind us relatively soon. The alternative would be an extremely painful and protracted conflict, which is possible yet improbable, in our assessment.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Sam McDonald
Sovereign Analyst, Emerging
Markets Fixed Income

CS 3.00 (unchanged)

The Iran war has added material uncertainty and risk premia to the global outlook, though the drag on growth is expected to be limited overall. Also expected is a short-term boost to inflation via higher oil, gas, and refined product prices. However, the length and intensity of the conflict will ultimately decide the outlook for the global economy. For the US, pass-through to inflation is expected to be limited if the conflict remains relatively short. For Europe, the impact is expected to be larger but not like the 2022 shock. US data overall continue to be mixed, with the "low-firing, low-hiring" labor market still in place.

The inflation shock from higher energy prices is coming at a time when tariff pass-through is at its peak. January core Personal Consumption Expenditures (PCE) increased by 3.1% year over year, or 0.4% month over month, with February numbers expected to be similar. The Producer Price Index (PPI), released mid-month, increased 0.7% in February, the most in seven months, driven by higher costs for services and a range of goods. The impact on headline inflation of surging gasoline prices in March is expected to be large, but the effect on core inflation and economic activity is less certain at this point. In Europe, the impact of the gas price spike is expected to be more material, but with timing differences across countries due to different energy tariff structures.

We believe the conflict in the Middle East and elevated oil prices (above \$100 a barrel) would have to persist longer than expected to have a large effect on economic growth. In the US, higher gasoline prices will likely offset some of the stimulus coming from the OBBBA. Nonetheless, growth momentum overall remains solid, with surveys and activity indicators showing a pickup in business and manufacturing sentiment. The fading impact of the government shutdown on growth will also add support to first-quarter GDP.

The February jobs report was weaker than expected, undoing the strength seen in January. Total payrolls declined by 92,000 and private payrolls were down by 86,000. The unemployment rate ticked up slightly, to 4.4%, but it is still unclear if it has stabilized. However, initial claims continue to be broadly stable. Meanwhile, private sector employment grew by 63,000 jobs in February, according to the ADP National Employment Report, showing improvement over January's gain of 22,000 jobs. The mid-March release of the Bureau of Labor Statistics' JOLTS ([Job Openings and Labor Turnover Survey](#)) report showed the number of job openings in January was little changed, at 6.9 million. Hires were unchanged at 5.3 million, while total separations changed little at 5.1 million.

Given uncertainty about the course of the economy, the Federal Reserve decided at its March meeting to keep the federal funds rate at 3.5% to 3.75%. This caution is likely to continue in the near term, with the Fed expected to hold rates at current levels as new economic projections flow in, which are likely to revise inflation higher and growth modestly lower. Assuming the Middle East conflict is not extended, we expect the Fed to look through the inflation impact, although it may push back the rate-cutting timeline.

Rates

Gunter Seeger

Portfolio Manager, Developed
Markets Investment Grade

CS 4.00 (unchanged)

The risk for greater inflation is currently underappreciated. If the war in Iran continues, spiking inflation may catch many unprepared. Right now, the war doesn't appear to offer any easy or quick off-ramps.

The world consumes 100 million barrels of oil daily, 20% of which is shipped through the Strait of Hormuz. With the strait too dangerous for transit, that creates a global deficit of 20 million barrels per day. To ease the shortfall, the global Strategic Petroleum Reserve (SPR) has released 400 million barrels. But that supply will last only 20 days so long as the strait is blocked. In addition, one-third of the world's fertilizer is shipped via the strait, putting half the world's urea and one-third of its ammonia at risk. If the strait remains closed through the summer, the world's crop yields are at risk regardless of fertilizer prices. Since there is no strategic reserve of fertilizer, food prices can go in only one direction.

The market has been short inflation risk for some time, with the base case for 2026 being the appointment of Kevin Warsh as Fed chair and two rate cuts. The base case now foresees just one cut, although that number should arguably be zero given that core PCE, the Fed's most-watched inflation indicator, has ticked up to 3.1% – more than 1 percentage point over the Fed's stated target.

Credit

Steven Oh, CFA

Co-Head of Leveraged Finance

CS 4.00 (+0.75)

The Iran war has taken center stage, with its primary impact seen in escalating energy prices, although markets do not expect a long-lasting supply shock. Nevertheless, the resulting rise in inflation has dampened expectations of a Fed rate cut.

Credit spreads have widened a touch but are far from levels reflecting any concern that US and global economies will tilt toward recession. However, the near-term impact will be to offset the fiscal stimulus, which was expected to boost growth.

With market spreads discounting much of a sustained impact from the war, we are shifting our short-term one-month score to a defensive posture, as we see elevated risk of additional spread widening. However, if 12 months were our time horizon, our score would be a more neutral 3.0, given that the base case remains squarely in a "no recession" outcome and valuations have become more attractive (albeit with higher dispersion between industries). As of today, however, we view it as prudent to increase cash substitute balances on days of market strength.

Currency (USD Perspective)

Anders Faergemann

Senior Sovereign Portfolio
Manager, Emerging Markets
Fixed Income

CS 3.00 (unchanged)

We maintain our base case that foreign exchange will remain range-bound amid markets that operate in a low-volatility, carry-friendly environment. The US dollar has strengthened on safe-haven demand amid geopolitical uncertainty and higher oil prices; however, this near-term strength is likely to be temporary, based on a combination of a cooling US economy in the second half, anchored inflation expectations, and the dimmer likelihood of additional Fed cuts. While oil is likely to remain elevated in the coming months, we expect prices to level off in the second half, with the inflationary fallout washing out over a 12-month horizon. The current environment favors higher-yielding currencies, pointing to confined FX ranges, with the euro/dollar relationship returning toward 1.15-1.20 once energy risks fade. Europe's more persistent energy risk premium suggests that the euro has likely peaked for the year vis-à-vis the dollar, even if broader dollar upside is capped. Natural gas prices are the euro's key vulnerability. Correlations between higher European gas prices and a weaker euro appear stronger and stickier than for oil, reinforcing the divergent policy expectations of the Fed and the European Central Bank (ECB) and limiting the upside for the euro, even as global risk stabilizes. While we previously anticipated a stronger euro on a European growth upswing, the energy shock and fiscal consequences are likely to weigh more heavily on Europe. Higher oil prices also act as a consumption tax in the US, offsetting some positive momentum from tax refunds.

Emerging Markets Fixed Income

Joseph Cuthbertson
Sovereign Analyst, Global
Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)
CS 2.75 (unchanged)

Local Markets (Sovereign)
CS 2.75 (unchanged)

Despite an uptick in volatility, emerging market (EM) spreads have remained resilient. Since the start of the Iran conflict, EMBI spreads are just five basis points (bps) wider — a total of 10 bps wider year to date. Under our base-case stabilization macroeconomic scenario, we still expect nominal growth levels to improve, EM current accounts to remain in surplus, and overall balances — still elevated owing to higher borrowing costs and debt levels from post Covid/Ukraine — to trend in the right direction. Despite high core rates, spread compression across most EM sovereigns has been sufficient to reopen market access down the rating spectrum. In 2026, we expect market access to extend to several issuers that defaulted in the previous cycle, which we view as supportive of sentiment.

We expect the Strait of Hormuz to remain disrupted for the next few weeks, leading to elevated oil prices over the next quarter. Higher oil prices should create terms-of-trade winners, but the duration of disruptions and extent of higher prices are likely to be manageable for the losers. We expect that countries including Azerbaijan, Angola, and Nigeria, which all have a high degree of hydrocarbon exports, will do relatively better than importers such as Kenya and Turkey. Terms-of-trade outcomes for countries including South Africa are likely to be negative, although higher metals prices should partly offset the impact. The market is already pricing in this divergence, and it has become excessive in some instances. The hard work done to improve external buffers going into this period gives us confidence that EM can handle the “shock,” which creates opportunities to exploit mispricing as the timeframe for reopening the strait becomes clearer. Still, we expect sovereign credit metrics to improve this year.

Robust economic data, high real rates, and growing external buffers support policy easing among local-currency high-yielders. While the uptick in oil prices will raise concerns about CPI spikes, we would expect these only to pause and elongate (not stop) the cutting cycle in many frontier and higher-yielding local-currency names. We see pricing of hikes in some names as excessive and would look for it to fade.

Fourth-quarter 2025 results, which continue to come in, show that earnings are broadly meeting expectations, with a modest positive skew to earnings beats. Credit-rating momentum has normalized following a strong positive year, with recent downgrades largely concentrated in Latin America, particularly Brazil. The default rate for 2026 has recently been revised higher, to 4.3% from 3.0%, driven by two large Latin American issuers. These defaults appear to be idiosyncratic and do not signal a broad-based deterioration in underlying credit fundamentals. Our view remains that balance sheets are strong and remain resilient during this volatile period.

Primary market activity in February slowed to \$24 billion, the lowest monthly total in almost a decade. The net financing for the month concluded at -\$12 billion. The expected supply in March is \$33 billion. However, with the ongoing conflict in the Middle East, we expect muted issuance. Month to date, gross issuance was \$5 billion, with scheduled cash flows of \$29 billion, and we expect another month of net negative financing. We have not yet heard of material outflows in the EM space, other than ETF selling. Locals and US investors are looking to buy the dip.

Multi-Asset

Peter Hu, CFA
Portfolio Manager,
Global Multi-Asset

CS 2.25 (unchanged)

Markets remain focused on elevated geopolitical tensions in the Middle East. The Strait of Hormuz remains effectively closed, disrupting oil prices. The Trump administration has explored options such as Navy escorts, but a practical solution has yet to emerge. While these risks continue to weigh on sentiment, we believe they are approaching their peak.

With the Supreme Court having blocked President Trump’s tariff plan, he is expected to pursue other legal paths to impose trade measures. We may still see some inflation coming from imported goods, but that is likely insignificant in the total inflation picture, as goods make up only about 12% of total US output. More meaningful to the inflation story is rapid AI adoption, which is pushing firms to implement efficiency gains sooner than expected. Companies are showing that AI enables labor reductions without harming output, weakening wage bargaining power and pulling forward disinflation in the service sector, which accounts for roughly 70% of the economy. This dynamic is likely to ease inflation pressures earlier than consensus and influence the Fed’s reaction function as job data softens, especially given expectations that incoming Chair Warsh aims to return to a forward-looking approach.

Despite the tensions in the Middle East and the recent signs of technological disruption, we continue to see a resilient global economy supported by what could become the longest productivity driven investment cycle on record. In environments like this, investors should stay focused on growth assets and remember that periods of overinvestment and late cycle credit stress have happened before. With that in mind, we remain constructive and maintain our 2.25 score.

Global Equity

Michael Mark
Client Portfolio Manager,
Global Equities

CS 3.00 (unchanged)

Global equity markets have sold off across all regions, though with considerable dispersion (with the US down 2%, Europe 5%, and Japan 10%). During this time, the market focus has shifted from AI bubble/disruption concerns to geopolitical escalation in the Middle East, surging energy prices, and shifting monetary policy expectations.

Strong PMI and other macro indicators continue to serve as a backstop. Fourth-quarter earnings thus far are strong (with 74% of MSCI All Country World Index constituents having reported), marked by elevated sales growth, record high margins, and upbeat corporate guidance, continuing support for global equity markets.

Amid headline-driven volatility, bottom-up selectivity remains key, which may present buying opportunities among the companies we own or are tracking.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager,
Global Equities

CS 3.00 (unchanged)

The Iran war has upended markets and brought geopolitics and oil prices to the forefront of global discussions. The war's duration and the effects of the blockage of the Strait of Hormuz are the most important near-term questions for markets, as all countries and regions are affected by the spike in oil prices, though to varying degrees.

In Asia, earnings reporting in Korea and Taiwan is largely over, while reports from Chinese and Indian companies are still coming in. Results from AI-component manufacturers and financials were generally above expectations, some significantly so. Other sectors were mixed. Meanwhile, President Trump's summit with Chinese leader Xi Jinping has been delayed.

In Latin America, earnings results have been mixed. While there were no large "blow-up" misses, there were quite a few small ones. The region is generally net neutral to higher oil prices, although sustained large price spikes will drive up CPI. As we move further into the year, Brazil's presidential elections will become more of a factor in the market.

In EMEA, all eyes are on the Ukraine peace process, which by now has failed, and on the war in Iran. Russia is a big winner of the Iran war, and Trump has abandoned all talk of new Russia sanctions. Upcoming elections in Hungary are also in focus, as their impact will be felt throughout Europe.

Quantitative Research

Yang Qian
Fixed Income
Quantitative Strategist

Our US Conviction Score retreated last month, with credit spreads widening by 8 basis points (bps) and the yield curve flattening by 15 bps, both contributing to the decline. Our global credit forecasts remain negative and favor developed market (DM) countries over those in emerging markets. In the DM universe, the industries the model favors are energy, industrials, and natural gas. The model dislikes DM finance companies, utilities, and brokerage companies. Among EM industries, the model likes metals and mining, financials, and infrastructure. It dislikes EM real estate, industrials, consumer goods, and transport.

Our global rates model forecasts higher yields for Switzerland, Japan, and North America and lower yields for Oceania, the UK, and most EU countries. The model forecasts a steeper curve in the UK and North America and a flatter curve in Oceania, Japan, and most EU countries.

The rates view expressed in our G10 model portfolio is overweight global duration by +0.70 year. It is overweight France, Spain, New Zealand, Belgium, and Canada and underweight the US, Germany, and Japan. Along the curve, it is overweight the 10-year and 20-year while underweight the two-year, five-year, Japan government bond seven-year, and the 30-year.

Disclosure

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