Investment Strategy Insights

Monthly Views From Our Diverse Global Investment Teams

PineBridge® INVESTMENTS

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A Fork in the Road for the Middle East

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

It has been said that "There are decades where nothing happens; and there are weeks where decades happen" – and this has certainly been true of late for the Middle East, where geopolitical events in recent weeks have marked an important fork in the road for this troubled region. Yet the conditions that led to the recent strikes on Iran by Israel and the US were formed by pivotal developments over the past 18 months, which resulted in a dismantling of most of Iran's Axis of Resistance and the fall of Syria's Assad regime. These developments, along with the destruction of much of Iran's air defenses in the exchange of attacks in October 2024, created a window for this war to ensue.

The question now is where the conflict will go over the intermediate (nine- to 18-month) period ahead, and how might conditions in the Middle East look over the next few years?

At present, the region has entered a period of relative de-escalation, but the ceasefire is fragile and heavily dependent on how events develop, particularly around Iran's nuclear capabilities. Conflicting narratives exist about the extent of damage caused to Iran's nuclear facilities – some suggest it was minimal and could be reversed within months, while others suggest severe damage that would take years to rebuild. If the damage was minimal, the likelihood of renewed conflict rises sharply, as Israel's top strategic priorities would have been largely unsuccessful.

Yet regardless of the degree of damage to Iran's nuclear program, the losses sustained are very clear; its ability to defend its airspace, and the loss of many military leaders and nuclear scientists, are a body blow. Israeli operations have also substantially degraded Iran's missile program, although many launchers remain operational and are difficult to eliminate entirely. Israel's missile defense systems also face practical limitations, and its missile stockpiles are reportedly under strain. The conflict therefore showcased Israel's incredible offensive strengths, both in terms of airpower and military intelligence, yet also revealed its limits in the form of a capacity-constrained defensive system and finite pain tolerance in the face of destructive missile attacks.

If Israel indeed assesses the damage done to be less than acceptable, this ceasefire may come to be seen as a period in which Israel replenished its stock of interceptor missile defenses and gathered further intelligence in preparation for another round of attacks to get the job done. Alternatively, if the damage done is deemed adequate for now, Israel's focus may shift to longer-term objectives of maintaining air supremacy via sporadic sorties to prevent Iran from rebuilding its air defenses and missile stockpiles. In any case, the ceasefire is fragile.

The outlook for renewed US-Iran negotiations is now the most pivotal determinant of the flow of events. Will Iran take the US's direct involvement and ongoing threats as a decisive motivation to pivot toward compromise and a negotiated settlement? Or will these coordinated attacks convince the Supreme Leader of Iran to make a dash for a nuclear weapon, having assessed it to be the only deterrent? It is extremely difficult to form a high-conviction view of how Iran will decide to navigate this fork in the road, yet we could find out relatively soon.

Over the medium term, the prospects for the region are perhaps more hopeful. As a result of Iran's multiple and significant setbacks, it is likely to turn much more inward. Playing defense, shoring up its internal controls, and ensuring survival of the regime will be its highest priorities, rather than projecting power across the region. Israel's air supremacy, if successfully maintained, will also limit Iran's ability to rebuild its military

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.

capabilities. The result may actually be a falling Middle East risk premium, with its chief antagonist significantly defanged. Any resumption of a “hot war,” even if temporary, will only add to this effect, as Israel’s offensive capabilities would only set Iran back further.

There are currently no signs of an imminent collapse of the Iranian regime, despite its unpopularity. The regime’s resilience may be overstated, but absent a significant internal upheaval, it will likely maintain its hold on power for the foreseeable future. In fact, the clear infiltration of Israel’s intelligence agencies deep into the Iranian population revealed in this episode will likely lead to even harsher crackdowns on any form of opposition, making regime change more difficult. Yet the Supreme Leader is 86 years old, and his eventual death may catalyze a pivot in a more positive direction, even if the regime remains intact.

So what implications do these current and future developments have for the markets? The main transmission mechanism for Middle Eastern geopolitical risk remains the oil market. Despite the unprecedented nature of the Israel-Iran war, oil price action was relatively muted. This comes down to two factors. First, strong supply from OPEC and non-OPEC producers, combined with efforts by key players, such as Saudi Arabia, to maintain ample supply, limits the risk of shortages. But perhaps the more important factor is that recent events revealed Iran’s lack of credibility on disrupting the flow of oil. Iran failed to even mount a credible strike on a US base in Qatar; closing the Strait of Hormuz (and keeping it closed), or even striking GCC oil instillations, have been revealed to be quite low-probability outcomes given Iran’s isolation and limited appetite to escalate any confrontation with the US.

We therefore expect oil risk premia to grind tighter, albeit with periodic (yet relatively muted) spikes if the conflict temporarily flares.

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,
Global Emerging Markets
Fixed Income

CS 3.25 (unchanged)

Stance: The Fed dot plot continues to point to two rate cuts this year. Based on the Fed’s higher inflation projections and lower growth expectations, the similar dot plot outcome implies a more dovish tilt. Tensions in the Middle East have added some uncertainty to the global environment, but the base case remains that the conflict will wind down and that recent oil moves are likely to be temporary, with minimal effects on inflation. Meanwhile, weakness is starting to emerge in auto sales and in some housing indicators.

The Fed’s growth projection was shifted lower to 1.4% for 2025, down from 1.7% in the September projection, while the core Personal Consumption Expenditures (PCE) inflation projection increased to 3.1% from 2.8%. Chair Powell continued to emphasize that the central bank is waiting to see how inflation data respond to the tariffs over the next few months. Long-term inflation expectations have largely remained anchored, and one-year inflation expectations appear to have peaked, with the University of Michigan and Conference Board survey results, New York Fed indicators, and inflation swaps moving lower.

If the Israeli-Iran ceasefire holds, we expect the conflict to wind down given military constraints in Iran, domestic constraints in the US (with voters against a protracted war), and Israel ultimately relying on the US for logistical/arms support to maintain offensive momentum. Recent temporary oil price moves are expected to have a limited impact on global inflation.

May headline retail sales were weak, declining by 0.9% month over month (m/m), while the control group increased by 0.4%. Some unwinding of earlier front-loading was evident, as auto sales fell by 3.5% m/m. Restaurant sales were down 0.9% m/m after strong sales in March and April. Consumer spending remains largely healthy but is still expected to slow in the coming months as tariff inflation weakens real income growth.

The labor market is expected to keep gradually cooling. Continuing claims have trended sharply higher since the start of May, while initial claims have also moved higher, albeit in a period of seasonality. The housing market has also shown signs of further weakening, with softer single-family housing starts and inventories reaching highs for the current cycle. Real residential investment is likely to take another leg lower. NAHB homebuilder sentiment continued to decline over the course of the month, even with a partial rebound in future expectations in other business surveys of the wider economy.

Rates

Gunter Seeger
Portfolio Manager, Developed Markets Investment Grade

CS 4.00 (unchanged)

Since March, when we changed our score to 4.0, the 10-year note is higher at 4.32% and the long bond (30-year) is 28 basis points (bps) higher at 5%. As we said last month, this year has been incredibly volatile so far, and we see no reason for volatility to abate. Instead, it may become far worse. Wars continue in Europe and the Middle East, albeit at levels of intensity that have cooled from a boil to an active simmer. In the past, active conflict and high global tensions would have led us to anticipate a flight to quality in the form of an equity selloff, sharply lower yields, and sharply higher oil prices. This time, none of that happened. As a result, we remain on track, and our forecast remains the same: the US 10-year note will soon join the 20-year, and the 30-year will touch 5% this year.

Credit

Steven Oh, CFA
Global Head of Credit and Fixed Income

CS 3.50 (+0.25)

Credit markets continue to shrug off any potential risks and remain steadfastly tight, with strong demand even in the face of war in the Middle East. Furthermore, trade negotiation deadlines are approaching, potentially leading to a continuation of current uncertainties. It is likely, therefore, that the positive impact of the first half's pull-forward in demand will reverse in the months ahead and we will see a decelerating economic climate.

Despite the increase in tail risks, valuations have not budged and remain at tight levels below our current fair value range. While our base case outlook remains intact due to the unlikelihood of any form of meaningful US recession, we continue to move the CS to an incrementally more defensive posture. We do not believe this is a market environment to become hyper defensive. Still, we favor trimming the highest-risk/beta positions within portfolios and adding back an element of dry powder.

Currency (USD Perspective)

Anders Faergemann
Senior Sovereign Portfolio Manager, Emerging Markets Fixed Income

CS 3.00 (-0.50)

We are gradually turning neutral on the US dollar, which has been correcting in recent months in response to a change in market perception around US exceptionalism. While we acknowledge that the US brand has faded slightly, the dollar's underlying support remains intact considering the AI and productivity outlook. In the short term, however, the US dollar's outlook may be different, with investors viewing a weaker dollar as the path of least resistance, as portfolio flows and technical factors appear to have gained more power in determining its direction. As an example, rising geopolitical uncertainty historically sparked demand for safe-haven currencies – chief among them the US dollar. But this time around, financial markets appeared to favor the Swiss franc and the euro.

While the US dollar trades cheap to its rate differential with Germany, other factors, such as the USD's long-term valuation, increasing FX hedging ratios, and the dollar's temporary loss of safe-haven appeal, suggest the USD could remain misaligned with rate differentials for a while.

Markets have absorbed the tariff and trade shocks and seem to be adjusting to the US fiscal situation, signaling a desire to add carry over the summer period once volatility surrounding geopolitical tensions subsides. Furthermore, we believe data distortions and the Fed's reaction function are likely to resurface as currency drivers from now through year-end, implying that 2026 may bring a change of fortune for the US dollar (or at least a degree of stability).

We have affirmed our "Soft Landing" scenario, seeing a gradual weakening of US growth over the next three to six months as labor market conditions soften and the second quarter's front-loading reverses. Higher real yields should allow the Fed to resume easing by December and into 2026, providing firmer ground for the US economy to recover, supporting the US dollar.

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 3.00 (unchanged)

Despite the tensions in the Middle East, emerging market spreads have been resilient. Oil exporters with higher fiscal break-even points have outperformed, in line with our view that the conflict will result in just a slightly higher average oil price for the year. While we have seen limited adverse reactions among oil importers and countries near the conflict area, we continue to monitor for negative spillovers that may occur through a country's external sector. We expect tension to remain elevated, but assign a low probability to new escalations or further retaliatory events that could lead to significantly higher oil prices for an extended period. Thus, we expect spreads to remain stable, with oil prices in a favorable range for the asset class.

The domestic macro environment is favorable for most EMs, and we expect sovereign credit metrics to improve throughout 2025. EM economic data remain robust, with disinflation trends continuing. This creates conditions in most countries that still support further policy easing, which we expect to remain the case in the absence of a flight-to-quality response in the dollar. As we look at credit-rating agency actions, the balance of upgrade candidates far outweighs downgrade candidates in number and aggregate index weight. These numbers include several potential rising stars, including Oman, Serbia, Azerbaijan, and Costa Rica. However, given the geopolitical and commodity price backdrop, we expect the pace of upgrades to slow, with rating agencies holding a higher bar for positive actions.

For EM corporates, first-quarter results were broadly as expected, with a slight skew to beating our expectations. The fundamental picture remains robust, and we expect leverage ratios to stay at healthy levels. Our credit trends skew positive in both investment grade (IG) and high yield (HY) names. Our corporate team recently attended Bank of America and JP Morgan conferences on EM corporates. At the former, our team met with 72 issuers, and their key takeaways suggest that the fundamental picture remains resilient and that leverage levels will be stable. Geopolitics and energy markets were key areas of focus.

Multi-Asset

Peter Hu, CFA
Portfolio Manager,
Global Multi-Asset

CS 3.00 (unchanged)

Over the past two months, markets have been unusually driven by policy developments, particularly regarding tariffs and the Big Beautiful Bill. While uncertainty remains, the direct impact of those issues on markets likely has peaked. For the rest of 2025, we see stagflation setting in as higher post-tariff prices emerge. Costco and Walmart have noted that while April prices reflected pre-tariff conditions, May brought noticeable increases, a trend expected to continue through year-end. April's tame core PCE inflation is likely to rise, depending on the degree to which consumers turn away from tariffed imports. The shift will determine the extent of lost purchasing power and economic drag.

Despite near-term pressures, structural growth forces are building and should take over by 2026. Yield curves are steepening globally as markets price in fiscal expansion across the US, Europe, and China. This reflects renewed private-sector appetite for investment after years of caution. Investment-led growth – driven by reshoring, climate initiatives, and AI – tends to favor equities over bonds. US growth will also benefit from upcoming deregulation in energy, finance, and small business. These drivers point to a return to stronger, more resilient growth in 2026.

We maintain our neutral score of 3.0 but are prepared to take advantage of market weakness. We see these stagflationary conditions as opportunities to position for a strong rebound in 2026, driven by productivity gains and private-sector investment.

Global Equity

Chris Pettine, CFA
Research Analyst, Equities

CS 3.00 (unchanged)

DM equity markets have recovered toward their early-year highs despite continued high US tariff/trade uncertainty. Signs of de-escalation and progress in trade negotiations have lowered the temperature. Meanwhile, first-quarter earnings demonstrated that the consumer is holding up relatively well and that spending on AI and infrastructure is proving durable. Europe has outperformed the US to date this year.

Markets also appear to be looking through to 2026 and a period of lower interest rates, less policy uncertainty, and a more business-friendly environment of lower taxes and deregulation. Earnings growth has broadened beyond tech to industrials, financials, and healthcare. Consumer spending remains supported. Company commentaries in general indicate the ability to absorb tariff impacts almost fully in 2025 and then fully in 2026.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager,
Global Equities

CS 3.00 (unchanged)

Broadly, the reaction of equity and oil markets to the Middle East conflict thus far has been restrained, and continued US dollar weakness has been supportive of EM assets. On a portfolio level, our exposure to China and India will not see much impact if the Iran conflict proves short-lived. Otherwise, there may be earnings downgrades, especially if oil prices spike.

In China, we see tentative de-escalation of trade tensions with the US. Beijing has reauthorized rare earth exports, albeit in a tightly controlled manner. It has reclassified some fentanyl components to make them less accessible – also a nod to the US. It remains to be seen if these actions result in more substantive progress on both sides. Investors are waiting for the decision on restrictions of chip sales to China.

Latin America again emerges as a relative winner amid the global turbulence, as it is not directly affected by global conflicts and has seen relatively mild trade asks from the US. In EMEA, the peace process has been largely derailed, and it appears the White House is readying to formally abandon Ukraine and the EU in the war with Russia. Geopolitical risks in Emerging Europe are rising again, with no clear path to a resolution.

Overall, geopolitics have overtaken bottom-up developments in the last month. We favor positioning the portfolio in companies that are relatively isolated from top-down shocks and focus on the long-term outlook, which is admittedly a challenge in this environment.

Quantitative Research

Haibo Chen
Portfolio Manager
and Head of Fixed Income
Quantitative Strategies

Our US Conviction Score improved, driven mainly by credit spread tightening of 23 bps. Our global credit forecasts remain negative and relatively favor EM over DM, where our model favors technology, banking, communications, natural gas, and electric and dislikes basic industry, finance companies, consumer cyclicals, energy, and transportation. Among EM industries, the model likes pulp and paper and financials and dislikes real estate and diversified companies.

Our global rates model forecasts lower yields for the US and the UK and higher yields for Japan and the euro area. For slopes, the model forecasts a steeper curve for the UK and the euro area and a flatter curve for the US and Japan. The rates view expressed in our G10 model portfolio is overweight global duration. It is overweight the UK, the euro area (with overweights in peripheral countries and underweights in core countries), and Oceania. It is underweight North America (with an overweight in Canada and underweight in the US) and Japan. Along the curve, it is overweight the 10-year and 20-year and underweight the five-year, the Japan yen seven-year, and the 30-year.

All market data, spreads, and index returns are sourced from Bloomberg as of 25 June 2025.

About PineBridge Investments

PineBridge Investments is a private, global asset manager focused on active, high-conviction investing. We draw on the collective power of our experts in each discipline, market, and region of the world through an open culture of collaboration designed to identify the best ideas. Our mission is to exceed clients' expectations on every level, every day. As of 31 March 2025, the firm managed US$188.9 billion across global asset classes for sophisticated investors around the world.