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Geopolitical Tensions Commentary – Week 4

Mashreq Capital – Market Update on the Middle East Crisis

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Global Commentary

Geopolitical Overview

Over the period from March 16 to March 22, notwithstanding the latest Trump tweets of Monday March 23 which we will comment on later, markets remained dominated by the interplay between oil supply disruptions, shifting geopolitical risks, and evolving rate expectations. Brent crude experienced sharp two way volatility, initially falling on expectations of partial shipment resumption and strategic reserve releases, before rebounding, as Iran intensified strikes on regional infrastructure and Strait of Hormuz traffic, came to a halt. The situation escalated further, with US strikes on Kharg Island, the removal of senior Iranian officials by Israel, and Washington issuing a 48 hour ultimatum for Iran to reopen the Strait, alongside a request by the Pentagon for an additional $200 bn military budget to sustain operations. These developments reinforced uncertainty around potential de escalation, as mixed signals persisted between the US and Iran, and allies refrained from committing militarily to reopening the Strait.

Rate markets responded dynamically to shifting inflation expectations. Early in the period, falling oil prices supported a rally in US yields and firmer expectations for additional Fed cuts, but the trend reversed as oil surged. By March 19, stronger inflation prints and the Fed's hawkish messaging, pushed the US curve into a bear flattening, with markets paring back rate cut expectations. Europe mirrored this volatility: initially rallying on weaker sentiment data and falling oil but later selling off sharply as rising energy prices drove, the UK and euro area front ends, higher. Across regions, central banks signaled caution, with the Fed holding but emphasizing inflation risks, the BoE staying on hold while sounding hawkish, and the ECB stressing upside risks to inflation as geopolitical tensions intensified.

Risk assets moved in tandem with the evolving macro backdrop. Equities initially benefited from softer oil prices and improved risk appetite-particularly cyclical sectors in the US and LatAm-but sentiment deteriorated as energy markets tightened and rate expectations shifted. The S&P 500 swung from gains (+1.27%) at the start of the week, to losses (-1.90%) by the weeks' close, with the sharpest declines occurring after the Fed's firm stance and renewed Middle East tensions. Gold showed similar volatility, briefly rising +90bps with risk aversion before falling -12% due to pressure from a stronger USD and higher real yields. FX markets tracked the path of rates: the USD initially weakened -23bps as safe-haven demand faded but later strengthened +77bps on Fed repricing and energy driven inflation concerns, while JPY and other G10 currencies moved according to shifts in rate differentials and geopolitical stress. Emerging market FX began the period stronger rallying +22bps by mid week but came under pressure as global financial conditions tightened finishing the week down -64bps.

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On Monday, markets briefly shifted to a more constructive narrative after President Trump announced on social media that the US and Iran had engaged in encouraging discussions over the weekend and that planned strikes on Iranian power and energy infrastructure would be postponed for five days. Risk assets responded sharply: oil futures fell as much as 15%, equity futures rallied roughly 2.5%, and Treasury yields declined by 3–4bps as investors unwound defensive positioning. However, the optimism proved short lived. Iranian officials swiftly denied that any communication had taken place, triggering a partial reversal in risk sentiment. Even so, markets managed to retain some of the earlier improvement, with price action stabilizing as investors reassessed the probability of near term escalation.

As highlighted in last week's commentary, we continue to assess the geopolitical outlook through three broad scenario paths:

1. De-escalation:

A negotiated step-down—whether through a unilateral declaration of strategic success by the US or a mutual return to diplomatic engagement—remains a plausible outcome.

2. Prolonged elevated tension:

This reflects the current state of play: a persistently fragile environment in which markets embed a geopolitical risk premium without a clear catalyst for resolution.

3. Further escalation:

This encompasses scenarios involving a deeper US military footprint in Iraq, coordinated action by NATO, the Gulf states or European partners, or even direct support for Iran from Russia or China.

Despite the volatile news flow, we remain camped to Scenario 2 as we expect the current geopolitical environment to last in the medium term. This implies oil prices at around $100/bbl. Our analysis indicates that the 30% increase in oil to $100/bbl, will not be a deterrent for the risky assets in the medium term (6M-1YR).The sell off we have witnessed, was due to the initial risk-off sentiment, however we believe that markets will recover from the initial shock. Historically, sharp oil moves to this level, still support risky assets such as Equities over the medium-term c. 2-4% over 6 months to a year. Earnings growth is in low single digits due to inflation and growth pressures, and interest rates tend to move higher by 10-15bps depending on the region.

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Regional Commentary

MENA Fixed Income

Core GCC sovereigns remain high-quality and structurally resilient, even as broader MENA fixed income sold off, amid higher global yields and wider spreads. MENA fixed income came under pressure this week, with the Bloomberg MENA Aggregate down -1.25%, driven by a combination of higher global yields and wider regional spreads. The move was exacerbated by the US 10-year Treasury yield rising to 4.4%, tightening global financial conditions and weighing on duration. Performance was broadly negative across the region, with core GCC markets relatively resilient, while higher beta names underperformed, most notably Bahrain (-2.87%) and, to a lesser extent, the UAE and Qatar. Iraq was a rare outperformer, broadly flat on the week. CDS moves reinforced the risk-off tone. Within investment grade, Saudi Arabia and Abu Dhabi widened modestly (+6–7bps), while Dubai underperformed (+19bps) given its greater exposure to cyclical, non-oil sectors. In high yield, Bahrain (+52bps) and Egypt (+37bps) saw more pronounced widening, highlighting continued pressure on weaker balance sheets. Despite this, core GCC sovereigns remain fundamentally strong, with low debt-to-GDP ratios and robust fiscal and external buffers, supporting their relative resilience. Overall, the week reflects a broader de-risking, with higher beta credits bearing the brunt amid rising global yields.

Local GCC bond market liquidity has become increasingly dispersed. While higher quality sovereign and quasi sovereign credits continue to trade in an orderly manner, liquidity conditions have softened at the lower end of the credit spectrum. Weaker high yield issuers, particularly in real estate, have seen a clear deterioration in market depth, with bid ask spreads widening to around 2 points versus a more typical ~0.5, reflecting limited buyer appetite. Liquidity was further constrained by the Eid holiday period, during which many local institutional investors were absent, temporarily removing a key source of natural demand from the market.

Investment implications, we remain duration neutral, preferring to await greater clarity on the outlook for oil, inflation and global growth before taking directional rate risk. Within credit, we are maintaining a selective approach to high yield. We are underweight some of the weaker HY real estate issuers, while expecting higher credit quality names in the sector to recover from current levels. We take a more favourable view on energy-related issuers with resilient fundamentals in countries that maintain export access, due to the energy price windfall they are beneficiaries of.

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MENA Equities

Following a period of sustained weakness since the outbreak of the conflict, regional markets stabilized last week, with the index gaining 0.67% over the period. Dubai, Abu Dhabi, and Egypt were among the better performers, though the move appeared technical in nature rather than indicative of a broader shift in sentiment. Foreign flows continued to reflect caution, with outflows from the UAE (USD 843mn) concentrated in UAE real estate names, followed by USD 84mn outflows from Qatar. Real estate and financial sectors led performance for the week, with the strongest gains seen in names that had previously underperformed, consistent with a technical rebound dynamic. The financial sector benefited from the Central Bank of the UAE's announcement of measures to support financial sector liquidity. These initiatives included enhanced access to Central Bank cash reserves and the relaxation of capital buffer requirements, both designed to bolster market confidence.

Regional liquidity declined modestly week-on-week as initial selling pressure eased and traded volumes normalized. Despite the pullback, liquidity remained above the region's prior-year average.

Last week was shortened by the Eid holidays. Following the prolonged break, **the UAE was the only market open on Monday, March 23rd, with significant pressure witnessed** - Dubai fell 3.05% and Abu Dhabi declined 1.55%. Among the scenarios we are monitoring, the current environment most closely resembles a prolonged period of heightened geopolitical uncertainty, under which UAE, Qatar, and Kuwait may face greater pressure relative to the broader region, given their exposure to potential disruptions in the Strait of Hormuz. In this environment, we expect energy and materials names to outperform, particularly petrochemicals and fertilizers, specifically those with export access intact. Disruptions to energy infrastructure remain a key escalation risk; however, President Trump's announcement of a five-day pause on strikes against Iranian energy infrastructure provides some near-term respite. Should negotiations progress well, a pathway towards ending the conflict would be beneficial for markets, particularly for UAE, Kuwait, and Qatar given their higher exposure to regional risk.

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