



Sheltering in Place

A view from the ground: when poolside meets projectiles

Key points:

- Middle East conflict escalation: US-Israeli strikes on Iran this week have sparked retaliation, with drones and missiles disrupting shipping and LNG production, while tourists (and a certain fixed income CIO) were left stranded...
- Energy shock parallels: oil and gas prices have surged sharply, potentially creating an energy crisis comparable to the aftermath of the start of the Russia-Ukraine conflict, should the attacks turn into a prolonged conflict.
- Dollar strength and currency volatility: the dollar outperformed against the euro and pound this week as investors sought safe-haven assets, while EM assets faced challenges amidst escalating geopolitical risks.
- Defence spending imperative: escalating global volatility has exposed Europe's inadequate defence planning, with the UK particularly marginalised and struggling to apply lessons from the Russia-Ukraine war.
- Macro outlook: opportunities to add risk may emerge ahead, however there are many different scenarios ahead for global investors and a 'wait and see' approach is warranted at present.

London, 6 Mar 2026: Last Saturday's launch of attacks on Iran by the US and Israel have had a significant impact on the global macroeconomic backdrop and financial markets during the course of the past week. Iranian drone and missile strikes, aimed at spreading a wider regional war, have sent oil and gas prices surging as shipping and also production (in the case of LNG in Qatar) is heavily disrupted.

In this context, we may be witnessing the beginning of an energy shock that ends up resembling what was seen in the aftermath of the launch of the Russia war on Ukraine, should this conflict persist for an extended period.

In light of this, we would note that for all the initial US/Israeli success in removing much of Iran's leadership, securing aerial supremacy and inflicting heavy losses on Iranian military infrastructure, the risk that this becomes a more drawn-out affair than President Trump has been hoping for remains a very real possibility.

Notably, it has been reported that Iran recently had a stockpile of as many as 75,000 Shahed drones, which can be transported and then launched using commercial trucks that can be hard to identify. This could mean that the new regime could continue to launch attacks for months to come, unless it is toppled or persuaded to negotiate.

Moreover, with Iranian drones costing not much more than USD10,000 each, there is a sense that the economics of the conflict are on their side, if they are able to play a long game. Interceptor missiles are very

expensive, and supplies will soon be stretched, if greater military advances in Iran are not secured by the US/ Israeli forces.

There remains hope of a domestic civilian uprising in Iran, but this seems more a wish than a plan at this stage and, from this point of view, the path forward is not an easy one to predict.

It is also worth reflecting that these attacks come at a time when Trump's poll ratings are low and continuing to fall. An extended move up in oil prices will be felt quickly by US consumers at the gas pumps and if prices don't come back down, it seems reasonable that the President will take some blame for this.

With mid-term elections ahead and affordability already a number one issue for many voters, it can thus be seen that pressure will quickly build in the US for a swift end to these actions. From this perspective, the complete destruction of uranium enrichment sites could end up counting as enough of a win before Trump sits back.

As for the Iranian regime, they seem committed to an ideal that suicide would be preferable to surrender. They will also reckon on the idea that they can wait things out longer than the US can, and this could incentivise them to dig in. By launching attacks across Gulf states, this has also created fear and a sense of panic in a part of the world that has seen itself as something of an oasis of calm and stability in the region. Damage to hotels and airports has the capacity to kill tourism for a period and could also trigger ex-pat flight.

This creates economic downside risk in these countries, on top of what is happening in energy. It is also possible to speculate that Iran may hope to force countries to conclude they would be better off by kicking out US bases across the region, given that this is a war that none of these have wanted to see but one in which they have the most to potentially lose, in a negative scenario.

It is also interesting to reflect that, on a regional basis, Europe is a disproportionate loser in this crisis too, as a huge importer of gas as well as oil. Regional energy policy has been in capture to the ESG lobby over the past decade, and thus it has been seen as desirable to import these commodities from regions like the Gulf (and Russia) when they could have been readily extracted closer to home.

This policy of outsourcing carbon production to third countries is now seen to have catastrophic consequences for domestic security and growth, largely for the benefit of virtue signalling. By contrast the US, as an exporter of oil and gas, is actually benefitting from Iran's attacks on this sector.

From this perspective, it does seem ironic to think that the biggest costs being borne will be by those who had tended to try to oppose this conflict more than those who have created it.

From a financial markets perspective, government bond yields have moved higher in response to upward revisions being made to inflation forecasts in the wake of elevated energy costs. In this context, the largest moves have been seen in the UK, where gilts had recently been rallying on hopes for a BoE rate cut in March.

However, although we do see a larger inflation pass-through in the UK than elsewhere, we also note that the UK economy is struggling and recent events will only worsen the growing output gap. Since Governor Bailey and his colleagues have tended to pay more attention to this forward-looking analysis than moves in spot prices, we still believe that the BoE is likely to continue to ease, as long as the inflationary backdrop does not grow substantially worse from here.

Relatively speaking, moves in Treasuries, bunds and JGBs were more muted though yield curves continued to flatten, with this being something of a pain trade for some investors, given that curve steepening had been held as a pretty consensual view coming into 2026. Meanwhile, credit spreads widened in response to the evolving macro backdrop. Yet moves also remained relatively orderly and restrained compared to other past significant volatility events.

In part, this was explained by US retail investors continuing to want to buy every dip in US stocks, though as was seen in a sharp reversal in flows in Korean stocks in the past week, there is always a risk when price

action starts to force out investors who have been building up leverage, investing on margin. This could earn against complacency in this respect.

We remain relatively cautious on credit and although we have repriced to levels where valuations no longer look as rich as they did, we think that it is too early in this move to begin to think about buying the dip, until an off-ramp to the conflict can be more easily seen.

This is tricky to see at the minute and ultimately if regime change in Iran is desired, then history tends to suggest this will necessitate a need for boots on the ground, which the administration is much more reluctant to commit to.

In currencies, the dollar outperformed, with the euro on the back foot along with the pound. Given the relative economic impacts at a national level, these moves are easy to justify in the short term. However, events of the past week may once more cause global investors to think about allocating towards US assets, on the back of moves by a mercurial President who has nothing but disdain for those who are not prepared to share his point of view.

In this context, we think a strong dollar trade could run a bit further, given how short dollar trades were widely held at the onset of this conflict. However, this could create more attractive opportunities to build a dollar short at more attractive valuations. In light of this, we continue to look at the yen and close the intervention threshold we see at Y160; a long position in Japan FX may well be warranted.

Elsewhere, it has been a challenging week in EM assets, which will always tend to be more sensitive to geopolitical risk drivers. Also, the fact that these markets remain more liquid than is the case for many other higher yield assets, this will also tend to inflate a sense of volatility in this part of the market.

A material re-pricing of Middle Eastern risk is very understandable given the elevated level of uncertainty. However, elsewhere, this is much less clear cut. From this perspective we look at weakness as a possible opportunity to add, as long as we don't move into a backdrop of a materially stronger dollar or a lurch towards a global recessionary outlook.

Looking ahead

We will all continue to be glued to global events over the coming days, as themes around AI or current economic data take a back seat for the time being.

It strikes us that the world continues to become more volatile and dangerous, so this continues to underline the imperative with respect to defence spending. Europe remains behind the curve and continues to be marginalised on the world stage.

Meanwhile, in the UK, there has never been a time when our country felt more marginalised and less relevant. The fact we have only one ship able to provide drone and missile defence only demonstrates how the lessons from four years of war in Ukraine are not being learned quickly enough. The fact that this vessel is in port and not even ready for action at a time when a massive build-up of assets in the Middle East had been building for weeks also shows the level of UK strategic thinking and ability to plan.

Having been sleeping in a hotel last weekend in Dubai that was struck by a drone was a surreal event. Evacuating alongside other shaken guests, there was a sense that we were witnessing something that most of us had never expected to have firsthand experience of.

Sitting by a swimming pool watching drones and missile shots from the sky subsequently prompted the reflection that it can take a little time for reality to sink in and this may also be the case global investors too.

There are many different scenarios and pathways currently ahead of us, ranging from the very benign and positive to outcomes that look considerably uglier. At some point the trajectory have more clarity, but for now it seems like a moment to shelter in place for a bit longer....

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