RBC BlueBay Asset Management

Marketing communication

Patriot Games

A complex geopolitical plot!

Key points:

- **Middle East peace deal:** renewed hopes for an Iranian peace agreement have supported bond yields and risk assets this week, with Tehran dictating terms from a position of strength given depleted U.S. Patriot missile reserves.

- **Oil and inflation outlook:** crude oil prices are expected to remain above USD70 per barrel despite peace hopes, with elevated crack spreads keeping inflation pressures more prevalent than market expectations suggest.

- **Fed policy uncertainty:** Kevin Warsh's no-forward guidance approach has increased market volatility, with the September FOMC decision finely balanced and likely to be determined by one or two key data points.

- **Tech sector stabilisation:** AI sentiment has improved markedly this past week, as forced deleveraging subsided and markets stabilised, allowing equities to rebound on the back of another strong earnings season.

- **Macro outlook:** the investment environment remains uncertain over the medium term, though shorter-term views have turned more constructive, with attractive valuations emerging in sovereign credit and select European bond markets.

London, 7 August 2026: Renewed hopes for an Iranian peace deal helped bond yields and risk assets rally over the past week. This saw the S&P Index surging to new record highs, helped by another robust quarterly earnings season and a moderation of tech fears, following the rout that occurred in the middle of last month.

With respect to the Middle East, over the past few weeks it has become clear that US reserves of Patriot missiles have been greatly depleted, putting countries in the Gulf at much greater risk from missile attacks. This has helped to cement a push towards a deal, with these states vying for peace, and with the US not in a position to ‘finish the job’ by committing boots on the ground. This has helped to put Tehran in a relatively strong position to dictate the terms, at this point in time. Yet the danger that the Iranian regime tries to overplay its hand could yet scupper any agreement getting finalised.

In this context, a version of the draft text appears to envisage a joint authority between Iran, Oman and possibly the US, which will receive a share in revenues from traffic transiting through the Strait of Hormuz. Negotiators have highlighted that such an agreement has some parallel with what is already in place, with respect to the Straits of Malacca in South East Asia.

Although such a template will represent a considerable climbdown by Donald Trump, domestic commentators will probably care more about an unpopular war being brought to an end, even if it is seen to be clear that Iran has stood strong and exits the conflict in a sturdier position than that when Operation Epic Fury was launched just under six months ago. Mid-terms are now not far off and with the President’s approval rating at a record low, the domestic agenda is now pressing.

In assessing these developments, it won't be surprising to us to see crude oil prices eventually back towards their recent lows in June. This could offer a catalyst for yields to rally somewhat, if perceived upside inflation risks start to abate, and this is seen as helping central banks to avert the need for additional monetary tightening.

However, we would note that the Middle East is set to remain extremely volatile going forwards, whatever comes to pass. We have already seen one peace deal fail and future negotiations could well break down and spillover into renewed hostilities. Certainly, Tehran will feel emboldened by its success using the Straits as an important bargaining chip and may continue to push for more. In this respect, there is a sense that both sides remain very much on a collision course, even should conflict subside for now.

With the Houthis also misbehaving in the Red Sea and mines needing to be cleared in the Gulf, it strikes us that it is likely to be some time before trade returns to pre-war levels, and thus we think that crude prices are unlikely to hold below USD70 per barrel.

Meanwhile, crack spreads will remain elevated for the foreseeable future, with the markets for refined products far tighter than is the case for crude, given lost refinery output. As a result, we see inflation pressures remaining more prevalent than is embedded in market expectations. This tempers our enthusiasm for owning duration over the medium term and underlines our ongoing preference for inflation-linked bonds and derivatives. However, short-term price action could be somewhat more constructive, with investors having wanted to buy into rallies before – even if they have ultimately been left disappointed.

In the US, it appears that the administration was somewhat bruised by the market reaction to Kevin Warsh's performance at the press conference following the FOMC meeting. But rather than lashing out at journalists such as Nick Timiraos at the Wall Street journal, perhaps those surrounding Trump would be better advised telling Warsh that if he wants to pursue a policy of no forward guidance and telling the markets nothing, then he would be better advised keeping his appearances very brief in future.

Meanwhile, last Friday's intervention in the yen FX market was also notable and may link back to Bessent's fear that additional yen weakness could add to the uptrend in global long-dated yields.

The US administration would dearly like to see mortgage rates fall, in order to help housing affordability. In this case, Bessent is keen to draw on past experience in order to guide markets, though he will be the first to understand that ultimately, market pricing will be determined by fundamentals.

Moreover, in Warsh we have a Fed Chair who wants to see the Fed play a much smaller role in the economy and financial markets anyway going forward. In this respect, fundamental factors should be expected to dominate policy during his tenure.

With respect to the yen itself, intervention has offered short-term respite and the hope will be that the threat of further co-ordinated intervention will be enough to cap it around Y160 for at least a number of weeks.

However, the Japanese currency will remain under pressure if interest rate differentials are allowed to grow. In this respect, it is important for the BoJ to be permitted to hike rates in September or October and it is interesting to speculate on the extent to which Washington's support for Tokyo was in any part linked to an assurance that future adjustments in Japanese policy would be forthcoming. Meanwhile, recent events have helped to stabilise long-dated JGBs with 30-year yields attracting demand around 4%, in line with what we have been expecting.

Elsewhere, a turnaround in sentiment in US tech over the past week was helped by the news that Citadel had taken on a large chunk of AI-related investments from the Situational Awareness hedge fund, which had run into trouble following a period of exceptionally strong, leverage fuelled returns. The unwind in leverage in July had triggered widespread stop loss protocols, but with markets stabilising, there is a sense that positioning has been cleansed, relatively speaking. This has enabled the equity market to form a base and subsequently push higher in response to earnings once again, beating already lofty estimates.

Corporate credit spreads remained relatively rangebound over the past week. However, the rebound in the AI complex helped improve the backdrop surrounding the hyperscalers, following on from several weeks of building stress.

To give some context, in the high yield space, a data centre name such as Coreweave saw the yield on its 2031 bond drop to 11.5% having breached 13.5% one week ago, from a low of just 9% as recently as June. Ongoing supply pressure remains a structural market concern, and in this respect, SpaceX was the latest example of a stock to be pushed lower in the wake of announcing an increased pace of AI-related investment spend.

We continue to retain a cautious outlook on the sector from a credit perspective over the near term. However, we would now highlight that selected issues currently trade at attractive levels, from a medium-term point of view, in situations where we can identify very low probabilities with respect to credit impairment.

The investment outlook remains very uncertain over the medium term, though our shorter-term views have become a bit more optimistic.

This has led us to reflect on areas where valuations may be attractive with respect to adding risk exposures. We currently see more value in sovereign credit versus a lot of IG corporate credit, with stable A-rated issuers such as Chile, with euro debt trading above 100bps over swaps, which is double the spread available for similarly-rated corporate bonds.

We have also added duration exposure in Hungary, where 10-year yields are more than 40bps above their June lows, notwithstanding constructive domestic newsflow and a trajectory which is making the country an EU convergence candidate. Medium-dated Norwegian bonds have also stood out as attractively priced to us.

We are more optimistic on the trajectory of Norwegian inflation, which should benefit from the relative strength of the krone over the past year, and we doubt that the Norges bank will be hiking at its upcoming central bank meeting. We are also more constructive on the near-term outlook for gilts, in the wake of a dovish Bank of England meeting.

Given that the BoE’s Catherine Mann only dissented and argued for a rate hike at the July MPC, as a result of renewed conflict in the Middle East should a peace deal prevail, then she may be expected to reverse this vote in September. Moreover, with fellow member Claire Lombardelli noting that the BoE remains some way from moving to hike rates, the dovish bias of the Committee may encourage investors to add exposure.

That said, we would not be too surprised if these trades ultimately end up under water, with higher inflation in Q4 this year. This is also a period when the Burnham government is likely to be exposed to greater fiscal scrutiny. However, with the PM on his holidays and Westminster on summer recess, there may be a quieter period over the next few weeks.

Looking ahead

We head towards today’s US Payrolls report reflecting on the fact that data releases have become even more important in order to understand the Fed’s policy reaction function. In the absence of forward guidance, markets can be more volatile, and increased uncertainty could suggest the need for a greater term premium, over time. Beyond Payrolls, next week’s US CPI report can be even more pivotal in this respect.

Generally speaking, it seems there are a good number of indicators suggesting that the US labour market is in broadly good health. Where the problem sits is with respect to inflation. Following a benign June CPI release, this alleviated any pressure on the FOMC to need to hike early.

However, a reversal higher at next week’s data release could be significant. Anyway, safe to say that with a September FOMC hike 60% priced, so we are delicately balanced, and it is very conceivable that the Fed’s hand is likely to be tipped by just one or two key data points.

Elsewhere, in addition to impacting the Middle East, the shortage of US manufactured Patriot missiles is also having a significant impact with respect to the ongoing war in Russia / Ukraine. With Ukraine now effectively out of interceptors, so Russian missile attacks have become more deadly, and we may be concerned that we are witnessing a dynamic in which both sides eye further escalation of attacks as the only path to an eventual peace.

These developments will also add to the sense of urgency, with respect to military rearmament in Europe, leading to an acceleration of spending. However, we continue to witness a situation where national enthusiasm for such expenditures is inversely proportional to the distance a country lies from the Russian border, with the Eastern European states seeking to drive the agenda, but those further away including France, Italy and Spain, far more interested in utilising government funds to address other spending priorities.

Nevertheless, we still see a rush to close gaps as a factor that could drive up costs, at a time of bottlenecks in supply. In this respect, defence expenditure may have both fiscal and more broad-based economic impacts.

Meanwhile, we expect Trump to steer the focus towards next weekend's Patriot Games being hosted in Washington DC, rather than the shortage of Patriot missiles and the weaknesses in defence supply chains, which are shaping global events. Mind you, when it comes to Patriot Games, the old Harrison Ford movie with the same title probably represents a much more worthwhile watch!!

Contact:
Lydia Cambata
lcambata@bluebay.com

About RBC BlueBay Asset Management
RBC BlueBay Asset Management ("RBC BlueBay") represents RBC Global Asset Management outside of North America and is an active asset manager with expertise across fixed income, equities and alternatives.

RBC BlueBay's solutions-driven approach means it endeavours to empower clients with the knowledge they need to help shape their investment decisions. It works and evolves with clients, creating and customising investment products that meet their needs.

Responsible investment is embedded across RBC BlueBay's business. This means it is not just an investment focus but is also ingrained in its client service experience and work to deliver solutions that support real-world impact.