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How can European and Middle Eastern investors weather uncertainty?

Investment strategy insights

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- CIO's base case is that equity markets will end the year higher and bond yields lower, but we remain vigilant for a negative feedback loop: Sustained higher oil prices arising from a prolonged Middle East conflict could dampen growth, push yields higher, and exacerbate fiscal and credit concerns.
- Rather than position for a single outcome, we believe European and Middle Eastern investors should position for multiple market paths and consider the impact on their unique financial goals and the portfolios built to attain those goals.
- We outline an action plan grounded in building core, diversified portfolios as a means of withstanding periodic market volatility.

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European and Middle Eastern investors continue to face a complex investment landscape. The immediate concern is the length and depth of energy supply disruptions in the Middle East. But even when the Iran conflict ends, lingering questions around which firms win and lose from AI disruption will likely resurface—along with concerns about the trajectory and sustainability of government debt.

CIO's base case is that equity markets will end the year higher and bond yields lower, but we remain vigilant for a negative feedback loop: Sustained higher oil prices could dampen growth, push yields higher, and exacerbate fiscal and credit concerns. In the short term, oil-price-sensitive parts of the world economy will be most affected. But the broader economic impact of scarcer oil depends on consumer behavior and the perceived duration of the shock. If oil prices remain above USD 120/bbl for over six months, inflation and growth could be meaningfully affected, especially in Europe and Asia. Fiscal support may cushion the blow, but at the cost of worsening deficits.

A positive scenario would see a combination of military and political measures restoring shipping, limited regional escalation, and only minor damage to energy infrastructure. Conversely, a negative scenario would be one of ongoing instability and persistent oil supply disruptions, with more severe market consequences.

Rather than position for a single outcome, we believe the region's investors should position for multiple market paths and consider the impact on their unique financial goals and the portfolios built to attain those goals.

Building an action plan

Stay diversified

Diversification remains the cornerstone of resilient portfolios. CIO recommends broadening equity exposure across sectors, regions, and styles. This includes going beyond US tech, adding to global industrials and US utilities, as well as building exposure to Asia, Japan, and China, while adding more predictable income. In the US, we also favor health care, consumer discretionary, and financials. For investors with concentrated positions, now is the time to diversify and rebalance.

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Commodities are, we believe, an important hedge against inflation and supply shocks. Gold, in particular, is expected to resume its role as a geopolitical hedge, with central bank demand and concerns over rising global debt levels providing support. Industrial metals like copper offer exposure to electrification and energy transition themes. We like to maintain an allocation to broad commodities, with active management to navigate sector divergences and some of commodity investing's unique complexities.

Government bonds, especially in the short- to medium-duration segment, can offer diversification and income. Despite recent sell-offs, benchmark yields would likely fall if the crisis abates or if growth fears intensify.

Within alternatives, we see particular merit in looking for diversifying strategies in hedge funds like discretionary macro, relative value, and equity market neutral. These may be of particular interest to Middle Eastern investors whose diversification "benefit" from holding more US dollars is more limited. Long-term investors concerned about renewed inflation could also look at private infrastructure, many of whose long-term cash flows are tied to and periodically reset with inflation.

Investing in alternatives comes with unique risks that investors must be willing and able to bear, including but not limited to illiquidity.

Hedge market risks
Volatility is likely to remain elevated as markets digest the implications of higher energy prices, AI competition, and stress in credit markets. Investors should consider adding hedges to limit the risk of losses in equities, currencies, and commodities. This includes potential use of structured strategies with capital preservation features, adequate exposure to high-quality bonds, and allocations to gold.

Spring cleaning equity positions
CIO maintains an Attractive stance on equities overall but emphasizes regional and sectoral diversification. We downgraded European banks from Attractive to Neutral. After strong performance, valuations are less compelling, and investor positioning is crowded. Even modest negative surprises—macroeconomic or sector-specific—could trigger sharper corrections as positioning unwinds. While earnings momentum and capital levels remain solid, the risk-reward profile has diminished. Investors overexposed to European banks should consider trimming positions. Instead, we favor focusing on "European leaders" across sectors, including defense stocks, to gain exposure to structural growth and diversification.

Prepare for a stronger US dollar in the near future
Given the potential for the Middle East crisis to persist, positioning for short-term US dollar gains may be an effective hedge for euro-based investors. The dollar typically benefits from safe-haven flows during periods of geopolitical stress and market uncertainty. Positions that gain when the US dollar rallies can help offset losses elsewhere in the portfolio, if the conflict drags on or broadens.

While the future is uncertain and risks are elevated, CIO's guidance is clear: Stay invested, diversify, and hedge. Attempts to time market corrections often result in missed opportunities and increased risk. By managing concentration risks, building allocations to quality bonds, commodities, gold, and alternatives, and making targeted reductions where appropriate, investors can navigate current challenges and position portfolios to capture future opportunities—even in the face of further geopolitical uncertainty.

Global asset class preferences definitions
The asset class preferences provide high-level guidance to make investment decisions. The preferences reflect the collective judgement of the members of the House View meeting, primarily based on assessments of expected total returns on liquid and commonly known indices, House View scenarios, and analyst convictions over the next 12 months. Note that the tactical asset allocation (TAA) positioning of our different investment strategies may differ from these views due to factors including portfolio construction, concentration, and borrowing constraints.
Attractive: We consider this asset class to be attractive. Consider opportunities in this asset class.
Neutral: We do not expect outsized returns or losses. Hold longer-term exposure.
Unattractive: We consider this asset class to be unattractive. Consider alternative opportunities
Note: For equities, we have a five-tier rating system with two additional preferences
Most Attractive: We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Least Attractive: We consider this asset class to be among the least attractive. Seek more favorable alternatives opportunities.
When equities are included with the other asset classes in the three-tier rating system, we collapse "Most Attractive" with "Attractive" and "Least Attractive" with "Unattractive."

Appendix

Risk Information
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