

What does renewed US-Iran conflict mean for bonds and commodities?

Investment strategy insights

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- Tensions between Iran and the US have escalated once again, leading to higher oil prices and volatility in government bond yields.
- We believe investors still overestimate central banks' willingness to hike rates, so we see merit in locking in elevated yields offered by high-quality bonds.
- We continue to believe commodities should be included in a well-diversified portfolio.



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US-Iran tensions have escalated over the past week. Both sides have launched missile and drone attacks across the Gulf region. Iran claims to have closed the Strait of Hormuz—which is vital for global oil shipments—while the US has responded with strikes on Iranian military targets and has maintained naval escorts for commercial vessels. These developments cast doubt on a recent interim agreement to reopen the strait and end hostilities. Jitters in the energy and financial markets have risen.

Global bond yields rose to their highest levels in a month on 9 July, as renewed strikes pushed up oil prices and minutes from the Federal Reserve's June meeting revealed persistent inflation concerns in the US. At the time of writing on 14 July, the 10-year US Treasury yield traded near 4.57%, while the 10-year German Bund yield stood at 3.09%, close to levels last seen in May. Meanwhile, Brent crude oil prices rose to USD 85.50/bbl, though they remained well below the USD 120/bbl peak seen earlier in the conflict.

Will oil prices and bond yields spike?

Despite the renewed conflict, CIO believes oil prices and bond yields are unlikely to revisit the extreme levels seen earlier during the war. Both the US and Iran have strong incentives to avoid a return to all-out war, and while shipping confidence and production recovery will take time, we think the market is overestimating the speed at which energy supply will normalize. CIO expects Brent crude oil

to end the year at USD 85/bbl—well below the wartime peak. The pass-through to core inflation should be limited, as preliminary data shows Eurozone inflation cooled in June, and similar disinflationary patterns are evident in the US.

Central banks, including the Federal Reserve and European Central Bank (ECB), have acknowledged easing inflation pressures and remain cautious about further rate hikes. While market pricing of central bank policies remains biased toward further rate hikes in 2026, CIO thinks this is too hawkish, as policymaker rhetoric looks set to soften as confidence grows that second-round inflation effects are limited. We expect the ECB to pause after one additional hike (most likely in September), and believe the Fed will hold current policy settings until it cuts rates in early 2027. As a result, we believe the justification for elevated yields is less clear.

Bonds may still offer value

Yield volatility may persist in the near term, but CIO views the recent sell-off in global bond markets as an opportunity to lock in attractive yields. With stocks outperforming bonds this year and yields at elevated levels, investors can consider revisiting high-quality bonds as both a portfolio diversifier and a source of returns. CIO favors short- to intermediate-maturity quality bonds denominated in US dollars and British pounds, and sees value in select European bonds with longer maturities. In Eurozone government bonds, CIO has higher

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conviction in extending into longer maturities, as the ECB's recent rate hike is expected to cap longer-dated yields, especially given the soft economic backdrop and limited inflation risks.

Can commodities rally again?

While broad gauges of commodity prices are trading roughly 8% lower than their wartime peaks in May (Bloomberg Commodity Index), we believe the rationale for owning them remains intact. Broad commodities are still sitting on year-to-date gains, and the asset class continues to offer portfolio diversification, potential portfolio insulation against persistent inflation, and exposure to structural demand trends that include AI and electrification.

We note that oil markets have absorbed recent disruptions better than expected, thanks to reserve releases and subdued demand from China, but inventories remain thin, leaving the market vulnerable to renewed escalation. Gold is supported by central bank demand and reserve diversification, while AI infrastructure, electrification, and weather-related risks underpin the outlook for industrial metals and selected agricultural commodities.

We see value in a broad, actively managed commodity allocation. Commodities have historically shown low correlations with equities and bonds, making them a useful portfolio diversifier—especially when stock and bond returns move in lockstep. Investors can access commodities through a variety of different vehicles.

For investors with substantial allocations to gold—the price of which remains well below its January peak as a result of firmer after-inflation yields, a stronger USD, and less dovish Fed expectations—broadening exposure to include copper, aluminum, and agricultural assets may help diversify sources of future return.

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

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