Habib Bank AG Zurich
Private Bank

AFTER THE OIL SHOCK

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Dear Reader

Geopolitics and geoeconomics have become key drivers of global markets – but only to a point. As the market's reaction to the conflict in the Middle East showed, investor attention can very quickly move back to fundamental themes once a military confrontation loses its saliency. Even a very substantial supply shock, such as the one created by the closure of the Strait of Hormuz, can turn out to have only a limited impact. Interest rates and earnings are the core structural factors that determine market movements and long-term investor returns.

AI has now become recognized as a transformational technology. The test will be how fast it can be monetized and how sustainable the emerging AI-driven business models will be. Investors will need to have exposure to this theme but need to be mindful of the risks involved. Selection, diversification (also across asset classes), and risk management therefore remain key to long-term investment success.

The US war with Iran will go down as a watershed moment in history. In our Special Topic, we look at the early lessons from the conflict and what they mean for investors.

We are hopeful that the situation in the Middle East will eventually de-escalate and that it will stay that way. Should you have any questions related to this or any other issue, please reach out to us. We cherish the exchange with our readers.

Yours sincerely

Dr. David Wartenweiler, CFA
Co-Chief investment Officer and
Chief Economist

MACRO BACKDROP

After the oil shock

The war in the Middle East continues to move between the kinetic stage and the negotiation table. The world economy should eventually recover from the largest energy shock in recent memory, which, so far, it absorbed with remarkable ease. Spending on AI will remain an important driver.

Key points

- Fed takes hawkish turn on growth and inflation mix
- Reduced tensions in the Middle East set to end inflation surge
- Resilient emerging-market economies

US: here comes Kevin Warsh

In June, Kevin Warsh chaired his first FOMC meeting. The policy outcome was widely expected: the Fed left the policy rate unchanged against a backdrop of higher inflation and a resilient labor market. Even Warsh, the Trump appointee seen as an interest-rate dove, could not ignore the impact of the war with Iran. Meanwhile, he has pledged to overhaul the Fed's operations, including a review of its policy framework. This could include replacing the Fed's numerical inflation target with a price-stability objective defined as an inflation band like the 0–2% range used in Switzerland. Five working groups have been set up to examine these and other issues. In the meantime, the Fed must balance higher prices against robust growth, fueled by a secular AI-led investment boom. Markets expect some tightening, but reduced tensions in the Middle East could ease inflation pressures and allow the Fed to remain on hold for longer. As the economy continues to expand at or above trend, estimated at around 1.8%, monetary policy does not appear too restrictive.

Worst avoided for Europe?

The surge in energy prices threw yet another wrench into the works of the European economy. A return to pre-war levels should allow the region to avoid another recession and prevent the ECB and other central banks from tightening further. More needs to be done at the structural level to lift European growth and avoid the recurring cycles of slump and recovery. For now, modest expansion is the best forecast for this year.

Emerging-market resilience

Most analysts expected that the energy price and supply shock following the US attacks on Iran would seriously impact energy-importing emerging-market economies. Arguably, many faced sudden shortages, slumping activity, and surging prices. Nevertheless, the worst was avoided. China had accumulated massive crude inventories, which it decided to draw down rather than chase barrels in the tight global market. The slowdown in economic momentum observed during the second quarter was due to a lack of domestic confidence, not the war in the Middle East. In India, weakness was concentrated in the gas-dependent industries, while broader domestic demand remained firm. Overall, diversified supplies, access to alternative sources of energy, and lower energy intensity per unit of GDP shielded much of the EM complex and point to recovering growth momentum.

Table 1: Real GDP growth (y/y in %)

	2025E	2026F	2027F	Short-term trend
United States	2.2	2.1	2.1	→
Eurozone	1.5	0.6	1.2	→
Germany	0.3	0.6	1.1	↗
United Kingdom	1.4	1.0	1.1	→
Japan	1.2	0.6	0.8	↗
China	5.0	4.6	4.4	→
India	6.4	7.5	6.6	↘
Russia	0.9	0.8	1.3	→
Brazil	2.3	1.9	1.8	→

Table 2: Consumer price inflation (y/y in %)

	2025E	2026F	2027F	Short-term trend
United States	2.7	3.4	2.5	↘
Eurozone	2.1	2.9	2.2	→
Germany	2.2	2.7	2.3	→
United Kingdom	3.4	3.2	2.5	→
Japan	3.2	2.0	2.1	↗
China	0.0	1.2	1.2	↘
India	4.6	2.0	5.0	↗
Russia	8.8	5.5	4.5	→
Brazil	5.0	4.7	4.0	↗

Source: Bloomberg, HBZ

INVESTMENT STRATEGY

Time for active management

Financial markets focused on the US-Iran war for about a month. As soon as the US looked for a way out, the attention switched back to the theme of our age, AI. Mounting risks, such as sector concentration and underlying inflation trends, favor more active management.

Key points

- High single-stock volatility offers opportunities for active managers
- Target neutral allocation for equities
- Earnings and rates the key market drivers

Dispersion as an opportunity

US equity market risk, as measured by the S&P 500's volatility of returns, is currently below its long-term average of 18. Single-stock volatility, meanwhile, the volatility of individual S&P constituents, is above 48, almost one-and-a-half times its long-term average. The spread between the two metrics is close to twice the long-term difference. While a risk manager may smell trouble, a portfolio manager will view this more like an opportunity. In other words, markets have started to discriminate between individual stocks, between the potential winners and possible losers of the fast-evolving early days of the age of artificial intelligence. On the surface, market forces have combined to create one of the highest degrees of concentration in history. However, the so-called Magnificent 7 have already lost some of their luster, delivering negative returns year-to-date and underperforming the S&P 500 index by almost 10%. Other industries as disparate as semiconductors and utilities, yet also related to the AI theme, have outperformed both, albeit by significantly different margins. Passive investments may therefore no longer beat active managers as handsomely as in recent years.

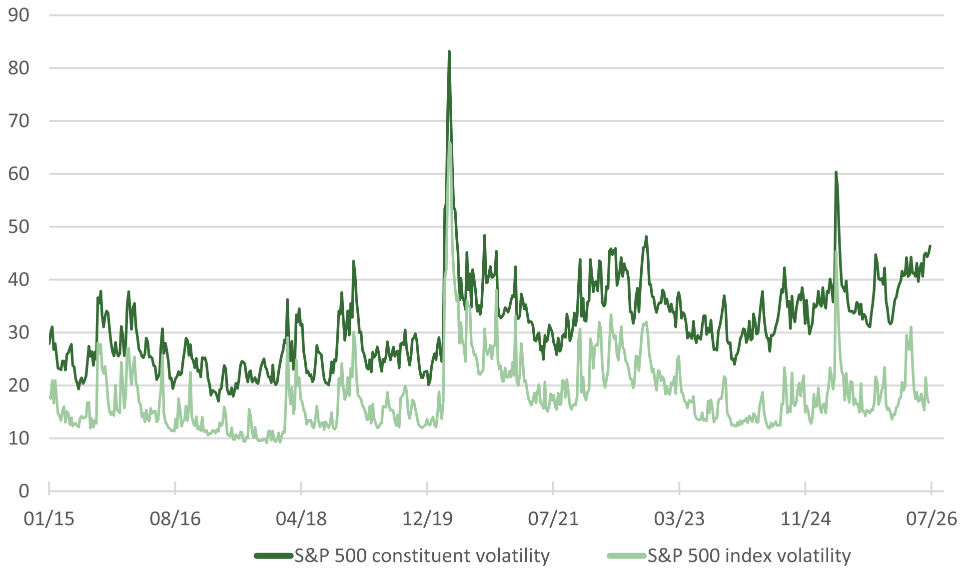
Our current positioning

The uncanny resilience of global markets to the shock emanating from the war in the Gulf took us by surprise. In the meantime, we have gradually increased our net exposure to equities to neutral once again while remaining underweighted in fixed income. We continue to maintain material exposure to gold as a diversifier and to hedge against the probable return of USD weakness.

What we are watching

The earnings season could change everything. With some of the strongest profit growth outside a post-recession recovery in the first quarter, companies will have to deliver against high expectations for the remainder of the year. The quick recovery after the initial phase of the war in the Middle East makes stocks vulnerable in case of disappointment. Inflation surged as a result of the recent energy price shock. Any settlement between the US and Iran could quicken a return to pre-war price levels, and this could buy central banks time to consider whether tighter monetary policy will indeed be required.

Lower market volatility masks greater single-stock dispersion



Source: Bloomberg, HBZ

FIXED INCOME

Markets set to test Fed's resolve

The second quarter brought a broad repricing of global policy as central banks pushed back against sticky inflation. The current quarter will be less about expectations and more about confirmation: whether incoming data justifies further tightening or allows yields to stabilize.

Key points

- Global central banks remain restrictive as inflation persists
- Incoming data will decide whether further tightening is warranted
- Higher yields support carry, quality credit, and selective duration exposure

Global central banks remain restrictive

The second quarter marked a repricing in fixed-income markets as central banks pushed back against easing expectations. The Fed removed its easing bias at the June FOMC meeting, while the ECB raised its policy rates by 25 bps in June, the Reserve Bank of Australia held at 4.35% after earlier increases, and the Bank of Japan continued its gradual normalization process. Together, these moves confirmed that inflation remains too persistent for policy to turn supportive quickly. Services inflation, elevated energy prices, and fiscal supply concerns continue to slow the disinflation path. The oil and energy price shock has added volatility to headline inflation, while resilient labor markets keep wage pressures in focus. At the same time, large public deficits and heavy bond issuance continue to place upward pressure on term premiums, the compensation for locking in rates for longer, particularly at the long end.

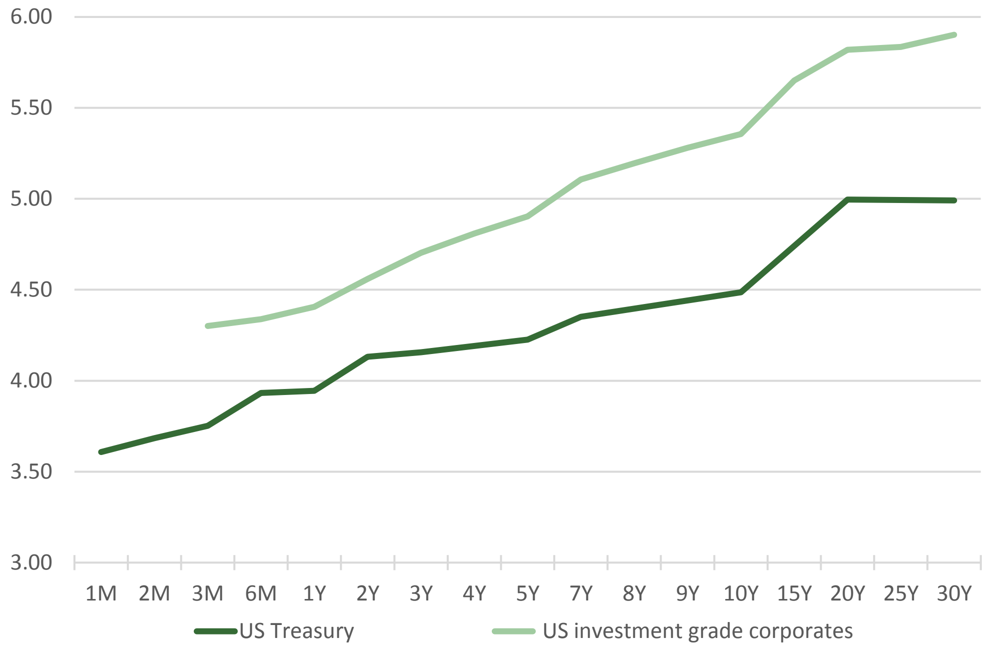
Data to determine the next move

After the recent repricing, markets now require confirmation. Strong inflation or labor data would keep another Fed hike in play and could push yields higher. Conversely, softer employment or clearer evidence that inflation will roll over following the jump during spring will support a prolonged pause and allow bond markets to stabilize. The Fed therefore remains the principal catalyst for the next move in global bond markets, even as other central banks reinforce the higher-for-longer message. Volatility is likely to remain elevated around each CPI inflation release, payrolls report, and central bank presser, as investors reassess the impact on policy rates.

Investment implications

Higher yields have restored the income appeal of fixed income, but policy uncertainty argues against taking undue duration risks. We continue to favor high-quality investment-grade credit, in both developed and emerging markets, where all-in yields offer attractive carry without materially increasing credit (default) risk. Intermediate maturities look more compelling after the sell-off, especially if inflation gradually moderates and policy expectations stabilize. Carry, quality, and disciplined duration management remain the core pillars of fixed-income investments.

Higher yields restore appeal of quality credit (% p.a.)



Source: Bloomberg, HBZ

EQUITIES

Earnings test for AI-driven market

The current reporting season will be a critical test of whether earnings will continue to support equity markets. With growth increasingly concentrated in AI-related stocks, attention is shifting to margin pressures, rising input costs, and the sustainability of the hyperscalers' spending plans.

Key points

- Q2 earnings set to test elevated expectations
- AI-related companies the primary growth drivers, with focus on monetization and ROI
- Diversification, active stock selection, and hedging remain essential

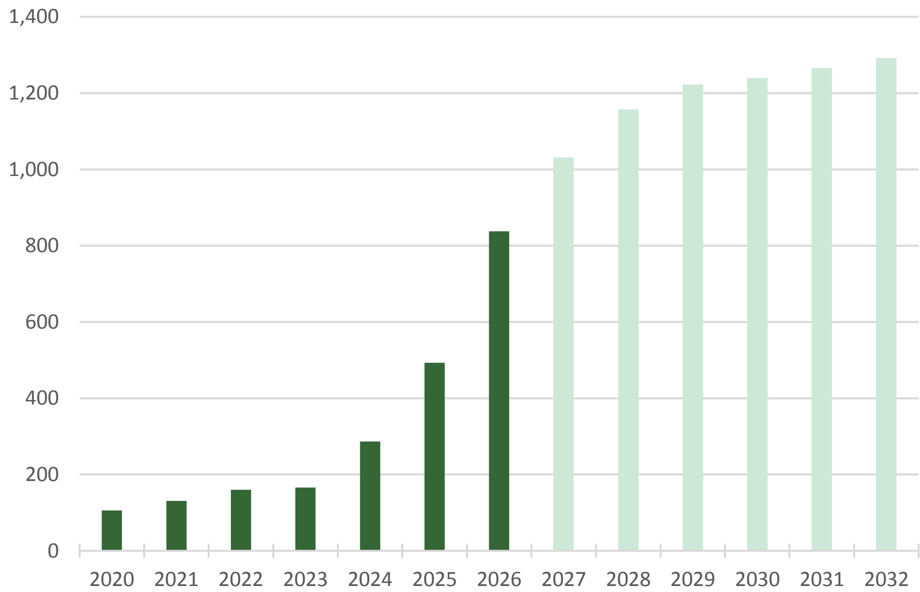
Watch the margin dynamics

Despite volatile geopolitics, higher headline inflation, and higher real rates, equity markets showed great resilience in the second quarter. The S&P 500's return of some 23% over the past year has been driven entirely by earnings. With valuation multiples no longer expanding, delivery against still-high expectations is key for the Q2 earnings season. Consensus forecasts call for 21.8% annual EPS growth, supported by a resilient macro backdrop and continued AI-related investments. However, growth remains highly concentrated in a narrow group of technology leaders, leaving the broader market more exposed to idiosyncratic risks despite some recent broadening beyond the mega caps. Margin dynamics will be a key focus. Given that companies have only been able to pass on part of higher energy costs so far, they are still feeding into the real economy. Tight supply in high-bandwidth memory and leading-edge processing chips is increasing input costs. This raises the bar in terms of pricing power and increases the disparity between companies able to protect margins and those facing erosion. Hyperscalers are still increasing their spending on AI infrastructure, which is supporting strong demand across semiconductors, networking, and data center ecosystems. Beyond the US, parts of Emerging Asia represent another set of key beneficiaries of AI-related demand. The focus, though, has shifted from the pace of spending to its efficiency and returns. While near-term visibility remains good, uncertainty around the trajectory of 2027 capex is building, and history suggests that revisions are likely as planning cycles evolve. Investors will therefore look closely at revenue growth and monetization trends at hyperscalers, particularly after recent share price volatility.

An uneven earnings landscape

All things considered, the backdrop points to a more uneven earnings landscape, with rising cost pressures, concentrated growth drivers, and evolving capex visibility, reinforcing the importance of selectivity and active positioning. Longer term, the regime appears to be shifting from globalization to localism, from deregulation to regulation, and from falling to increasing real rates, giving way to higher macro volatility. In this new world, earnings growth is likely to drive returns, while scope for further multiple expansion appears limited. It is precisely during such shifts that active selection, diversification (within and beyond AI), and selective hedging provide the most value.

Hyperscalers still ramping up their capex (USD billlion)



Source: Bloomberg, HBZ

COMMODITIES AND FX

Beyond the war

The second ceasefire in the US-Iran conflict initially sent crude oil prices plunging, easing short-term pressures. Gold also took a dive, hit by the end of investor exuberance and higher US real rates. The US dollar firmed up, although downside risks are appearing once again.

Key points

- Crude oil may head lower once supply normalizes
- Gold in consolidation mode
- US dollar supported by real rates; weakness set to return eventually

Where is crude oil headed?

After the initial announcement of the extended ceasefire in the Middle East, crude prices quickly fell back to their pre-war levels. The opening of the Strait of Hormuz, although still tenuous at the time of writing, has brought tens of millions of barrels back to the market and put to rest fears of any near-term supply crunch. Equally important, some empty vessels have started to return to the Gulf despite the recent flare-up of hostilities. The starting normalization of supply has brought back concerns about a possible glut; China has yet to resume its imports at pre-war levels, and US exports are at all-time highs. The desire of major Gulf producers to regain lost market share suggests that more long-term downside pressure is on the cards. Nevertheless, volatility could return quickly following the momentous drawdown of strategic reserves, including in the US, where they reached the lowest level since the early 1980s. Renewed disruptions at Hormuz could send prices sky-high in no time.

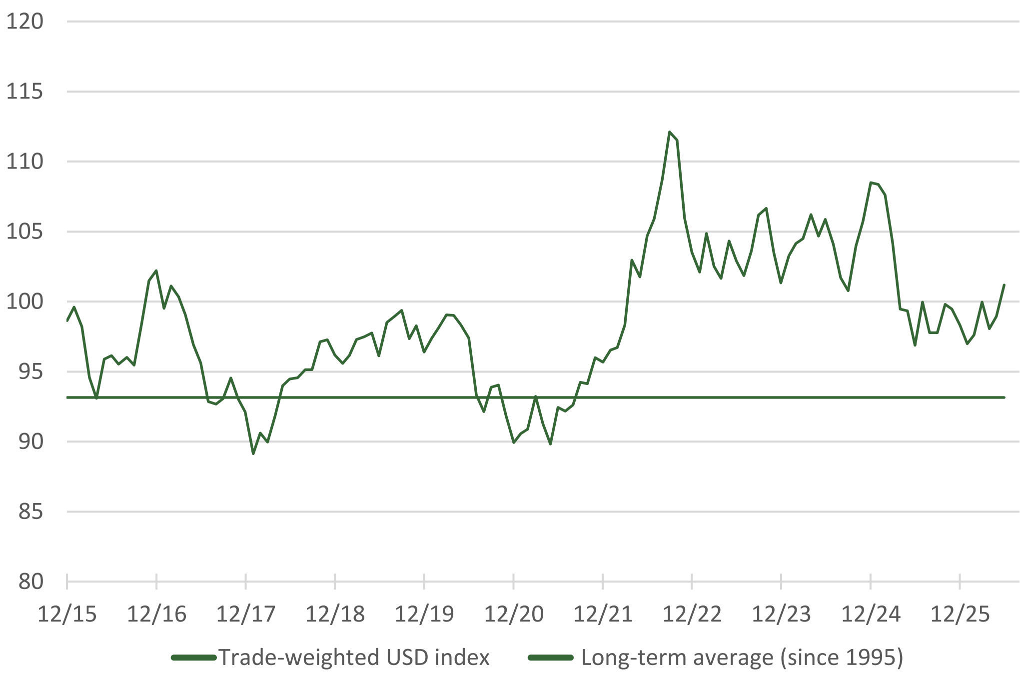
Froth taken out of gold trade

Gold retraced all gains made since the last quarter of 2025; the euphoria did not last. Record-high prices and then the war triggered profit-taking and outright selling, including by some central banks whose economies were particularly stressed by the war, such as Russia and Turkey. At a price of around USD 4,000/oz., meaningful retail demand has yet to return. Meanwhile, the metal has become the single most important reserve asset for central banks; key buyers in past years, their appetite for additional purchases may be more limited in the near term, although gold's appeal as a sanction-proof asset remains intact.

US dollar expensive

The US dollar staged a recovery following the outbreak of the war when risk aversion gripped markets. Somewhat surprisingly, the prospect of a long-term settlement further lifted the currency, pushing it to its highest level in more than a year. High US real rates, a revised rates outlook, resilient growth, and a booming stock market all turned out to be important supports. The long-term outlook, however, remains challenging, and suggests renewed weakness ahead: mounting government debt with no signs of serious efforts to contain it, a retreat from global engagement, and high asset valuations count among the main risk factors.

USD remains expensive



Source: Bloomberg, HBZ

KEY MARKETS

Weathering the storm

As tensions in the Middle East begin to ease, our key markets are emerging from a testing period. The UAE is rebuilding after facing direct disruption, Pakistan is stepping up as a mediator, and the UK is turning to fresh leadership to navigate the aftermath.

Key points

- Pakistan managing strain of war effectively
- Building new resilience in the UAE
- Burnham promising fresh leadership for the UK

Pakistan: managing conflicts

With an erupting conflict in a neighboring country, Pakistan faced stress around energy supply, inflationary pressures, and overall uncertainty over its outlook. Despite this, the nation has navigated the period quite effectively, playing a key role in de-escalating the conflict as a mediator between the US and Iran, managing its finances responsibly, and proactively steering monetary policy. Foreseeing the pick-up in inflation, the State Bank raised its policy rate once the conflict had gone beyond two months. Higher energy prices led to the current account balance turning into deficit in April, still cushioned by sustained remittance inflows. When the UAE declined to roll over a loan, the timely release of a tranche from the IMF facility and the first issue of a CNY-denominated bond prevented worse. Together with ongoing central bank purchases, reserves have grown to USD 15.9 billion, with further inflows anticipated in the near term. The government banks on fiscal consolidation and austerity measures to deliver a primary surplus of 2.0% of GDP for the next fiscal year.

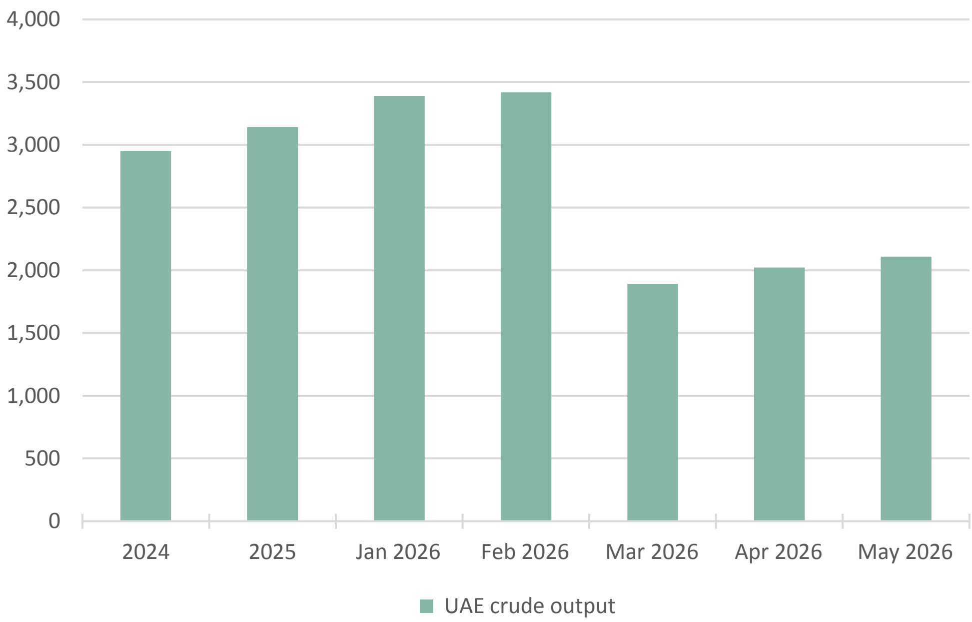
UAE: caught in the crossfire

Embroiled in the regional conflict, the UAE has faced disruption in key sectors. The closure of the Strait of Hormuz materially restricted the nation's oil exports, trade flows, and tourism-related sectors. Real estate transactions have also fallen from the previous year's highs. Despite this, the economy is expected to continue expanding owing to its strong fiscal position and targeted support measures. Currently, central bank estimates project a rate of expansion of 1.7% in 2026. While the UAE welcomes de-escalation, it is already applying some lessons: The country exited OPEC to be able to increase crude output and stepped up pipeline capacity to reduce reliance on the Strait of Hormuz for oil exports.

UK: a new plan

The war on Iran has indirectly touched the lives of people in the UK as well. But following higher energy costs and the urgency to increase defense spending, a change of prime ministers has now created fresh pressure on the nation. So far, leader-in-waiting Burnham has promised adherence to fiscal rules and a commitment to not expanding income or corporate taxes. In this complex context, the Bank of England refrained from raising the base rate, considering overall fiscal conditions already sufficiently tight.

Iran conflict stymies UAE crude output (in thousand bpd)



Source: OPEC, HBZ

SPECIAL TOPIC
Lessons from the Iran war

Wars are often watershed moments as simmering tensions come to a head, bringing to the surface facts that were hidden or merely ignored. It is no different with the fateful US-led attack on Iran. Who would have expected the world economy simply to take it on the chin and move on?

Key points

- Lower oil intensity and large reserves absorb some of the price and supply shock
- US power is no longer what it used to be
- Diversification matters in a world of scarcity

Resilience in the face of adversity

Contrary to most expectations, the global economy coped well with the closure of the Strait of Hormuz and the daily loss of some 10 to 12 million barrels of crude. Several factors help explain this fortuitous outcome. For one, global growth has become less dependent on oil and, more generally, less energy intensive. China, for example, the world's manufacturing hub, has reduced its use of energy per unit GDP by two-thirds over the past 35 years. Moreover, a growing share of the world's primary energy comes from renewables such as solar and wind. Second, China, a main destination for fossil fuels from the Middle East and the world's second-largest consumer of oil, reacted to soaring prices by cutting its crude oil imports by almost 40%, instead drawing on vast stocks amassed when prices were low. As a result, there was less competition for the barrels which did reach the market. Finally, users apparently resorted to options rather than futures to hedge their oil risks, considerably reducing the pressure on traded crude prices.

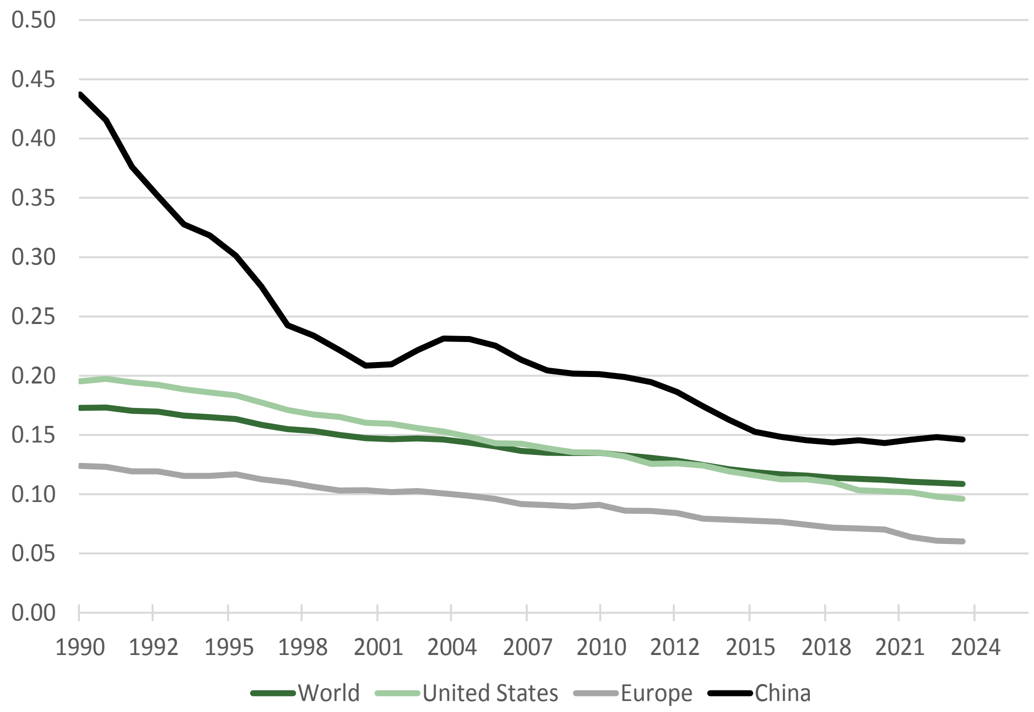
Limits to US power

The folly of Trump's war becomes fully apparent when we contrast his initial demands – "unconditional surrender" – with the terms of the recent agreement to extend the ceasefire, which leaves Iran in a stronger position than before bombs started falling. Of course, the US is far from being a spent force, but its absolute power advantage is declining. The erratic behavior displayed by the current administration forces other nations to hedge their bets and consider alternative alliances and arrangements for their economic and military security. China is clearly waiting in the wings but seems to struggle to operate in the chaos of the modern world.

Takeaways for investors

Financial markets recovered remarkably swiftly from the initial shock, as investors realized that the US economy and its financial markets were better insulated than most from the war. After all, the country is the world's largest oil producer. More importantly, investors kept their sights on the AI-led transformation which, at least until now, has remained largely a US story. What are the early lessons for investors? Don't write off the US yet but diversify more broadly. Commodities matter in a world of scarcity and belong in most portfolios.

World needs fewer barrels to grow (koe/USD PPP 2015)



Source: Bloomberg, HBZ

MARKET SUMMARY DATA

As of 6 July 2026

Equity indices	Last	–3M %	YTD %	–3Y %
BBG World USD	3,158.4	13.0	11.3	69.4
S&P 500	7,483.2	13.2	9.3	69.6
EuroStoxx 50	6,396.1	12.4	10.4	51.5
FTSE 100	10,654.7	2.1	7.3	46.3
SMI	14,345.7	10.5	8.1	30.6
Nikkei	69.737.7	30.6	38.5	112.8
BBG EM USD	2,475.8	17.7	20.9	74.5
Sensex 30	78,285.1	5.6	-8.1	19.0
KSE 100	187,538.0	23.9	7.7	324.2
Hang Seng	23,616.3	-6.0	-7.9	27.4
Brazil Bovespa	174,070.3	-7.5	8.0	48.2

Bond indices	Last	–3M %	YTD %	–3Y %
BBG US Gov	2,437.93	0.2	0.1	10.9
BBG US Corp	3,569.62	0.8	0.7	18.1
BBG US HY	2,974.15	1.9	2.0	30.1
BBG Euro Gov	249.35	1.2	0.8	9.5
BBG Euro Corp	269.04	1.9	1.2	16.3
BBG EM Sov	468.27	3.4	2.1	33.3
DB EM Local USD	192.78	2.3	1.0	21.8

Currencies vs. USD	Last	–3M %	YTD %	–3Y %
DXY	101.08	1.1	2.8	-2.0
EUR/USD	1.14	-1.1	-2.7	5.0
USD/CHF	0.81	-1.0	-1.5	11.2
GBP/USD	1.33	0.8	-0.9	4.9
USD/JPY	162.30	-1.6	-3.3	-11.2
AUD/USD	0.69	0.3	3.9	4.8
USD/CAD	1.42	-2.1	-3.5	-6.0
USD/ZAR	16.22	4.0	1.9	17.9
USD/INR	95.40	-2.5	-5.8	-13.5
USD/PKR	278.16	0.4	0.7	-0.5
Gold oz.	4,157.79	-10.8	-3.8	117.7

Interest rates	3M % p.a.	10Y bond % p.a.
USD	3.75	4.46
EUR	2.32	2.93
GBP	3.77	4.78
CHF	-0.05	0.33
JPY	0.39	2.83
AUD	4.45	4.79
CAD	4.97	3.43
ZAR	7.00	8.34

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