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War in the Middle East injects meaningful risk to otherwise favourable macro outlook



Eric Savoie, MBA, CFA, CMT
Senior Investment Strategist
RBC Global Asset Management Inc.

Coordinated attacks by the U.S. and Israel on Iran began on February 28, 2026, and have introduced a new meaningful macroeconomic risk. Military conflicts rarely escalate to the degree that they negatively affect economies and markets for more than a few months, and we would expect the current situation to be no different (Exhibit 1). We acknowledge, however, that the range of potential outcomes for the economy and markets has widened. Iran and the Middle East are a key source of energy for the world and, should the conflict extend beyond a few weeks, restrictions to oil supply and/or higher crude prices could hinder economic activity and/or weigh on investor sentiment. While headlines can invoke fear, a path to a positive outcome is also possible should a resolution come before the economy sustains excessive damage.

Exhibit 1: Market response to acts of war

Returns and median statistics

	S&P 500 Peak to Trough	US 10-year yield change (bps) from S&P 500 peak to trough	Gold change from S&P 500 peak to trough	DXY change from S&P 500 peak to trough	Crude oil (WTI) change from S&P 500 peak to trough	Trading days of S&P 500 decline	Trading days to S&P 500 recovery
Acts of War (median of all 41 events)	-3.0%	0	1.5%	0.3%	0.7%	5	12
U.S. Aggressor (median of 13 events)	-1.4%	9	-1.0%	0.5%	0.3%	5	11
U.S. Target (median of 6 events)	-5.2%	-6	1.1%	-1.9%	0.8%	10	12
Assassinations (median of 2 events)	-0.6%	0	n/a	n/a	n/a	2	2
External (median of 11 events)	-5.4%	17	3.3%	0.5%	2.5%	13	18
Terrorism (median of 9 events)	-3.0%	-4	3.4%	-0.2%	-3.9%	5	12

Note: Please refer to the table in the Appendix for a list of all the events captured in this table. Source: Bloomberg, Macrobond, Ned David Research, RBC GAM

Risk assets suffered significant declines, led by international equities

As a result of the increased uncertainty in the outlook, stocks have encountered significant volatility especially in international markets. Exhibit 2 plots the performance, in U.S. dollars, of a variety of major indices as well as S&P 500 sectors. U.S. stocks have held up the best so far, declining less than 1% (or even increasing slightly in the case of the Magnificent 7), while major equity-market indices in Japan, Europe and emerging markets declined anywhere from 5% to 7% since Friday, February 27. From a sector perspective, Energy has outperformed, rising slightly so far this week supported by the spike in oil prices, while every other sector has declined, with losses led by Materials.

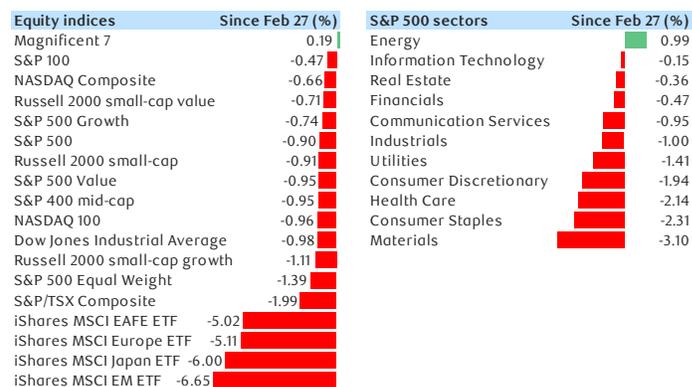
Aside from Iran risk, global economy is in solid shape with activity picking up

Global fundamentals were in solid shape when hostilities erupted last week, with leading indicators suggesting that economic activity was picking up (Exhibit 3). Growth has been supported by increased fiscal stimulus, a year-long decline in interest rates and a surge in capital spending related to the build-out of artificial intelligence (AI). Our overall assessment is that the economic cycle is in its later stages, and barring a meaningful escalation in the Middle East conflict, we expect that the expansion has room to run. As a result, our base case expectation is for continued growth over this year and next, and our GDP forecasts are slightly above the consensus.

Tariffs and AI disruption remain important themes

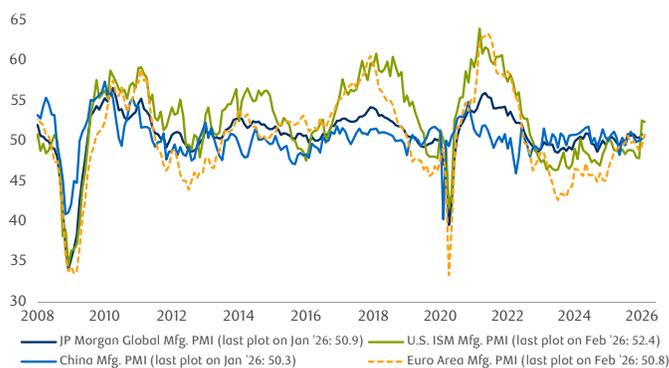
In addition to geopolitical tensions, our base case view could be impacted by other risks such as higher U.S. tariffs and disruption from AI. The drag from tariffs has temporarily slightly eased after U.S. Supreme Court’s decision last month to block a number of Trump’s tariffs, though the administration immediately invoked a 1974 trade law to impose a 10% global tariff (with threats to increase it to 15%). Tariff rates are overall a bit lower when all is said and done (Exhibit 4). AI is the other risk that requires analysis. On one hand, AI provides significant productivity benefits to the companies and the economy in general (Exhibit 5). On the other hand, the widespread use of AI could eliminate many businesses and displace workers, both of which would weigh on employment and amplify worries about value of stocks and debt in the software industry.

Exhibit 2: Equity performance since February 27, 2026
In U.S. dollars, as of March 3, 2026



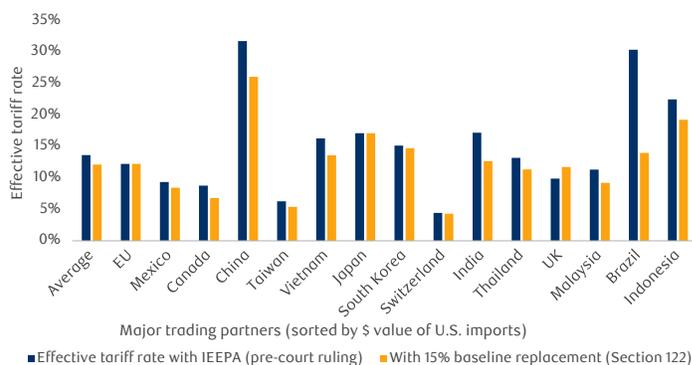
Note: Sorted from best to worst. Source: Bloomberg, RBC GAM

Exhibit 3: Global purchasing managers’ indices



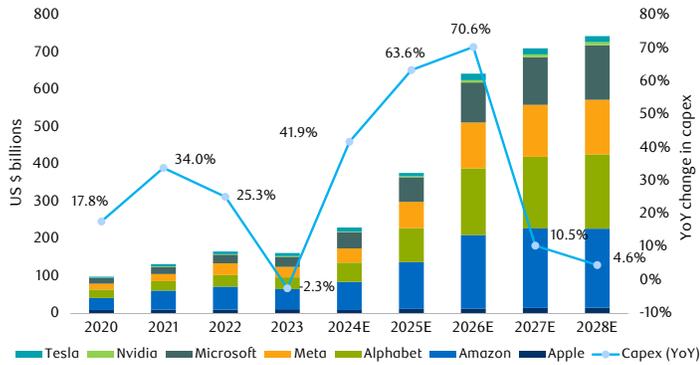
Source: Macrobond, RBC GAM

Exhibit 4: U.S. effective tariff rate before and after IEEPA ruling



Notes: As at 03/02/2026. Source: Evercore ISI, RBC GAM

Exhibit 5: Magnificent 7 capital expenditures



Note: As of March 3, 2026. Source: Bloomberg, RBC GAM

Most central banks on hold for now, Fed likely to cut again in second half of 2026

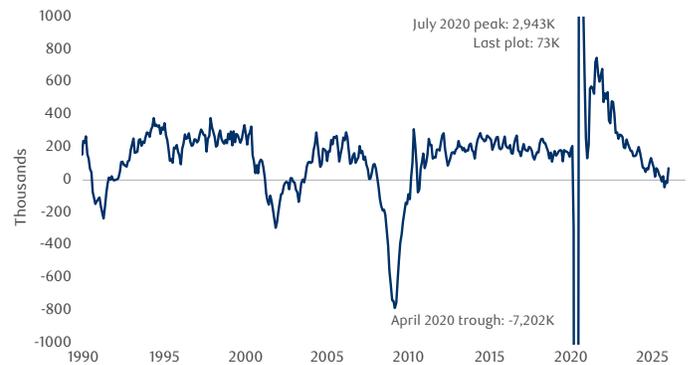
Against this backdrop, the U.S. Federal Reserve (Fed) has paused interest-rate cuts for now, indicating that the monetary relief delivered so far is sufficient to support the labour market without reigniting inflation concerns (Exhibit 6 and 7). The war in the Middle East complicates the picture, because higher energy prices would make it more difficult for consumer inflation to fall to the Fed’s 2.0% target. That said, investors still believe economic conditions will allow newly appointed Fed Chair Kevin Wash to resume interest-rate cuts ahead of November’s midterm elections. The futures market is pricing in 50 basis points of U.S. rate cuts by year-end, with the next 25-basis-point cut pencilled in for this summer (Exhibit 8). Importantly, the market is not pricing in any further easing by the European Central Bank or Bank of Canada over the year ahead, and our forecasts are in line with pricing in fixed-income markets.

Competing forces sway sovereign bond yields, expect low single digit returns

Government bond yields fluctuated over the past quarter as investors weighed the effects of elevated government debt levels and stimulative global fiscal policies amid an uncertain macroeconomic environment. The U.S. 10-year yield rose to as high as 4.30% in late January but retraced toward 4.00% as demand for safe-haven securities increased in light of geopolitical worries. Although, since the attacks in Iran, the U.S. 10-year yield rose once gain by about 10 basis points to as high as 4.10% as investors priced in higher odds that inflation could nudge higher due to the spike in energy prices.

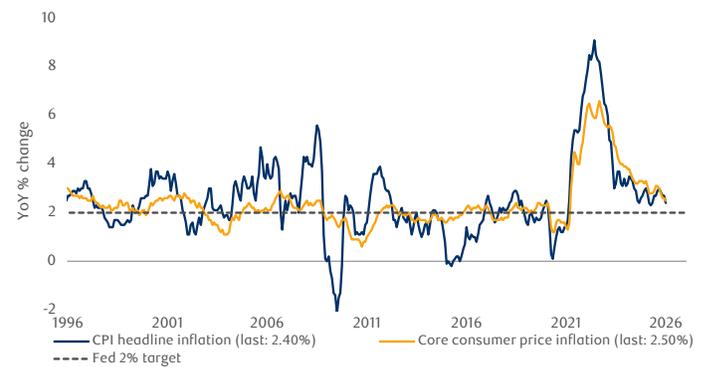
Exhibit 6: United States

Monthly change in non-farm employment (3mma)



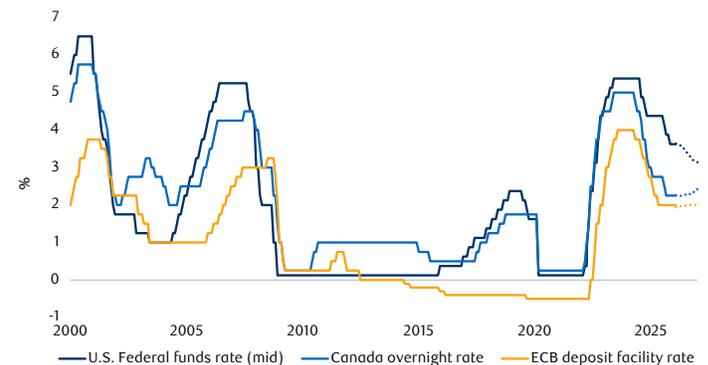
Note: As of January 2026. 3mma = 3-month moving average. Source: Bureau of Labor Statistics

Exhibit 7: U.S. inflation measures



Note: As of January 31, 2026. Source: Bloomberg, RBC GAM

Exhibit 8: Central bank policy rates



Note: Forecasts, shown as dotted lines, are based on futures for the U.S. and OIS forwards for other regions. As of March 3, 2026. Source: Bloomberg, RBC GAM

At current levels, yields are slightly above our modelled estimates of equilibrium across most major bond regions that we track, representing only modest valuation risk as long as inflation continues to calm (Exhibit 9). That said, we recognize that a strong economic backdrop fuelled in part by fiscal spending could limit the extent of any further declines in yields from here, and we look for low single-digit returns on sovereign fixed income over the year ahead. Corporate debt offers slightly higher return potential, but we caution that historically narrow credit spreads offer investors little reward for taking on the risk that corporations default on their financial obligations in an economic downturn (Exhibit 10).

Prior to Iran conflict, global stocks rallied in the first two months of 2026

Carrying the strong momentum from 2025, global equities extended their gains into 2026 prior to the outbreak of war in Iran. Most major markets climbed to records, led by non-U.S. regions, amid a robust economic backdrop and strong corporate-profit growth. The MSCI World Index rose 2.9% in U.S. dollars between January 1 of this year and February 27. Japanese equities rose 17.1% and emerging markets 14.7% during that period, while the S&P 500 eked out a 0.5% gain (Exhibit 11). Valuations have crept higher, and our models suggest that stocks in the U.S., Canada and Japan are situated around one standard deviation above our modelled estimate of fair value (Exhibit 12). However, stocks in Europe, the UK

Exhibit 9: U.S. 10-year T-bond yield

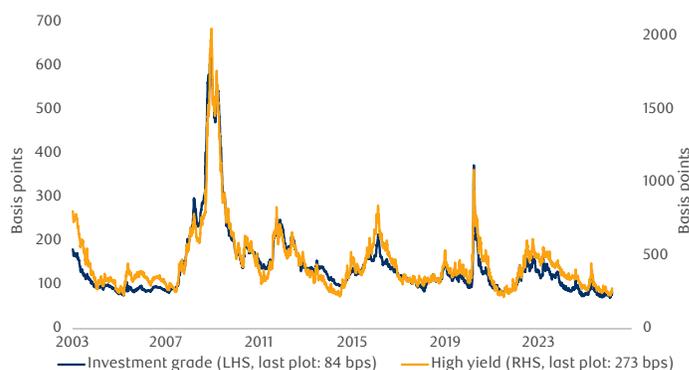
Equilibrium range



Note: As of February 28, 2026. Source: RBC GAM

Exhibit 10: U.S. corporate bond spreads

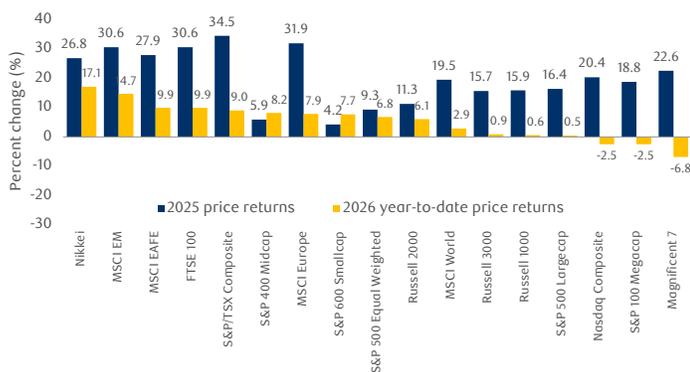
Difference with U.S. 10-year Treasury yield



Note: As of March 2, 2026. Source: Barclays Capital, Bloomberg, RBC GAM

Exhibit 11: Major indices' price change in USD

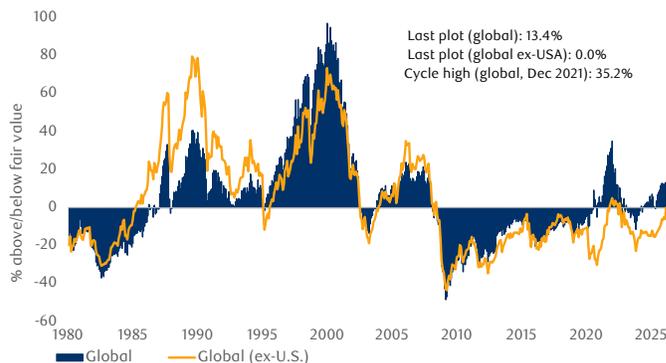
2025 & 2026 year-to-date (up to February 27)



Note: As of February 27, 2026. Magnificent 7 includes Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta and Tesla. Source: Bloomberg, RBC GAM

Exhibit 12: Global stock market composite

Equity market indexes relative to equilibrium



Note: As of February 27, 2026. Source: RBC GAM

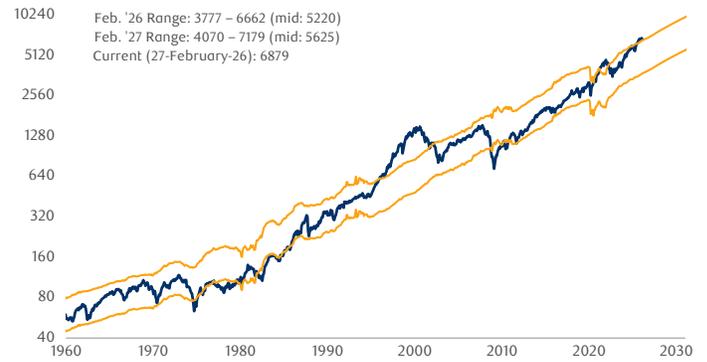
and emerging markets remain at attractive distances below fair value and represent greater opportunities for gains as a result. Overall, our base case view, which we now recognize is subject to larger uncertainty due to the war in Iran, looks for mid-to-high single-digit returns for stocks over the year ahead, with the higher end of those returns being generated in regions outside of North America.

Strong corporate-profit backdrop is reflected in demanding S&P 500 valuations

The hefty premium investors are willing to pay for stocks in regions like the U.S. could be justified as long as corporate profits continue to grow at a rapid pace (Exhibit 13). Analysts look for S&P 500 profits to rise 15% this year and by the same percentage in 2027 (Exhibit 14). These estimates have been raised in recent months, reflecting corporations' impressive ability to increase profit margins even against a backdrop of rising input costs (Exhibit 15). Helping the bottom line are the benefits from AI, which in addition to supporting the earnings of technology companies, but producing efficiency gains for AI adopters. That said, AI is expected to disrupt a number of industries and investor expectations are elevated, and stocks would therefore be vulnerable if the profit outlook disappoints.

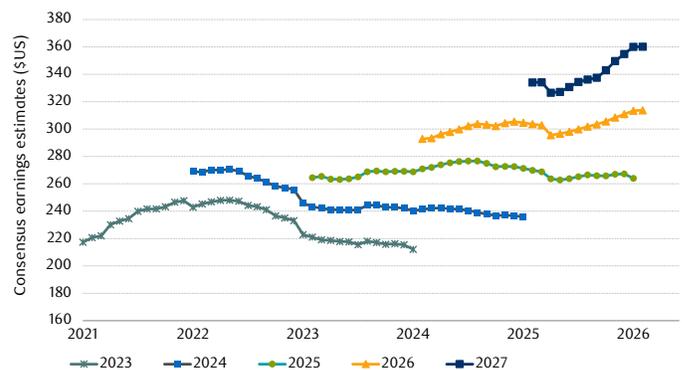


Exhibit 13: S&P 500 equilibrium Normalized earnings & valuations



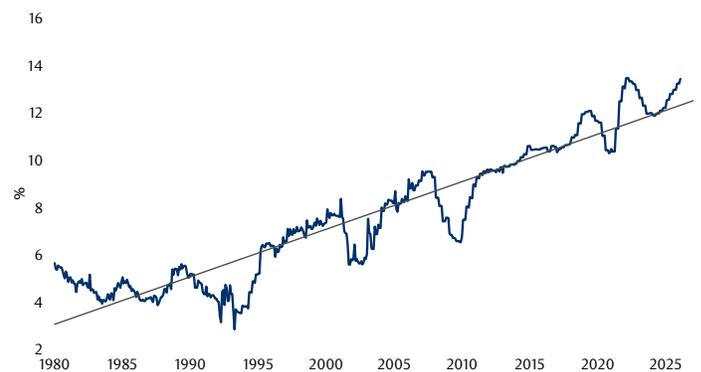
Source: RBC GAM

Exhibit 14: S&P 500 Index Consensus earnings estimates



Note: As of February 27, 2026. Source: Bloomberg, RBC GAM

Exhibit 15: S&P 500 Net Margin



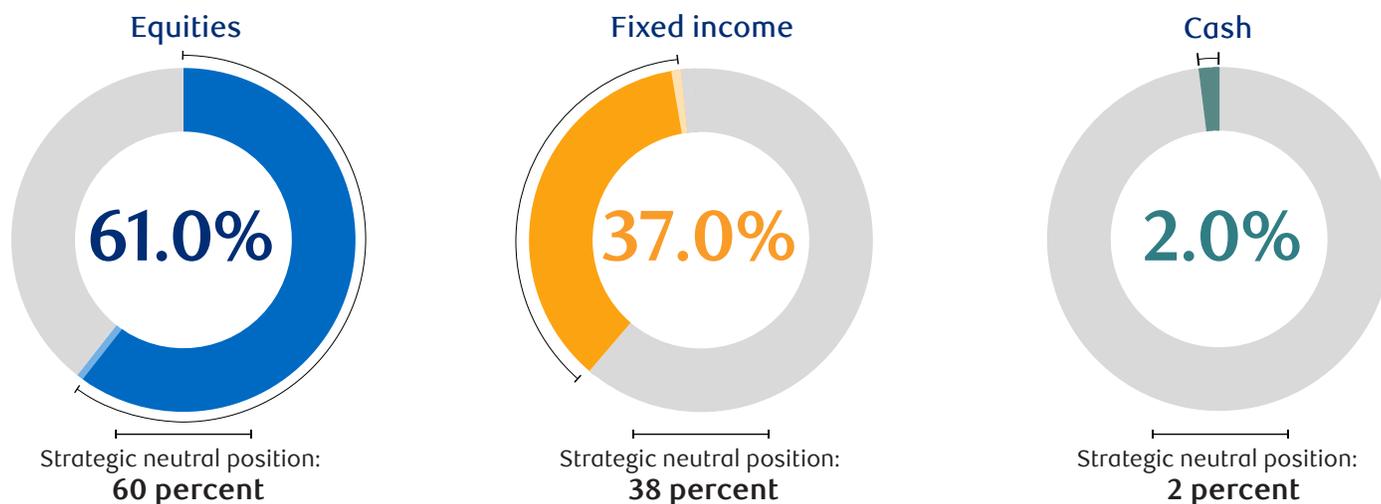
Note: As of February 27, 2026. Source: RBC GAM

Asset mix: expanding underweight in U.S. equities and boosting overweight in non-U.S. equity regions

Our asset mix recommendation considers the balance of risks and opportunities amid the macroeconomic backdrop, with a nod to withstanding a variety of possible scenarios, as well as reflecting what’s being currently priced into financial markets. In our base case scenario, the Middle East conflict has limited impact on broader economic growth and inflation pressures subside later in 2026, allowing the Fed to resume interest-rate cuts. Against this backdrop, we expect

government bonds to deliver low single-digit returns. While gains in the perhaps overvalued S&P 500 may be limited (i.e. mid-single-digit returns), we still see potential for attractive returns (i.e. high-single-digit returns) in regions outside of North America, where valuations are more appealing. As a result, our asset mix is positioned with a slight overweight in stocks, with a meaningful tilt that we expanded this quarter toward non-U.S. equities. Our current recommended asset mix for a global balanced investor is 61.0% equities (strategic “neutral”: 60%), 37.0% bonds (strategic “neutral”: 38%) and 2.0% in cash (Exhibit 16).

Exhibit 16: Recommended asset mix
RBC GAM Investment Strategy Committee



Note: As of March 3, 2026. Source: RBC GAM

APPENDIX

Exhibit 1A: Market response to acts of war

Returns and median statistics

	Date	S&P 500 Peak to Trough	US 10-year yield change (bps) from S&P 500 peak to trough	Gold change from S&P 500 peak to trough	DXY change from S&P 500 peak to trough	Crude oil (WTI) change from S&P 500 peak to trough	Trading days of S&P 500 decline	Trading days to S&P 500 recovery
Acts of War		-3.0%	0	1.5%	0.3%	0.7%	5	12
US Aggressor		-1.4%	9	-1.0%	0.5%	0.3%	5	11
Hiroshima bomb	Aug 6, 1945	-1.4%					2	4
Bay of Pigs invasion announced	Apr 17, 1961	-3.4%					6	20
Gulf of Tonkin Incident	Aug 4, 1964	-0.8%	-1				3	6
US Bombs Cambodia	Apr 30, 1970	-15.0%	40		0.0%		19	87
Attempt to free Iranian hostages fails	Apr 28, 1980							
US invades Grenada	Oct 25, 1983	-2.8%	16	-4.0%	2.1%	-0.3%	11	15
US Bombs Libya	Apr 15, 1986							
US invades Panama	Dec 18, 1989	-0.4%	0	1.2%	0.5%	0.7%	2	3
Coalition bombing of Iraq	Jan 17, 1991							
Coalition Invasion of Afghanistan	Oct 5, 2001	-1.4%	9	-1.0%	0.5%	0.3%	3	4
Invasion of Iraq	Mar 19, 2003							
U.S. kills top Iranian commander	Jan 3, 2020							
U.S. captures Venezuelen president	Jan 3, 2026							
US Target		-5.2%	-6	1.1%	-1.9%	0.8%	10	12
Japanese bomb Pearl Harbor	Dec 8, 1941	-6.7%					16	20
U-2 shot down; US admits spying	May 9, 1960							
Cuban Missile Crisis begins	Oct 23, 1962							
US Marines killed in Lebanon	Oct 24, 1983							
Spy plane captured in China	Apr 2, 2001	-3.7%	-6	1.1%	-1.9%	0.8%	3	4
Snowden Releases NSA files	Jun 6, 2013							
Assassinations		-0.6%	0	n/a	n/a	n/a	2	2
Martin Luther King assassinated	Apr 4, 1968	-0.6%	0				2	2
Robert Kennedy assassinated	Jun 5, 1968							
External		-5.4%	17	3.3%	0.5%	2.5%	13	18
N.Korea invades S.Korea	Jun 26, 1950	-7.9%					16	65
Soviet Union invades Afghanistan	Dec 26, 1979							
Iraq invades Kuwait	Aug 2, 1990	-12.6%	63	8.3%	-3.0%	38.3%	16	135
Russia Invasion of Georgia	Aug 7, 2008							
Egypt's Hosni Mubarak removed	Feb 11, 2011							
Syria Uprising begins	Mar 15, 2011	-1.9%	-13	0.2%	0.5%	0.8%	2	4
Libya – Muammar Gaddafi Overthrown	Aug 28, 2011							
Russia invades Crimea, Ukraine	Feb 28, 2014	-0.7%	-5	1.8%	0.5%	2.4%	2	3
Russia invasion of Ukraine	Feb 24, 2022	-4.8%	17	3.3%	2.5%	12.5%	12	15
Hamas attack on Israel	Oct 7, 2023	-5.9%	28	7.0%	0.7%	2.5%	13	20
Israel attacks Iran	Jun 13, 2025							
Terrorism		-3.0%	-4	3.4%	-0.2%	-3.9%	5	12
Seizure of American Embassy in Iran	Nov 5, 1979	-1.9%	15	3.7%	-0.2%	0.5%	3	5
World Trade Centre bombing	Feb 26, 1993							
Oklahoma City bombing	Apr 19, 1995							
U.S. Embassy Bombings Africa	Sep 23, 1998	-10.0%	-11	3.4%	-3.5%	-5.6%	12	20
Bombing of USS Cole	Oct 12, 2000							
WTC and Pentagon Attacks	Sep 11, 2001	-11.6%	-14	7.2%	-1.5%	-7.8%	10	18

Note: Highlighted rows show median statistics. Source: Bloomberg, Macrobond, Ned David Research, RBC GAM

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