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Quarterly Review and Outlook

The first quarter of 2026 was marked by downside pressure in stock indices with notable volatility in certain sectors. The S&P 500 index finished down 4.2% for the quarter, while the NASDAQ finished lower by 7.0%. Stocks came under pressure particularly in March following the start of the Iran War in late February. The consequential 50% increase in oil prices sparked investor concern about rising inflation and what the impact on economic activity would be, thereby weighing on equity valuation multiples. A rotation away from the "Mag 7" stocks into small-mid capitalization and international stocks was a noticeable shift in the investment landscape. The "Mag 7" stocks, including Alphabet (Google), Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla, underperformed as investors questioned the return on investment (ROI) of these companies' massive amounts of capital spending to build data centers and procure AI (artificial intelligence) compute power. Investors also debated whether AI programs will disintermediate traditional enterprise software applications which led to downside pressure in software stocks. Financials stocks also came under pressure based on recently rising interest rates following the start of the Iran war. Unsettled conditions in the private credit market, particularly relating to loan quality and the ability to meet investor redemptions, added to the downside pressure. Meanwhile, "old economy" stocks such as those in the industrials, energy and basic materials sectors, rose to lead performance.

US military engagements during the quarter triggered investor nervousness and amplified stock market volatility. The first strike was in Venezuela in early January which resulted in the capture of the country's leader, Nicolas Maduro. He was replaced with Delcy Rodríguez, Maduro's second in command. The Trump administration has made clear she is beholden to follow its edicts, including those related to the country's oil production and exports.

In Iran, the US and Israel launched joint military attacks beginning February 28th, killing the country's leader, Ayatollah Ali Khamenei, and ~40 top officials. Iran has retaliated by bombing US allied nations in the Middle East, targeting military sites and oil processing facilities. The result has been a rapid rise in oil prices from ~$65/barrel pre-conflict to a peak of ~$120/barrel. As we go to print in early April, oil is trading at $110/barrel. The sharp move higher in oil prices has ignited investor concern about inflation, resulting in upward pressure on bond yields. Iran, with drone strikes and mine threats, effectively closed the Strait of Hormuz where ~20% of worldwide oil passes. In response to world oil supply disruptions, the International Energy Agency (IEA), which includes all G-7 nations, decided in mid-March to release about 400 million barrels of strategic energy stockpiles which should help ease oil market tightness to some degree.

Leading up to President Trump's evening address to the nation on April 1st, the stock market rallied ~4% on reports the president was willing to end the Iran war in short order. Various news sources quoted him as saying that the US will be "out of Iran pretty quickly" and will return "if needed for spot hits." However, market optimism faded following his April 1st speech. While President Trump confirmed that he plans to conclude US military involvement in Iran over the next two to three weeks, he stated he would not refrain from striking Iran "extremely hard" in the ensuing period. He also confirmed that negotiations are ongoing and that Iran will be continuously watched by satellite. Additionally, he reiterated the administration's policy of ensuring that "Iran will not have any nuclear weapons." The President's comments about the prospect of continued bombings unnerved investors as oil prices rose by ~10%, sparking an initial stock market decline. As we go to print on April 2nd, the market has been buoyed by subsequent reports that Iran is drafting a protocol with Oman aimed at facilitating maritime traffic through the Strait of Hormuz.

A key question for investors will be how Iran responds to the prospective US military withdrawal, particularly regarding their willingness to open the Strait of Hormuz for oil tanker and other commodities traffic. President Trump stated in his nationwide address that the US will leave it to others to open the strait. Time will tell how it plays out, but our best guess is that Iran will reopen the Strait of Hormuz, albeit possibly not right away, as most of their oil is destined for non-participants in the war, including Asian countries, notably China, as well as the European Union.

Turning to the private credit market, write-offs of certain loans and worries about loan quality have resulted in redemption requests by investors. These requests have only been partially fulfilled by underlying fund managers, consistent with the "gating" terms in investment agreements that restrict redemptions as a percent of total assets. The private credit market represents only ~10% of the total corporate bond market; nonetheless, we are keeping a close eye on developments in this area. While recognizing the potential for additional headlines, we believe private credit concerns are unlikely to reach the threshold of "systemic risk." A significant majority of these loans are held by institutional investors rather than on the balance sheets of money center banks or other financial firms deemed to be systemically important financial institutions (SIFI's).

Given the rise in oil prices and uncertainty engendered by the war, the Federal Reserve at its March 18th meeting decided to keep interest rates unchanged. The Fed faces a delicate balancing act between the threat of higher inflation and a weakening job market. On that count, the February employment report came in much weaker than expected, showing a decline of 92,000 workers vs. a strong January. Inclement weather and a healthcare workers strike may have been factors. The 10-year US Treasury bond yield ended the quarter at ~4.35%, up ~15 basis points since the beginning of the year and up ~40 basis points from the low reached in February. The rate rise reflects investor concern about an oil price driven spike in inflation. Upon the conclusion of military action in Iran and presumed reopening of the Strait of Hormuz, the price of oil could be expected to decline. This would provide the Fed more leeway regarding monetary policy and would help to reinvigorate investor confidence.

Turning to the domestic economy, thus far in 2026 inflation remains sticky in the mid-high 2% range. This is above the Fed's target of 2%, but the long-term trend has been down. The Fed at its mid-March meeting indicated that with the economic and inflationary impact of the Iran war still ahead of us, it would likely remain in a "wait and see" mode as data is forthcoming. With respect to pre-war economic conditions, the Fed in late January initiated a 25 basis point cut in the Fed funds rate in response to a weakening job market. Employment growth last year came in at an historically weak level of 15,000 (non-farm) jobs on average per month. Business leaders became cautious in their hiring plans following the implementation of Trump's "Liberation Day" tariffs over a year ago. The hiring rate year to date has been mixed with January up and February down. That said, solid US corporate profit growth, which is expected to be up by a mid-teens percent rate this year, should help sustain at least moderate employment gains this year. Some argue that AI might erode employment opportunities over time, but we do not see any widespread evidence of that occurring yet. We view AI investments and the deployment of agentic applications as tools that will likely be utilized widely across industries which should amplify corporate productivity beyond the current rate of ~2.8% and help boost company operating margins.

Of note during the quarter, the Supreme Court denied President's Trump's authority to impose tariffs under IEEPA, the International Emergency Economic Powers Act. As such, many companies are seeking the return of the tariff funds they paid over the past year along with interest from the federal government. The Supreme Court did not address the repayment issue and President Trump seems disinclined to make the repayment process an easy one. The path to repayment resolution will likely be a long and litigious one. Meanwhile, President Trump has indicated he will use other legally sanctioned tariff measures to maintain his de-facto tariff policies and trade agreements.

In this market environment, we have maintained our focus on high quality stocks with sustainable earnings growth prospects. With the conclusion of the Iran war seemingly in sight, investors can return their focus to company fundamentals and the outlook for top and bottom line growth. We believe it is earnings growth over time that drives long-term capital appreciation in stocks. We look for companies with defensible business moats, conservative balance sheets and strong management teams. Stocks are purchased at what we deem to be reasonable valuation levels and attractive return prospects. Our investments are focused in the technology, communications, industrial, healthcare, specialty finance and select consumer areas.

In the fixed income arena, we primarily invest in corporate, government or municipal bonds tailored to each client's tax status. We use a laddered investment approach which provides flexibility to reinvest client funds when individual bonds mature. Given recent upward pressure on interest rates, driven by inflationary concerns following the oil price spike related to the conflict in Iran, we have maintained a defensive posture by focusing purchases in the shorter end of the maturity curve. However, we anticipate the long-term trend lower in inflation will reestablish itself once the war concludes. At that point, a normalization of energy prices should provide the Fed greater latitude to resume a more accommodative monetary policy.

As always, we value your trust and would welcome hearing from you should you wish to discuss your investments or portfolio positioning.