

QUARTERLY REVIEW

March 31, 2026

Q1 Economic and Market Commentary

The first quarter proved to be one of the most turbulent in recent memory, shaped by a convergence of geopolitical shock, energy disruption, and persistent macroeconomic uncertainty. While we have used the adage previously “when decades happen in weeks”, the recent events involving the Iran war have caused us to resurrect the phrase again. A year that started with inflation trending lower, government fiscal spending flowing, Maduro’s extraction from Venezuela, and a Fed that seemed likely to cut rates at least twice, has morphed into uncertainty that is forcing investors to recalibrate Fed cuts, inflation expectations, GDP growth, and earnings forecasts. Of course, the length of the conflict will weigh on determining if the near-term impacts are merely transitory, or if the conflict extends what will be the longer-term impacts of higher energy prices as well as their flow through to other areas such as agriculture, semiconductor chips, and maritime insurance. The IEA has called this the largest oil supply shock since the 1970’s as roughly 20% of the world’s crude flows through the Strait of Hormuz. Brent crude started the quarter at nearly \$71 a barrel and reached \$120 at its peak. After hitting a new record high earlier in the year, the S&P index posted five consecutive weeks of losses, its worst streak since 2022. The quarter ended with the S&P posting a decline of 4.36%. At its worst point, the S&P experienced a drawdown of 9%, while the Dow Jones Industrial Average and Nasdaq did enter correction territory by declining 10% from their most recent highs. In a less headline worthy, but also significant event, the US Supreme Court ruled against the Trump administration’s use of the International Emergency Economic Powers Act on reciprocal tariffs as exceeding statutory authority. The administration responded by applying a 10% global import duty applied under Section 122 of the Trade Act of 1974. The market was near the point of “lapping” the tariff announcement from “Liberation Day” last April, and now tariff uncertainty has again become an unknown.

The Economy

GDP growth softened meaningfully from the Q3 level of 4.4% as Q4 GDP was revised down to a 0.7% annualized rate. The government shutdown in Q4 was a major contributor to slower growth. Forecasts for 2026 expect GDP in the 2%+ range, but the impact and duration of the war could dampen the outlook, especially if inflation expectations rise and cause consumers to pull back on spending. We continue to see a “K shaped” economy with higher income consumers doing well and lower income struggling. Retail sales are projected to grow 4.4% in 2026 but consumer confidence (which unexpectedly rose in March), could prove fleeting as consumers 12-month inflation expectations rose to 5.2% and survey comments indicated prices remain at the top of consumers minds. The jobs market has shown contrasting data, with the February report showing a shocking loss of 92,000 jobs, but the March report showed a surprising gain of 178,000 jobs. Unemployment has edged down to 4.3% and the Labor Force Participation Rate has fallen to 61.9%. This is reflective of an aging workforce and lower immigration. With fewer workers only small job growth numbers will be required to keep the unemployment rate from rising. Average Hourly Earnings only grew by 0.2% for the month and 3.5% year over year. There is a bifurcation between lower and higher income earners, with lower- and middle-income earners experiencing slower wage growth. Inflation remains above the Fed’s 2% target, with Core PCE rising by 0.1% last month to 3.1% year over year. Core excludes the more volatile components of food and energy, but other price increases such as transport and utilities that could be downstream of the higher energy prices of March will be reflected in coming reports. Tax refunds are higher in 2026 by 10 – 11% (averaging close to \$3700) because of the OBBA but also run the risk of being mitigated by higher energy prices. The Personal Savings Rate at 4.5%, while below longer-term averages, provides some cushion for consumers. We are also watching producer inflation as it leads to consumer inflation, and the most recent Core PPI showed an uptick as it increased to 3.9% year over year, a 3 year high. The implications of rising inflation and the uncertain impacts from the war have placed the Federal Reserve “on hold” with rate cuts for 2026, and currently Fed Funds Futures imply no rate cuts in 2026.

Market Review **First Quarter Market Recap:**

The quarter started with the market making new highs and was slightly positive YTD at the end of February. News of the Iranian strikes on February 27th sent the market lower by almost 5% for March, and down 4.3% officially for the quarter. The earnings reports for Q4 were supportive of the market and were the 5th consecutive quarter of double-digit EPS growth. The rotation away from the Mag 7 that started in the back half of 2025 continued, with the Mag 7 stocks all posting drops for the quarter that exceeded the index loss. For example, Microsoft declined 23%, Tesla -17%, Amazon -9.7%, and Nvidia -6.4%. With the large cap technology names dominating the weightings in the S&P 500, it's not surprising that the equal weighted S&P index outperformed the cap weighted index with a +0.6% return. Value stocks outperformed Growth for the second consecutive quarter (almost a 12% advantage over Growth in Q1), and small caps beat large cap stocks posting a positive return for the quarter. From a sector standpoint, Energy was the top performer at +38.2% driven by the rise in crude oil prices. Materials were the second-best performing group at +9.7%, followed by Utilities at +8.3%. There was a definitive non-AI feeling in sector returns in the quarter, with "old economy" areas doing well such as Industrials, hard assets, and infrastructure, as opposed to areas like Software that in some cases could be upended by AI tools. Sectors that lagged in Q1 were Financials (-9.3%), Consumer Discretionary (-9.2%), Technology (-9.1%), and Communication Services (-6.9%). Financials and Discretionary were hurt by the combination of rising interest rates and inflation. Higher inflation can slow growth as it cuts consumer demand and in turn the demand for loans and capital formation. We also saw increasing concerns over loans in the private credit market in Q1 (most of which are software-related). The tech software sector was down over 24% in Q1, and the phrase "SaaSocalypse" came into being to describe the fear of software companies with per seat licensing fees being disrupted by AI.

Stock Market Indexes

| Market/Index | 2025 Close | Q1 2026 Close | Month Change Total Return | YTD Change Total Return |
|--------------|------------|---------------|---------------------------|-------------------------|
| DJIA | 48063.29 | 46341.51 | -5.20% | -3.19% |
| Nasdaq | 23241.99 | 21590.63 | -4.68% | -6.96% |
| S&P 500 | 6845.50 | 6528.52 | -4.98% | -4.35% |
| Russell 2000 | 2481.91 | 2496.37 | -5.01% | 0.92% |
| IEFA | 89.46 | 90.53 | -7.92% | 1.20% |

What to Expect Going Forward:

One of the compelling aspects of working in investment management is that things constantly change. In merely 30 days a case could be made that the entire outlook for 2026 has been turned on its ear. We entered 2026 expecting better GDP growth driven by government spending and Fed rate cuts. Inflation seemed to be moderating and the job market slowing. Energy prices were expected to be well controlled as markets forecasted daily oil surpluses of as much as 4 million barrels. But now, inflation is a top concern, the Fed is most likely on hold, recession risk for European and Asian countries has risen due to higher energy costs, and consumer demand could be pinched as rising costs force cutbacks, which ultimately could lead to job losses even as we just experienced a strong jobs report. The one thing for now that has remained constant (if not actually better) is that earnings growth still looks strong with Q1 forecasted at +13.2% (revised higher from 12.8% at year-end), and full year 2026 at +17.4%. We would anticipate that as companies report Q1 earnings and provide forward guidance they will temper expectations. But the degree of negative revision will be contingent on the length of the war, and how quickly things can return to pre-war status, if at all. The economy is in a solid position, but stagflation could develop (slow growth with rising inflation). That would be a tough position for the Fed as rate cuts would fuel inflation, while rate hikes would further slow the economy. The 12-month forward market multiple is now 19.8X, which is only slightly higher than the 10-year average of 18.9X. The top 10 companies command a P/E of 20.8X, while the remaining 490 stocks sell at a less demanding 15.9X. Earnings for 2026 are now forecasted to grow 17.4%, with operating margins expanding to 19.7%. The tech sector is still forecasted to drive the bulk of eps growth for 2026, and South Korean exports which are a good leading indicator of the AI capex cycle for semiconductors continue to come in strong at +48% year over year in March. So, for now the profit outlook is solid. The Q1 performance of Financials and Consumer Discretionary attests to the market's aversion of interest sensitive groups and segments subject to consumers tightening their belts. We have learned over the years that when something becomes scarce it gets a premium price. If the economy were to slow, then companies that can still grow at an attractive rate will command a premium valuation, and that could portend a reversal in the Tech sector's recent performance. The group's earnings are forecasted to grow 37% in 2026, and this is up from a projected 29% at year end. Combined with the recent drop in Technology (sector multiple is now 21X forward earnings vs 23X a year ago and the 5-year average of 25.9X), if the earnings come through, we could see money flow back into the group. The forward outlook hinges acutely on the trajectory of the Iran conflict and the durability of earnings, both of which will come into clearer focus soon. In the meantime, our position is to remain invested, as any type of positive resolution is likely to result in some market recovery. Strategy and portfolio positioning can then focus on the earnings/inflation outlook as to how the rest of the year might unfold. The market has tended to look through geopolitical events, and we expect this time to be no different. In times of great uncertainty, it is wise to maintain a longer-term perspective, and that is what we will continue to do in the management of your assets.

Fixed Income Recap and Outlook

The first quarter of 2026 presented a challenging market environment for fixed income investors. While underlying economic data generally trended positive, broader macroeconomic developments ultimately drove market pricing and volatility. Early in the quarter, markets were focused on the potential economic and corporate implications of AI-driven disruption. Combined with easing inflation trends and downward revisions to job growth, this sentiment pushed Treasury yields approximately 20 basis points lower across the curve. By the end of February, the 10-year Treasury yield had fallen to 3.94%. This trend reversed abruptly in March following the military campaign in Iran. Heightened geopolitical risk and concerns over renewed inflation pressures drove yields higher, prompting markets to price in a small probability of a Federal Reserve rate hike. This marked a significant shift from prior expectations for rate cuts later in 2026. As a result, fixed income returns came under pressure as investors reassessed the longer-term implications of an extended period of elevated inflation.

Economic Data - Overall, the U.S. labor market continues to reflect a low-hiring environment. Nonfarm payrolls were volatile during the quarter, posting a gain of 126,000 jobs in January followed by a loss of 92,000 jobs in February. Meanwhile, declining unemployment claims reinforced the view of a labor market that is stable, but not yet robust. Inflation data sent mixed signals. January CPI surprised to the downside for both headline and core inflation; however, the Fed's preferred measure, PCE inflation, came in firmer than expected. While shelter-related disinflation continues to provide some relief, sticky service-sector inflation remains a concern. This underscores the dilemma facing the Federal Reserve as it balances a moderating labor market against inflation that has yet to return to target. Given this backdrop, the Fed remained on hold at both its January and March meetings, noting that "economic activity has been expanding at a solid pace," "job gains have remained low," and "inflation remains somewhat elevated." Entering the second quarter, policy consensus remains elusive, with some Fed officials favoring a prolonged pause, others anticipating modest easing, and a minority supporting multiple cuts.

Market Environment - The 10-year Treasury, which yielded 3.95% in February, ended the quarter at 4.33%, matching its highs from the summer of 2025. Despite heightened rate volatility and macro uncertainty, fixed income risk assets showed only modest underperformance. Issuance remained robust, with near-record investment-grade corporate supply totaling approximately \$660 billion during the quarter. Encouragingly, demand remained strong, as elevated all-in yields continued to attract investors.

Looking Ahead - The second quarter unfolds, markets will be shaped by competing forces. AI-driven productivity gains may support long-term growth while increasing equity volatility and pressuring labor demand. At the same time, inflation risks persist—not only from episodic energy shocks but also from sticky service-sector inflation. Together, these dynamics may leave the Federal Reserve constrained for the foreseeable future.