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Resilient growth amid uncertainty

Investor sentiment softened in the first quarter amid the Iran conflict, private credit default concerns, and profitability questions after heavy AI-related investment.

The S&P 500 fell -4.3% in Q1 as uncertainty over the Middle East conflict persisted and the Strait of Hormuz remained closed. Around 20% of the world's oil and liquified natural gas passes through the strait making it a central negotiating issue as both Iran and the US have blocked the strait sending energy prices sharply higher.

Offsetting these concerns, UBS analysts expect the strongest earnings in four years with 17% growth supported by solid consumer spending and a resilient labor market.

Private credit concerns have eased from the flurry of cautious headlines of recent months as banks and lenders report low systemic risk, despite a rise in troubled loans. Private loans have grown rapidly in recent years due to investor appetite for this higher yielding debt, which is popular with private equity. Corporate borrowers benefit from avoiding the costs and regulatory requirements of issuing bonds through the traditional banking system.

Mega-cap tech stocks struggled with AI-spending concerns, valuation pressure and rising scrutiny from investors. The shares in Magnificent 7 companies including Apple, Microsoft, Amazon, Google, Meta, Nvidia and Tesla were all down at quarter end between 5-20%, which weighed on the S&P 500.

Investors targeted software companies that sell per user licenses often called "software as a service," or SaaS, as potential losers to AI as this group was down beyond 20%. Some large



examples include Salesforce, Adobe and Intuit (owner of Quickbooks) that were down 30-40%. This may be an example of economist Joseph Schumpeter's "creative destruction" where innovation replaces or disrupts legacy business models.

	<u>1Q 2026 (%)</u>	<u>2025 (%)</u>
Dow Jones Industrials	-3.19	14.92
Standard & Poor's 500	-4.33	17.88
NASDAQ Composite	-6.96	21.14
Russell 2000	0.89	12.81
Russell MidCap	1.29	10.60
Russell 1000 Growth	-9.78	18.56
Russell 1000 Value	2.10	15.91
Barclays Capital Govt./Corp. Bond	-0.20	6.88
Barclays Capital 5 Year Municipal Bond	0.01	5.03
MSCI AC World ex US	-0.60	33.11

Source: Morningstar

Staying the Course

Despite the ongoing naval blockade, we remind readers not to throw your investment plan overboard!

Markets have since rebounded in April on de-escalation and optimism that the US-Iran conflict will reach a conclusion. Both sides appear eager to reach an agreement.

The S&P 500 has now gained +5% this year, and the quick reversal in sentiment reminds us of the futility in market timing. Buying or selling based on emotion often leads to trouble.

Our US strategy team led by David Lefkowitz has a 7,500 price target for the S&P 500 at year end, which is around 5% ahead of current levels. This implies close to a 10% gain on the year. He notes that further de-escalation and lower energy prices could push his target higher.

Earnings growth is the ultimate engine of stock returns, and the outlook remains encouraging for US businesses. Overseas, fiscal stimulus in the largest Asian and European economies can help support global growth despite near term headwinds from the conflict.

In the US, large investment by technology companies continues while other areas of the US economy are strong and accelerating, excepting the automotive sector. Energy and materials companies are doing well given the demand for oil and gas as well as the need for commodities like steel and copper given infrastructure demand. Consumer spending remains stable and the growing investment in US manufacturing and infrastructure is an enduring theme.

Bond investors continue to benefit from attractive yields for high quality issuers, and the new Fed Chairman, Kevin Warsh, will take over in May bringing some optimism that interest



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rates may decline later in the year as inflationary pressures cool. Mr. Warsh brings a solid reputation to a job which faces many political challenges in this difficult global environment.

The markets are familiar with the new Fed Chair and generally believe he is fully up to the job. The frequently mentioned concern is whether he will remain independent from President Trump, something Mr. Warsh has strongly assured will be his objective. Thus far markets seem comfortable. We'll see!

While tensions continue to exist in the Mideast (e.g. Strait of Hormuz), the "accepted wisdom" currently is that all the controlling parties have more to gain in seeking cooperative solutions. Markets globally would seem to confirm that expectation. There will continue to be threats to the contrary. Though most belligerent players seem to be seeking settlements rather than greater conflict, while "rattling swords" and pointing to missiles hidden in silos.

We, as undoubtedly you, hope to see reasonable minds prevail. Certainly the average Iranian, if press reports are correct, longs for respite from the horrific conflicts of the past many years of strife. The quest for peace may not be easily fulfilled, as "neighbors" (e.g. Ukraine) seek payback for past sins.

Financial markets have maintained relatively positive conditions in the expectation that the countries involved given the enormous costs, which have already been endured, will seek an honorable way to end the conflict to the benefit of all peoples affected in the region.

In the meantime, financial markets buoyed by growth and strong earnings have advanced on the year (S&P 500 as we write is ahead approximately 9% on a price only basis).

There likely will be some volatility ahead but corporate CEOs have generally been positive in their forecasts.

Conditions are positive but decidedly slower for many industries. Some clients have mentioned that they have "right sized" operations to deal with less robust business conditions. While AI (Artificial Intelligence) has been around for quite some time, clients more frequently tell us that they have really improved their operations.

Stocks continue to be valued at more than 20x earnings, high by historical standards. The costs of inflation have remained in the 2%-3% area. Although inflation numbers have increased more recently, leaving the annualized price change up around 3.5%. Long term numbers have averaged around 2.5%. While still reasonable, one needs to keep an eye on these changes recognizing that the Fed is seeking a number closer to 2.5%.



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There will be more focus on this as the numbers have risen, which began when they shut down the ACC Tournament in 2020 over concerns with Covid. All NCAA basketball fans will remember that!

Short of any epidemics or business shutdowns we see the environment sufficient to allow further upside over the balance of the year.

Maintain the diversification currently in your portfolios. Things are likely to slow down but still provide a pro-equity environment over the period ahead.

So hang in there and enjoy the rest of the spring. We wish you all a great summer with loved ones and friends.

Cheers!

Bill, Trammel, and Sarah



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