

Market Update: Q1 2026

The first quarter of 2026 has served as a stark reminder that financial markets rarely move in a straight line. While the year began with a sense of cautious optimism driven by resilient economic growth, the narrative shifted abruptly on February 28 following the onset of the joint U.S.-Israeli military campaign against Iran. We are writing to provide a detailed perspective on how these geopolitical events triggered a significant rotation in the stock market and a reversal in bond performance.

Stock Market Performance: A Tale of Two Chapters

The equity markets essentially experienced two distinct chapters this quarter. Before the conflict, the environment was relatively stable, buoyed by above-trend growth and continued investment in artificial intelligence (AI). However, the post-conflict period was defined by an energy supply shock that injected extraordinary volatility into the markets.

- **Broad Market Declines:** The S&P 500 fell -4.3%, marking its most challenging start to a year since 2022. The tech-heavy Nasdaq was hit even harder, entering correction territory in late March but recovering to end the quarter with a total decline of -5.8%.
- **The Great Rotation:** Beneath these headline numbers, we saw a powerful rotation away from the mega-cap technology stocks that dominated the last three years. As investors sought safety and inflation hedges, Energy stocks surged by a staggering 38.5%. Defensive sectors like Materials (+9.7%) and Utilities (+8.3%) also acted as safe havens. Conversely, previously leading sectors such as Financials (-9.5%) and Information Technology (-9.1%) were among the worst performers.

Key Takeaways

- Geopolitics drove volatility, with Middle East conflict triggering market swings
- In a reversal, energy surged while large-cap tech and financials declined
- Rate expectations shifted with rising oil prices reviving inflation concerns
- Opportunities may broaden beyond U.S.-based growth stocks

TOTAL RETURN AS OF MARCH 31, 2026

INDEX NAME	Q1 2026	1 YEAR	ANNUALIZED 3 YEAR	ANNUALIZED 5 YEAR
S&P 500	-4.33%	17.80%	18.32%	14.4%
Russell 2000 Small Cap	0.89%	25.72%	13.05%	6.1%
MSCI EAFE	-1.12%	21.88%	14.19%	9.5%
MSCI Emerging Markets	-0.10%	30.30%	15.41%	4.7%
Bloomberg US Agg Bond	-0.05%	4.35%	3.63%	-0.40%

SOURCE: BLOOMBERG

- **Small-Cap Resilience:** Interestingly, while large-cap stocks struggled, U.S. small-cap stocks (Russell 2000) showed remarkable resilience, finishing the quarter with a modest gain of approximately 0.9%.
- **AI Fatigue:** A new theme emerged as “AI fatigue” set in. Investors began demanding tangible proof

of profitability from massive AI investments rather than just infrastructure build-out. This shift led to a sell-off in companies deemed vulnerable to AI disruption, with Microsoft suffering its worst quarter since 2008, declining -23.3%.

For investors, this environment is a departure from strong equity returns we experienced in recent years. With valuations already reflecting a good deal of optimism, future gains are likely to be driven more by corporate earnings growth than by expanding valuation multiples. In other words, the market may continue to move higher, but at a more measured pace.

We also expect opportunities to broaden beyond the handful of sectors that dominated the last phase of the market. As economic activity recovers and earnings growth becomes more widespread, areas such as international equities, value-oriented companies, and select smaller-capitalization businesses may play a more meaningful role in portfolio returns.

Bond Market: From Rally to Reversal

The fixed income market followed a similar “two-chapter” trajectory. The quarter began constructively, with yields declining and the bond market rallying through February as inflation appeared to be moderating.

- **The Rate Reversal:** This rally was abruptly interrupted by the military strikes on February 28. The ensuing energy shock forced a fundamental repricing of the Federal Reserve’s path. Instead of the interest rate cuts many expected coming into 2026, the market is now pricing in the possibility of rate hikes to combat renewed inflationary pressures.
- **Yield Spikes:** The 10-year Treasury yield, which had fallen to a low of 3.97% just before the conflict, reversed course sharply to end the quarter at 4.33%.
- **Index Returns:** As a result of rising rates, the

Bloomberg U.S. Aggregate Bond Index gave up all its early-year gains to finish the quarter with a loss of -0.05%. High-yield bonds and municipal bonds also saw slightly negative returns, falling -0.50% and -0.18%, respectively.

Economic Outlook and Policy Conundrum

The closure of the Strait of Hormuz—a vital artery for 20% of the world’s oil—sent Brent crude surging 73% this quarter, introducing a genuine risk of stagflation (a combination of slowing growth and rising inflation). This puts the Federal Reserve in a difficult position, as raising rates cannot directly fix energy supply disruptions but may be necessary to prevent inflation from embedding into the broader economy. The inflationary impact of higher energy prices puts Fed policymakers in a bind, with markets predicting that the Fed will not cut rates at all in 2026. Meanwhile, the European Central Bank (ECB) put a planned interest rate cut on hold in March, and markets are pricing in one or two rate hikes by the ECB in 2026.

The path forward for the economy, at least in the near term, is now highly dependent on the ultimate scope and duration of the war in the Middle East, and its impact on energy prices and inflation. The response of policymakers and the trajectory of AI-related capital spending are other key variables that will likely impact the economy in 2026.

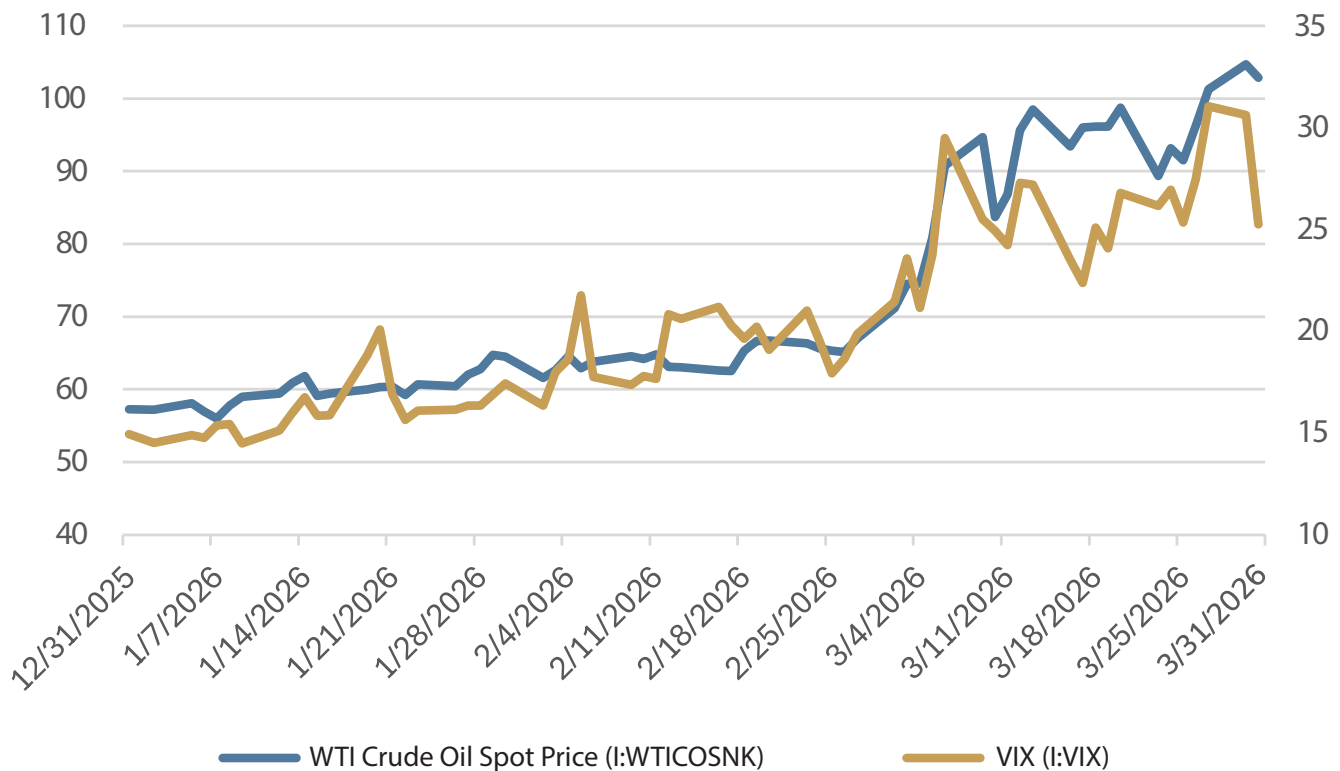
Outlook and Strategy

Despite these challenges, we remain focused on building resilient portfolios. History suggests that U.S. equities have a remarkable ability to eventually recover from military conflicts, and our economy remains on a relatively solid footing due to our high level of energy independence.

To navigate this complexity, we are:

- **Emphasizing Quality:** Tilting toward companies with durable earnings and strong balance sheets that can execute through a full market cycle.

PRICE OF OIL AND VOLATILITY INDEX SURGE IN Q1 2026



SOURCE: YCHARTS

- Broadening Exposure:** Diversifying across sectors and geographies to capture the broader market participation, while also looking for opportunities in “oversold” high-quality growth franchises.
- Active Management:** Utilizing active strategies to find value outside of the large cap U.S. stock universe, as well as, reviewing asset allocation policies with an eye toward ringfencing near term liquidity needs and mitigating portfolio volatility.

We cannot forecast the exact duration or scope of the conflict in the Middle East. Markets will likely continue to react to these developments in the near term. We are prepared for a wide range of outcomes and remain committed to a disciplined, long-term perspective. The investment landscape in the spring of 2026 is genuinely complex. But complexity, when properly navigated, can be a source of long-term portfolio returns.

Markets can be defined as forward-looking pricing mechanisms that attempt to incorporate future earnings, interest rates, growth and financial conditions into security prices. Despite the unstable market conditions facing investors today, history teaches a consistent lesson: periods of maximum uncertainty can be fertile ground for long-term wealth creation. The future may be different than what it was expected to be a few months ago, but these periods can offer a chance to harvest the opportunities created by volatility in a systematic manner, while remaining committed to a structured, long-term strategic investment plan.

As always, we appreciate your continued trust and support. Please do not hesitate to reach out to your advisor with any questions or concerns.

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