

Market Commentary

Dire Straits

Q1, 2026

Summary

- Geopolitical conflict, as well as concerns about the impacts of AI, shaped market returns in the first quarter.
- U.S. large-cap stocks ended the quarter down 4.3%, and U.S. small-cap stocks gained 0.9%. U.S. intermediate-term bonds ended the quarter flat.
- U.S.–Israeli strikes on Iran effectively closed the Strait of Hormuz. Crude oil surged from \$57 to \$101 per barrel in March. This pushed U.S. fuel prices to four-year highs, amplifying inflationary pressures.
- The “SaaSocalypse” pushed software stocks down 30–50%, the result of fears that AI dominance will threaten traditional software licensing models. Technology sector valuations fell to broader market levels for the first time in nearly a decade.
- Despite geopolitical-driven volatility, credit and futures markets remained stable, indicating that underlying fundamentals were stable and that patience, not reaction, may be the optimal strategy.

Overview

Geopolitical conflict, combined with increased uncertainty about the potential disruption from AI dominance shaped first-quarter returns. U.S. large-cap stocks (as proxied by the S&P 500 Index) closed at a new all-time high on January 27, but ended the quarter down 4.3%. U.S. small-cap stocks, as represented by the Russell 2000 Index, fared better, finishing the quarter up 0.9%. U.S. intermediate-term bonds (the Bloomberg U.S. Aggregate Bond Index) ended the quarter flat.

The U.S. economy added 205,000 jobs over the first three months of 2026. In February, however, jobs declined by 133,000, largely due to adverse weather conditions and worker strikes, but this notable decline was offset by a rebound of 178,000 new jobs in March¹. Overall, layoffs remain below 2025 levels when a wave of federal job cuts were cut after President Trump took office. In the first quarter of 2026, U.S. employers announced just over 217,000 job cuts—the lowest first-quarter total since 2022. The technology sector recorded the highest number of layoffs year-to-date (52,000 jobs cut), followed by transportation, which saw over 32,000 jobs lost.²

The quarter ended in the middle of tax filing season. So far, many taxpayers have received larger refunds than in recent years. This was driven primarily by the One Big Beautiful Bill Act (OBBBA). As of late March 2026, the average refund was \$3,521—up roughly 14% from a year earlier and the highest since 2022, according to the IRS.³

As expected, the Federal Reserve kept interest rates unchanged at its March Federal Open Market Committee (FOMC) meeting. According to projections, Fed officials no longer expect any changes in interest rates for 2026.⁴ Market expectations for the rate path fluctuated throughout the quarter, ranging from two 0.25% cuts to a small probability of a 0.25% hike, but ultimately converged with the Fed’s guidance for no cuts in 2026.⁵

Q1 returns were shaped by geopolitical conflict and AI-related concerns

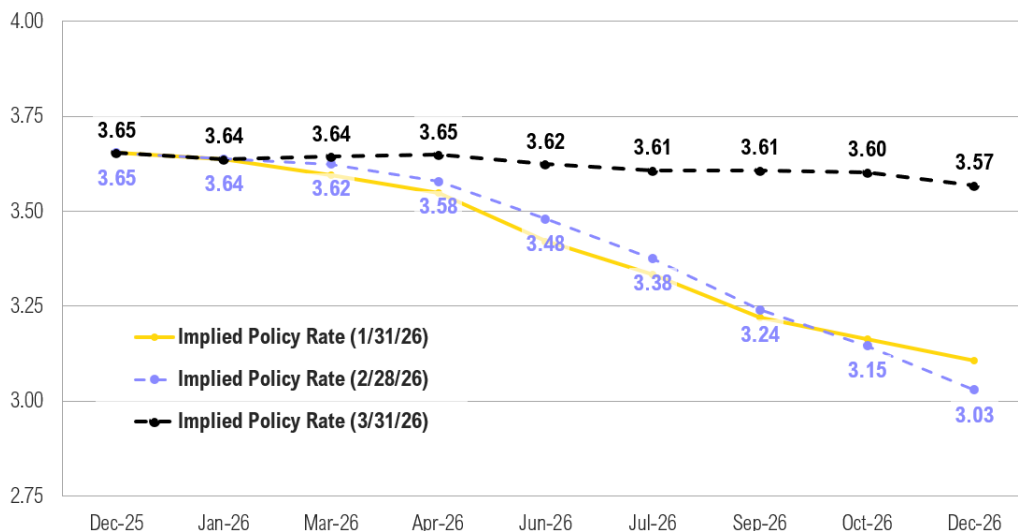
Layoffs remain below 2025 levels

Individual income tax refunds are 14% higher than last year

Current Fed Chair Jerome Powell's term ends in May, and Kevin Warsh has been nominated as his successor. His confirmation hearing was scheduled for April 16 but appears to have been delayed with a new date not yet scheduled.^{6,7}

Interest Rate Cut Expectations Fluctuated Throughout the Quarter

Implied Fed Funds Rate, %



Source: Bloomberg

Rate cut expectations ranged from two 0.25% cuts to a slight chance of a 0.25% hike

The 2025 earnings season concluded in March. S&P 500 earnings grew by a solid 14% for the year.⁸ Technology (+28%), communication services (+19%), and industrial (+14%) were the best-performing sectors.⁸ Looking ahead, earnings growth estimates for the first quarter have improved modestly, rising from 12.8% at the start of the year to 13.2% by the end of March. At the sector level, technology (+45%), materials (+24%), and financials (+15%) are expected to drive first-quarter earnings growth.⁸

Dire Straits

The Strait of Hormuz, situated between Iran and Oman and just 30 miles wide at its narrowest point, is one of the world's most critical energy chokepoints. Approximately 20 million barrels of oil per day, or nearly 25% of global seaborne supply, passes through the Strait via two unidirectional shipping lanes.⁹

On February 28, a coordinated strike by U.S. and Israeli forces targeted Iran's leadership, military command centers, air defense systems, missile launch sites, naval facilities, and elements of its nuclear and missile infrastructure. The initial strike killed Iran's Supreme Leader and much of the Islamic Revolutionary Guard Corps' command structure.¹⁰ Iran retaliated with a series of missile and drone attacks across the region, including strikes on Gulf energy infrastructure across Qatar, Saudi Arabia, the United Arab Emirates, and Bahrain.¹¹ In Qatar, attacks impacted a major domestic LNG producer, temporarily disabling roughly 17% of capacity, with repairs expected to take three to five years.¹¹

The conflict led to a de facto closure of the Strait of Hormuz, severely constraining global oil flows.¹² While non-U.S. and non-Israeli vessels have reportedly been allowed transit, overall traffic remains significantly reduced. As a result, export-dependent producers, including Iraq, Saudi Arabia, the UAE, Qatar, and Bahrain, collectively temporarily stopped or reduced output, reducing crude oil production by an estimated 7.5 million barrels per day in March.¹³

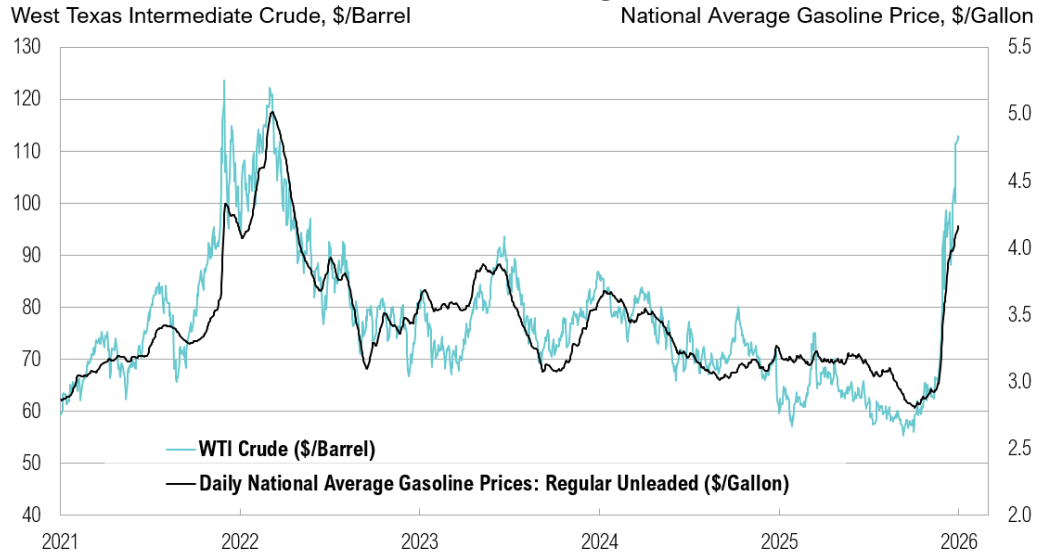
25% of the world's seaborne oil flows through the Strait of Hormuz daily

The U.S.-Iran conflict has led to a de facto closure of the Strait of Hormuz

National average gas prices rose to the highest since 2022

Crude oil and refined fuel prices surged in response. West Texas Intermediate (WTI) crude began the year at approximately \$57 per barrel and ended the first quarter at \$101 per barrel. U.S. retail fuel prices followed suit. By the end of March, national average gasoline prices reached \$4.06 per gallon, and diesel hit \$5.40, both the highest since 2022.¹⁴ In response, the U.S. announced a release of 172 million barrels from the Strategic Petroleum Reserve in March, although the phased deployment implies that meaningful relief is unlikely before mid-to-late July.¹⁵

Crude and Gasoline Prices in March Rose to Highest Levels Since Russia-Ukraine



Source: Bloomberg

In late March, the U.S. tabled a 15-point proposal to Iran (reportedly conveyed via Pakistan) aimed at curbing Tehran's nuclear and missile programs in exchange for phased sanctions relief and security guarantees.¹⁶ After President Trump ramped up threats further, a two-week ceasefire agreement was reached in early April.¹⁷

The outlook for energy prices remains highly dependent on the status of the Strait of Hormuz

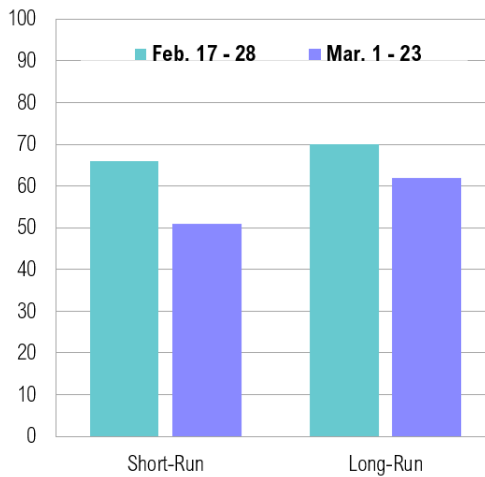
The outlook for energy prices remains highly dependent on the status of the Strait of Hormuz. Oil markets indicate the conflict is expected to resolve beyond a temporary ceasefire in the near future, and December futures ended March at around \$70 per barrel. The U.S. Energy Information Administration (EIA) has projected that the conflict will not extend significantly beyond April.¹⁸ Betting market probabilities suggested it will conclude by May 31.¹⁹ The EIA expects production shut-ins to peak in April before declining through the second half of the year. Retail fuel prices are expected to normalize, but not until year end.¹⁸ The slow normalization of energy prices is often referred to as a "rockets and feathers" effect. For example, fuel prices rise rapidly when crude oil increases, but fall more slowly when it declines. The lag is driven by both physical supply chain mechanics (since it typically takes four to six weeks for crude to be refined, distributed, and sold as gasoline) and retailer behavior.²⁰

Energy accounts for nearly 8% of U.S. inflation

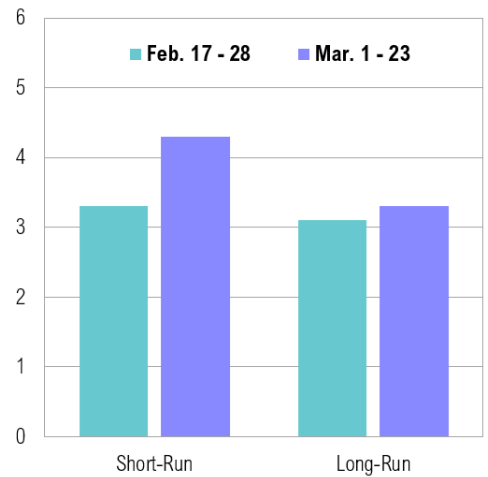
Energy accounts for between 7% and 8% of inflation, and it has further indirect effects on inflation via transportation, logistics, and production costs, creating broader but more gradual second-round inflationary pressures across goods and services.²¹ Headline inflation rose 0.9% month-over-month in March, reaching 3.3% year-over-year, as energy prices jumped by 11% in March.²²

Short-Term Consumer Expectations Worsened After Start of Iran Conflict

Expected Business Conditions*



Inflation Expectations, %



Source: University of Michigan. *Expected Business Conditions = % Favorable - % Unfavorable + 100

The U.S. government entered 2026 with affordability as a defining priority

The administration entered 2026 with affordability, including housing, credit card interest rates, healthcare costs, and gasoline prices, as a defining priority, a political narrative it built before the November midterm elections. The conflict in the Middle East and the subsequent closure of the Strait of Hormuz led to a surge in energy prices that has fed directly into rising inflation expectations and the increased likelihood of a stagflationary environment (slowing economic growth, higher unemployment, and rising inflation) in 2026.

The Middle East conflict has increased the likelihood of a stagflationary environment

The Cleveland Fed's inflation nowcast, the Atlanta Fed's GDPNow forecast, and survey-based measures such as the University of Michigan consumer survey point to a clear re-acceleration in inflation momentum and a slowdown in economic growth. The Cleveland Fed nowcast expects headline inflation to rise to 3.3% year-over-year in March and 3.6% in April, while the Atlanta Fed's GDPNow forecast for the first quarter fell from 3.1% in mid-February to 1.9% by quarter-end. Preliminary April results shows that the University of Michigan's one-year consumer inflation expectations increased from 3.8% to 4.8%.^{23,24,25}



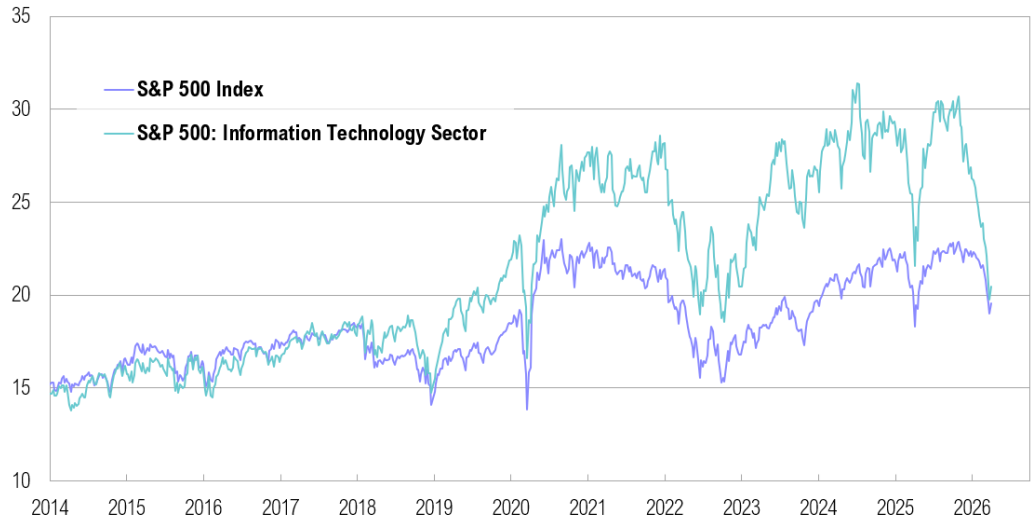
Source: SpringTide, Noah Kroese

In early February, software stocks fell on fears AI agents would disrupt licensing models

In early February, markets experienced a sharp sell-off across the technology sector, particularly in the software segment, amid rising concerns that AI agents will erode traditional per-seat licensing models. The move, dubbed the “SaaSocalypse,” was catalyzed by updates to Anthropic’s Claude model, which proved that more advanced AI models could handle complex tasks across different business systems.^{26, 27} The reaction was swift, pushing many into dire straits. Software stocks fell more than 30% from late-2025 highs, and some names declined by over 50%. After trading at a persistent premium for over a decade, software valuations compressed sharply, converging with S&P 500 price-to-earnings levels for the first time since the early 2010s.

Tech Valuations Have Declined to Market Levels For First Time in Nearly 10 Years

12-Month Forward Price-to-Earnings Ratio



Source: Bloomberg

After nearly a decade at a premium, software valuations compressed sharply

AI-related disruption is also now affecting employment data. Technology layoffs have increased year-to-date, as companies reallocate budgets toward AI investment and reduce roles—particularly in coding and support functions.² For example, Dell reduced its workforce by 10% over the past year, and Oracle reportedly cut 30,000 jobs.²⁸ While these changes are not yet broad-based, the direction is clear: AI is reshaping the workforce requirements in certain sectors, and companies are shifting budgets towards AI investments, increasingly at the expense of headcount.

Companies are shifting budgets to AI investments at the expense of headcount

Market positioning around AI remains crowded. “AI” was mentioned by a record 331 S&P 500 companies during fourth-quarter earnings calls.²⁹ At the same time, broader tech valuations decreased meaningfully. For example, Nvidia’s 12-month forward price-to-earnings ratio declined to 18.8x at the end of the quarter, its lowest level in at least five years.³⁰ Valuation compression occurred over the quarter, even as earnings expectations strengthened, rising from 29% at the end of 2025 to 37% growth for 2026 by the end of March. The tech sector is expected to deliver the strongest revenue growth across the S&P 500 in 2026 (23%), and positive guidance (64%) remains well above historical averages (32%).⁸

Tech valuation compression occurred even as earnings expectations strengthened

Markets

U.S. large-cap stocks declined by 4.3% over the quarter, but remain only 6% below all-time highs, a relatively muted drawdown considering we are experiencing the largest oil price shock since the pandemic and the most significant drop in the S&P 500’s largest

All things considered, the U.S. large-cap drawdown in Q1 was relatively muted

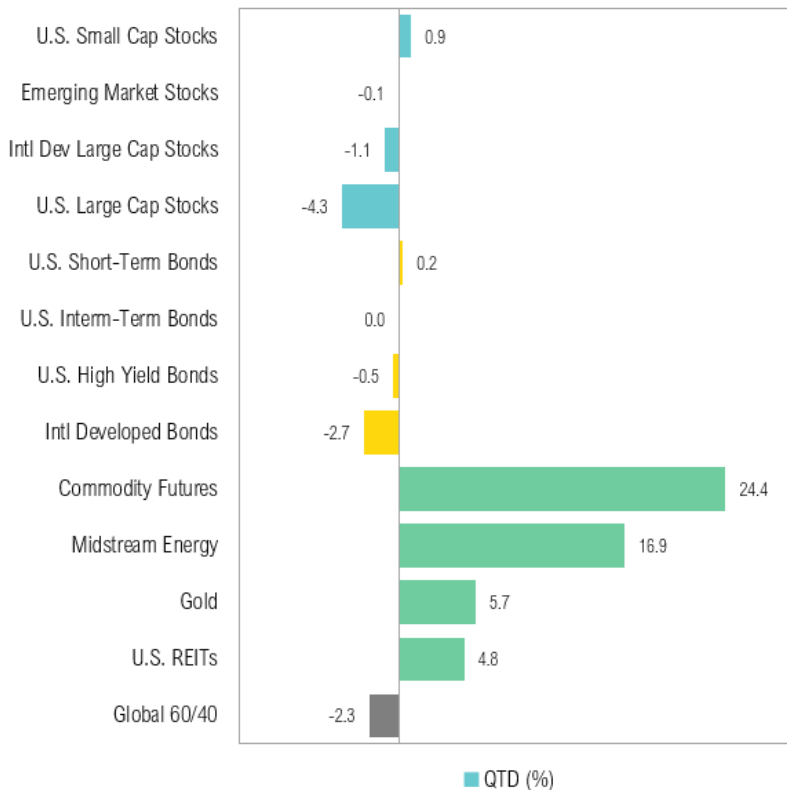
sector, technology—all happening in the same three-month period. U.S. small-cap stocks were a relative outperformer, ending the first quarter up 0.9%.

Emerging markets were resilient, particularly given disproportionate exposure to Middle Eastern oil, ending the quarter down only 0.1%. International developed large-cap stocks (predominantly European markets) ended the quarter down 1.1%. Among emerging markets, Peru (+21%), Brazil (+19%), and South Korea (+17%) led the gains. Indonesia (-21%), India (-18%), and China (-9%) stood out as notable laggards. In developed markets, European countries saw notable declines over the quarter, including Germany (-9%) and France (-5%).

Fixed-income markets had a muted start to the year. U.S. intermediate-term bonds ended the quarter flat. After rising to 4.4% on March 27, the 10-year U.S. Treasury yield ended the quarter at 4.3%. The yield curve (the spread between the 10-year and 2-year Treasury yields) remained positive throughout the quarter, finishing March at 0.5%.

Gold gained nearly 6% over the quarter, despite a 12% drop in March. Driven by the conflict in the Middle East, which started on the last day of February, West Texas Intermediate (WTI) crude oil prices jumped by \$44 per barrel over the quarter to end at \$101 per barrel. WTI crude prices dropped by 16% to \$94 per barrel on news of a two-week ceasefire in early April.

Q1 2026 Key Market Total Returns



Source: Bloomberg

Despite a 12% drop in March, gold ended Q1 up 6%

Each week of disruption fuels price rises and delays Fed easing

The ‘SaaSocalypse’ may simply be an overdue correction

While supply disruptions are likely to persist, they appear temporary and not structural

Looking Forward

Two questions hang over markets today. First, how long will tanker traffic in the Strait remain disrupted? Every week of continued disruption compounds fertilizer, food, and energy price increases and delays the Fed's ability to resume its easing path (although we do not anticipate major policy changes in the first few months of Warsh's term as Fed Chair). A strategic pivot toward de-escalation, framed as a policy success, appears to be the only viable path forward for the government, though it is likely not what the Trump administration had in mind when strikes began. Without a sustained ceasefire in the coming weeks, markets will likely begin to anticipate a global stagflationary slowdown, including potential recessions for economies that are heavily dependent on imported energy. European and Asian economies dependent on imported Middle East crude oil are likely to be disproportionately affected, potentially left in dire straits.

Second, we are monitoring whether the “SaaSocalypse” is simply a repricing moment or an extinction event for software. History suggests the former. What has been dubbed the “SaaSocalypse” could perhaps be a long-overdue correction dressed in apocalyptic language. The companies most likely to emerge stronger are those with durable data moats, outcome-based pricing models, and genuine AI integration—not those that just sell basic software access by the seat. Further, if AI advancements are so profoundly disruptive that market participants can simply “vibe-code” secure and scalable software solutions to any data-based task, then that would likely be quite positive for the other roughly 90% of the stock market that isn't SaaS.

Looking back over the quarter and in particular the conflict that defined it, the optimal strategy from an investment perspective may have been to do nothing, treating recent turbulence as a short-term shock. Credit spreads never spiked meaningfully, and crude oil futures do not signal a sustained supply shock. Although supply disruptions will likely persist, effects appear likely to be temporary rather than structurally transformative. Conditions on the ground may change, of course, and if they do, we can change our minds with them.

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Asset Class Definitions

Asset class performance was measured using the following benchmarks: U.S. Large Cap Stocks: S&P 500 TR Index; U.S. Small & Micro Cap: Russell 2000 TR Index; Intl Dev Large Cap Stocks: MSCI EAFE GR Index; Emerging & Frontier Market Stocks: MSCI Emerging Markets GR Index; U.S. Inter-Term Muni Bonds: Bloomberg 1-10 (1-12 Yr) Muni Bond TR Index; U.S. Inter-Term Bonds: Bloomberg U.S. Aggregate Bond TR Index; U.S. High Yield Bonds: Bloomberg U.S. Corporate High Yield TR Index; U.S. Bank Loans: S&P/LSTA U.S. Leveraged Loan Index; Intl Developed Bonds: Bloomberg Global Aggregate ex-U.S. Index; Emerging & Frontier Market Bonds: JPMorgan EMBI Global Diversified TR Index; U.S. REITs: MSCI U.S. REIT GR Index, Ex U.S. Real Estate Securities: S&P Global Ex-U.S. Property TR Index; Commodity Futures: Bloomberg Commodity TR Index; Midstream Energy: Alerian MLP TR Index; Gold: LBMA Gold Price, U.S. 60/40: 60% S&P 500 TR Index; 40% Bloomberg U.S. Aggregate Bond TR Index; Global 60/40: 60% MSCI ACWI GR Index; 40% Bloomberg Global Aggregate Bond TR Index.

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