

Review & Outlook

FIRST QUARTER 2026



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Review and Outlook

Coming into 2026, it was viewed by many on Wall Street that upcoming corporate and income tax cuts, coupled with continued fiscal stimulus through multi-trillion-dollar deficit spending, would be enough to keep the economy growing, and to keep a floor under the equity markets. It was also thought that the Federal Reserve would continue to lower interest rates wherever possible. With the implementation of new tariffs, and the overlapping tariffs from the prior year, the view was that inflation over the coming year would be stable or decreasing.

Further, an incoming new Fed Chair would likely be more sympathetic to the Administration's desire to see the Fed rate cut significantly, which would also be positive for the

stock market. As long as there was not some kind of confidence crisis in U.S. Treasury purchases, and the AI investment boom did not fizzle, market tailwinds were looking likely to outweigh any potential headwinds.

For the first two months of the year, this optimistic scenario played out, especially in small cap and international equity markets. For large mega cap stocks, 2026 has been disappointing, given concerns about massive investments in AI, including a shift from financing with existing cash flow to issuing corporate debt. In fact, after the first two months of the year, every stock in the "Magnificent Seven" (Amazon, Alphabet, Apple, Meta, Microsoft, NVIDIA, and Tesla) was negative,

ranging from -2.7% for Apple to -18.6% for Microsoft. This was in broad contrast to the Equal Weight S&P 500 index, where each of the 500 largest companies are equally weighted, which returned a very healthy 7% in the first two months of the year. Small cap stocks, measured by the Russell 2000 index, were up 6.2%; and global stocks, measured by the iShares MSCI ACWI ex-USA index, were up 11.3% through February 28th. The

bond market, measured by the Bloomberg U.S. Aggregate index, was also up 1.75% in the first two months of the quarter, thanks to the view that interest rates would be coming down, and some support throughout the yield curve looking out 10 years.

In March, however, the markets experienced a significant downturn. While the main driver was the start of the war with Iran on February 28th, there were also growing concerns about the return on investments in AI, and cracks in confidence in the private equity markets, particularly private credit. Interest rates, especially farther out the yield curve (like 10-year rates), started to move up, pushing bond prices down. The impacts of this downturn were broadly felt, with the S&P 500 index down 5% for March 2026, and the Equal Weight S&P 500 index down slightly more at 6%. Small cap was also down about 5%, and the Bloomberg U.S. Aggregate

Bond index was down 2%. Especially hard hit were global markets, both developed and emerging, where increased oil and gas prices following war-related supply disruptions created immediate inflationary pressures. In March, the iShares MSCI ACWI ex-US index was down 10.7%.

There still remains much uncertainty in the markets, as there seems to be no clear path to reopening commercial shipping traffic through the Strait of Hormuz, and ongoing hostilities seem to be furthering the damage to and destruction of long-term energy production capacity in the Persian Gulf region.

In Focus

On February 28th, the USA joined Israel in an arial bombardment campaign on Iran. The immediate market consequence of this was that the international spot price of oil started to increase significantly as oil and gas shipments out of the Persian Gulf were curtailed. Within the first few days of February, the Brent Crude price was up 30%; and by the end of the month, it was up 78%. Prices of natural gas in Europe and Asia increased significantly, since around 20% of the liquid natural gas (LNG) used globally is shipped out of the Persian Gulf. It also turns out that around one-third of the world's traded fertilizers come through the Strait of Hormuz, with those exports also coming to a standstill.

The economic fear was that this would be inflationary in the energy and food production markets, with a non-linear negative impact the longer shipping out of the Persian Gulf is curtailed, and further if production and shipping facilities were additionally damaged or destroyed. Oil is used broadly for transportation (cars, trucks, rail, shipping, air transport), and LNG is used for electricity production. Oil and natural gas are also used in the production of plastics, chemicals,

and fertilizers. To the extent that oil and fertilizer are agricultural inputs, it is reasonable to think that inflation will move globally into the production of food.

In response to the oil supply shock, many countries, including the U.S., announced significant releases from strategic reserves. The U.S. also removed sanctions on oil shipped from Russia and Iran. Additional actions have been taken, like suspending the Jones Act, which prohibits non-U.S. registered ships from transporting between U.S. ports. This would make it cheaper to move crude oil and distillates from the Gulf Coast to America's Northeastern States. While this may have some downward impact on oil prices, at this point it seems marginal. At the time of writing, the prices of both Brent and WTI Crude Oil were close to \$110 a barrel.

Index Performance Data
Total Return as of 3/31/2026

Indices ¹	Q1 2026	Trailing 12 Months
CRSP U.S. Total Market Index Total Return	-3.96%	18.21%
iShares MSCI ACWI EX-US Total Return	2.00%	23.48%
Bloomberg U.S. Aggregate Bond Index	-0.05%	4.35%

As long as the Strait of Hormuz (the only sea-way out of the Persian Gulf, and through which about 20% of ocean-shipped oil is transported) remains closed, or effectively in the control of Iran, prices of oil and fertilizer will likely remain significantly high.

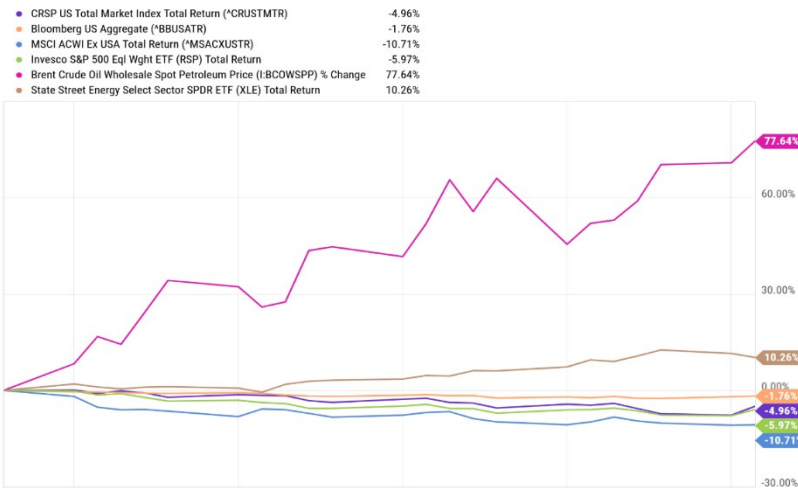
The global market for LNG is different, where market pricing can be local or regional. In the United States, spot natural gas prices can be significantly lower than an internationally-shipped LNG price, since much of it is produced as a by-product of fracking, and there is often no good way to move it around the country, let alone to an LNG export facility that is already operating at 100% capacity. In contrast, gasoline and diesel prices have gone up significantly in both the U.S. and around the world because it can be easily transported in huge volumes across the ocean, moving to any location where the price paid is the highest. We have all recently experienced higher global oil prices directly with the increase in fuel prices at the pump, and the start of those price changes took place seemingly overnight when the war commenced.

With respect to LNG, which is used globally to produce electricity, countries in Europe and Asia have been hit particularly hard. For example, Japan imports 97% of its oil, and is the world's largest importer of LNG. Further, 90%-95% of these imports come from the Middle East, most of it from the Persian Gulf. The numbers for South Korea are similar, and Europe is in the same ballpark. Many developing countries, such as Turkey, also import most of their oil and natural gas; and, for political reasons, provide subsidies to domestic fuel prices. For all of these countries, the higher energy costs are immediate and of high consequence for the stability of their economies, including the value of their currencies, domestic budget deficits, and the ability to repay debt, especially that denominated in U.S. dollars. One asset that sold off globally at the beginning of March was gold, where it is speculated that countries, like Turkey, needing to raise cash quickly were liquidating gold from their central bank reserves.

And while, economically, the most significant and directly visible global price impacts are related to oil and gas, it is important to remember that there are additional negative impacts to consider. For example, about 10% of global aluminum production comes from the Persian Gulf, and, consequently, we are seeing global prices for aluminum increase. Additionally, about a third of global helium production, much of it used for manufacturing in the semiconductor industry, ships through the Strait of Hormuz, so it comes as no surprise that the global price of helium is also now significantly higher.

For the U.S., there is an off-set to higher oil prices, as the U.S. is currently the largest oil producing country in the world. In fact, currently, the increased oil prices are a profit windfall for many U.S. energy companies. The

Figure 1: Oil Prices and Financial Markets Indicators; March 2026



State Street Energy Select Sector SPDR ETF, which reflects the S&P Energy Sector, is up over 10% for the month of March. This, however, is not much consolation for most Americans who are feeling added pain at the gas pump, or who have to pay a new fuel surcharge, like many of the airlines are now charging.

As we move into the second month of the war with Iran, there remains a significant amount of uncertainty about

how events are going to resolve. From the markets' perspective, the principal concerns are when the Strait of Hormuz will reopen, and how much long-term damage is done to energy production infrastructure in the Persian Gulf. As long as the Strait of Hormuz it is closed, there will be a period of increasing inflationary pressure, and there is little reason to think that the price of oil will decrease from where it is now. The potential downside is likely some kind of global slowdown or recession. While this would almost certainly negatively affect the energy importers like Japan and Europe, it will also flow through to the U.S. economy with higher gas prices and reduced global demand for U.S. exports.

Outside of the energy sector, it is hard to see how this supports higher stock prices, which still have historically elevated valuations. Even a seemingly undesired outcome, such as Iran controlling shipping into and out of the Persian Gulf, charging a large fee per ship (\$2 million per ship is a number that has been thrown around), would be positively received by the financial markets. Presuming production infrastructure remains largely intact, the inflationary impact would be minimal, and it would restore much certainty for investors. Any move to secure the Strait of Hormuz will likely take a significant military commitment and time to implement. This course would likely see high volatility and downward pressure on the markets for months to come. At present, we think that anyone claiming to know how to handicap potential outcomes is probably more than a little overconfident.

Given that there seems to be a plausible scenario that includes a significant market downside going forward, we have decided to manage risk by raising some cash in client accounts. In particular, we have reduced exposure to global markets, both developed and developing, and small cap, where we think there is more sensitivity to longer-dated interest rates. Most clients will notice that their actual allocation to fixed income and cash equivalents is significantly higher than target. We are hoping this is transient, as we look for opportunities to move assets back into the market.

1. Index performance data provided by ICE Data Services, and calculated by Black Diamond, an SS&C Advent company.

2. Chart data for Figure 1 provided by the YCharts! research platform.

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