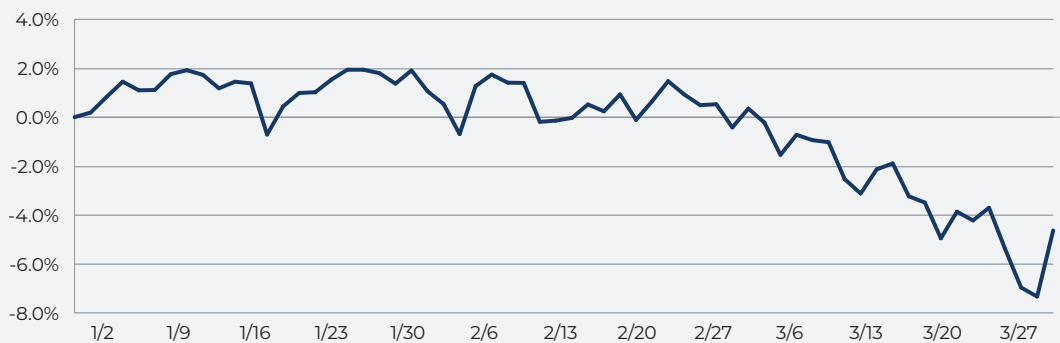


### Recessionary oil shock or bump in the road?

The first quarter ended with the U.S. seeming to have one foot in and one foot out of a conflict with Iran. Just a day after threatening to attack critical oil infrastructure in Iran if they did not negotiate a peace agreement and with the S&P 500 down 10% from the start of the conflict, President Trump said the U.S. would end military action in 2-3 weeks, even if the Strait of Hormuz remained closed and Iran had not agreed to peace terms. This caused what has been called the “Hormuz hope” rally in the stock and bond markets, even though a re-opening of the strait is the single most important economic variable for the global economy.

...re-opening of the Strait [of Hormuz] is the single most important economic variable for the global economy.

S&P 500 Returns Volatile in Q1



While we have seen less coverage in the U.S. as to who is actually making leadership decisions in Iran, the international press has been much more consistent in reporting that Iran's hardline Islamic Revolutionary Guard Corps (IRGC), who report directly to Iran's supreme leader, are now sheltering the new inexperienced supreme leader, refusing access to even Iran's president, with the IRGC making most key decisions.

#### “Hormuz hope” or false hope rally?

Even before the war started, the IRGC feared attacks aimed at taking out their leadership, so they reportedly delegated authority to hardline local commanders to launch attacks. The IRGC has pledged that they will retain control of the Strait of Hormuz, and despite extensive military losses, they continue launching attacks with missiles and drones.

The situation in Iran can clearly change drastically in just 24 hours, but with this hardline paramilitary group in control, we would have expected global markets to have little hope that the strait will be open in the coming weeks, especially if the U.S. pulls out. This leaves us skeptical of the merits of the “Hormuz hope” rally, especially since much of the world, who are very reliant on goods transported through the strait, will feel like they were only made worse off by the events in Iran.

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Hopefully, there are reasons for optimism of which we are unaware and we will see a quicker resolution, but with a timeframe of possibly months to re-open the strait and clear all bottlenecked shipping traffic, significantly higher inflation for the rest of 2026 seems increasingly likely given how long it will take to get back to normal supply levels globally for a wide range of critical supplies from fertilizer to liquefied natural gas to oil that are all heavily supplied out of the Persian Gulf.

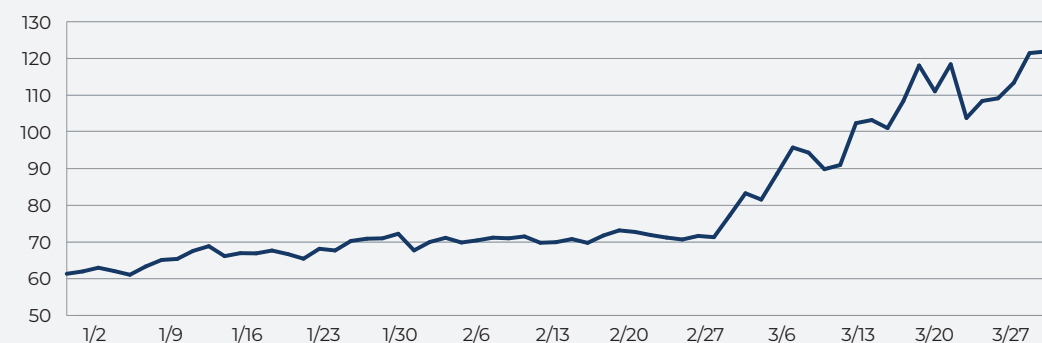
Not only had energy been an expenditure category that had been helping restrain inflation, but with about 30% of the world's fertilizer coming from the Persian Gulf, missing planting season could have significant inflationary and supply impacts for food. Having actually amassed more ground troops and resources in the Middle East in recent weeks, there are more questions than answers at this point as to what the U.S. will actually do before leaving the Gulf, and what it will mean for markets.

### **Are 2026 market tailwinds still in place?**

Readers may recall that the market narratives as we began 2026 were that prospects were bright with more strong earnings on the way, the Federal Reserve expected to cut interest rates twice this year, the economy still showing surprising stamina, and economic growth getting a boost from the new tax bill. In a reminder that what derails bull markets generally catches investors by surprise, these narratives have largely been, at least temporarily, cast aside by concerns of economic headwinds arising from a conflict with Iran that the White House thought was going to be rather quick and easily dominated, but turned out to be anything but.

If a path can be found to opening the Strait of Hormuz again in the coming weeks, then we think these positive narratives will largely remain intact and the war-related inflation and supply shortages will not be enough to derail a strong global economy. If the strait is still closed months from now, the outlook will be significantly less rosy.

**Brent Crude Oil Price per Barrel**



Source: YCharts

Despite the optimism of the “Hormuz hope” rally, the quarter ended with oil still over \$100 per barrel (from \$65 before the conflict). As we said last quarter, we think the midterm

elections have been and will continue to drive most policy decisions from the White House until November. Ultimately questionable public support, market turmoil, increasing affordability and economic concerns, especially regarding gas prices, and the increasingly negative impact they appeared to be having for midterm election prospects ultimately drove the apparent decision to wind down military operations, even if the Strait of Hormuz remains closed.

## U.S. Equities

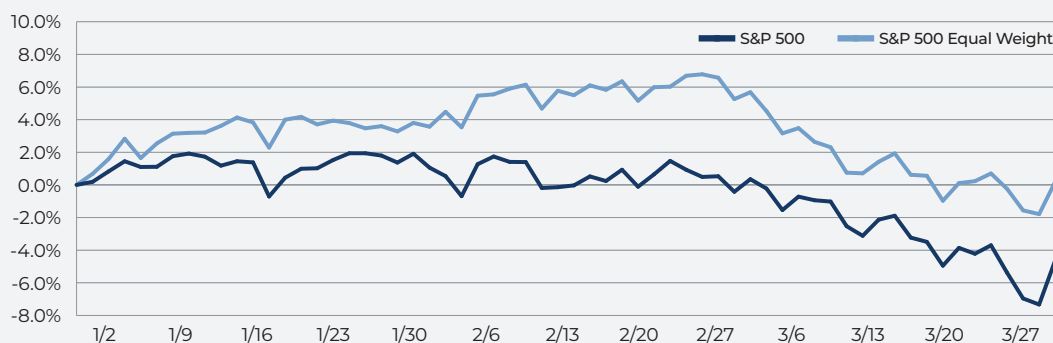
| Index                        | Q1 2026 | Since Iran |
|------------------------------|---------|------------|
| S&P 500                      | -4.33%  | -5.38%     |
| Equal-Weighted S&P 500 Index | 0.67%   | -5.87%     |
| Dow Jones Industrial Average | -3.19%  | -6.19%     |
| Nasdaq Composite             | -6.96%  | -5.55%     |
| Russell 2000 (Small Caps)    | 0.89%   | -6.58%     |

Source: Morningstar

Iran has dominated the headlines for more than a month now, so before returning to the market implications of that conflict, let us first reflect on what else drove markets in the first three months of this year.

In our last quarterly missive, we decried that speculation drove market results in 2025 more than sound investing did, but early 2026 saw stock markets take a healthy turn as value and non-AI stocks soundly outperformed those that had fueled the mania of recent years. Despite the broad market decline since the onset of the Iran conflict, the table above shows that the AI-dominated and capitalization-weighted S&P 500 is still trailing its equally-weighted counterpart (that has much more diverse exposures) by a full five percent.

### S&P 500 vs. S&P 500 Equal-Weight YTD Return



Source: YCharts

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**...all of the “Mag 7” stocks had a very challenging first quarter as they all underperformed the S&P 500...**

In fact, all of the “Mag 7” stocks had a very challenging first quarter as they all underperformed the S&P 500 despite accounting for about one-third of its market value. The rest of the index, often called the “S&P 493” clearly outperformed.

### **"Mag 7" Stocks**

|                            | Q1 2026 | Since Iran |
|----------------------------|---------|------------|
| Apple Inc                  | -6.55%  | -7.02%     |
| Tesla Inc                  | -17.34% | -9.01%     |
| Alphabet Inc Class A       | -8.06%  | -6.38%     |
| NVIDIA Corp                | -6.48%  | -5.67%     |
| Meta Platforms Inc Class A | -13.25% | -12.85%    |
| Microsoft Corp             | -23.27% | -7.85%     |
| Amazon.com Inc.            | -9.77%  | 0.17%      |

Source: Morningstar

### **A.I. bubble and software**

We think the broad market health we saw early in the quarter with the A.I. bubble gently deflating was actually an ideal scenario for U.S. equities as A.I. valuations were becoming increasingly precarious, so we think it would be an encouraging sign to see it resume once the market is able to move beyond the Iran conflict.

Surely, nearly everyone has noticed the extremely rapid proliferation of A.I.-based tools, but as we have discussed many times, the biggest investment booms (and sometimes busts) driven by technological breakthroughs tend to occur before the long period of broader adoption. (Following the 2000 internet bust, U.S. stocks were flat from 2000 to 2013 despite the fact that widespread adoption of the internet changed the way we live during that period.) While such bubbles typically end more dramatically, investors would clearly prefer to see the proliferation of A.I.-based tools simply be able to gradually catch up to the valuations.

The most notable stock market development involving A.I. in early 2026 wasn't the beneficial aspirations of A.I., but rather the prospects for A.I. to wipe out entire industries as we know them today, and software companies took it on the chin in a widespread panic that all software would be displaced by A.I. “Throwing out the baby with the bathwater” is an expression that comes to mind when reflecting on the indiscriminate selling experienced in the software sector this year. As you can see below, software stocks were down significantly even before the onset of the Iran conflict.

| Index            | Q1 2026 | Since Iran |
|------------------|---------|------------|
| S&P 500 Software | -23.71% | -5.20%     |

Source: Morningstar

**...the market has been far too pessimistic about the destructive capabilities of A.I. to wipe out the entire software industry.**

Just as we believe that the market has frequently been overly enthusiastic about the positive capabilities and profit potential of A.I., we also think the market has been far too pessimistic about the destructive capabilities of A.I. to wipe out the entire software industry.

There will certainly be types of functional software that will be replaced by A.I. tools, but there are also many types of mission-critical software with high switching costs and years of institutional knowledge, customization, and operating history that leave them deeply imbedded within organization and cannot be easily displaced. Many, while mission-critical, represent such a small share of operating costs, that it would not be rational to take the risk of turning over the function to a far less proven A.I.-based software. Others serve highly regulated end markets, such as healthcare and financial services, where security concerns are paramount. It is these types of software firms that have the largest “moats” around their business and are most highly valued by the stock market.

We think the market will eventually be reminded of this, and these highest quality software stocks will recover and prosper. One fund that we utilize in many client portfolios, called the Akre Focus Fund, has some of its largest holdings in such quality companies. One of the reasons this has been a very successful investment for us for many years is that they are very disciplined managers, and we have been pleased to see them stick to that discipline and use the opportunity to add positions at valuations that they think are unreasonably distressed.

### Midterm elections and tariffs

We mentioned last quarter that we think the midterm elections will be the motivating factor in any domestic policy decisions coming from the White House for most of 2026. We think that has been borne out as, with “affordability” still one of the biggest issues for voters, we have heard very little from the president about new tariffs other than immediately instituting some temporary tariffs upon losing the Supreme Court decision that ruled many of his tariffs illegal.

Having had plenty of time for importers to gradually adjust their prices, almost every study we have seen indicates that the majority of the cost of tariffs has been passed along to end consumers, and a report from the New York Federal Reserve suggests that 90% of the cost of tariffs is being borne by importers and consumers<sup>i</sup>. With inflation likely headed closer to 4% this year than 3% due to the closure of the Strait of Hormuz, we would not expect the White House to weaken their “affordability” position further with many new tariffs before the election, except in select strategic sectors.

### International Equities

| Index                         | Q1 2026 | Since Iran |
|-------------------------------|---------|------------|
| MSCI EAFE (Developed Markets) | -1.24%  | -9.84%     |
| MSCI Emerging Markets         | -0.17%  | -13.51%    |

Source: Morningstar

i. Who is Paying for the 2025 U.S. Tariffs, February 12th, 2026, Liberty Street Economic, New York Federal Reserve

**...the state of our economy six to nine months from now appears to be heavily dependent on the Strait of Hormuz getting re-opened fairly soon.**

International stock markets entered 2026 with substantial momentum having delivered very strong returns in 2025. Their lead over U.S. equities continued to grow early in the first quarter with both developed and emerging markets quickly reaching double-digit gains in the young year. However, with Europe and Asia much more reliant on oil and gas coming out of the Persian Gulf, the conflict with Iran has caused larger pullbacks in those markets, although they are still generally ahead of U.S. markets year-to-date.

With several Asian nations already implementing fuel rationing and energy conservation measures, international markets are even more reliant on a speedy re-opening of the Strait of Hormuz than the U.S. Fortunately, the tailwinds fueling those markets have largely remained intact, so their relief rallies fueled by the change in rhetoric from the U.S. have been as strong or stronger than those in U.S. markets.

### **U.S. economy**

The economic tailwinds that were fueling the U.S. economy coming into the year are still largely intact, the big difference is that we are now facing some economic headwinds created by the conflict in Iran. The U.S. economy, now a net exporter of oil, is less exposed to oil shocks today than it was in previous decades, but a sustained increase in oil prices is still a serious problem as oil prices are dictated by global markets. There are also different types and grades of oils used to refine different products and U.S. refiners still blend a substantial mix of imported oil with domestic oil.

Two of the pillars that have been supporting the economy in the U.S. are A.I.-related capital expenditures and the “wealth effect” of high-end consumers maintaining high levels of spending supported by their stock market gains. We continue to think any unwinding of the wealth effect is the biggest threat to the economy, so if sustained higher oil prices do lead to a substantial stock market decline, then we think the economy will find it difficult to keep avoiding a recession, especially if falling stock prices cause a marginal reduction in the A.I.-related capital expenditures.

Bottom line, the state of our economy six to nine months from now appears to be heavily dependent on the Strait of Hormuz getting re-opened fairly soon.

### **Fixed Income**

| Index                                 | Q1 2026 | Since Iran |
|---------------------------------------|---------|------------|
| Bloomberg US Aggregate Bond Index     | -0.05%  | -1.54%     |
| Bloomberg Global Aggregate Bond Index | -0.13%  | -1.63%     |
| Bloomberg Municipal 5-Yr Index        | 0.01%   | -1.71%     |

Source: Morningstar

Fixed income markets had been relatively flat on the year prior to the Iran conflict with two Fed rate cuts expected to help fuel the economy and revive the housing market. Instead interest rates climbed markedly as war-driven inflation fears gripped the bond markets, driving down bond prices.

**To protect client portfolios from volatility, we have focused for the last few years on building what we call “durable portfolios” for clients.**

The quarter ended with futures markets no longer expecting any rate cuts this year. In fact, inflation concerns had grown so much that, before the “Hormuz hope” rally, the markets had begun to price in the next action by the Fed being a rate increase due to expectations of that higher oil prices would reverberate through the economy.

Fed Chairman Powell has made clear that the Fed would not raise rates simply due to a short-term inflation increase from an oil price shock such as we are experiencing now. However, if oil prices stay high for a more sustained period and start to impact general inflation expectations for the future, the Fed may be forced to raise rates, even with President Trump’s carefully selected new chairman in place later in the year (who was nominated due to his desire to lower rates).

### **What does all this mean for client portfolios?**

In Q1 of last year, we did not expect that the markets would be dominated by the “liberation day” announcements of shockingly high tariffs. Heading into Q1 of this year, we did not expect that the markets would be rising and falling with daily developments in a war against Iran. However, with a range of increasing risks, including a U.S. stock market rising to historical levels, what we have been expecting is volatility. We have no way of predicting if the U.S. will, in fact, cease military activity in Iran in the coming weeks, if the Strait of Hormuz will be open again anytime soon, or if the global economy will flounder or continue to prosper, but we do expect more of the same when it comes to volatility.

To protect client portfolios from volatility, we have focused for the last few years on building what we call “durable portfolios” for clients. Portfolios designed to better protect against significant stock market declines, but without sacrificing compelling returns. With stocks and bonds becoming increasingly correlated in recent years, which only increases downside risk for client portfolios, we have sought to make portfolios more durable through the introduction of additional asset classes that do not move in sync with stocks and bonds, whether they be alternative strategies in the public markets or private market strategies in private equity, credit, infrastructure, or real estate. While we are pleased with the “durability” of client portfolios so far this year, we are constantly searching for new compelling investments that provide different return streams that move independently of those we already have.



**Dennis Follmer**

Chief Investment Officer

April 1, 2026

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