

First Quarter Summary

It was a volatile first quarter for most asset classes, due in part to the U.S./Israel military conflict with Iran and expanding concerns about problems in the private credit market. The S&P 500 experienced its worst quarter since 2022Q1, falling 4.3%. There was quite a bit of turmoil beneath this headline number. In a reverse of trends experienced over the past few years, value stocks outperformed growth stocks by a wide margin in Q1. Specifically, the Russell 1000 Value Index increased 2.0% in Q1, in contrast to the 9.8% loss experienced by the Russell 1000 Growth Index. Technology giants, Microsoft, Oracle, Salesforce, Intuit, ServiceNow, and Adobe each dropped at least 20% on a year-to-date basis, as investors fretted about the impact of the proliferation of artificial intelligence tools on the profitability of software firms. Blue Owl, perhaps the firm most associated with the growth in private credit over the past few years, lost almost 40% of its equity value in Q1.

Small cap U.S. and international equities squeaked out modest gains, both increasing roughly 1% in Q1. Bonds, as represented by the Bloomberg Barclays Aggregate Bond Index, started the year strong, but ended with a whimper, rising just 0.03% in Q1. Inflation concerns resulted in the benchmark 10 Year U.S. Treasury Note rising 15 basis points since the beginning of the year to 4.31%. Gold continued its blistering run, rising 8.6% in Q1, albeit with quite a bit of intra-quarter volatility. It somewhat surprisingly fell sharply in price, subsequent to the commencement of hostilities in Iran, in contrast to its reputation as a safe haven during times of political turmoil. The increase in the U.S. Dollar, the lower likelihood of near-term interest rate cuts, and forced selling to meet margin calls partially explain the loss of luster for the gilded metal. Commodities were the best performer in Q1, with the S&P GSCI Commodity Index up a robust 39.6%. Of course, commodity indexes were boosted by the surge in oil prices to over \$100 per barrel after Iran effectively shut the pathway of oil tankers traveling through the Strait of Hormuz. The price of oil, as measured by West Texas Intermediate Crude, has increased an astonishing 95% in Q1.

The Federal Reserve remained on hold in Q1 with respect to changes in short-term interest rates, but significant changes are afoot with its other operations. President Trump officially named Kevin Warsh to succeed Jay Powell as Fed Chair when his term expires in May. In events that seem like they were derived from a Hollywood script, Republican U.S. Senator Thom Tillis has pledged to block Warsh's nomination until the criminal investigation involving Jay Powell is dropped. Mr. Powell stated he plans to remain in his position, as Chair or Governor, until he is fully exonerated. In the meantime, Jay Powell delivered a speech to Harvard University, suggesting that the spike in inflation was temporary, and that it is unlikely that the Federal Reserve will raise interest rates this year. Mr. Warsh has expressed a desire to lower interest rates when he eventually takes the reins of the Fed, but he will have to convince his fellow governors to follow suit. Warsh is somewhat cut from the Alan Greenspan mold with his belief in markets, a smaller Fed Balance Sheet, and the view that technology driven productivity measures may lower inflation and spur economic growth.

Market Outlook

The proverbial elephant in the room is the ongoing military conflict with Iran. If the conflict ends in the relatively near future, we believe the economy can resume its moderate growth path and asset price volatility will materially decline. However, the longer the conflict persists, the greater the likelihood that heightened inflation will feed into the broader economy and potentially place it on the precipice of a recession. As we have often stated, we believe intelligent diversification is the best way to navigate the current uncertainty.

High oil prices do not guarantee that the economy will be pushed into a recession. There have been three other occasions where oil prices exceeded \$100 per barrel, and a recession did not necessarily follow. First, oil prices exceeded \$100 per barrel in 2008 due to a strong global economy, that was ultimately undermined by the financial crisis that led to the Great Recession. Second, there were several periods in the 2011-2014 time frame when oil

exceed \$100 per barrel, due in part to the “Arab Spring” and Civil War in Libya which occurred in this period. Third, when Russia invaded Ukraine in 2022, oil briefly spiked to over \$100 per barrel. Hence, high oil prices are not necessarily a death knell for the economy. However, with GDP currently growing at roughly 2%, high oil prices impact discretionary consumer spending and tend to increase inflation, potentially pushing the economy to stall speed, or worse.

We expect the Federal Reserve to continue to remain on hold, at least through the first half of 2026. However, if the military conflict with Iran is largely ended and the inflation rate returns to levels closer to 2%, we believe there may be room for 1 or 2 interest rate cuts of 0.25% by year-end. As noted earlier, there may be a change in Fed policy once newly nominated Fed Chair, Kevin Warsh, takes the reins. We expect bonds, especially those of short-term to intermediate-term duration, to continue to serve as ballast for diversified portfolios during times of equity distress. In our view, the problems with private credit are somewhat contained since these funds often have a substantial lockup period of 5-10 years. Hence, there cannot be a formal run on these funds like there were with many banks during the Great Recession. Nevertheless, this specific sector of the investment universe may be under pressure for a while as redemption requests overwhelm the ability of these funds to sell substantial assets at fair market values. It will also likely remain a challenging environment for these firms to raise substantial new funds.

There are several positives related to the current economy. The biggest tax refunds on record may help consumers overcome higher energy prices. More specifically, income tax refunds are estimated to be roughly \$3,800 per taxpaying individual, a 10.2% increase over the prior year. Updates to existing artificial intelligence models, such as Anthropic’s Claude LLM, continue to be released in rapid fashion. AI tools may boost worker productivity and firm profitability. Although there is a risk that AI destroys some jobs, it may create new ones as well. For example, there have been numerous headlines related to technology firms, such as Oracle and Block, laying off thousands of workers. However, thousands of new jobs have also been created for the data center and power generation infrastructure buildouts, complemented by secular growth in other areas, such as Healthcare. Reported earnings have been strong thus far, with analysts projecting full-year S&P 500 earnings to increase in excess of 12% versus 2025 levels.

In aggregate, we remain optimistic that U.S. equities can achieve our year-end target of gains in line with their historical gains, somewhere in neighborhood of 10%. A well-known Wall Street axiom is that market participants are good at pricing in risk, but hate dealing with uncertainty, which by definition is difficult to quantify. Hence, we believe that equity markets may achieve a surer footing as further clarity is achieved with respect to the military operations in Iran. The Congressional midterm elections in November may result in another bout of uncertainty, but that is a topic we will save for a later day.

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