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Market Review and Outlook 1Q26

Highlights

While stocks entered 2026 with early momentum, the S&P 500 Index closed the first quarter with total return loss of -4.3%.

Destabilizing impacts from the military conflict in Iran created turmoil in the energy markets, which put downward pressure on global equity prices.

With the S&P 500 Index sitting just 6% below its all-time high, the market's response to the geopolitical strife has been relatively measured thus far. A more pronounced market correction remains a possibility, however, particularly if oil prices sustain levels above $100 per barrel.

Slowing economic expansion paired with a resurgence of inflation has created more uncertainty around the future direction of monetary policy.

Fixed income proved more stable than equities in the quarter, but the bond index still recorded a modest first-quarter decline of -0.1%.

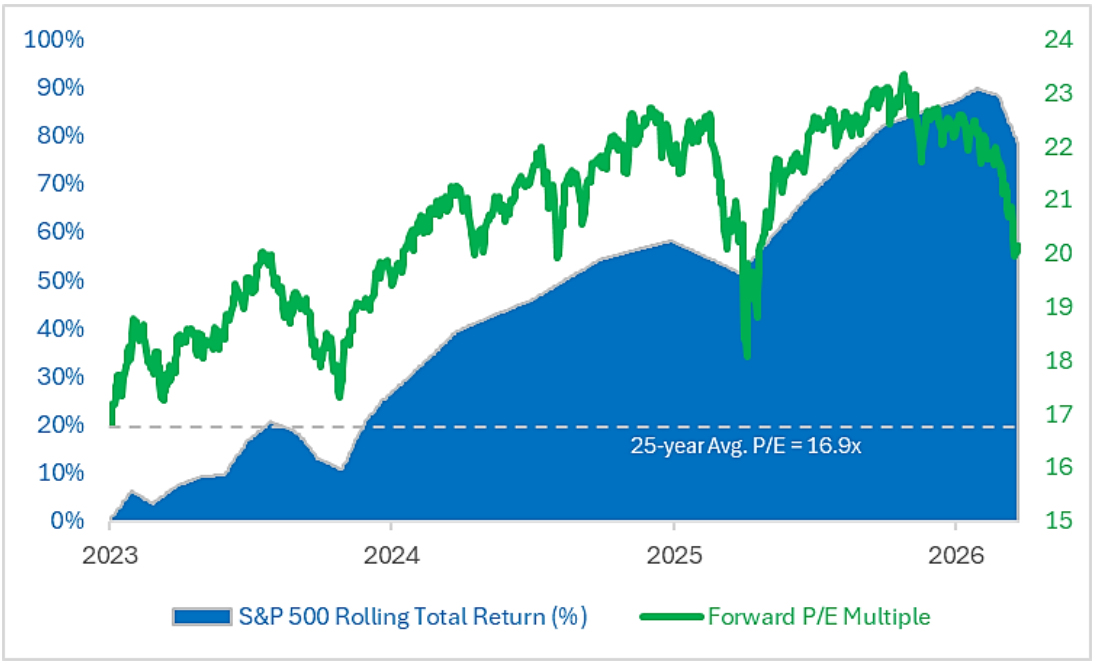
We continue to favor short- to medium-duration bonds, as their prices are less sensitive to inflation/fiscal risks than long-term bonds.

Market Review and Outlook

Global equities initially started the year on a strong footing, supported by the convergence of resilient economic fundamentals, accommodative monetary and fiscal policies, and robust corporate profits. Each of the major indices climbed to new highs intra-quarter, but stocks surrendered those gains as energy prices surged throughout March. The S&P 500 Index posted a first-quarter total return of -4.3%, closing the period -6.2% below the all-time high it crossed earlier in the year. International stocks also trended lower, with developed markets (EAFE) declining -1.2% and emerging markets (EM) dropping a modest -0.2% in the quarter.

After a remarkably persistent three-year market rally from 2023-2025, during which the S&P 500 Index produced an 86% cumulative (23% annualized) gain, the first-quarter retreat in equities was relatively benign and arguably overdue. Domestic stocks entered the year at demanding valuations, as the S&P 500 Index's forward P/E multiple of 22x sat more than 30% above its 25-year average. This priced-for-perfection backdrop left equities acutely susceptible to a shift in sentiment. That pivot was ultimately triggered by three developments: a more sober assessment of the AI revolution, mounting anxiety around private credit, and the destabilizing impact of the military conflict in Iran.

S&P 500 Total Return and Forward P/E Multiple
(12/31/22 - 3/31/26)



Source: FactSet

Artificial Intelligence has been the undisputed engine of U.S. equity returns over the past three years, as a concentrated group of technology hyperscalers and chipmakers (i.e., the Mag 7) drove ~60% of the S&P 500 Index's gains from 2023-2025. While earnings expansion for these high-flying tech stocks remains robust, shareholders are increasingly scrutinizing their "growth at any cost" mantra and demanding more quantifiable returns on investment. That drove a compression in valuation multiples for the mega-cap tech stocks during the first quarter—as investors tried to reconcile the massive capital outlays (and increasing debt loads) of these traditionally capital-light firms—and a rotation in market leadership towards more value- and small-cap names.

On the other side of the AI ledger, the market began analyzing AI through the lens of disruption risk. Premium-priced software stocks fell under significant fire during the first quarter, due to concerns that AI poses an existential threat to the Software-as-a-Service (SaaS) architecture—challenging the economic foundations that have underpinned the industry for two decades.

AI Threat Impact on Software Stocks
(12/31/25 - 3/31/26)

Company	Ticker	Total Return (1Q26)
Salesforce, Inc.	CRM	-29.5%
Adobe Inc.	ADBE	-30.5%
Service Now, Inc.	NOW	-31.8%
Intuit Inc.	INTU	-34.6%
Workday, inc.	WDAY	-39.5%
S&P 500 Index		*-4.3%*

Source: FactSet

The narrative swing—from viewing AI as a universal tailwind to a structural risk—quickly bled beyond software into other sectors. Notable selling pressure in financial services, real estate, and logistics stocks during the quarter implied that AI will also fundamentally dismantle "old economy" operating frameworks. This broader multi-industry selloff may prove overly impulsive though, as feverishly discounting valuations of well-established businesses based on speculative second- and third-order AI impacts seems premature.

The private credit market—where non-bank entities (primarily alternative asset managers) provide privately negotiated loans to small and mid-sized enterprises—was another source of consternation in the quarter. With the influx of capital chasing higher-yielding private credit investments in recent years, suspicions began to mount that this trend had spurred weaker underwriting standards and deteriorating portfolio quality. The private credit market hit its first pocket of turbulence following two headline-grabbing company defaults (where private lenders had significant exposure) in early 2026. As the quarter progressed, the AI disruption threat also permeated the private credit market after it was flagged that software companies comprise more than 20% of all outstanding private credit loans. When including broader business services firms (e.g., call centers, legal support, data providers) susceptible to the automatization of standardized tasks, the private credit market's exposure to companies with high AI-disruption risk rises to as much as 40% of total loans. Though few actual defaults have occurred, the fear that AI could materially impact these borrowers' businesses only compounded prior concerns, leading to a record level of investor redemption requests from private-lending funds during the quarter. Given how deeply entwined private credit has become with traditional banks (which provide financing to these funds), the market also started assessing the potential ramifications a private-credit crash could have on the broader financial system and economy. This systematic threat is likely limited though, in our view, given the large U.S. banks' solid financial health and ample capital buffers.

AI disruption and private credit vulnerabilities merit careful monitoring over the medium to longer term, but the military conflict in Iran and its ultimate duration/outcome is the most pressing near-term issue facing financial markets. While geopolitical events typically don't have a longstanding impact, they do create volatility in the short term. The energy complex is the primary way through which this crisis will affect markets globally. Disruptions in oil and natural gas production have sent energy costs soaring, with WTI crude finishing March up a staggering 77% year-to-date. This is disconcerting because energy price shocks in the past have typically been disruptive for economies and markets. As the chart below illustrates, oil price spikes often are accompanied by recessions—as governments, businesses and consumers spend more on energy and reduce spending on other things, slowing economic growth.

Oil Price Spikes and the U.S. Business Cycle
(12/31/69 - 3/31/26)

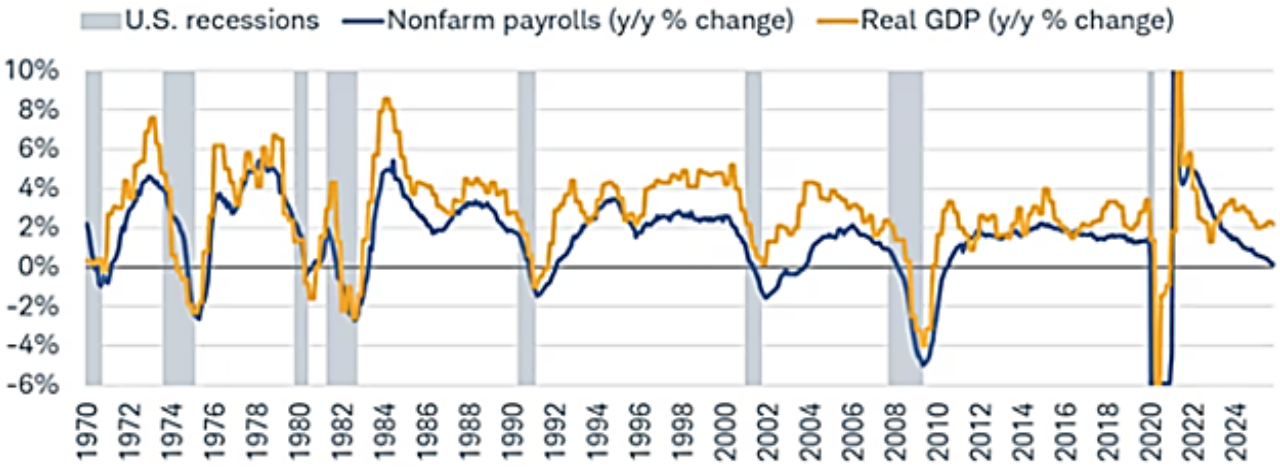
Source: EIA, St. Louis Fed (FRED), BCA Research

The link between the domestic economy and oil prices has weakened in recent years, however, due to increased domestic petroleum production (the U.S. became a net exporter of energy in 2020) and a decline in U.S. oil intensity (as the increasingly service-oriented economy requires less fuel per dollar of GDP). During the last major oil price spike following Russia's invasion of Ukraine in March of 2022 (when WTI oil prices increased 74% over a three-month period), U.S. GDP temporarily declined during the first two quarters of 2022. The economy swiftly rebounded in the ensuing quarters though and avoided recession. Expectations for a similar non-recessionary outcome may help to explain the equity market's relatively measured response to the current oil shock, with the S&P 500 Index down just 6% from its all-time high.

A more pronounced market correction remains a possibility, particularly if oil prices sustain levels above $100 per barrel, but investors currently view the risk of a full-scale economic or profit recession as low. This confidence largely rests on the assumption that the conflict in Iran will be short-lived. Furthermore, the market is finding support in the economy's resilient underlying foundation: earnings are still projected to grow in the mid-teens this year; and unemployment remains low at 4.4% (vs. the 5.7% historical average). Additionally, tax law changes are expected to boost individual IRS refunds by 10% to 15% this filing season, offering a timely cushion against rising energy costs.

Those positive factors notwithstanding, current data suggests the economy may be entering the later stages of the business cycle. Growth had begun to moderate even before the recent geopolitical turmoil; 4Q25 GDP rose at an annual rate of just 0.7%, less than half the rate that was expected and a sharp downshift from the 4.4% growth reported in 3Q25. The labor market is also losing steam—the 181,000 jobs added throughout 2025 represented the weakest expansion since 2003 (outside of recession years), and payroll growth in 2026 has continued to decelerate. Softening labor data has often coincided with broader GDP declines, as illustrated in the chart below.

Nonfarm Payrolls and GDP Growth
(12/31/70 - 12/31/25)



Source: Charles Schwab, Bloomberg, Bureau of Labor Statistics (BLS)

Slowing economic momentum paired with a resurgence of inflation creates a conundrum for the Federal Reserve. This "stagflationary" trend pulls the Fed's dual-mandate pursuit of maximum employment and price stability in opposite directions. While further rate cuts could bolster a sagging labor market, they risk fueling higher prices. On the other hand, raising rates to curb inflation could inadvertently exacerbate the economic slowdown.

Considering the Iran conflict's unpredictable resolution, along with signs of an aging economic cycle and a complicated monetary policy backdrop, we think it's prudent to maintain an elevated level of caution in this market climate. While the prospect of mid-teen earnings growth remains a potential tailwind to the market overall, the deceleration in GDP and labor data suggests a more selective investment approach is advisable. Our current portfolio strategy emphasizes quality and resilience, as we are prioritizing companies with strong balance sheets and pricing power to navigate a more challenging operating environment. By focusing on these fundamentals, we aim to capture the remaining growth in this cycle while building in a layer of protection against further volatility.

Core Portfolio

During the first quarter, we initiated a new position in Suncor Energy and sold our holding in EOG Resources.

Suncor Energy is an integrated energy company, meaning it controls all operations from the petroleum extraction site to the retail gas station. Production from the company's oil sands assets accounts for two thirds (66%) of Suncor's operating income. The Canadian oil sands are the fourth largest proven oil reserve in the world (behind Venezuela, Saudi Arabia, and Iran) and are among the cheapest sources of supply in North America, with most of the oil sands producers reporting breakeven WTI oil prices in the low $40s. That rivals the breakeven levels for some of the most efficient producers in the U.S. Permian Basin, the heart of the U.S. shale boom. Moreover, the production decline rates of oil sands projects are much lower than those of competing shale basins. With this combination of low breakeven costs and multi-decade production stability, we believe oil sands operators like Suncor offer long-term oriented shareholders a compelling investment opportunity.

EOG Resources is an independent oil and gas producer with acreage in several U.S. shale plays, primarily in the Permian Basin and the Eagle Ford. While EOG remains one of the premier, low-cost operators in the U.S., we believe the Canadian oil sands producers currently provide a better long-term risk/reward outlook for investors in the North American energy sector. As a result, we sold our position in EOG to fund our purchase of Suncor Energy.

Tactical Portfolio

Our tactical investments provided valuable diversification this quarter. Gains in commodity and real asset holdings helped to offset broader market losses—including the tactical portfolio's equity and interest rate strategies. This smoothing effect contributed to more resilient returns overall, but the portfolio still experienced volatile activity underneath the surface.

For example, gold reached record highs in January, driven by a weakening U.S. dollar and anticipation of Fed rate cuts. Sentiment shifted in March, however, as reaccelerating inflation risks led markets to price in a potential interest rate hike. This diminished the appeal of non-yielding bullion and sparked a substantial price reversal late in the quarter, though gold remains at a higher price year-to-date and continues to offer an effective way to hedge longer-term inflation risks.

Uranium followed a similar trajectory, surging early in the quarter on supply concerns and rising data center demand for stable/carbon-free baseload power. That rally was upended by mid-quarter reports of stronger-than-forecasted uranium production and the shifting macro climate in March. Despite the retrenchment, uranium finished the quarter at a higher price than where it started the year. More importantly, as a critical component of the AI-driven secular growth story, it remains well-positioned for further price gains.

Fixed Income

Bonds held up better than equities in the quarter, but the benchmark U.S. Aggregate Index still recorded a modest first-quarter decline of -0.1%. The 10-year Treasury yield sank to under 4.0% in late February, as the market was pricing in a more aggressive interest-rate cycle for 2026. However, yields quickly spiked with the onset of war and closed March back at 4.3%. This seems counterintuitive, as investors typically move to safe-haven investments like U.S. Treasuries during periods of uncertainty, pulling their prices up and their yields down. So far, the bond market reaction appears more focused on upside inflation risks to the oil shock and its implications for monetary policy, rather than the potential economic hit.

Fixed income market could struggle if the war drags on longer than expected, as concerns would intensify around inflation and the U.S. debt/deficits—putting upward pressure on yields and downward pressure on bond prices. For this reason, we continue to maintain a bias toward short- to medium-duration bonds. Bonds at the shorter end of the curve still provide decent yields and their prices are less sensitive to inflation/fiscal risks than long-term bonds. If yields continue to move higher, the faster maturation of our shorter duration bonds would also allow us to gradually roll into the higher-yielding new issuances.

Final Thoughts

It remains far from clear how the war in the Middle East will play out in the near term and what its impact will be on global economies longer term. While uncertainty is never comfortable, it is a normal part of investing. Rather than reacting to short-term headlines, we will continue to prioritize disciplined market exposure to support our clients in meeting their long-term financial objectives.

May the transition to spring bring warmer temperatures and more peaceful times!

Parkside Investments, LLC

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