

The US Stock Market entered 2026 with strong momentum after a year driven by AI optimism and a US economic growth resurgence. However, the first quarter delivered a meaningful setback, with the S&P 500 declining 4.3% as a confluence of geopolitical shocks, monetary policy uncertainty, and rapid technological disruption tested investor conviction. The defensive rotation that defined February, with Utilities rising sharply while Technology, Financials, and Consumer Discretionary faltered, accelerated through the remainder of the quarter. Energy and select defensive sectors emerged as relative bright spots, while areas most exposed to artificial intelligence (AI) disruption bore the brunt of the selling. Despite the turbulence, underlying earnings fundamentals remain encouraging, with S&P 500 earnings growth for the first quarter of 2026 currently tracking at approximately 13% y/y and above estimates set at the start of the quarter.

The most significant catalyst for the quarter's volatility has been the outbreak of hostilities involving Iran and the resulting spike in global energy prices. Oil and natural gas prices surged 50% as markets moved quickly to price in supply disruption risk across one of the world's most critical energy corridors. Higher energy prices flow through the economy in the form of elevated input costs for manufacturing, transportation, and agriculture industries, while simultaneously pressuring consumer discretionary spending as household energy budgets expand. Markets are weighing these second- and third-order effects, including reduced growth, tighter margins, and the potential for a global demand slowdown that could ultimately weigh on US and global economic growth.

The Fed now finds itself facing a renewed inflationary impulse driven not by demand excess, but by supply disruption, a far more difficult dynamic to manage. Market participants have moved to price out further interest rate cuts, and in some scenarios a resumption of tightening is no longer considered implausible. While the simultaneous prospect of slowing growth and rising prices introduces a new level of macro uncertainty, periods like these have historically rewarded disciplined investors who remain focused on fundamentals and maintain a longer-term perspective.

Adding a third layer of complexity, artificial intelligence continues to reshape the competitive landscape in ways that create both significant opportunity and meaningful disruption. The rapid advancement and enterprise adoption of AI, accelerated by the rise of highly capable models such as Anthropic's Claude, is beginning to show tangible productivity benefits across corporate America, providing a genuine tailwind for output and operational efficiency. At the same time, the displacement effects are real and are already manifesting in the form of meaningful volatility across software, consulting, data services, and other knowledge work intensive industries. Investors are grappling with a challenging paradox in that AI is simultaneously a source of productivity driven optimism and a destabilizing force for established business models and labor markets. The resolution of this tension will likely define market leadership for years to come.

Not all signals point toward pessimism, however, and several structural green shoots deserve acknowledgment. Manufacturing PMIs have moved into expansionary territory for the first time in several years, supported by the ongoing reshoring of industrial capacity to North America.

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Infrastructure investment continues to build, with the backlog of major domestic construction projects surpassing \$3 trillion and growing approximately 30% y/y, reflecting sustained commitment from both the private sector and government to reinvest in domestic productive capacity. Together with robust earnings and continued AI-driven productivity gains in the early stages of enterprise deployment, these dynamics provide a credible foundation for a more constructive outlook as the year progresses.

Periods of elevated uncertainty are perhaps the most reliable barometer of business quality, exposing the true durability of a competitive position in ways that calm markets never can. Companies with wide competitive moats, high free cash flow conversion, and low earnings variability do not merely survive difficult environments but emerge from them with stronger competitive positions, having gained customers, talent, and market share from less resilient peers. Our investment philosophy is built on identifying these businesses and holding them with conviction through inevitable periods of short-term volatility. While the macro backdrop for the balance of 2026 will require careful navigation, we remain confident in our belief that the companies in our portfolios are well positioned to compound value for our clients over the long term.

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The S&P 500 is an index of 500 stocks designed to reflect the risk/return characteristics of the large-cap universe.

The Manufacturing PMI (Purchasing Managers' Index) is a monthly economic indicator measuring the health of the manufacturing sector based on surveys of purchasing executives