Entering 2026, the global economy and financial markets appeared to have the wind at their backs. Following three years of robust gains, the prevailing consensus among Wall Street commentators was a "Goldilocks" outlook: inflation was cooling, the labor market was slowing but stable, and the Federal Reserve seemed poised to begin a cycle of interest rate cuts. Furthermore, the Trump Administration's hallmark legislation of 2025 was set to catalyze business investment and provide significant tax refunds for consumers this spring. With massive capital expenditures in artificial intelligence from the largest technology giants continuing to permeate the economy and trade tensions appearing to thaw, the stage was set for continued growth. The outbreak of the Iran War has fundamentally altered that trajectory. Since the conflict began on February 28, the benchmark S&P 500 declined ~5% through quarter end, erasing modest year-to-date gains. The volatility has not been contained to domestic equities: the MSCI World ex-US Index (International Equities) fell ~10%, while the US Aggregate Bond Index (Fixed Income) dropped ~2% during the same time period. While we acknowledge that the true cost of this war is borne by those directly in harm's way—civilians and American servicemembers—the financial markets are focused on a singular economic chokepoint: the Strait of Hormuz.

The Strait of Hormuz, a narrow waterway off the coast of Iran and Oman connecting the Persian Gulf ultimately to the Indian Ocean, is the world's most critical commodities artery, facilitating upwards of 34% of the total global crude oil trade. Less discussed, but also extremely critical, is its role in global food security, as the Strait handles roughly 50% of the world's urea, a fertilizer that is critical for global food production. Since the onset of hostilities, U.S. spot oil prices have surged 50% in just over a month. More concerning is the rise in "back-month" contracts, suggesting that the market is increasingly pricing in a protracted conflict rather than a short-term disruption. Gulf producers are nearing maximum storage capacity; if the Strait remains closed, they may soon be forced to "shut in" wells, which could lead to long-term infrastructure damage and even tighter future supply. This has revived the spectre of "stagflation"—the dreaded 1970s-era combination of stagnant growth and high inflation—as the market grapples with the dual shocks of energy scarcity and supply chain paralysis.

While the United States remains somewhat insulated as a major energy and food producer, the situation abroad is becoming more dire, especially in many poor areas of the world. For example, Sri Lanka has revived fuel rationing and instituted mandatory public holidays to conserve energy, Bangladesh has implemented rolling blackouts to prioritize its garment export sector, and Ethiopia has effectively shuttered non-essential government functions to mitigate a suffocating fuel shortage. Despite not facing these types of shortages at home, predictive markets and political polling suggest the domestic landscape is shifting. Unlike the swifter operations in Venezuela, this conflict's duration is weighing on public sentiment. Prediction markets like Polymarket now reflect a 53% chance of a "Democratic sweep" in the upcoming mid-terms, a sharp increase from the 22% seen as recently as October. Of course, we realize that sentiment can change rapidly, and that President Trump is very aware of the political ramifications of this lengthening conflict. We've anticipated that the Administration would seek to declare a "victory" of some kind to provide a political and economic off-ramp and, as of this writing,

the United States and Iran have agreed to a two-week ceasefire. While this ceasefire seems fragile, with attacks originating from both Iran and Israel continuing across the region, the fact that direct talks are scheduled is a good sign. The initial basis of the truce appears to be the Iranian 10-point peace proposal, which includes lifting of all U.S. sanctions. This would be a win for Iran and would likely be acceptable to the U.S. only if it includes free and open access to the Strait of Hormuz, and a verifiable and permanent end to Iran's uranium enrichment program. Whether this is achievable, or other issues become roadblocks, will likely not be known for many weeks, with tensions and confusion likely to continue in the meantime. China may also play an increasing role as "mediator", and a long-awaited meeting between Presidents Trump and Xi looms in mid-May in Beijing, where the conflict will take center stage along with continued trade negotiations.

Throughout this difficult period, investors have been bracing for sharply divergent outcomes, attempting to game out market reactions to "ceasefire", "mission accomplished" and "escalation" scenarios. With the ceasefire scenario playing out, equity markets have rallied off their March lows. Despite the recent ceasefire, the Strait of Hormuz remains largely closed. Energy and food markets may continue to face physical shortages in the coming months, and we expect near-term economic and inflation data to deteriorate based on the events that have already occurred. For a durable rally to take place in markets, the Strait needs to see increasing activity. Every day that the Strait remains closed, more economic damage is "baked into the cake." Should the Strait "open" to increased traffic, we believe that forward-looking financial markets will look through weak economic and inflation data to refocus on domestic fundamentals. While markets have been volatile, the correction in the S&P 500 stopped short of a 10% decline, with investors cautious on one hand but fearful of missing a strong "peace progress" recovery on the other. Volatility is the price of admission for long-term equity returns, but we recognize that moments like this test the resolve of even the most disciplined investors. As always, please reach out to us if you have concerns about investment strategy or if you simply want to discuss recent events.

Turning to other matters, we want to take this opportunity to let you all know about the upcoming retirement of our colleague, Donna Gacek! Donna has been an amazing member of the team and is like family to all of us. We know from the positive feedback from many of you over the past 12 years that she will be greatly missed. We've known this day was coming for many years, as Donna's work hours have gradually been reduced, but the time has finally come for her to have more freedom in her schedule, and more time to spend with her beautiful, and growing, family! Please join us in wishing her the very best in her retirement!