



A Trifecta of Concerns Hit Markets in the First Quarter of 2026

Geopolitical surprises began immediately in 2026 when on January 3rd, the U.S. military performed a daring raid in Venezuela and arrested Venezuelan President Maduro. The negative market action reversed as the new Venezuelan leader pledged to work with the U.S. Shortly after, we received another surprise as the U.S. Attorney for the District of Columbia issued two grand jury subpoenas to Fed Chair Powell surrounding the renovation of the Federal Reserve building. That action renewed concerns about attacks on Fed independence, which, if compromised, could destabilize inflation expectations. While these surprise headlines caused short bursts of market volatility, stable economic data and solid fourth quarter earnings helped keep economic and earnings growth forecasts intact.

The volatility continued in early February, but this time it was more focused on specific sectors, i.e., technology and financial services. Artificial Intelligence (AI) company, Anthropic, released a Claude application that caused a steep decline in the software sector. There are growing concerns that AI advancements could eliminate the need for entire software-related sectors of the economy. Software stock declines ultimately spread into the private credit market as a number of large alternative asset managers limited redemptions from their private credit funds. Finally, on the last day of February, geopolitical risks surged as U.S. and Israel launched a massive attack on Iran, sparking a war that effectively closed the Strait of Hormuz. These actions caused oil prices to surge overnight.

The market decline accelerated in March as hopes for a quick resolution to the military action faded. While U.S. and Israel dominated the conventional military conflict, Iran and its proxies attacked neighboring Gulf states' energy infrastructure and oil tankers in the Persian Gulf. These actions contributed to the rise in oil above \$100/barrel adding additional pressure to the global economy. The S&P 500 fell moderately on the surge in geopolitical risks, although hopes of a ceasefire late in March helped limit losses.

First Quarter Performance Review

As mentioned above, market internals and performance in the first quarter were driven primarily by the Iran war, but also by concerns about private credit and potentially negative impacts from AI.

On an index level, the three major large cap stock indices finished the quarter with losses. The Nasdaq was the worst performer among the group due to weakness in AI-related tech and software stocks. Small caps stocks outperformed relative to large caps as the Russell 2000

finished the first quarter with a small gain. Small-cap stocks were generally viewed as more insulated from the headwinds of geopolitical tensions, private credit worries, and AI concerns.

US Equity Indexes	Total Return 2025	Total Return YTD 2026
S&P 500	17.86%	-4.35%
S&P 500 Equal Weighted	11.40%	0.65%
DJ Industrial Average	14.92%	-3.19%
NASDAQ Composite	21.17%	-6.96%
S&P 500 Dividend Aristocrats	7.28%	2.42%
Russell 2000 (Small Cap)	12.79%	0.92%
MSCI EAFE (International Developed)	32.03%	-1.09%
MSCI Emerging Markets	34.29%	-0.13%

Source: Bloomberg Professional (3/31/2026) Past performance is not indicative of future results. Index performance is shown for illustrative purposes. Indices are unmanaged and cannot be invested in directly.

On a sector level, performance was mixed as six of the eleven S&P 500 sectors finished the quarter with a positive return. The best performing sector in the first quarter, by a large margin, was energy, which surged more than **38%** in the first quarter thanks to rising oil prices. The materials sector, which includes companies with heavy commodity exposure, also was a solid performer (**9.7%**). Finally, utilities (**8.3%**) and consumer staples (**7.7%**) also finished the first quarter with strong gains, as investors rotated to less volatile, more defensive market sectors.

Looking at sector laggards, the financial sector was the worst performing and suffered losses (-9.5%), due to the aforementioned private credit concerns. The consumer discretionary sector also posted a negative return (-9.2%) on worries that higher oil prices would reduce consumer spending. Finally, the technology sector dropped (-9.1%) because of weakness in software stocks and AI-linked technology stocks.

Foreign markets outperformed the S&P 500 and ended the quarter with a small decline, despite the surge in geopolitical risks. Emerging markets outperformed both developed markets and the S&P 500 and registered a fractional loss despite the strong dollar. A surge in commodity prices was seen as offsetting the rising U.S. dollar. Foreign developed markets declined in the quarter, but only modestly, and outperformed U.S. markets owing to the smaller weighting of tech shares in foreign indices. In fixed income markets, the leading benchmark for bonds (Bloomberg US Aggregate Bond Index) finished the quarter with a slight loss. Surging oil prices and hotter than-expected inflation readings reduced expectations for additional Fed rate cuts. Short-term bills modestly outperformed longer-duration bonds and logged a positive return as they tend to be less sensitive to rising inflation risks.

US Bond Indexes	Total Return 2025	Total Return YTD 2026
Bloomberg US Aggregate Bond	7.30%	-0.05%

Bloomberg US T-Bill 1-3 Month	4.29%	0.88%
ICE US T-Bond 10-20 Year	6.53%	-0.16%
ICE BofA US High Yield Index	8.50%	-0.55%
S&P National AMT-Free Municipal Bond	3.77%	-0.20%

Source: Bloomberg Professional (3/31/2026)

Turning to the corporate bond market, both high yield and investment grade corporate bonds declined slightly in the first quarter as spiking oil prices raised concerns about an economic slowdown. The losses were similar in the tax-free bond market during the quarter.

Second Quarter Market Outlook

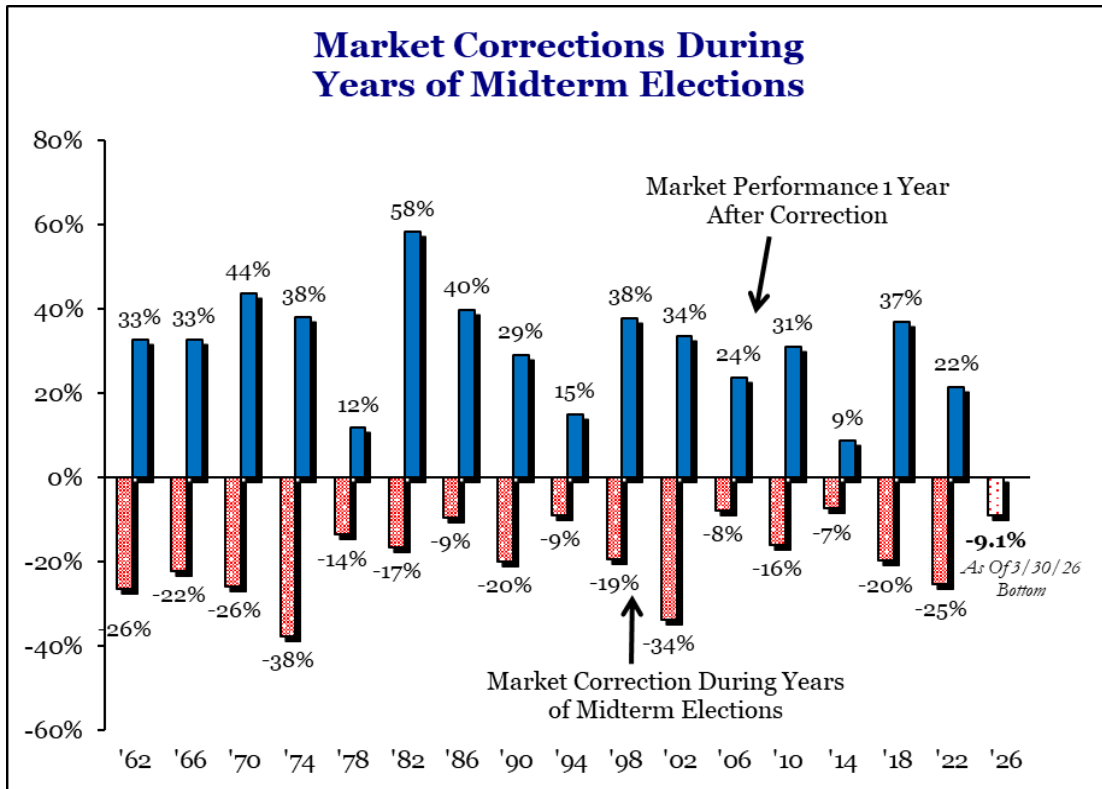
Stocks began the second quarter facing three distinct market headwinds: higher oil prices, private credit concerns, and creative destruction from transformative AI technology. Each of these concerns will need clarity if the market is going to rebound and make new highs. It is important to note that economic growth and corporate earnings forecasts remained solid throughout the quarter and helped provide support to the market.

Starting with geopolitics and its impact, the focus remains on the price of oil. Elevated oil prices pose a risk in multiple ways including: **1)** No Fed rate cuts as the Fed worries higher oil prices may spur inflation; **2)** Depressed consumer spending as higher gas prices reduce disposable income, and **3)** Lower corporate margins given increased transportation and infrastructure costs. For geopolitical risks to fully recede, we would need to see a credible ceasefire agreement between all parties (the U.S., Israel, and Iran). Transit through the Strait of Hormuz would need to return to something close to normal and oil prices would need to decline back towards pre-war levels.

Meanwhile, private credit is evoking memories of the financial crisis amongst more tenured investors. While analogies to the financial crisis are understandable, it is important to realize that private credit as a whole is a small subset of the fixed income asset class, i.e., less than 5% of the \$73 trillion US fixed income market. Additionally, Fed officials have recently said they see no indication of a systemic problem. While that is reassuring, private credit concerns are still weighing on the financial sector. An easing of concerns, more clarity on Fed policy on interest rates, and a rebound in financials is needed to help stabilize the market for the remainder of the year.

Turning to AI, opinions on the impact of AI on the economy have shifted from mostly positive to that of increased skepticism. First, there is fear that massive spending on AI infrastructure by large tech companies may ultimately generate poor return on investment (ROI), thus depressing future earnings. Second, there is fear that AI advancement may disrupt entire portions of the economy (such as the software sector) and could lead to large job losses that hurt overall economic growth. Both issues need clarity for AI and the software industry to fully recover.

A looming market risk we need to address here is midterm elections. Historically, midterm election years are the toughest in the four-year cycle for stocks, with an average intra-year decline of -19.4%. Corrections in stocks every year are a normal function for markets to operate efficiently and to release pressure from periods of excessive sentiment and stock valuations. The historical precedent is that intra-year declines in midterm election years tend to be larger, with the average decline larger when compared to -12-13% average corrections in non-midterm election years. During these years, the equity market becomes more defensive, with health care, utilities, and consumer staples being stronger relative performers compared to the broad S&P 500 index.



Source: Strategas Research Partners. Data represents historical market performance; methodology available upon request. Historical trends and past performance are not indicative of future outcomes.

There is a positive aspect. Years where the corrections are larger also tend to be those with larger bounce backs. Bottom line, midterm election years have historically been tough for stocks, but that weakness has also coincided with periods of attractive returns for investors. In fact, the S&P 500 index has not declined in the twelve months following a midterm election going back to 1938 – with the average gain just over +30%!

To conclude, the first quarter did contain several negative surprises, and we begin the second quarter with the above-mentioned uncertainty. But there are also positive factors at work that must be considered - a resilient economy, strong corporate earnings growth, and a Federal Reserve that is signaling an easy monetary policy. Those factors provide support for stocks and bonds despite the volatility and elevated uncertainty. As such, the underlying outlook for both

the economy and financial markets for the intermediate term is not universally negative and, as we experienced firsthand in April of 2025, the market landscape can shift direction quickly.

As stewards of your wealth, we have experienced similar market environments where selling creates high volatility reflecting the emotional intensity of the time rather than a clear deterioration in the underlying economic fundamentals. For advisors, this reinforces a principle we manage to: bouts of volatility and negative investor sentiment are inevitable, underscoring why portfolios should remain anchored in diversification, aligned with long-term objectives, liquidity needs, and investor risk tolerance. Our emphasis on maintaining a diversified approach is not simply defensive, it is the mechanism through which uncertainty can be transformed into long-term opportunity for investors. Be assured that our entire wealth advisory team will remain dedicated to helping you navigate this market environment to the best of our ability.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,
The Slatestone Wealth Investment Committee

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