

Market Newsletter

First Quarter 2026

EXECUTIVE SUMMARY

- Global optimism from late 2025 evolved into a more complex environment where resilient U.S. consumer spending and a stable labor market offset pressures from sticky inflation and geopolitical tensions.
- While global equities and bonds faced headwinds, investors found success by rotating into "out-of-favor" areas like Value and Small-Caps, which provided a critical buffer against the 12% drop in the "Magnificent 7."
- The U.S. economy continues to grow, though at a more fragmented pace, with high-migration regions in the Sun Belt and new industrial hubs significantly outperforming more stagnant coastal markets.
- Outside the U.S., economic conditions remain mixed; however certain countries are benefiting from appreciating commodity prices.
- A major highlight of the market's fundamental strength is that most of the 2025 equity returns were driven by robust earnings growth rather than just speculative hype.
- Corporate profitability remains a strong foundation, with 76% of S&P 500 companies beating expectations in the fourth quarter of 2025 and delivering the fifth consecutive quarter of double-digit earnings gains.
- Although valuations are facing increased scrutiny, forward-looking earnings and revenue forecasts for 2026 have recently been revised upward, which augurs well for future equity performance.
- The quarter reinforced the "fallacy of point-in-time returns," proving that a disciplined, diversified approach is the most reliable way to navigate shifting market tides.
- Historical shifts in S&P 500 leadership (such as AIG and Citigroup) remind us that diversification allows investors to capture the rising stars of "creative destruction" while avoiding over-exposure to yesterday's winners.

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Table 1: Market indices

<i>(Returns include dividends reinvested)</i>	Quarter to date	Year to date	1 Year	3 Year Annualized	5 Year Annualized
S&P 500	-4.33%	-4.33%	17.80%	18.32%	12.06%
S&P Mid Cap 400	2.50%	2.50%	17.35%	12.09%	6.92%
S&P Small Cap 600	3.51%	3.51%	20.50%	10.51%	4.49%
MSCI Emerging Markets	-0.10%	-0.10%	30.30%	15.41%	4.16%
MSCI EAFE	-1.12%	-1.12%	21.88%	14.19%	8.45%
Vanguard Total Bond Market Index	0.02%	0.02%	4.21%	3.48%	0.21%
Investment Grade Credit	-0.42%	-0.42%	4.85%	5.16%	0.95%
Non-Investment Grade Credit	-0.50%	-0.50%	6.90%	8.82%	4.19%
Bloomberg Commodity Index	24.42%	24.42%	32.29%	13.88%	14.04%
Dollar Index	1.58%	1.58%	-4.16%	-0.86%	1.39%
10 Yr. Rate	4.31% 03/31/2026	4.16% 12/31/2025	4.25% 03/31/2025	3.49% 03/31/2023	1.75% 03/31/2021

Source: S&P Dow Jones, St Louis Fed, MSCI.com, Morningstar, Bloomberg, Yahoo Finance

Table 2: Vanguard Life Strategy (Asset Allocation) Funds

	Quarter to date	Year to date	1 Year	3 Year Annualized	5 Year Annualized
Income (20% stocks)	-0.44%	-0.44%	7.4%	6.25%	2.15%
Conservative Growth (40% stocks)	-0.76%	-0.76%	11.12%	8.93%	4.04%
Moderate Growth (60% stocks)	-1.04%	-1.04%	14.77%	11.57%	5.86%
Growth (80% stocks)	-1.3%	-1.3%	18.45%	14.25%	7.69%

Source: Vanguard

Table 3: Recent Major US Economic Releases (These indicators have a significant impact on the stock market)

As of 04/06/2026			
	Latest Release	Recent Trend	Notes
Non-Farm Employment	178,000	Negative	While the latest number was better than expected, with revisions, the employment number has been choppy and reflects a "low-hire, low-fire" labor market. Tariffs, War and interest rate uncertainty have made employers cautious.
Weekly Claims for Unemployment Insurance	202,000	Positive	Weekly claims have settled in the low 200K range indicating labor market stability.
ISM Manufacturing Index (over 50 indicates growth)	52.7	Positive	This marked a third consecutive month of expansion. While production and new orders remained strong, the report highlighted a significant surge in the Prices Index to 78.3, driven by Middle East supply chain disruptions

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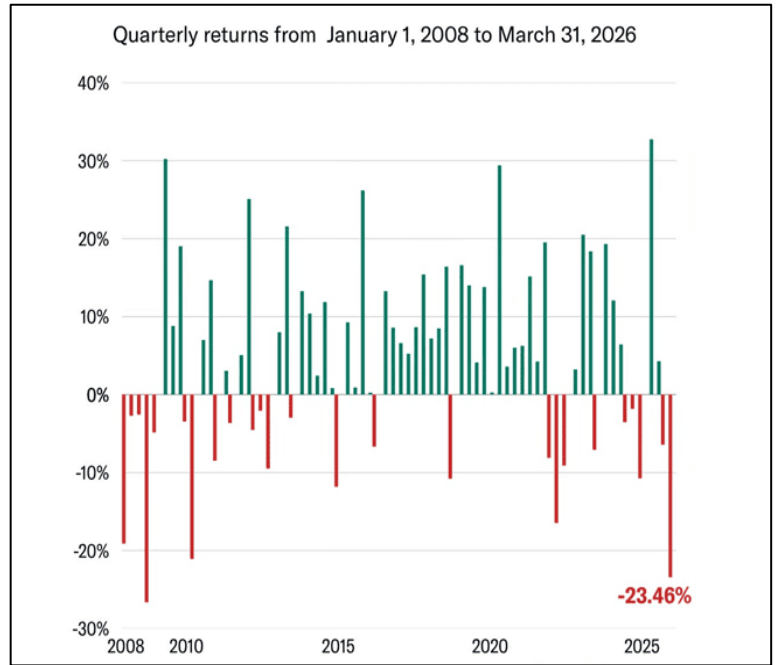
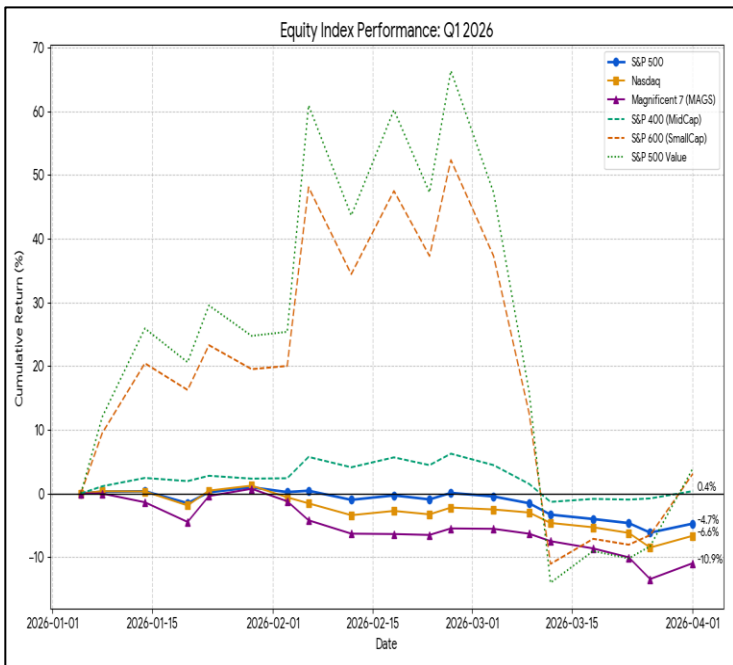
	Latest Release	Recent Trend	Notes
ISM Non Manufacturing Index (Over 50 indicates growth)	54	Positive	The services sector is still growing but employment shrank by the most since 2023 and input prices accelerated sharply. Uncertain economic conditions could weigh on the sector.
Consumer Prices (Month over month change)	0.3%	Positive	Inflation has dropped since December. However, this was before the conflict in middle east, which is expected to increase inflation. The year over year reading was 2.4% and core inflation, stripping out food and energy, was 2.5%
Producer Prices (Month over month change)	0.7%	Negative	This was the highest increase in 7 months. Services sector accounted for a majority of the increase. The war in the middle east is expected to increase this further. Year over year inflation was 3.4%.
Retail Sales (Month over month change)	0.6%	Positive	Retail sales was better than expected. Growth was driven by motor vehicle sales and online shopping, signaling resilient consumer demand despite ongoing inflationary pressures and global supply chain concerns.
Consumer Confidence (Conference Board)	91.8	Negative	Consumer confidence was better than expected helped by current conditions. But consumers are anxious about rising oil prices and geopolitical tensions involving Iran.
Durable Goods Orders (Month over month change)	0%	Positive	While the headline number has been sluggish, the core excluding transportation has grown for three consecutive months. Headline durable goods has increased by over 10% since last year.
Industrial Production (Month over month change)	0.2%	Positive	Despite tariff uncertainty industrial production has been resilient and surprised to the upside. The recent number was helped by motor vehicle production, mining and energy. The middle east conflict could hurt going forward.
Capacity Utilization	76.3%	Positive	Capacity utilization is 3.1 percentage points below its 1972–2025 average but still stable.
Housing Starts	1.487 Million	Positive	Housing starts rose at the fastest rate in nearly a year boosted by multifamily sector (Apartments). Low mortgage rates and incentives helped. Single family homes have been relatively sluggish.
Home Prices (Case-Shiller Home Price Index- Year over Year)	1.20%	Negative	The data indicates a significant cooling in the housing market, with national home price growth hitting its weakest start to a year since 2012. Prices remain elevated and mortgage rates have backed up with inflation concerns.
GDP (Real, Annualized)	0.7%	Negative	The economy decelerated sharply in the fourth quarter as compared to the third. The Government shutdown subtracted a significant portion of the growth. Weaker-than-expected exports, and lower levels of business investment also hurt. Consumer spending remained resilient.

Source: Bloomberg, www.federalreserve.gov, www.bls.gov, www.ismword.org, www.nahb.org

The first quarter of 2026 marked a turning point in financial markets, as the optimism that carried through late 2025 gave way to a more fragile and uncertain environment shaped by inflation persistence, geopolitical tensions, and shifting expectations around central bank policy. Global equity markets broadly declined during the period, with U.S. stocks leading the pullback as elevated valuations—particularly in large-cap technology and artificial intelligence—linked names—came under pressure. Investors rotated away from growth-oriented sectors and toward more defensive and value-oriented areas of the market, including energy and industrials, reflecting a more cautious stance on the economy. Stocks of smaller companies, which had been underperforming for years, fared better on account of their relative cheapness. (Fig 1). An equally weighted portfolio of the 'Magnificent 7' tech stocks fell over 12% this quarter, led by Microsoft, which saw its sharpest decline since 2008 with a 23% drop. (Fig 2).

Fig 1: Dispersion in US stocks

Fig 2: Microsoft had the worst quarterly return since 2008



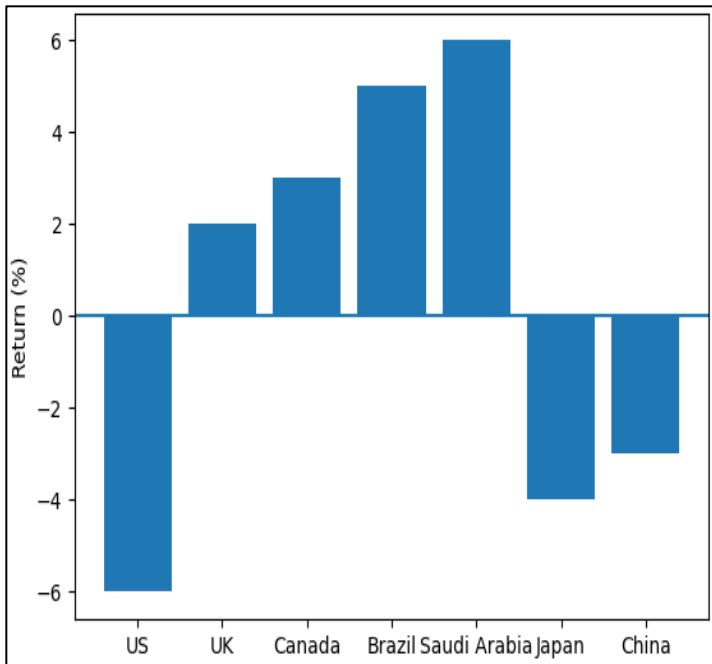
Source: S&P, Nasdaq

Source: Yahoo Finance.

International equities also faced headwinds, although performance varied by region; markets with greater exposure to commodities and energy production, such as Norway, Brazil, Canada, and the UK, were relatively more resilient, benefiting from rising input prices and improved earnings outlooks in those sectors. (Fig 3) Volatility increased meaningfully across equity markets as investors reacted to both macroeconomic data and geopolitical developments, reinforcing a more risk-averse tone.

Fixed income markets delivered modestly negative returns, highlighting the challenges of navigating an environment where inflation remains above central bank target levels. Government bond yields trended higher throughout much of the quarter, particularly in longer maturities, as expectations for imminent rate cuts were pushed further out. This repricing reflected central banks' continued emphasis on maintaining restrictive policy until there is clearer evidence of disinflation. Credit markets also weakened somewhat, with spreads widening modestly in both investment-grade and high-yield segments, as investors demanded additional compensation for economic and market uncertainty. The result was a quarter in which traditional diversification benefits were less effective, as both equities and bonds struggled simultaneously. However, diversified portfolios of bonds (Such as the Vanguard Total Bond Market Fund) eked out a positive return as short duration bonds and interest income compensated for the losses supporting the case for diversification.

Fig 3: Countries with exposure to commodities benefited



Source: MSCI Country Indexes

Fig 4: Markets have risen over time through various events



Source: Dimensional Fund Advisors

Commodities were the notable exception to this pattern, emerging as one of the strongest-performing asset classes during the quarter. Energy markets saw significant gains driven by supply concerns and escalating geopolitical tensions, which contributed to sharp increases in oil prices. Other areas of the commodities complex also moved higher, though performance was more uneven; industrial metals benefited from supply constraints and expectations of infrastructure demand, while precious metals experienced bouts of volatility because of rising real yields.

The first quarter of 2026 underscored a shift toward a more macro-driven market environment. Correlations across asset classes became less predictable, making diversification more challenging but also more critical. For investors, the quarter served as a reminder of the importance of maintaining a disciplined, long-term approach while remaining adaptable to changing market conditions. While geopolitical events like the war in the Middle East upend stock markets, historically, they have rewarded long-term investors. (Fig 4)

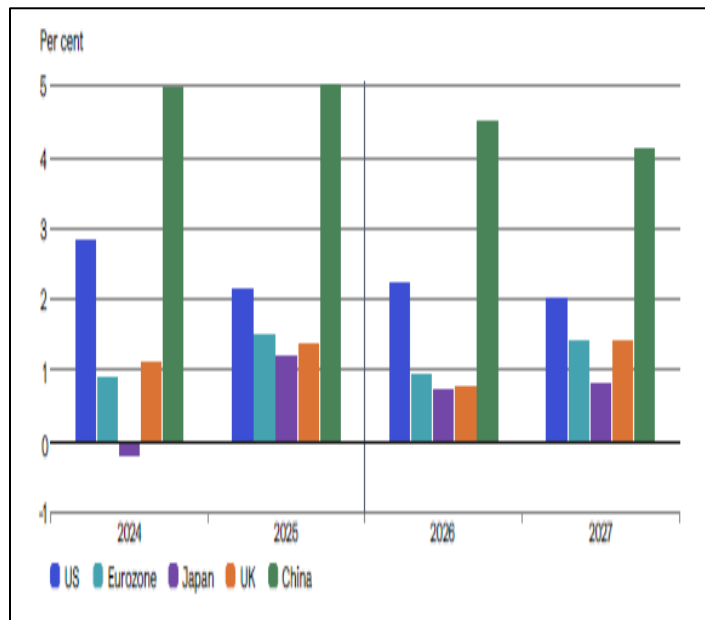
The Economy

In the first quarter of 2026, the global economy evolved against a backdrop of slowing—but still positive—growth, persistent inflationary pressures, and heightened geopolitical uncertainty, all of which contributed to a more fragile macroeconomic environment than many had anticipated at the start of the year. In the United States, economic activity remained relatively resilient, supported by steady consumer spending and a still-solid labor market, but there were increasing signs of moderation as higher interest rates continued to work their way through the system. Business investment showed pockets of softness, particularly in interest rate-sensitive sectors such as commercial real estate and manufacturing, while surveys of corporate sentiment pointed to a more cautious outlook. This pressure was equally visible in the housing market, where elevated mortgage rates and limited inventory created a challenging environment for buyers and sellers alike. Furthermore, economic growth became increasingly uneven across the country, with high-migration regions in the Sun Belt and emerging industrial hubs significantly outperforming more stagnant coastal markets. Inflation, although off its peak levels from prior years, proved sticky, especially in services, complicating the path forward for the Federal Reserve and delaying expectations for policy easing. Wage growth remained elevated relative to historical

norms, reflecting ongoing labor market tightness, but also raising concerns about sustained price pressures. Overall, the economy is growing, but at a more fragmented and lower rate than before (Fig 5).

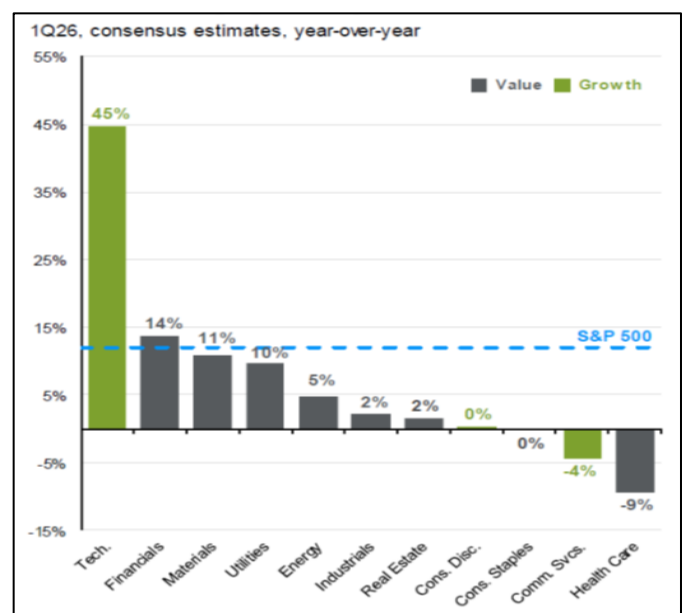
Outside the United States, economic conditions were mixed across regions. In Europe, growth remained subdued, constrained by weak industrial activity and lingering energy-related vulnerabilities, although lower natural gas prices compared to prior years initially provided some relief to both households and businesses (Before the war in the Middle East affected it). The European Central Bank maintained a cautious stance, balancing the need to contain inflation with concerns about stagnating growth. In Asia, China’s economic recovery continued to fall short of expectations, with ongoing challenges in the property sector, uneven consumer demand, and limited effectiveness of policy stimulus measures weighing on momentum. This softness had spillover effects on global trade and commodity demand, particularly for industrial inputs. Other emerging markets experienced a more varied environment, with some benefiting from commodity exports and relatively stable domestic conditions, while others faced pressure from a stronger U.S. dollar and tighter global financial conditions.

Fig 5: GDP Growth rates (Real)



Source: Aviva Investors

Fig 6: S&P 500 earnings growth by sector (1Q 2026)



Source: JP Morgan

A defining feature of the quarter was the impact of geopolitical tensions, particularly in the Middle East, which contributed to renewed volatility in energy markets and introduced additional uncertainty into the global growth outlook. Rising oil prices acted as a tax on consumers and businesses, squeezing margins and dampening purchasing power, while also reinforcing inflationary pressures at a time when central banks were seeking clearer progress toward price stability. Global trade dynamics remained uneven, with supply chains largely normalized compared to the disruptions of earlier years, but still vulnerable to sudden shocks tied to political developments.

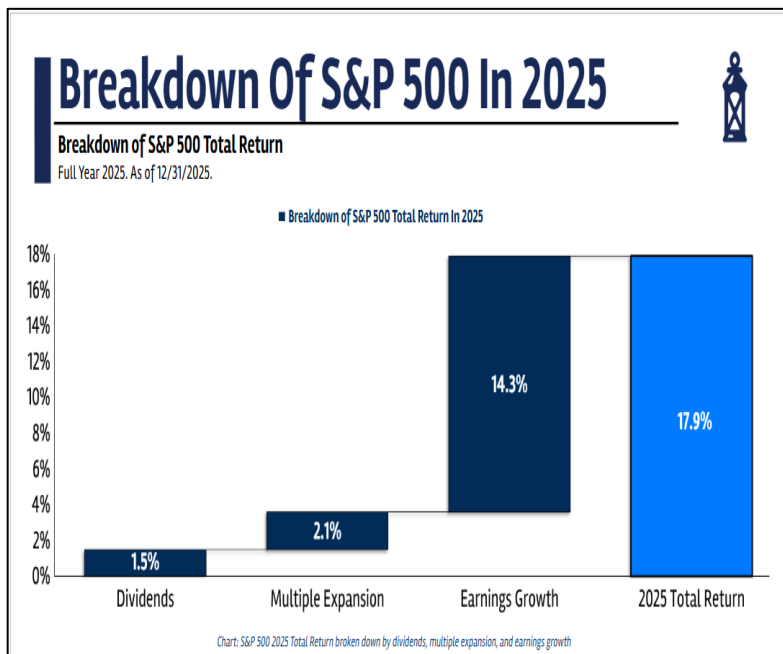
Overall, the first quarter of 2026 highlighted an economy navigating the late stages of a tightening cycle, where growth is slowing but not collapsing, and inflation is easing but not yet fully contained. Policymakers faced a delicate balancing act, attempting to sustain economic expansion without reigniting price instability, while businesses and consumers adjusted to a higher-cost environment. The result was a period characterized less by acute crisis and more by accumulating crosscurrents, leaving the trajectory for the remainder of the year highly dependent on the interplay between inflation trends, policy decisions, and geopolitical developments.

Corporate earnings

U.S. corporate earnings exiting 2025 provided a strong foundation for equity valuations heading into 2026. According to FactSet, the S&P 500 delivered 14.2% year-over-year earnings growth in Q4 2025 (up from the initial 13.0% estimate), marking the fifth consecutive quarter of double-digit gains, with revenue growth of 9.1%. Importantly, about 76% of companies beat earnings expectations, which aligns more closely with historical averages than previously thought, suggesting profitability remained robust. Earnings growth was led by the Information Technology, Industrials, and Communication Services sectors. On the other hand, two sectors reported a year-over-year decline in earnings: Consumer Discretionary and Energy.

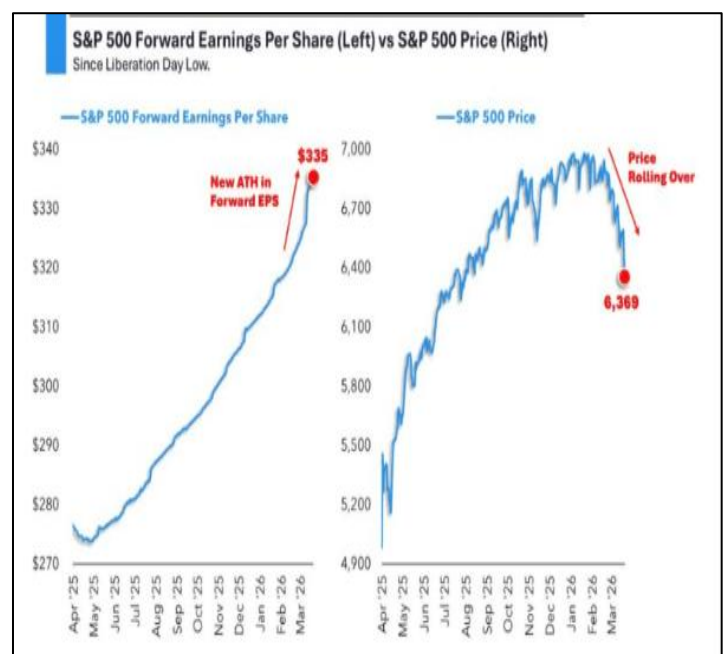
By the end of the quarter, the forward 12-month P/E ratio for the S&P 500 was 19.8. This P/E ratio is below the 5-year average (19.9) but above the 10-year average (18.9), indicating that markets were pricing in continued strong earnings delivery. One of the underappreciated factors of US equity returns in 2025 is that most of the stock market's return was due to earnings growth as seen in Fig 7.

Fig 7: Earnings were most of market return in 2025



Source: A wealth of common sense (Ben Carlson)

Fig 8: The S&P 500 drop in 2026 is multiple contraction



Source: Chartkidmatt.com

Looking ahead, earnings expectations for the first quarter of 2026 remained constructive. FactSet expects year-over-year earnings growth of 13.2%, and revenue growth of nearly 9.7%. The technology sector is expected to be responsible for almost half the earnings growth (Fig 6). These forecasts were revised modestly lower during the fourth quarter of 2025, reflecting softer economic momentum and persistent cost pressures. This combination—decelerating earnings growth alongside elevated starting valuations—led to increased scrutiny of multiples, particularly in growth sectors. As a result, even with continued earnings expansion, equity markets experienced multiple compression, as investors recalibrated expectations for forward returns and demanded a greater margin of safety in a more uncertain macro environment. Since the end of the fourth quarter, both earnings and revenue forecasts have been revised upwards, and this augurs well for future equity performance. In fact, as seen in Fig 8, the entire decline in S&P 500 in the first quarter was because of multiple contraction.

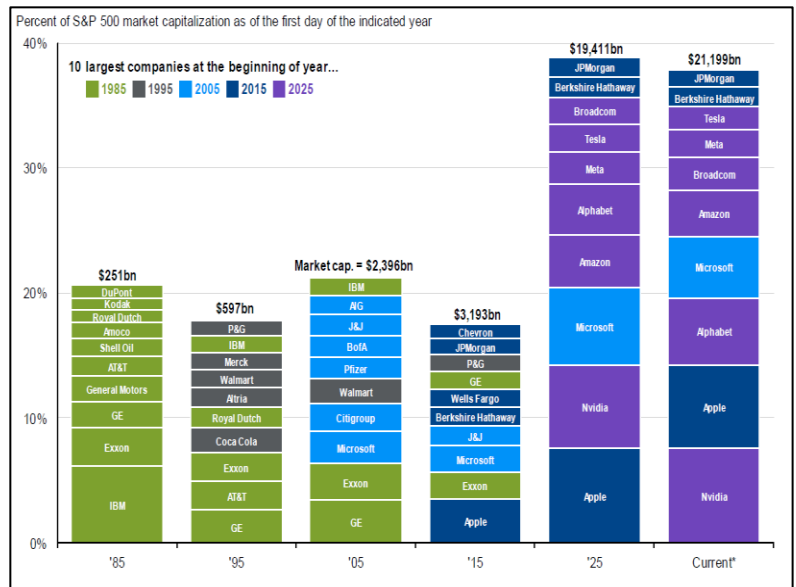
Reinforcing the need for diversification

Table 1: The Fallacy of point-in-time returns

Start Date	Index	Final Portfolio Value	Total Return	CAGR (Annualized)
1/1/2000	S&P 500 Value (IVE)	\$68,340	583%	7.62%
(Bubble Peak)	S&P 500 Growth (IVW)	\$55,120	451%	6.72%
1/1/2003	S&P 500 Value (IVE)	\$81,200	712%	9.45%
(Post-Crash)	S&P 500 Growth (IVW)	\$104,450	944%	10.63%

Source: Sarsi

Fig 9: The top S&P 500 companies by market capitalization.



Source: JP Morgan

We have frequently discussed the importance of building a diversified portfolio for long-term resiliency and reliability (see previous insights [HERE](#) and [HERE](#)). Recent market action has reinforced this, as "out-of-favor" segments—such as international stocks, value stocks, and small-company stocks—have stepped up to deliver strong returns. Another argument for diversification is the fallacy of point-in-time returns, where comparing investments based on a single arbitrary start date can lead to misleading conclusions. For instance, a \$10,000 investment in S&P Value stocks on January 1, 2000, would have handily beaten S&P Growth stocks because that date marked the peak of the "Internet Bubble." However, as shown in Table 1, if an investor had started just three years later in 2003, the result would have completely reversed. Since it is impossible to exactly predict when the tide will turn for any specific style, diversification is the only reliable solution. Diversification also allows you to capture the winners of "creative destruction", the process whereby new leaders rise and old titans fall. As seen in Figure 9, the list of top S&P 500 companies shifts remarkably every decade; staying diversified ensures you own the rising stars of tomorrow rather than over-investing in yesterday's leaders, some of which, like AIG and Citigroup, eventually delivered extremely poor returns.