
FIRST QUARTER 2026 ECONOMIC AND FINANCIAL MARKETS REVIEW

The stock market became exceptionally volatile during the first quarter of this year. One reason for this volatility was the fear that the growth of Artificial Intelligence may have gotten too overheated, and also that its expanded use would disrupt certain industries, leading to lower corporate profits and possibly higher unemployment. Another reason the stock market recently became unstable is uncertainty regarding the Federal Reserve Board's future interest rate policy. President Trump nominated a new Fed Chairman, and it is now less predictable how many times the Fed will lower interest rates this year. Additionally, ever-changing tariff policies led to further stock market instability during the first quarter. Finally, the breakout of war with Iran created significant anxiety among investors in March. As a result, the stock market declined during the first quarter, with the S&P 500 Index down 4.63% and the Dow Jones Industrial Average down 3.58%. The Bloomberg Intermediate U.S. Government/Credit Bond Index decreased 0.02% during the first quarter.

Some investors are worried that the release of Artificial Intelligence tools could replace certain businesses, or at least eat away at their profit margins, thereby negatively impacting many industries. For example, stocks of financial companies came under pressure in the first quarter amid fears that AI would disrupt their investment banking businesses. Trucking and logistics companies declined due to concerns that AI would streamline freight operations, thereby weighing on revenues. Certain software stocks lost much of their value as investors worried that AI models could enable businesses to perform legal and accounting work by building programs themselves, rather than paying for expensive software licenses. Finally, many office real estate stocks also declined in the first quarter because the volume of white-collar jobs that fill office buildings may no longer be needed, as many workers could eventually be replaced by AI. These are just several examples of high-fee, labor-intensive businesses that are susceptible to disruption.

In addition, there has been considerable uncertainty regarding the interest rate policy of the Federal Reserve Board. Although inflation remains above target and the labor market is relatively stable, economic growth has been weaker than expected. These conflicting factors that impact the Fed's decision making create an unsure path forward. In addition, the current Fed chairman's term is coming to an end, and President Trump has nominated a new chairman. Although investors expected the nominee to be a proponent of lowering interest rates aggressively, it appears unlikely that the chairman-elect will encourage the Federal Reserve Board to lower rates this year as much as previously expected. The Fed lowered interest rates several times last year, and such moves are generally positive for the stock market. There is no doubt that interest rate uncertainty is now at the top of investors' minds.

During the month of February, the Supreme Court ruled that some of President Trump's tariffs were unconstitutional. President Trump initially responded by using other means to increase tariffs on all countries to 15%. This sparked a short-term market selloff as well. It remains to be seen which path forward this will take, as tariff policies have been fluid over the course of the president's second term.

The commencement of war with Iran added to investor uneasiness at the end of the quarter. Iran is a large oil and gas producer, as are many of its neighboring Gulf countries involved in the war. Iran is also located alongside the Strait of Hormuz, through which approximately 20 percent of the world's oil and gas supply is transported. Investors fear that prolonged energy supply disruptions caused by the war will

continue to raise energy costs for the global economy. This also furthers inflation concerns at a time when inflation has not declined as much as the Fed would like. However, although wars and other geopolitical events can make the markets unstable in the short term, they typically do not cause a meaningful long-term impact.

It bears keeping in mind that stock market returns have generally been exceptionally positive over the past several years. Although we are hopeful that the financial markets will continue to perform well, there may be some further headwinds this year. We do not expect a long, drawn-out bear market in the near future, but it would be abnormal for the stock market to continue rising at the same pace as in the past few years. Despite the first-quarter decline, stock valuations remain high, and often this can lead to profit-taking and a cooldown period for the stock market to reset valuations closer to normalcy.

Last year, we generally overweighted large-company growth stocks, which outperformed, and underweighted large-company value stocks, which underperformed. We also allocated more to foreign stocks for some clients while underweighting U.S. small-company stocks last year. This year, we will likely prioritize less-volatile, value-oriented U.S. stocks over growth-oriented stocks, and we may reallocate more money from domestic stocks to foreign stocks for our more aggressive investors. We continue to favor short-term bonds over long-term bonds because they provide a better risk/reward profile. We may also add additional exposure to bonds if circumstances warrant it.

As always, we will continue to monitor ongoing economic and financial market conditions. In the meantime, please contact us if you have any questions regarding your portfolio or the financial markets in general.

** Index returns were obtained from the Wall St. Journal and Bloomberg on April 1, 2026.*

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