

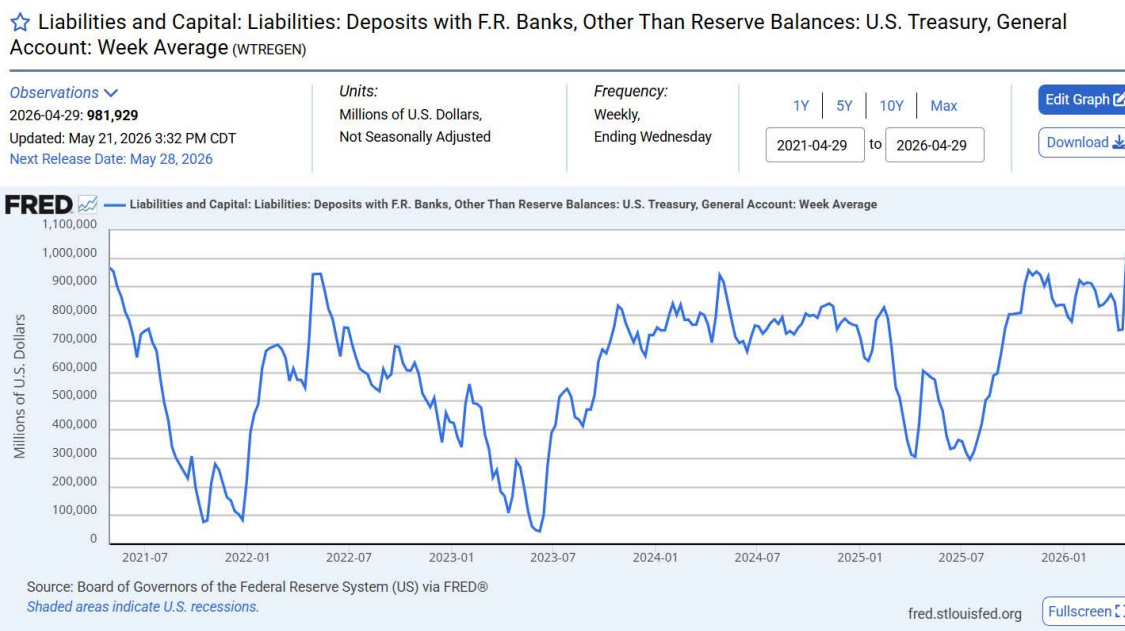
MARKET SPOTLIGHT

May 2026

After a volatile first quarter, markets rebounded significantly in April with the global stock market index returning nearly 10%. Numerous other well-known indices like the Nasdaq and Russell 2000 rewarded investors with even greater returns. Despite this rally, the risks posed by the conflict in Iran remain. The Strait of Hormuz remains effectively shut, choking off a vital energy artery that many large economies rely on.

In our recent quarterly outlook, we wrote that despite this large risk, technical factors were building in equities (particularly in the U.S.) that would likely overwhelm any fundamental issues the market faced. As a result, not only did risk assets find a market bottom, they sharply rebounded as well. Specifically, we highlighted the large amount of cash being held by the treasury, and how the spending down of that cash balance could benefit markets (see below). A reduction in funds held in the TGA represents a direct infusion of cash into the economy, which ought to provide some ballast to equity prices. Combined with ongoing quantitative easing, these forces will provide a tailwind to markets. If earnings expectations remain resilient, the setup into next quarter begins to look more constructive. We would not be surprised to see risk assets stabilize and potentially rebound as liquidity helps market sentiment to bottom.

We should note that as of this writing (April 30, 2026), the treasury was still holding significant cash balances (see chart below). We expect hundreds of billions of dollars will be spent down from this balance, and a significant amount of that cash is likely to find its way into stock markets.



Additionally, we would note that as first quarter earnings season passes, share buyback windows will open soon, allowing companies to begin repurchasing their shares. Needless to say, this adds more technical buying tailwinds to the U.S. equity picture.

All told, the technical picture of markets remains solid and we advise clients to maintain healthy risk asset positions at this point. That might change in the near future though, as valuations have expanded materially and systemic risks posed by the Iran conflict still looms large. The fallout from prolonged closure of the Strait of Hormuz and the chain reaction of events it could bring are nearly impossible to predict, and we will need to remain vigilant.

One additional news item we would note is that Jerome Powell announced at his most recent press conference that he will remain on the board of governors for the Federal Reserve even after Kevin Warsh becomes chair. While not unprecedented, it has been decades since a chair has taken this step. This is an important move because of the different policy outlooks Warsh and Powell have. Warsh believes that given the likely disinflationary productivity boost that artificial intelligence will bring to the economy, interest rates should move lower in anticipation of that effect. Powell and most Fed governors do not seem to share this outlook. They have been overly hawkish with respect to rate policy in our view, as we agree that significant productivity gains are coming.

Part of the reason why we hold our rate view is due to the effect interest rates are having in today's economy. We are also concerned by who is bearing the cost of those higher rates. Numerous commentators have noted the "K-shaped" aspect to our economy, where wealthy individuals and enterprises appear to be benefitting from economic growth in a disproportionate way. Part of this is because low-income cohorts and smaller businesses tend to borrow at short-term interest rates in a greater proportion to their counterparts. For example, credit card and student loan delinquencies are elevated and tend to float with short-term rates. On average, private credit loans are made to small and mid-size businesses, and we are similarly seeing stress build partly because of high short-term interest rates. An acute housing shortage persists, and construction loans taken by homebuilders are typically short-term in nature too. Lower short-term interest rates would ease burdens on borrowers feeling acute stress. We also think this would lead to a more balanced economic growth trajectory that is less reliant on a small segment of the population to keep spending.

We have been watching interest rate futures closely, and over the past week the odds of a rate decrease happening by year-end have fallen from 31% to 12%. Somewhat ominously, the odds of a rate increase have increased from nearly 0% one week ago to 9% today. As we stated in our quarterly outlook, should interest rate policy veer off course, it would put our market outlook at risk and we would have to adjust accordingly. We are not at that point yet but again, we are monitoring this effect daily.

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