1Q26 Market Overview: Goldilocks, Interrupted

While a number of broad equity indexes established new all-time highs early in the new year, rumors of war and the war itself weighed on investor sentiment.

Relatively benign first quarter declines belie the severity of the selloff experienced following the February 28 attack on Iran by US and Israeli forces. While the S&P 500 Index lost 4.3% for the period as a whole, it was down more than 9% from its peak. Similarly, the MSCI EAFE Index's decline of 1.2% during the quarter obscures a peak-to-trough loss of more than 11%. After surging to a new all-time nominal high in January, gold gained 8.1% at quarter end.[1]

The war in Iran has altered the Goldilocks narrative, but April has seen a number of equity indexes bounce off their March lows as markets took advantage of less-bad news to rotate back into risk assets. However, we remain wary of a quick declaration of victory and a return to normal macroeconomic and market conditions.

KEY TAKEAWAYS

- Modest quarterly declines across financial markets belie a sharp selloff in risk assets that followed the outbreak of the war in Iran, which has shifted investor sentiment and prompted a physical supply disruption to global energy markets and increased inflationary pressures.
- Markets globally are expecting tighter monetary conditions, but impacts will vary according to an individual economy's reliance on imported energy and its ability to cushion the effects of higher energy prices via policy.
- It appears to us that gold over the past two years had been steadily pricing in the risk of a such a large-scale geopolitical event as the war in Iran. The prospect of higher nominal interest rates in an inflationary environment has weighed on the price of gold since the war began.

1. Source: FactSet; data as of March 31, 2026.

Impulsive Behaviors

In recent quarters, we have repeatedly called attention to the very low risk perception evident in financial markets broadly, as corroborated by high equity market valuations, tight credit spreads and low implied volatility. As we entered the year, these Goldilocks conditions were not entirely without support. Corporate earnings expectations were strong, economic activity was picking up, and hyperscalers continued to direct massive levels of capex toward supporting their ambitions in artificial intelligence. At the same time, expectations of lower interest rates had investors looking forward to easier financial conditions.

The war in Iran has altered the Goldilocks narrative.

The primary economic disruption of the attack on Iran was the shock to the global energy supply chain. In addition to assaulting major Middle East energy hubs, Iran quickly moved to shut down the Strait of Hormuz, the narrow seaway between the Persian Gulf and the Gulf of Oman through which approximately 20% of the world's oil and liquefied natural gas (LNG) supply passes along with a large range of petrochemical inputs and end products. Commodity prices responded violently, with oil and LNG prices climbing more than 50% and 85%, respectively. Fertilizer prices, too, have soared just in time for spring planting season in the northern hemisphere; the Strait handles a large share of the global seaborne fertilizer trade, while LNG is a key feedstock in nitrogen-based fertilizers.[2]

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By prompting what appears to be the largest-ever physical supply disruption to world oil markets, the war with Iran has sent a stagflationary impulse to the global economy that, the longer it persists, is likely to weigh on economic growth while adding to inflationary pressures. The severity of that shock will depend on its duration, each economy's reliance on imported energy and energy-intensive inputs, and policymakers' ability to cushion the effects of higher energy prices on households and businesses.

Global financial conditions have tightened somewhat, with lower equity prices, wider credit spreads and a stronger dollar, but the moves have been relatively modest on expectations that the disruption of energy flows will be short lived. However, infrastructure damage in the Gulf suggests disruptions could be longer than widely appreciated, and uncertainty remains high. Extended supply disruptions would result in significant demand destruction (which we are already seeing signs of in Asia through fuel rationing and flight cancellations), food-price spikes and shortages of important industrial inputs such as helium and sulfur.

Signs of the war's financial toll have just started to trickle into macroeconomic data releases. In the US, for example, the headline consumer price index for March increased to 3.3%, its highest level in nearly two years, driven by a significant increase in gasoline (up 18.9%) and fuel oil (up 44.2%) prices. Though food prices increased a more modest 2.7%, the energy shock is likely to further pressure a US agriculture sector already struggling with the impacts of trade and immigration policy and ultimately contribute to higher food prices.[3]

After entering the year with a dovish bias, markets are now expecting tighter monetary policy in most advanced economies despite the deteriorating macro backdrop. This largely excludes the US, where market expectations have moderated but still imply the Fed will lower rates marginally by year end.[4] And while the US's relatively balanced energy position should enable it to weather the economic impacts of the energy crisis better than many others, oil's nature as a globally traded commodity and a key input into many goods makes some degree of inflationary pressure likely, in our view, and creates challenges for Federal Reserve rate cuts absent much tighter financial conditions or substantial labor market deterioration.

2. Source: Center for Strategic and International Studies; data as of April 1, 2026.
3. Source: US Bureau of Labor Statistics; data as of April 10, 2026.
4. Source: Bloomberg; data as of April 8, 2026.

Gold Prices Puzzle but Persevere

We have noted in the past that gold can sometimes serve as a proverbial canary in a coal mine, sensing potential dangers before they are perceived by the financial markets more broadly. With the benefit of hindsight, it seems to us this prognostic ability may help to partially explain gold's substantial appreciation over the past two years.

Essentially, it appears to us that gold had been steadily pricing in the risk of a large-scale geopolitical event—one that ultimately came to fruition when war broke out between the US/Israel and Iran. Notably, gold surged 14% in January alone as the drumbeats of war grew louder, even before advances in assets likely to benefit most directly from eventual disruptions to energy supply, such as the stocks of integrated oil majors and—with a lag to the equities of oil majors—spot oil prices.[5]

Given gold's reputation as a perceived safe haven during challenging times, however, some have expressed disappointment with its subsequent selloff. In our view, such disappointment overlooks the fact that the price of gold had more than doubled over the preceding two years in response to rising geopolitical risk; a correction upon the realization of a priced-in risk is not surprising and consistent with the pattern observed during similar supply shocks in the Middle East in the 1970s. In the near term, the prospect of higher nominal interest rates in an inflationary environment may also weigh on gold. Over the longer term, however, it is real rather than nominal interest rates that have historically been the more important driver of gold prices.

Short-Term Windows for Long-Term Values

"Never let us be elated by the fatal hope of the war being quickly ended by a devastation of their lands," warned Thucydides in his recounting of the Peloponnesian War, a conflict that lasted for 27 years.[6] And while the Iran conflict seems unlikely to stretch on for three decades, we'd be wary of a quick declaration of victory and a return to normal conditions.

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For example, while hopes of a nearer-term resumption of energy flows through the Strait of Hormuz were temporarily bolstered by the April 8 announcement of a cease fire, the subsequent US naval blockade of ships entering or exiting Iranian ports raised new questions about supply conditions across a range of key commodities. Further, a hostile Iran with the ability to weaponize the Strait at a moment's notice may result in a persistent price premium for commodities dependent upon this shipping route. Meanwhile, the additional financial strains of the war are likely to add to many of the challenges already facing sovereign balance sheets worldwide.

In such an uncertain environment, market volatility would not be surprising. However, such volatility may offer opportunities to acquire high-quality companies at market prices temporarily dislocated from their "intrinsic values."[7]

5. Source: Bloomberg; data as of March 31, 2026.
6. Thucydides, *History of the Peloponnesian War*.
7. "Intrinsic value" is based on our judgment of what a prudent and rational business buyer would pay in cash for all of a company in normal markets.

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