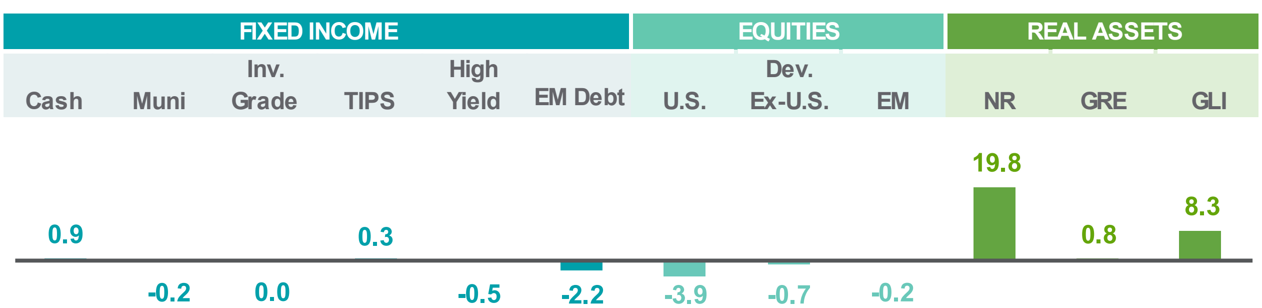
# BROAD SHOCKS FROM A NARROW STRAIT

**Assessing the energy supply shock.** The quarter was defined less by realized macroeconomic outcomes than by a reassessment of risks. Economic momentum entering the quarter was reasonably constructive, and published consensus estimates for trend-like global growth and manageable inflation largely remained intact by quarter-end. However, sentiment shifted as the Iran war moved into its second month, biasing expectations toward weaker growth and higher inflation. The effective closure of the Strait of Hormuz disrupted the flow of a meaningful share of global commodity supply, including oil, natural gas, fertilizers, and other inputs. While strategic stockpiles provided a buffer, each day without a definitive path to resolution increased the risk of supply depletion and a more pronounced global energy shock. The potential economic implications varied across regions, with net energy importers in Europe and Asia facing greater scrutiny than the U.S. Oil futures pointed to a baseline scenario of easing tensions, consistent with expectations for a manageable global economic impact. Still, mixed headlines exiting the quarter tempered confidence that a resolution was imminent, leaving investors to contemplate the risk of a more prolonged disruption. While it remained too early to assess the conflict's impact in economic data, central bank expectations responded more rapidly during the quarter. Futures markets now price multiple rate hikes this year from both the Bank of England and the European Central Bank. Markets also dialed back Fed easing expectations, shifting from two cuts to a hold this year.

**Tough first quarter for markets.** Despite a strong start, a challenging March led to weak 1Q financial market returns. Global equities declined 3%, while fixed income returns were slightly negative with headwinds from both rates and credit spreads. Brent crude oil prices surged above $100 per barrel, leaving the energy sector as the standout winner in the equity space. Real assets outpaced equities, with natural resources and global listed infrastructure aided by energy exposure and lower AI disruption risk. Gold dipped almost 20% from late-January highs, but still posted a 7% quarterly gain. U.S. equities lost 4%, while both non-U.S. developed and emerging market equities finished with small losses after surrendering earlier double-digit gains. Broader U.S. equity market rotation away from megacap tech continued – the Mag 7 was down 12% in the quarter versus a 1% loss for the other 493 S&P 500 companies. Sector-level returns diverged sharply, ranging from a 38% energy gain to 7-10% losses for financials and the tech-adjacent sectors. A number of cross-currents around AI adoption remained a central market theme. Capital spending plans of the largest tech companies continued to top investor expectations, while software companies fell over 20% on concerns around AI business model disruption. The software issues raised concerns for the private credit space, increasing redemption requests and weighing on alternative asset manager stock prices. Full-year 2026 S&P 500 consensus earnings expectations have increased since the start of the year. The bright 2026 earnings outlook (17% y/y growth) helped buffer U.S. equities against further losses in the Iran war's early days.

## FIRST QUARTER 2026 TOTAL RETURNS (%)

There were few diversifying assets outside of the energy complex this quarter.




| | Cash | Muni | Inv. Grade | TIPS | High Yield | EM Debt | U.S. | Dev. Ex-U.S. | EM | NR | GRE | GLI |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2025 | 4.3 | 4.2 | 7.3 | 7.0 | 8.6 | 19.3 | 17.3 | 32.9 | 32.1 | 29.7 | 10.9 | 22.6 |

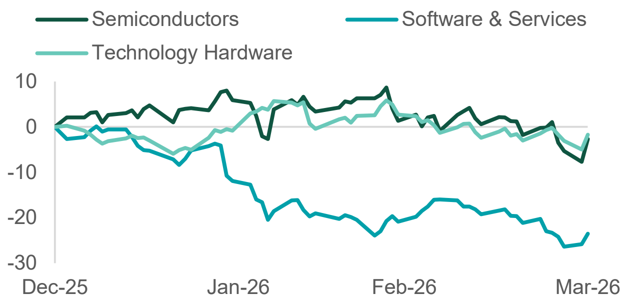
Source: Northern Trust Asset Management, Bloomberg. NR: Natural Resources; GRE: Global Real Estate; GLI: Global Listed Infrastructure. Indexes are gross of fees. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

## KEY DEVELOPMENTS

### AI Adoption and Disruption

Investors grappled with multi-faceted questions on AI including potential returns on massive capital spending, winners and losers, and risk of broad labor market disruption versus productivity benefits. This led to sharp differences in returns across the broader tech universe. Memory stocks led the way, while the software group sold off over 20% due to AI-driven business model disruption risks. The software risks weighed heavily on the private credit space – increasing concerns on both near-term liquidity and longer-term return prospects.

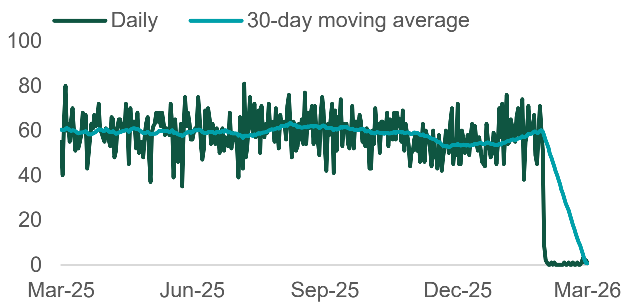
**S&P 500 TECH RETURNS BY INDUSTRY GROUP (%)**




### Iran War Energy Shock

Initial financial market implications from the Iran war centered around global energy markets. Brent crude oil prices quickly moved above $100 per barrel, while some Middle East oil benchmarks topped $150. The war escalated in March with Iran retaliation on targets across the Middle East, damages to energy facilities and tanker traffic halted in the Strait of Hormuz. At quarter-end, the scope of potential outcomes remained wide with a key watchpoint for investors being the extent of energy market and supply chain disruption.

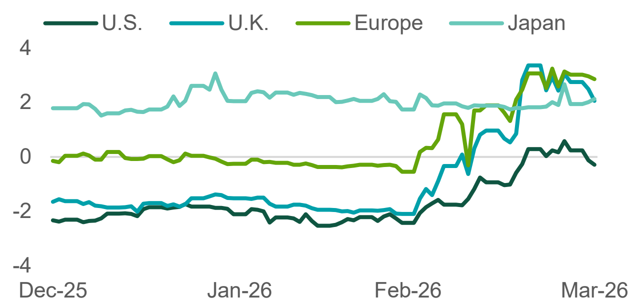
**STRAIT OF HORMUZ: # OF TANKER TRANSIT CALLS**




### Shifting Central Bank Expectations

Elevated near-term uncertainty around the Iran war's economic impacts led to a sharp swing in investors' central bank expectations (outside of the Bank of Japan). European Central Bank and Bank of England expectations swung to three 2026 rate hikes, while Federal Reserve expectations shifted from two rate cuts to a possible hike by year-end. This hawkish upswing in expectations moderated somewhat by quarter-end, with many central banks likely in a wait-and-see mode to better assess economic impacts from the war.

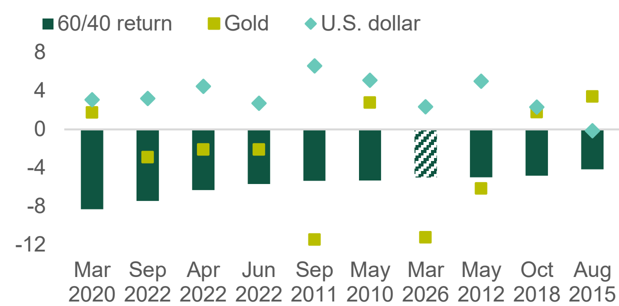
**EXPECTED NUMBER OF RATE HIKES (CUTS) IN 2026**




### Nowhere to Hide in March

The Iran war led to a weak month of financial market returns in March. Despite a late-month bounce, global equities dropped 7% and traditional portfolio diversifiers such as Treasurys (down 2%) and gold (down 11%) were still in negative territory. This led to the worst monthly return for a 60/40 portfolio since late 2022. Outside of March, broader U.S. equity market rotation continued with the largest tech companies lagging and the rest of the market performing relatively well – continuing a prior trend since late 2025.

**10 WORST MONTHS FOR 60/40 MIX SINCE 2010 (%)**



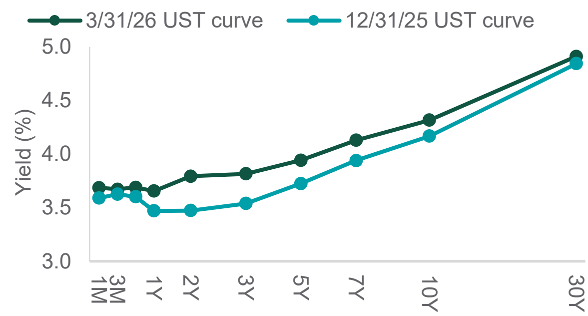

Source: Northern Trust Asset Management, Bloomberg. Data as of 3/31/2026. Note: assumes 25-basis-point moves (third chart); 60/40 mix = 60% MSCI ACWI & 40% Bloomberg U.S. Aggregate (fourth chart). Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

**MARKET REVIEW**

## Interest Rates

Most major sovereign bond yields were declining into late February, before reversing sharply following the outbreak of the Iran war. The surge in commodity prices in March pushed up near-term inflation expectations and drove a hawkish repricing of central bank policy paths, lifting government bond yields globally, with China a notable exception. Across the quarter, the 2-year Treasury yield increased 32 basis points (bps) to 3.79%. The 10-year yield gained 15 bps to 4.32%, resulting in a flatter Treasury curve overall.

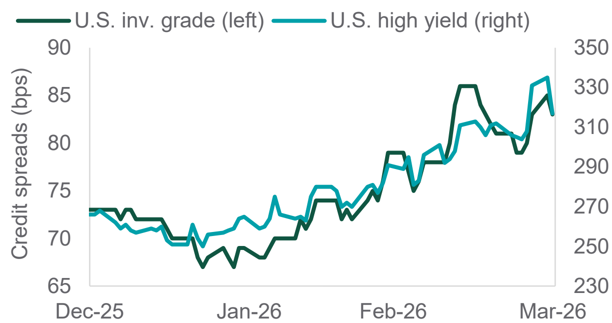
**U.S. TREASURY YIELD CURVE**




## Credit Markets

Investment grade (IG) credit spreads widened by 10 bps to 0.83%, while high yield (HY) spreads widened more sharply, by 51 bps to 3.17%. In terms of return, IG fixed income was flat and high yield posted a 0.5% loss. Higher energy prices led to a stagflation-type impulse that weighed on most fixed income assets, with shorter duration and less credit-sensitive segments generally faring the best. While most acute in private credit, a selloff in software amid competitive risks from AI also kept some pressure on broader credit markets.

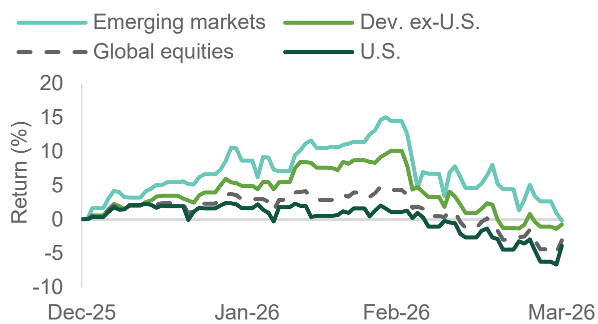
**CREDIT SPREADS**




## Equities

Equities were headed higher before the outbreak of the Iran war. Global equities gained 4% prior to the conflict, led by emerging markets – where Korea surged more than 55% on chipmaker rallies – and gains in non-U.S. developed markets, while U.S. equities lagged amid a greater than 20% loss in software stocks. In March, equities turned lower, with the reversal most acute in non-U.S. markets. Net, global equities lost 3.1% in the quarter, with losses of 0.2% in emerging markets, 0.8% in non-U.S. developed markets, and 3.9% in the U.S.

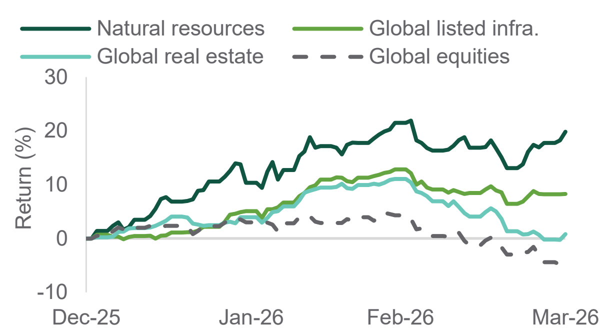
**REGIONAL EQUITY INDICES**




## Real Assets

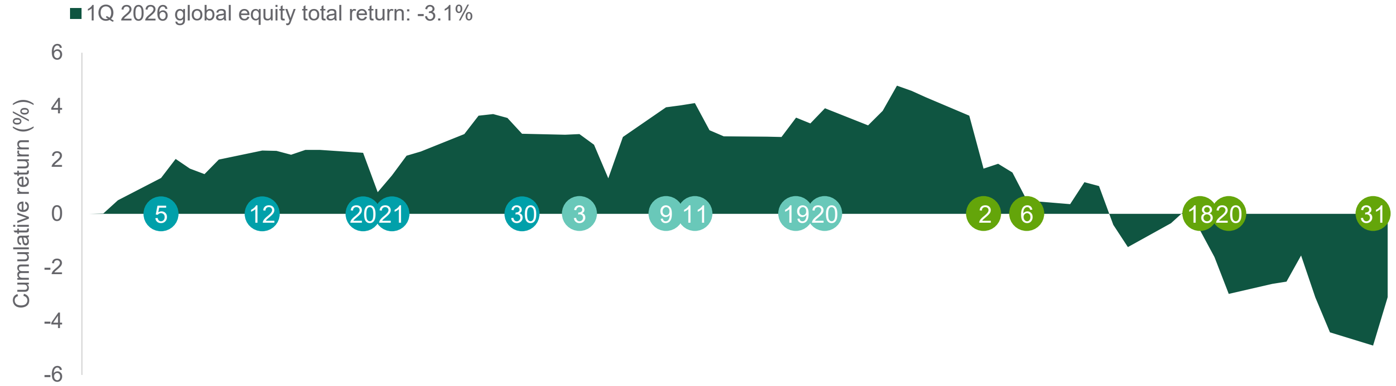
Real assets were one of a few corners of the market to produce gains across the quarter. Natural resources increased 19.8%, followed by an 8.3% gain for global listed infrastructure and a 0.8% rise for real estate. All three outperformed global equities (-3.1%), though real estate lagged amongst the group amid interest rate headwinds. Leadership within natural resources shifted from the metals to energy sector at the onset of the war, however, both commodity sectors finished the quarter up – including gold (+7%), despite an 11% March loss.

**REAL ASSET INDICES**




Source: Bloomberg. Returns in U.S. dollars. Indexes are gross of fees. Past performance is not indicative or a guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

## MARKET EVENTS




| JANUARY | FEBRUARY | MARCH |
| --- | --- | --- |
| **5** Markets digest weekend news of U.S. operation into Venezuela that results in the capture of Venezuelan President Maduro. | **3** The launch of an Anthropic AI legal work automation tool leads to downward pressure on a few industries including software on disruption fears. | **2** Financial markets digest news of the initial U.S.-Israel airstrikes on Iran that mark the onset of the Iran war. |
| **12** Investor concerns on Fed independence rise as Fed Chair Powell releases brief video explaining the Fed has been targeted in a Department of Justice investigation. | **9** Japan's equity market gains over 2% after the Liberal Democratic Party (LDP) wins a supermajority in the Lower House snap election. | **6** February U.S. jobs report is well below consensus expectations (-92k payrolls figure), albeit with heavy impacts from a healthcare worker strike. |
| **20** At a time of broader geopolitical risk and recent news of an upcoming snap Lower House election, Japan long-end bond yields surge following a weak 20-year government bond auction. | **11** A slightly delayed January jobs report surprises to the upside with 130k jobs added. Annual benchmark revisions are mostly in-line with expectations. | **18** Iranian attacks cause extensive damages to Qatar's Ras Laffan liquefied natural gas (LNG) complex, raising concerns on energy infrastructure. |
| **21** In a speech at the Davos economic conference, President Trump backs away from threats of tariffs and use of military force over Greenland. | **19** Concerns on liquidity in the private credit space grow as Blue Owl permanently closes redemptions in one of its retail-focused credit funds following accelerated redemption requests. | **20** Global short-end interest rates rise as investors anticipate more hawkish policy from major developed-market central banks. |
| **30** President Trump announces Kevin Warsh as his selection for the next Fed Chair. The financial market reaction includes modest yield curve steepening, a stronger U.S. dollar and a major sell-off in precious metals. | **20** The Supreme Court rules against IEEPA tariffs in a 6-3 decision with a number of caveats. The decision does not directly address tariff refunds. | **31** S&P 500 rallies nearly 3% on increased investor optimism around potential de-escalation in the Iran war. |

**Indexes used:**

**Bloomberg (BBG) 1-3 Month UST (Cash):** The Bloomberg U.S. Treasury Bills: 1-3 Months Index tracks the market for treasury bills issued by the U.S. government with time to maturity between 1 and 3 months. US Treasury bills are issued in fixed maturity terms of 4, 8, 13, 17, 26 and 52 weeks.

**BBG Municipal (Muni):** The Bloomberg Municipal Bond: Index is a flagship measure of the US municipal tax-exempt investment grade bond market. Included in the index are securities from all 50 US States and four other qualifying regions (Washington DC, Puerto Rico, Guam, and the Virgin Islands). The index includes state and local general obligation bonds and revenue bonds. All bonds in the Municipal Bond Index are tax exempt and hence are not eligible for other indices that include taxable bonds, such as the Bloomberg U.S. Aggregate.

**BBG Aggregate (Inv. Grade):** The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, fixed-rate agency MBS, ABS and CMBS (agency and non-agency). Provided the necessary inclusion rules are met, US Aggregate-eligible securities also contribute to the multi-currency Global Aggregate Index and the US Universal Index.

**BBG TIPS (TIPS):** The Bloomberg US Treasury Inflation-Linked Bond Index (Series-L) measures the performance of the US Treasury Inflation Protected Securities (TIPS) market. Federal Reserve holdings of US TIPS are not index eligible and are excluded from the face amount outstanding of each bond in the index.

BBG High Yield 2% Capped (High Yield): The Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on the indices' EM country definition, are excluded. The US Corporate High Yield Index is a component of the US Universal and Global High Yield Indices.

**JP Morgan GBI-EM Global Diversified (Em. Markets Fixed Income):** The J.P. Morgan Emerging Markets Bond Index Global Diversified tracks total returns for U.S. dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities.

**MSCI U.S. Equities IMI (U.S. Equities):** The MSCI USA Investable Market Index (IMI) is designed to measure the performance of the large, mid and small cap segments of the US market. With 2,319 constituents, the index covers approximately 99% of the free float-adjusted market capitalization in the US.

**MSCI World ex-U.S. IMI (Dev. ex-U.S. Equities):** The MSCI World ex USA Investable Market Index (IMI) captures large, mid and small cap representation across 22 of 23 Developed Markets (DM) countries--excluding the United States. With 2,955 constituents, the index covers approximately 99% of the free float adjusted market capitalization in each country.

**MSCI Emerging Market Equities IMI (Em. Markets Equities):** The MSCI Emerging Markets Investable Market Index (IMI) captures large, mid and small cap representation across 24 Emerging Markets (EM) countries. With 3,080 constituents, the index covers approximately 99% of the free float-adjusted market capitalization in each country.

**S&P Global Natural Resources (Natural Resources):** The index includes 90 of the largest publicly-traded companies in natural resources and commodities businesses that meet specific investability requirements, offering investors diversified and investable equity exposure across 3 primary commodity-related sectors: agribusiness, energy, and metals & mining.

**MSCI ACWI IMI Core Real Estate (Global Real Estate):** The MSCI ACWI IMI Core Real Estate Index is a free float-adjusted market capitalization index that consists of large, mid and small-cap stocks across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries engaged in the ownership, development and management of specific core property type real estate. The index excludes companies, such as real estate services and real estate financing companies, that do not own properties.

**S&P Global Infrastructure (Global Listed Infrastructure):** The S&P Global Infrastructure Index is designed to track 75 companies from around the world chosen to represent the listed infrastructure industry while maintaining liquidity and tradability. To create diversified exposure, the index includes three distinct infrastructure clusters: energy, transportation, and utilities.