

Quarterly Newsletter



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Market Overview

All three major U.S. indices faced first-quarter declines as a "perfect storm" of AI capital expenditure fatigue, a bear flattening of the yield curve, and escalating conflict in Iran rattled investor confidence. Despite the broad sell-off, the Russell 2000 Index emerged as the relative outperformer, finishing up 0.89%. In contrast, large-caps struggled: the Dow Jones declined 3.19%, the S&P 500 fell 4.33%, and the tech-heavy Nasdaq bore the brunt of the volatility, sliding 6.96%.

The market narrative has shifted decisively toward the physical buildout of the AI ecosystem. Energy was the stand-out leader, surging 37.91%, followed by Materials up 10.68% and Utilities positive 8.25% as investors rewarded power providers and industrial infrastructure. Conversely, the Financials (-9.40%), Consumer Discretionary (-8.55%), and Technology (-7.57%) sectors lagged. We are observing a significant rotation away from software companies—threatened by rapid advancements in Claude AI—and a deepening caution toward private credit within the financial space.

The Federal Reserve maintained its "higher-for-longer" stance during the January and March meetings, keeping the effective federal funds rate at 3.50%–3.75%. The last mile of disinflation has proven elusive; Core PCE remained sticky at 3.1% in January, fueled primarily by sticky services inflation. Fixed income markets reflected this uncertainty. The 10-year Treasury yield swung between a low of 3.96% (02/27/26) and a high of 4.48% (03/27/226). This volatility was underscored by the MOVE Index—a measure of U.S. Treasury volatility—which doubled from its quarterly lows, signaling heightened anxiety over the bond market.

International and emerging markets maintained their recent alpha, consistently outperforming U.S. equities. The U.S. Dollar also found a bid, finishing the quarter up 1.71% in a flight-to-safety trade. In the commodities space, gold reached a historic peak near \$5,600/oz before a sharp 27% correction. However, oil remained the primary story; with the Strait of Hormuz closure impacting 20% of global supply, Brent crude surged by 83.65% to close out the quarter at \$118.35 per barrel.

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U.S. Equity Returns Table

Source: Tamarac

U.S. Treasury Yield Table

Source: Treasury

Other Indices Table

Source: Morningstar

Index	Q1 2026 Returns	2026 Returns		03/2026	03/2025	03/2024		Q1 2026 Returns	2026 Returns
Dow Jones	-3.19%	-3.19%	3 month	3.70%	4.32%	5.46%	Gold (GLD)	8.57%	8.57%
S&P 500	-4.33%	-4.33%	2 year	3.79%	3.89%	4.59%	Brent Oil (BNO)	83.65%	83.65%
NASDAQ	-6.96%	-6.96%	5 year	3.92%	3.96%	4.21%	U.S. Dollar Index (UUP)	2.77%	2.77%
Russell 2000	0.89%	0.89%	10 year	4.30%	4.23%	4.20%	Int'l Equity Markets (EFA)	1.15%	1.15%
MSCI World	-0.60%	-0.60%	30 year	4.88%	4.59%	4.34%	Emerging Equity Markets (EEM)	3.80%	3.80%

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Will the U.S. Economy Navigate the Energy Shock—or Stumble into Stagflation?

As we entered 2026, the prevailing market consensus centered on a resilient U.S. economy gradually gliding toward a soft landing, with the Federal Reserve methodically easing policy to support employment while inflation continued its measured descent. That narrative has been complicated—though not necessarily derailed—by the U.S.-Israeli military campaign against Iran, initiated on February 28th, and Iran's subsequent closure of the Strait of Hormuz, a chokepoint responsible for roughly 20% of global seaborne oil flows. **Against this backdrop, the key question has shifted from whether the economy can sustain its expansion to whether it can absorb a potentially prolonged energy price surge without tipping into stagflation.**

The growth trajectory entering the year was already slowing, though the context remains important. Real GDP increased at a 0.7% annualized rate in the fourth quarter of 2025, a sharp deceleration from the prior quarter.¹ However, the headline figure was likely materially affected by the 43-day federal government shutdown, which disrupted activity and data collection across multiple agencies. For full-year 2025, real GDP grew 2.1%, down from 2.8% in 2024 but still a respectable pace given the headwinds from tariff adjustments and reduced immigration. Consumer spending remained reasonably firm, rising at a 2.1% annualized rate in the fourth quarter, driven primarily by services demand. Business investment also remained a positive contributor, increasing at a 2.4% annualized rate. Within that category, intellectual property investment remained a bright spot, rising 8.1% and reflecting the continuing AI-driven capital expenditure cycle. **While the fourth-quarter slowdown reflected genuine deceleration, the private-sector core of the economy—consumer spending plus business investment—continued to expand, suggesting a firmer underlying foundation than the headline GDP figure alone would imply.**

The labor market entered 2026 in what the St. Louis Fed has aptly characterized as a "low hire, low fire" stasis—and the March employment report, released April 3rd, provided welcome evidence that this characterization still holds, with the emphasis on "low fire." Nonfarm payrolls surged by 178,000 in March, the strongest monthly gain since December 2024 and well above the consensus estimate.² The unemployment rate edged down to 4.3% from 4.4% in February. Healthcare led the rebound, adding 76,000 jobs as Kaiser Permanente strike workers returned to payrolls, while construction (+26,000) and transportation and warehousing (+21,000) also contributed meaningfully. Federal government employment continued to decline (-18,000), extending the DOGE-driven contraction that has persisted throughout the past year.

That said, areas of concern remain. Long-term unemployment rose to 1.8 million in March, up meaningfully from a year earlier, and the labor force participation rate slipped to 61.9%, remaining below pre-pandemic levels. In addition, hiring remains concentrated in a relatively narrow set of sectors, particularly healthcare and social assistance. **On balance, we view the March report as encouraging, but not conclusive. The combination of resilient private-sector hiring and still-contained layoffs suggests the economy retains a meaningful buffer against recession. However, the energy shock remains the principal risk to that relatively constructive outlook in the months ahead.**

Before the onset of the Iran conflict, the inflation picture—as measured by the Federal Reserve's preferred Personal Consumption Expenditures (PCE) price index—was showing continued but incomplete progress. The January 2026 PCE report, the most recent available at the time of writing, showed headline PCE inflation at 2.8% year over year, down only modestly from 2.9% in December, while core PCE (excluding food and energy) firmed to 3.1%—a level still well above the Fed's 2.0% target.³ The Dallas Fed's Trimmed Mean PCE, which attempts to filter out unusually large price moves, came in at 2.43% on a 12-month basis, suggesting that underlying inflation pressures may have been somewhat more contained than the headline figures implied.⁴

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Since the onset of hostilities, oil prices have risen sharply, at least temporarily, creating a new source of upside inflation risk. Brent crude moved significantly higher before retreating on early-April ceasefire signals, while WTI also rose to levels not seen since 2022. If energy prices remain elevated, headline PCE is likely to move higher over the coming months. **We believe headline PCE could reaccelerate into the 3.2%–3.8% range by midyear if oil prices remain near recent levels.** At the same time, there are meaningful offsets to consider. Strategic reserve releases, lower futures pricing for late 2026, and the pre-conflict deceleration in shelter inflation could help limit the persistence of the shock. Core PCE, while less directly exposed to energy prices, could still face upward pressure through transportation costs, tariff pass-through, and sticky services inflation. Even so, **if the conflict de-escalates in the coming weeks, the energy spike may ultimately prove transitory, allowing the broader disinflation trend to reassert itself in the second half of the year.**

The Federal Reserve held the federal funds rate steady at 3.50%–3.75% at its March 18 FOMC meeting. The updated Summary of Economic Projections reflected a somewhat more hawkish recalibration, with the median projection now implying just one 25-basis-point rate cut in 2026, down from two previously expected.⁵ The Fed also raised its 2026 inflation forecast while maintaining a relatively constructive view on growth and unemployment. Chair Powell acknowledged that the economy was “doing pretty well” but emphasized the heightened uncertainty created by Middle East developments and their potential effects on energy prices and inflation expectations. **In our view, the Fed is facing a more difficult trade-off than it was at the start of the year: a gradually softening labor market argues for eventual easing, while an energy-driven inflation shock argues for patience. Markets are now pricing in no rate cuts this year, with that outcome heavily dependent on how the conflict and inflation data evolve from here.**⁷

Equity markets have reflected the heightened uncertainty but have also demonstrated notable resilience. After the S&P 500 reached an all-time closing high near 6,978 in late January, the index retreated to the low-to-mid 6,500s by quarter-end—a pullback of approximately 6–7%—before rebounding on ceasefire signals in early April. The Dow and Nasdaq both briefly entered correction territory (defined as a decline of 10% or more from a recent peak) during March. The VIX⁶ spiked above 30 at the height of the conflict fears in late March—the index’s highest level since the post-tariff selloff last April—before settling near 25.

Energy stocks have outperformed sharply, while rate-sensitive growth and technology names have lagged. Importantly, however, the market’s structure remains healthier than the headline index level suggests: AI-related capital expenditure commitments remain robust, corporate earnings have broadly held up, and the selloff has brought valuations for many leading technology companies back to levels approaching their April 2025 tariff-shock troughs—potentially creating attractive entry points for long-term investors. **We view the current pullback as a risk-repricing event driven by a discrete geopolitical shock rather than a fundamental deterioration in corporate earnings or economic activity. This distinction matters for portfolio positioning.**

Synthesizing these developments, we have revised our scenario framework from the prior quarter. The Iran conflict has introduced an important exogenous variable, but recent diplomatic developments and the economy’s underlying resilience still support a broader range of outcomes than the most pessimistic headlines would suggest:

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1. Contained Conflict with Gradual Normalization (Soft Landing):

Scenario: The conflict de-escalates over the coming weeks, and the Strait of Hormuz gradually reopens by late April or early May. Oil prices retrace toward more moderate levels by midyear as strategic reserve releases and increased production help stabilize supply. The energy-price spike proves temporary, adding only modestly to headline inflation before fading. Core PCE resumes its gradual descent toward 2.5%. The labor market stabilizes, with hiring broadening beyond healthcare, and the Fed delivers one 25-basis-point cut in the second half of the year as inflation data improve. Consumer spending slows but remains positive, supported by real wage gains and stronger balance sheets among higher-income households.

Market Impact: The S&P 500 recovers toward the 6,800–7,100 range by midyear as the geopolitical risk premium fades, with the potential to retest January highs by year-end. The Nasdaq could outperform on a catch-up basis if rate expectations ease and investors regain confidence in longer-duration growth assets. Volatility would likely moderate from current levels.

Likelihood: Moderate. Diplomatic signals are cautiously encouraging, but the physical damage to shipping infrastructure and the pace of Strait reopening introduce execution risk. Oil industry analysts warn that even a swift resolution may leave energy prices structurally higher for several months.

Implications: Broadly constructive for equities, particularly quality growth, AI infrastructure beneficiaries, and select domestic cyclicals. Fixed income could also benefit modestly if rate-cut expectations become firmer.

2. Protracted Conflict with Persistent Energy Shock (Stagflation):

Scenario: The conflict extends through the second quarter and into the third, with little meaningful reopening of the Strait of Hormuz. Oil prices remain above \$100 and potentially move higher as supply disruptions persist. Headline inflation reaccelerates meaningfully, while the energy shock acts as a tax on consumers and erodes real purchasing power. GDP growth slows materially, and the unemployment rate drifts higher. In this environment, the Fed remains constrained: labor-market softness would argue for easing, but inflation expectations and elevated energy prices would likely keep policy on hold.

Market Impact: The S&P 500 could correct 15%–25% from January highs, with the Nasdaq likely underperforming as higher discount-rate sensitivity and slower earnings growth weigh on long-duration growth stocks. Credit spreads would likely widen, pressuring risk assets more broadly.

Likelihood: Moderate. The physical realities of the Strait closure—shut-in production, tanker traffic at a standstill, exhaustion of strategic reserves by mid-April—create a narrowing window for a benign outcome. Every week the Strait remains closed, the probability of this scenario increases.

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Implications: Broadly bearish for both stocks and bonds. Portfolio positioning would likely need to tilt toward energy equities, commodities, inflation-protected securities, cash equivalents, and businesses with pricing power. Consumer discretionary, travel and leisure, and more rate-sensitive growth equities would likely be among the weaker areas of the market.

3. Swift Resolution with Overheated Recovery (No Landing):

Scenario: The conflict de-escalates quickly, energy prices fall back sharply, and consumers respond positively to lower fuel costs. At the same time, resilient household demand, possible fiscal tailwinds, and accelerating AI-related capital expenditure support stronger second-half growth. In this scenario, GDP re-accelerates meaningfully. However, renewed demand strength also causes inflation pressures to reemerge, particularly in core categories, causing the Fed to abandon any easing bias and potentially signal a tighter policy stance for 2027.

Market Impact: Equities could initially rally 10%–15% as the geopolitical risk premium evaporates, potentially lifting the S&P 500 toward the 7,200–7,600 range. Over time, however, rising yields and a more hawkish Fed could create a late-year correction risk. Cyclical and value-oriented sectors would likely outperform.

Likelihood: Moderate and falling. This scenario requires both a swift geopolitical resolution and sustained demand strength that seems at odds with current labor market trends and consumer sentiment.

Implications: Initially constructive for risk assets, but increasingly supportive of cyclical sectors, inflation hedges, and floating-rate instruments later in the year. Long-duration bonds would likely remain vulnerable in this scenario due to rising yield risk.

As the above analysis underscores, the 2026 outlook has been fundamentally reshaped by the Iran conflict. The range of potential outcomes is wider than at any point since the 2020 pandemic shock, and the interaction between energy prices, inflation, and Fed policy creates a complex feedback loop that resists simple base-case forecasting. What is clear is that the era of easy gains driven by expanding multiples and a benign macro backdrop has given way to an environment that demands selectivity, discipline, and downside awareness.

Our growth at a reasonable price ("GARP") strategy is positioned to navigate this uncertainty by emphasizing companies with pricing power, robust balance sheets, and secular demand tailwinds—particularly in domestic energy infrastructure, AI and data center buildout, defense and aerospace, and essential services. We have increased our portfolio's exposure to energy and commodity-linked equities as a direct hedge against the stagflationary scenario, while maintaining core positions in quality growth names that we believe can compound earnings through a range of macro outcomes. For fixed income allocations, we favor a shorter-duration posture while also taking advantage of any short-term yield spikes to tactically extend duration where appropriate. **In our view, this balanced approach—combining participation in long-term structural growth themes with portfolio defenses against macro volatility—positions us well to navigate both recovery and correction scenarios during this critical inflection point of 2026.**

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¹<https://www.bea.gov/news/2026/gdp-second-estimate-4th-quarter-and-year-2025>

²<https://www.bls.gov/news.release/pdf/empisit.pdf>

³<https://www.bea.gov/news/2026/personal-income-and-outlays-january-2026>

⁴<https://www.dallasfed.org/research/pce#current>

⁵<https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20260318.pdf>

⁶VIX is the ticker symbol and popular name for the Chicago Board Options Exchange's CBOE Volatility Index, a popular measure of the stock market's expectation of volatility based on S&P 500 index options.

⁷<https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html>

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