UNIFIED INVESTMENT MANAGEMENT
Q1 2026 MARKET UPDATE
AI CONCERNS PRESSURE SOFTWARE STOCKS AND PRIVATE CREDIT
IRAN CONFLICT CAUSES ENERGY SPIKE AND STOCK VOLATILITY
FED PUTS SHORT TERM RATES ON HOLD

Equity markets declined in Q1 as investors became more sensitive to valuation and macro risks after an extended period of strong returns. While economic growth has remained positive, elevated starting valuations left little margin for error. Geopolitical tensions and rising energy prices further pressured risk assets by increasing uncertainty around inflation and future policy decisions.

Sentiment around artificial intelligence shifted notably during the quarter, with software stocks bearing the brunt of investor reassessment. While long-term AI adoption remains intact, near-term concerns around pricing power, rising competition, and longer timelines to profitability led to multiple compression across much of the software sector. These concerns have begun to bleed into private credit markets, where many AI-adjacent companies rely on floating-rate financing and continued access to capital. We believe certain market narratives around AI disruption, especially related to the largest enterprise and system of record software companies (ie Microsoft, Salesforce), are premature, and the selloff in these many of these stocks looks overdone. While pricing models may shift from seat-based to consumption-based, which could impact near-term growth, software companies have historically been able to adapt to new pricing models and remain very profitable, especially ones integrated into core business processes.

Energy markets were another source of volatility, as escalating conflict involving Iran pushed oil prices higher. Prolonged periods of elevated energy prices can act as a tax on consumers, pressure corporate margins, and reintroduce inflation risks—particularly if price increases spread beyond fuel. Historically, equity markets have reacted negatively to sustained energy spikes, as higher input costs and reduced consumer spending weigh on earnings and economic confidence. Hopefully, the Iran conflict will end soon, and energy markets will stabilize.

The Federal Reserve remained on the sidelines throughout Q1 with no additional rate cuts. With inflation still above target and economic data mixed, the Fed is likely to remain on hold until clearer trends emerge. In this environment, future market returns are likely to depend less on policy support and more on earnings growth, valuation discipline, and selectivity across asset classes.

Here's What Happened in Q1:

- Inflation readings held steady in the quarter with the latest year-over-year readings on core CPI and core PCE (fed's preferred gauge) of 2.5% and 3.1% respectively*, both above the Fed's stated target of 2%. The Fed kept rates unchanged in Q1 as there is still uncertainty around new job creation, even as the unemployment rate remains in the low 4% range. The current Fed Funds rate is 3.75% with a median forecast of two more 25 basis point cuts in 2026*.

- Yields on the 10-year Treasury bond were up slightly in the quarter, from 4.1% to 4.3% as the spike in oil prices raised inflation concerns.

- The S&P 500 was down 4.4% in Q1. The index went negative in March after bouncing between flat and up 2% in January and February*.

- Value stocks continued to outperform growth stocks in Q1 with the large-cap value index up 2.1% while the large-cap growth index was down 9.8%*.

Index Total Returns (indices listed in footnotes)

	US large-cap	US mid-cap	US small-cap	Developed International	Emerging Mkts.	Agg Bonds
Q1 2026	-4.4%	2.5%	0.9%	-1.2%	-0.2%	-0.1%

How the Markets Look Now & What's Ahead:

- **Valuation**: The S&P 500 continues to trade at a higher valuation than historical averages. Based on trailing 12 month estimates of $278* in earnings per share for the index through Q1, the trailing price/earnings (P/E) ratio would be 23.6 (higher P/E= stocks are more expensive). This compares to a 34-year median of 18.8*. Based on the consensus 2026 estimate of $324 per share, the market's forward P/E of 20.2 compares to a 34-year median of 17.7*. The S&P 500, a benchmark for large-cap stocks, is clearly expensive. Yet, the S&P indices for mid and small cap stocks are trading below historical valuations and appear to be a much better relative value when compared to large-caps, hence our recommendation for asset class diversification.

- **Liquidity**: There continues to be a record $3.1T in retail money market funds *. This represents a lot of liquidity that could eventually flow into stocks, even if a significant portion is likely earmarked as a fixed income alternative. One-year flows into US equity Exchange Traded Funds (ETFs) are still very positive at $604 billion, including $44 billion in the last month, another sign of favorable liquidity for stocks.

- **Sentiment**: Momentum indicators on the S&P 500 are positive (as of 3/5), while investor sentiment from the American Institute of Individual Investors (AIII) is net bearish (this can be a contrarian indicator at extremes).

- **Stock Volatility:** Stock volatility as measured by the VIX index (currently 24) trended higher throughout Q1 due to concerns over oil prices, the economy, and inflation. When this index spikes above 30 (which happened on 3/27), it can indicate we are close to a near-term bottom in the market.

- We still expect the yield on the 10-year Treasury to remain at or above 4.0% (currently 4.3%) unless there is increased fear of an economic slowdown.

Investment Considerations:

- Since elevated stock valuations=higher risk of below average long-term (5 year+) returns.*** , we believe a more defensive allocation is still warranted. Within one's risk allocation (stocks), we suggest some tech exposure, but also exposure to unloved value stocks, small and mid-cap stocks.

- There are still good values outside mega-cap tech, particularly in healthcare and consumer discretionary stocks. Within tech, certain enterprise software names look very attractive. We would look to trim some energy exposure as many stocks have moved higher with oil prices. Yet, we still like energy as a core allocation due to the growing electricity demand from AI.

- In fixed income, we would avoid long-term bonds due to the risk of long rates moving higher and stick to short-term and intermediate term (3-7 years) bonds.

- Other major risks beyond elevated valuations and an uncertain jobs market include: selling in the bond markets sends the 10- year Treasury yield above 5%; corporate earnings growth disappointing; oil prices remaining high and dragging the economy into recession; a deteriorating situation in Iran and the Middle East and other global and domestic geopolitical risks. The biggest long-term risk is out of control government debt and spending.