WESTEND Advisors
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Economic and Market Commentary

Q1 2026

Macro Drives Markets. WestEnd Knows Macro.

Markets Down, But Not Out

The Iran conflict has increased volatility and uncertainty, but underlying macroeconomic conditions still show potential for continued late-cycle growth. Our current positioning balances defensive and economically sensitive exposures that we believe can help weather volatility and capture opportunities as the conflict eventually de-escalates.

SUMMARY

- The Iran conflict has elevated uncertainty, volatility, and near-term inflation pressures, but its broader macro impacts depend on how and how long it proceeds from here (see box on page 2).
- The U.S. is relatively well positioned as a net oil exporter with policy tailwinds that help offset near-term impacts of the conflict.
- Beyond the Iran shock, a late-cycle macroeconomic backdrop globally persists with potential for continued-but-slowing growth.
- We maintain a balance of defensive and select economically sensitive exposures across portfolios and stand ready to adjust positioning as conditions and our outlook evolve.

Q1 2026 REVIEW

The global macroeconomic and geopolitical backdrop in Q1 2026 was dominated by the conflict in Iran and the ensuing disruption of global oil supplies that began with U.S. and Israeli attacks on February 28. Iran's response, including the functional closure of the Strait of Hormuz and strikes on energy infrastructure and U.S. assets in neighboring Gulf states, sent crude oil prices spiking, with Brent crude approaching $120 a barrel before pulling back to around the $95-$110 range since mid-March. As a matter of scale, the closure of the Strait of Hormuz effectively cuts off about 20% of global oil supply, nearly three times that of the 1973 Arab Oil Embargo.

Financial markets were initially somewhat sanguine, given the historic disruptions of the conflict, though downside accelerated in late March. In the U.S., the S&P 500 fell nearly 8% in March before a last-day rally to end the quarter with a return of -4.33%. Implied volatility as measured by the CBOE Volatility Index (VIX) rose sharply in March and sustained levels similar to the 2022 market downturn, but the VIX is more a measure of perceived risk than actual volatility, and its rise has yet to translate into 2022-like market downside.

Volatility and Mixed Reactions
Despite high volatility in Q1, a mix of defensive and economically sensitive U.S. sectors posted positive returns.

From a sector perspective, Energy led consistently throughout the quarter and was, unsurprisingly, the only U.S. sector with positive returns in March. For the quarter as a whole, a mix of defensive and cyclical sectors outperformed, while all mid-phase sectors (e.g., Info. Tech. and Comm. Services) underperformed, in part tied to concerns over the cost and business risks (e.g., for software developers) of AI investment.

International stocks generally underperformed the U.S. after the Iran conflict began, likely tied, in part, to their greater economic dependence on energy imports. Still, international outperformed the U.S. for Q1 due to strong performance in January and February.

Economic data released in Q1 (mostly covering periods that pre-date the Iran conflict and some delayed due to the Q4 government shutdown) showed slowing U.S. economic growth in Q4 with a possible stabilization in Q1. Real GDP for Q4 was revised down to just 0.7%, leaving full-year 2025 growth at 2.1%, slightly below the 30-year average of 2.5%. Job growth remained sluggish, with net payroll growth through February of just 34,000, but the unemployment rate remained low and steady at 4.4% in February.

U.S. interest rates have risen during the conflict, but the 38 basis point increase in the 10-year Treasury yield in March was well within normal volatility for recent years. Market expectations for Fed rate cuts this year have diminished amid concerns over potential inflationary pressures from the conflict. Futures markets now imply less than one cut in 2026 versus 2-3 cuts at the end of January.

International economic growth in Q1 benefited from a budding manufacturing boost in Europe and continued tech investment in Asia. Europe continued to see fiscal stimulus, including a continued push to increase defense spending, while unemployment remained low and the ECB maintained a fairly neutral policy rate of 2%. In Asia, tech investment driven by the growth of AI remained robust, particularly in emerging markets including China. However, the Iran conflict has introduced new risks for both Europe and Asia which are particularly dependent on energy imports.

Iran Conflict: The Shorter, The Better

While financial markets often look past geopolitical conflicts, the magnitude of disruption to energy markets and related risks of the Iran conflict warrant attention. The duration of the conflict and related supply disruptions is a key factor, in our view – the longer the conflict persists (or the more it escalates), the more severe the potential impacts. While this is likely to be a matter of degrees rather than binary, we consider two primary scenarios below:

Scenario 1 – Near-term Resolution

- If oil market disruptions are resolved in a matter of weeks, we believe economic damage can be contained.
- Disruptions thus far have likely eroded near-term benefits from tailwinds for growth like recent tax cuts in the U.S., but the follow-on effects have yet to reach a point we would expect are likely to precipitate recession.
- For now, disruptions are largely logistical, with shipping of oil, LNG, and other Gulf region commodities frozen by the effective closing of the Strait of Hormuz, and we believe commodity markets could still normalize in a manageable timeframe with a near-term end to the conflict, given some of the measures already taken to alleviate supply constraints.

Scenario 2 – Extended Disruption/Escalation: If the conflict continues for many weeks from here, or if escalations lead to increasing damage to energy and chemical infrastructure, the risk of recession this year could increase meaningfully.

- Oil supply disruptions and prices at or above current levels for an extended period would present meaningful risk of inflation and headwinds to economic growth, through direct increases in energy costs and indirect inflationary pressures on related goods and services.
- The Gulf region is also a key source of liquid natural gas (LNG) and fertilizer for global markets, disruption of which risks follow-on price and supply impacts across a range of goods and services, including food production, pharmaceuticals, transportation of goods, travel, etc.
- Tech is not immune either, as the conflict is estimated to have shut off about a third of global helium supply, which is primarily extracted alongside natural gas production and is vital in advanced semiconductor manufacturing.
- If escalations further damage commodities infrastructure (e.g., production and transport facilities for oil and LNG), that could extend the lingering impact of the conflict long past a potential ceasefire.

We continue to monitor and evaluate developments in the conflict and will adjust our outlook and positioning accordingly.

OUTLOOK

Overview. We entered the year with cautious optimism. At this point, our 6-to-18-month macro outlook still leans toward continued late-cycle expansion, though with increased risks to that outlook should the Iran conflict persist or escalate materially.

Late-Cycle Potential Persists

Late cycle growth could stay intact with a conflict de-escalation, and profit growth could support stocks.

Through February, economic developments across the globe seemed largely in line with our initial outlook. We saw potential for a near-term uptick in cyclical growth in the U.S. tied, in part, to stimulative impulses from fiscal policy, such as tax cuts in the "One Big Beautiful Bill Act" (OBBBA), as well as factors including healthy consumer balance sheets and easing credit conditions. Internationally, we saw an easing of some headwinds, with supportive fiscal policy in Europe, Japan, and China, as well as potential for monetary easing in most major economies.

From a market perspective, we still see U.S. profit growth as a primary market driver, which could help deliver positive returns for the year despite a recent pullback in valuations. While the Middle East conflict has dampened our near-term optimism somewhat, the key question for our broader macro and market outlook is how much longer oil supply and other disruptions persist. For now, financial markets largely appear to be looking past the conflict, which is common for short-term regional conflicts.

U.S.: U.S. economic growth slowed in 2025, consistent with a late-cycle backdrop, but can persist, in our view, assuming impacts from the Iran conflict remain limited in magnitude and duration. Consumer spending and technology investment have been key drivers of sustained late-cycle growth, and we believe both can remain supportive of growth in 2026. While we do not anticipate material improvement in the labor market, real wage gains have supported spending growth, a dynamic that could persist in 2026.

Fiscal and monetary policy remain supportive, on balance. While benefits we anticipated in the first half of the year from tax changes (particularly for consumers) and regulatory easing in the OBBBA have likely been eroded by headwinds from the Iran conflict, we believe longer-term benefits for businesses remain intact. Monetary policy, meanwhile, has reached a fairly neutral rate stance according to various policy rules frameworks, and we expect the Fed likely retains a cutting bias over time, but uncertainty over the duration and impacts of the conflict complicate the Fed's rate-setting calculations. The spike in oil prices and early follow-on effects are already likely to push up near-term headline CPI in the U.S., though impacts on core CPI should be more muted. If the conflict ends soon, the inflation impacts could prove less severe and less persistent than experienced in 2022, when baseline trends in economic growth and the job market were substantially stronger than they are today. However, soft labor markets and stubborn inflationary pressures already presented a tenuous balance, and Fed overreaction in either direction could amplify the conflict's impact on inflation, growth, or both.

Credit conditions, meanwhile, seem supportive of continued growth. Loan officer surveys suggest banks have stopped tightening lending standards, and loan growth has broadened beyond private credit, which had been a key driver of credit expansion in 2024 and 2025. We view these conditions as supportive of economic activity overall and, along with deregulatory trends, the Financials sector, in particular.

Recent concerns over systemic financial risk from private credit are another area we are monitoring. While private lending is inherently opaque, we know that outstanding bank loans to non-depository financial institutions, which include private credit lenders, represent less than 15% of commercial bank loan balances, and many estimates indicate that loans on bank balance sheets tied specifically to private credit are in the 4% to 8% range. The default rate for business development companies, a key conduit for private credit, also remains around 2%, which is below its 10-year average. In our view, greater distress in private credit would likely pressure other areas of credit (e.g., high yield spreads, financing costs, etc.), but it is unlikely to create systemic contagion.

While we are allowing for risks from the Iran conflict, the U.S. is in a relatively strong position to weather its near-term impacts. Late-cycle conditions including softening labor markets and slowing consumption pre-dated the conflict, but the U.S. — a net petroleum exporter — is structurally better positioned to absorb energy shocks than in prior cycles.

U.S. Relatively Insulated
The U.S. has near-term buffers as a net exporter of oil and from policy tailwinds like recent tax cuts.

Consumers are among the most exposed to the first-order impact of the price shocks from the conflict through rising gas prices. Higher inflation will mechanically reduce real disposable personal income, and the increase in energy prices can crowd out non-energy spending. However, U.S. households entered the Iran oil shock from a position of relative strength, with healthy balance sheets and gasoline spending near historic lows at about 2% of DPI. Higher prices are also coming at a time when consumers have a buffer from the tax refunds associated with the OBBBA. We estimate that the near-term price shock from crude oil at recent prices would be largely offset by the lagged impact from this stimulus.

From a market perspective, continued earnings per share (EPS) growth provides potential stability in the intermediate term. EPS estimates have risen for 2026, especially for Information Technology, despite anticipated Iran impacts. Meanwhile, our outlook coming into 2026 assumed a potential pullback in valuations. With the pullback we have seen since the conflict began, there could be some upside to valuations whenever the conflict is resolved.

We also anticipated a broadening out of earnings growth and sector performance leadership this year, which we began to see in early Q1, prior to the conflict. This included potential earnings improvement in more cyclical sectors, like Industrials and Materials. However, in our view, the near-term impact of the Iran conflict has eroded the potential for some cyclical sectors, and there is a likelihood that input cost pressures begin to reveal themselves in reduced earnings estimates in the coming months, particularly if the conflict persists.

At this point, we continue to avoid the most cyclical U.S. sectors and retain a mix of defensive and select economically sensitive U.S. sectors across portfolios. This includes overweights of all three late-phase sectors (Consumer Staples, Utilities, and Health Care), which we expect could outperform if the situation in the Gulf worsens. We also have an overweight of Communication Services, a significant-but-underweight exposure to Information Technology, and allocations to Consumer Discretionary and Financials, which we believe present opportunities if we begin to get clarity on a de-escalation in Iran.

Regarding the Energy sector, while uncertainty over the conflict continues, the sector has seen its valuation expand meaningfully as investors priced in greater earnings power given the rise in oil prices. In a near-term resolution scenario, we believe that Energy sector performance would become much more muted as the sector's valuation would likely revert lower. In a worst-case scenario, oil prices could rise materially even from current levels, which could propel the sector higher and likely lead to greater outperformance. Historically, however, the headwinds to growth during a sustained energy crises also lead to defensive, late-phase sectors outperforming. In summary, after a period of substantial outperformance, it is possible that the Energy sector outperforms further from here, however we would expect this scenario to equate to a weak market where defensive sectors also perform relatively well.

International: Last year was positive for many international markets, despite uncertainty around trade, as economic growth accelerated across Japan, Europe, and the U.K. However, we believe growth in 2026 is set to stay moderate across most regions as the cycle remains advanced, even before accounting for Iran impacts. Most major central banks were poised to ease monetary policy further in 2026, in our view, but at a decelerating pace, and inflationary pressures from the Iran conflict, tied to both Europe's and Asia's dependence on energy imports, could stall further easing. As a result, we see limited potential for a cyclical up-shift in global growth.

We have seen a convergence of growth trends and policy support internationally. If the Iran conflict is resolved soon, we believe expansionary fiscal policy initiatives in Europe, paired with a stimulative impulse from lower short-term interest rates, can provide tailwinds for European sectors and industries that have experienced challenges over the last several years, including industrial goods, machinery, capital equipment, and manufacturing. Additionally, recent trends in consumer confidence and credit expansion suggest an improving backdrop for European households.

The outlook for Asia, meanwhile, became less compelling, in our view, as valuations re-rated higher in the months before the conflict, as sentiment improved alongside a strong memory chip cycle, and robust earnings growth appeared well-anticipated by the market at a time when further acceleration in economic growth looked unlikely.

In global portfolios, we retain an underweight of international equities overall, given the relatively strong economic position of the U.S. both before and in view of Middle Eastern supply disruptions. In early March, however, we shifted from a regional overweight of Asian equities to an overweight of European equities, which we anticipated to generate earnings growth at-or-above that of Developed Asia while facing less headwinds from elevated valuations.

Fixed Income: Prior to the Iran, conflict we saw potential for continued steepening of the Treasury yield curve, driven primarily by the declines in shorter-term rates, with limited upside risk to longer-term rates. The conflict has diminished expectations for 2026 rate cuts amid short-term inflation concerns, while an increase in longer-term rates was driven entirely by real yields, suggesting longer-run inflation expectations remain anchored. However, the impact on our outlook has been limited thus far. As with much of our outlook, our intermediate expectations for interest rates will depend, in part, on the duration of the conflict.

Meanwhile, given the normalized yield curve and elevated real long-term yields, we expect fixed income returns to be driven primarily by healthy coupon yields, with modest price gain potential. We retain a relatively neutral stance toward fixed income in balanced portfolios, as well as toward overall duration of our allocations within fixed income. However, we continue to focus our corporate exposure in shorter maturities to limit risk from a potential widening of credit spreads.

Real Assets: For multi-asset portfolios, we continue to see both diversification benefits and return opportunities from select real asset exposures.

Gold has received a great deal of attention amid the Iran conflict, as the price fell more than 15% (before a partial rebound), despite the precious metal's perceived status as a safe-haven and inflation hedge. We had reduced gold exposure in February, prior to the conflict, as we believed many of the tailwinds propelling gold prices in recent years had become well appreciated by the market, including inflationary dynamics, geopolitical uncertainty, falling real interest rates, and a weaker U.S. dollar. Gold's decline so far during the Iran crisis reflects, in our view, both the dollar's rebound and a possible unwind of speculative behavior that may have bid up gold prior to the conflict. At this point, we believe the pullback in gold, along with a brief spike in real interest rates, has likely reset the metal, and it should still offer potential diversification benefits over our investment horizon.

We broadened our real asset exposure to commodity-linked equities within multi-asset portfolios in Q1. We anticipated a favorable demand backdrop for copper and aluminum over our investment time horizon, as both metals stand to benefit from ongoing investment trends around data centers and electrification as well as macroeconomic factors mentioned previously such as impulses from OBBBA and sustained fiscal spending globally.

We also added to our existing energy infrastructure allocation in multi-asset portfolios in Q1, which includes MLP and equity exposure to midstream energy infrastructure such as storage and pipelines. Valuations for these companies became appealing, in our view, and we continue to believe that they stand to benefit from ongoing growth in natural gas demand in North America.

CONCLUSION

While uncertainty and volatility tied to the Middle East conflict persist, we continue to see a mix of late-cycle macroeconomic fundamentals that impact the outlook over our investment time horizon. We believe our current balance of defensive and select economically sensitive exposures can help portfolios weather near-term volatility and capture potential opportunities as geopolitical uncertainties eventually ease.

As always, we continue to evaluate the evolving macroeconomic backdrop, which includes potential impacts across a range of scenarios for the Iran conflict, and we stand ready to adjust portfolio positioning as our outlook evolves.

WestEnd Advisors Investment Team | April 1, 2026