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APRIL 2026 INVESTMENT LETTER

In retrospect, the environment that confronted investors in 2025, dominated as it was by the unilateral and broadscale imposition of Byzantine tariff mandates by the Trump administration last April, seems analogous to a warm up band in relation to the main event that the investment community has had to navigate this year. I say this for two reasons. First, there was only one element of President Trump's first year back in office that was in any material way out of the ordinary (putting aside the President's totally out-of-the-ordinary verbal stylistic flourishes), namely his jig-saw tariff construct, and this was essentially a one-off inflation bump. Second, tariffs, by their nature, are exclusively within the control of the authority imposing them. They are the government policy equivalent of computer software in that they can be changed, or even eliminated, in a flash. There is nothing necessarily permanent about them, as the U.S. Supreme Court has concluded.

Already in this year's first quarter, three unrelated issues of major consequence have burst onto the investment scene, all of which have substantial ambiguity embedded within them regarding their ultimate resolution. The first centers on the explosion of multiyear capital commitments announced over the past twelve months by 1) essentially every cloud provider (Amazon, Alphabet and Microsoft) and large semiconductor company, and 2) the nascent Artificial Intelligence (AI) model developers (such as OpenAI and Anthropic) in pursuit of realizing the epic sized computational and analytical potential associated with the term Artificial Intelligence. The size of these commitments has been sufficiently gargantuan that it has triggered substantial anxiety that this excessive capital spending on data centers will end up not generating a strong return on investment and/or might result in a steep shrinkage of the computer software sector, significantly reducing sectoral jobs and future company prospects in its wake, in a phenomenon known as "AI disintermediation."

The March 27th issue of Barron's ran a banner headline stating "AI Has Broken the Market", and, indeed, both categories of companies offer reasons for investor caution. The tech Goliaths earned their top of the class valuations and leadership positions by sustainably producing prodigious amounts of free cash flow for an extended number of years, until suddenly doing a full U-turn into heavy multiyear capital spending programs to create and power the requisite data centers needed to actually power the AI analytical work. Needless to say, this substantial shrinkage in prospective free cash generation has had a palpably negative effect on related company valuation metrics. As Seaport's Jonathan Golub has recently pointed out, between late July 2025 and mid-March this year, the software and semiconductor sectors saw their sectoral P/E ratios decline by -33.4% and -31.4%, respectively, while their respective 2026 earnings expectations rose +14.6% and +50.8%. Even Microsoft, once the world's most highly valued company, declined -34% during that stretch.

The AI model developer community has generated its own issues for investors to wrestle with. These companies are still private, and the financial condition and aspirations of the most highly regarded of these companies share the same profile that Amazon exhibited when it first went public in May 1997: big aspirations, huge financial needs, and a long runway before profitability arrives over the horizon. This naturally raises the question as to whether these companies have the financial stamina to actually achieve the lofty expectations they have set for themselves, as none are expected to be profitable until the next decade. At the same time, an opposite concern has also quickly developed that if AI developers actually succeed in realizing their full potential, software companies, and coding professionals, would be directly in their line of fire.

The second source of investor uncertainty is centered in an identically unexpected corner of the stock market, namely the extended archipelago of private credit funds established in recent years by numerous large alternative asset managers that have been directly targeted at retail investors, as a complement to their longstanding institutional fixed income offerings. Here again, AI is a main culprit, as the newly marketed retail fixed income funds have meaningful investment exposure to software companies, as their robust margins and free cash flow streams have seemed so creditworthy.

A foundational component of these funds is that investor liquidity is restricted to a quarterly redemption window, usually 5% in amount, as the underlying investments involve privately issued fixed income instruments with little liquidity. With the fever pitch of anxiety regarding software public equities intensifying as the New Year began, a broad wave of retail investor redemption requests quickly surged into high surf territory. As a benchmark measure, the shares of Blackstone and KKR, the country's largest private equity firms, depreciated -34% in value in this year's first ten weeks. Fortunately, as Capital Economics recently wrote, "while the private credit sector is coming under increasing strain, its size and structure mean it is more likely to generate a modest macro headwind than a sudden financial crisis."

The third, and certainly most consequential, intruder on the investment scene so far this year has been the coordinated American/Israeli military assault on Iran initiated as February turned into March. With Iran dominating daily news coverage, I will quickly just make several points. First, I have not read anyone forecasting that active warfare will last more than an additional two/four weeks. Second, America has progressed from its substantial deficit hydrocarbon position that existed during the 1970's oil crisis to becoming an oil exporter in 2001 for the first time in 70 years, thanks to President Reagan's extensive energy development initiatives.

At the present time, the United States is both the largest crude oil producer and the largest exporter of total petroleum products (such as gasoline, diesel and LNG) in the world, which, combined with the increasingly digitized nature of America's economy, has exquisitely positioned the United States as the single most capable economy in the world to navigate the current oil crisis. Importantly, crude oil consumption relative to real GDP is 60% lower today

than in the 1970's, and 34% lower than in 2000. The simple fact is that the American consumer is much less sensitive to oil price changes than they were historically. Finally, as Roth's Michael Darda has pointed out, since the country has become a net exporter of oil and refined products, the previously inverse relationship between changes in inflation-adjusted crude prices and real GDP growth has disappeared, evidenced by bond yields not reacting nearly as closely to changes in oil prices as had been the case in the past.

Given this trifecta of unexpected, and impactful, maladies, it is remarkable that America's financial markets have been as resilient as they have been since the first bombs were dropped on February 28th. The two main public market volatility measures are the CBOE VIX Index for equities, and the Bank of America bond market volatility index (MOVE) for fixed income securities. In the four weeks beginning February 25, 2026 the oil price's trampoline bounce caused a sharp rise in both equity and bond volatility reflected in these measures briefly spiking 73% and 84%, respectively, before returning to their "the coast is clear" former levels. As Alpine Macro recently pointed out, panic about wars tends to peak up front.

It is a longstanding investment truism that the bond market is the best early warning barometer of "trouble ahead." Fixed income investors have limited upside return potential, and so avoiding capital loss really matters. In this regard, over the past 12 months the U.S. 10-Year Treasury yield has oscillated in a narrowing sideways manner (much like a cheerleader megaphone on its side with the narrow end on the right side) between 4.0% and 4.6%, and currently rests in the middle at 4.34% after topping out briefly at 4.43%. Incredibly, the 10 Year Treasury bond is currently providing the same yield as it offered when oil was trading at \$55 in January. Crucially, financial market manifestations of one, five and ten-year forward inflation expectations have consistently exhibited that inflation expectations remain fully under control. At the same time, the forward curve for oil prices exhibits steep backwardation, evidencing that the Iran war will not alter hydrocarbon pricing in any permanent way.

As reflected in the statistics presented above by Seaport's Golub, starting last July equity investors began to meaningfully rotate out of large capitalization technology exposure in favor of All Other, because of the AI related anxieties discussed previously. That trend reversed dramatically as the war began, with the unusual result that the individual equities included within the S&P 500 exhibited much more price volatility than the index itself. As Morgan Stanley's Mike Wilson wrote in late March, 50% of all stocks in the Russell 3000 were down at least 20% from their 52-week highs. The S&P 500 declined roughly (8) % in five weeks, whereupon the market turned on a dime on March 31st and marched up +12.3% over 14 trading days to a new all-time high. Jefferies noted that the tech sector had its strongest 10 day move in 25 years. The main catalyst for this eruption was the announcement of a two-week U.S/Iran ceasefire, followed by a cool March inflation report and strong corporate earnings.

Turning to the economy, Jim Paulsen, one of my very favorite independent strategists (along with Ed Yardeni), recently wrote that U.S. recession frequency/longevity has dramatically declined over the past 150 years. Dividing this extended stretch into four time periods, he concluded that the American economy was in recession 45% of the time between 1855-1900, subsequently declining to 41% during 1900-1940, 17% in 1940-1990 and culminating at 8% in 1990-2026.

In the last month Paulsen has also presented an analysis of the manner in which the American economy has developed since 1965. He focused exclusively on private sector real GDP, excluding government spending and taxation changes, and he specifically separated this private sector economy into two parts: the “new era” sector, which comprised spending on information processing equipment and intellectual property, and all other. Since 1965, real new era spending has risen at an average annualized pace of +7.2% compared to only +3% for real private sector GDP excluding new era spending. In other words, for 63 years new era spending has been rising almost 2.5 times compared to traditional private sector spending. In 1970 new era spending was only 1.3% of total real private GDP, and has now risen steadily to 11% now. New era investment spending comprised only 12.9% of total non-residential investment in 1965, whereas today it comprises almost 63%. Perhaps more starkly, in 2025 new era real private sector spending surged by 14%, while growth in real private sector spending excluding new-era nearly stalled at only 1%. Given these statistics, it is not surprising that corporate profits have been growing faster than GDP since 2000, as published by Bloomberg.

As Paulsen’s analysis demonstrates, the U.S. economy has been transformed by technological innovation over the past 60 years, which unfortunately cannot be said about anywhere else in the developed world, China excluded. The current state of the American economy is as strong as I have seen in the last 30 years, thanks largely to the astonishingly dynamic domestic technology sector, which continues to vigorously innovate and quickly extend the power and reach of this innovation. Despite supply-side shocks (tariffs last year and energy this year), the American economy remains exceptionally stable. Essentially every economic projection I have read has forecast American GDP growth of at least +2% this year, with Piper Sandler’s superb economist Nancy Lazar continuing to expect growth of at least +3%.

Annual growth rates for both nominal spending and private wages and salary disbursements are just over 5%, with real growth of slightly over +2%. In addition, the U.S. Bureau of Economic Analysis measure of national output and income showed that profits rose +6.0% quarter over quarter and +9.6% year over year in 2025’s last three months. As Roth’s economist Michael Darda has pointed, the ISM Services Employment Index at its current reading of 51.8 is at levels consistent with average monthly private sector payroll growth above 100,000. First time jobless claims and overall layoffs both have remained remarkably low for an extended timeframe, and EvercoreISI business surveys show continued strength.

In spite of the record-long government shutdown in the fourth quarter, which negatively affected GDP growth, S&P500 earnings estimates for 2026's first quarter steadily rose during that period, and this has continued so far this year. Indeed, Morgan Stanley's Mike Wilson has called current conditions "unique", because forward earnings growth continues to accelerate, "closing in on a 20% rate", which has to reflect real margin expansion. Importantly, in that period real final sales to private domestic purchasers still advanced at a +1.9% annual rate, with tracking estimates of +2.4% for the March quarter just ended.

Both Piper's Lazar and EvercoreISI's chief equity strategist Julian Emanuel stress how contributory productivity initiatives have been and will be in enhancing both GDP growth and enterprise profit potential. As Emanuel has written, "the Pandemic has catalyzed an era of digitization to produce the largest productivity shock in more than half a century. Ongoing AI adoption can further augment those strong gains, as the technology is in the very early innings". As Roth's Darda has written, non-farm productivity growth has averaged 2.3% since the prior cycle peak at the end of 2019, noticeably above the prior 12-year average of just 1.6% per annum. Darda believes that +3% GDP growth is possible without any job growth, and EvercoreISI's Emanuel is basically in the same camp. Supporting this view, Lazar recently published an analysis showing that the jumbo AI-related capital spending initiatives for 2026 alone would boost overall capex spending +16.5% year over year, if all other spending components stayed the same. The last time this happened was in the Reagan era.

Just as America's economic free enterprise persona has inspired sustained technology innovation and productivity enhancement, so it has made possible an extended period of increasing prosperity for the country's citizens, who continue to shop with vigor. The Wall Street Journal made this graphically clear in a commentary presenting data from a recent study on the financial circumstances of the nation's middle class by the American Enterprise Institute, which certainly makes clear how the American consumer has been able to continue resembling Atlas holding up the world's economy:

"America's middle class is becoming wealthier as more families scale the economic ladder into higher-earning groups. New research shows that the ranks of the affluent have grown markedly over the last 50 years or so, while the lower rungs of the middle class have shrunk. In 2024, about 31% of Americans were part of the upper middle-class, up from about 10% in 1979...The analysis looked just at incomes, not assets such as stocks and real estate... Many families see themselves as comfortable, not rich. The AEI report divided families into five different groups by income. Three groups were in the middle: lower middle class, core middle class and upper middle class. The authors found that more families now fall into the two highest earning groups – upper middle class and rich – and fewer fall into the three lower earning categories. In 2024, about 19% of American families were considered 'poor or near poor', according to the AEI report, down from about 30% in 1979."

Especially with oil prices so elevated, it is important to briefly discuss inflation trends. I have to acknowledge up front that the Federal Reserve has not achieved its +2% inflation mandate in six years. Having said that, the underlying disinflation trend in the United States remains intact. Credit spreads are exceptionally tight, and nominal wage and spending levels and bond market inflation expectations remain firmly anchored at levels consistent with the Fed's inflation target. Average hourly earnings growth is at a 5-year low, and productivity increases have pushed unit labor cost growth below price inflation, a rare occurrence over the past decade.

At the same time, the oil futures market clearly shows that traders expect oil prices to return fully to their pre-war price range around \$70 per barrel, after the dust settles. The Bloomberg Economic Consensus forecast calls for 2026 and 2027 Core PCE (the Fed's preferred benchmark) inflation of +2.9% and +2.4%. The bond futures market projects that the Fed will remain on pause through the end of the year, even as most economists expect that rate cuts will be "delayed, not derailed," thanks to continued productivity expansion and the fact that new age contemporaneous inflation statistics, especially involving housing, show meaningful progress. Indeed, the only daily measure of CPI – Truflation – has actually declined since the end of last year from about 2% to 1.65%.

In conclusion, as long as the Iran war maintains a demonstrably "hot" dimension, investors need to remain on active alert, as the longer it continues the more damage it can do to economies and financial markets around the world. This is especially the case given the oft-quoted statistic that the average mid-term election year market drawdown since 1930 has been -19.2%. As Jim Paulsen has graphically pointed out, the nation's broadscale technology sector continues to expand vigorously in a manner that is essentially self-generated and, therefore, independent of other economic sectors. My view is that greater technology will remain the main engine of economic growth and equity market levitation for some time. Oxford Economics seem to agree, as it expects potential GDP growth to remain above +2% over the coming decade, with almost all of it coming from productivity.

I hope this letter finds you well!

With warmest regards,

