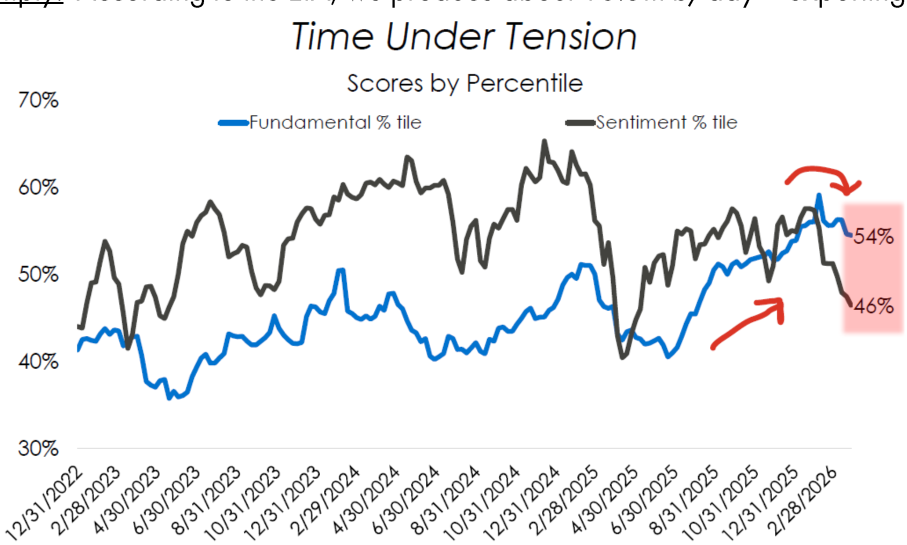
"Time Under Tension"

"Geology is the study of pressure and time. That's all it takes, really. Pressure and time."

– The Shawshank Redemption (1994)

When hitting the gym, "time under tension" refers to how long a muscle is held under strain during a set. It's not just about the weight but also the duration of the stress before one hits muscle failure. We find this to be a good analogy for describing the war between US/Israel and Iran as it relates to the concept of "time under tension" for the global economy.

While the kinetic activity and loss of life remain the most considerable impact on the world, the global economy is most sensitive to the effective closure of the Strait of Hormuz. But why? This 21-mile-wide waterway is responsible for about 20 million barrels of oil per day (b/d) or 20% of the world's oil consumption (including 20% of global LNG – a key input for the Persian Gulf's delivery of 35-40% of the world's total fertilizer exports). One of the common misconceptions of the US being a net exporter of petroleum is that we're not as energy independent as that would imply. According to the EIA, we produce about 13.5m b/day – exporting about 4m of that – but our US refineries need about 16-18m b/d to operate at about 90%+ efficiency. Why do we export 4m b/day when we're already net short? We can't refine all of the light, sweet crude (WTI) that we produce. That means that we have to import oil back – in the form of heavy, sour crude (Brent) – in order to achieve the right blend for our refineries to process it effectively. The bottom line is that oil markets are still very globally interconnected with this "time under tension" interplay related to both the price and duration of energy inputs. As a result, this global energy shock has a domestic impact and could affect everything from prices at

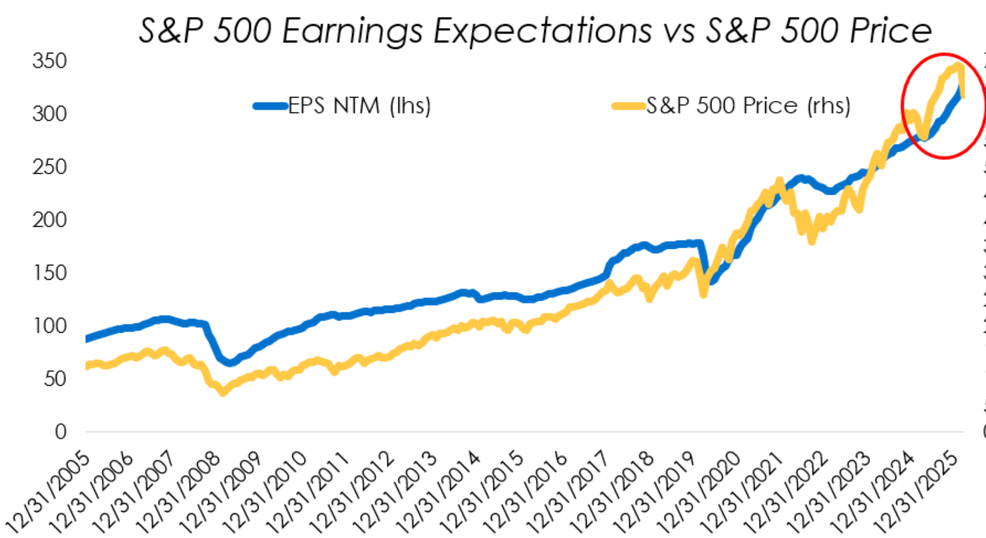


Source: Factset; Yellow Cardinal Proprietary Research; Fundamentals and Sentiment readings track a number of indicators in each category and take the average percentile score in each. Data as of 3/27/26.

the pump to one's grocery and utility bills. The good news is that the fundamental data was strengthening leading up to this conflict. As can be seen in the chart on the prior page, the average percentile reading for the fundamental data (blue line – measures that include things like earnings and economic metrics) was on an upward trajectory for much of the second half of last year. Sentiment data (gray line – measures that indicate how investors feel about markets and the economy) had also been moving higher since its recovery from Liberation Day a year ago – up until recently. Today, the sentiment data has rolled over more sharply as investors are anticipating a negative feedback loop eventually impacting the fundamentals.

As can be seen in the chart below, the most visible place this shows up is in the compression of the price to earnings multiple (P/E NTM from 21.7X to 19.9X as of 3/31/26). Note that the price of the S&P 500 (yellow line) has fallen more sharply of late while the forward estimate for S&P 500 earnings (blue line) has actually been climbing. We surmise that commodity analysts have been quicker to adjust the favorable impact from higher energy prices while the rest of the analyst community has been slow to lower their numbers. In short, investors are less willing to pay as much for a dollar of earnings today when the growth of that dollar of earnings is in greater question.

The bottom line is that much of the fundamental impact will be influenced by this "time under tension" concept. Furthermore, energy prices that stay higher for longer further fan the inflationary flames (with measures that were already showing some re-acceleration in February) and have likely moved the Fed to the sidelines with the Rate market now pricing out any Fed cuts for the remainder of the year.

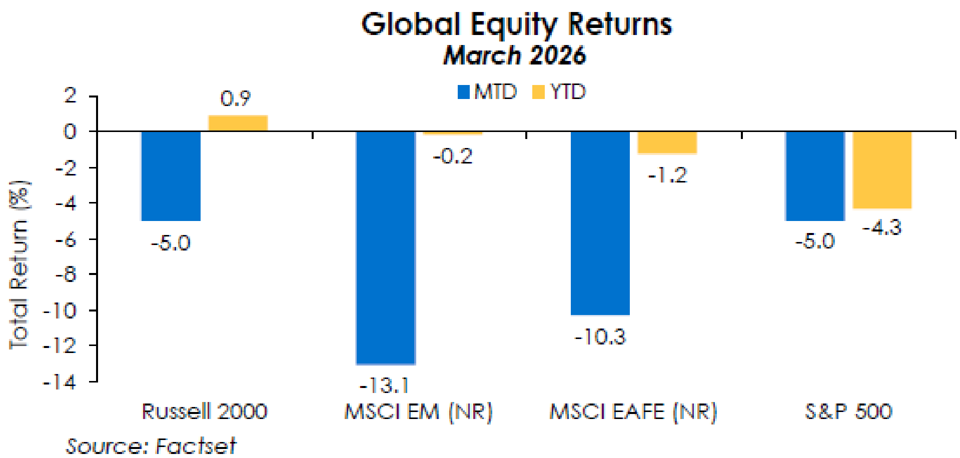


Source: Factset; EPS NTM represents bottom up consensus analyst estimates for S&P 500 earnings per share over the next twelve months. Data as of 3/31/26.

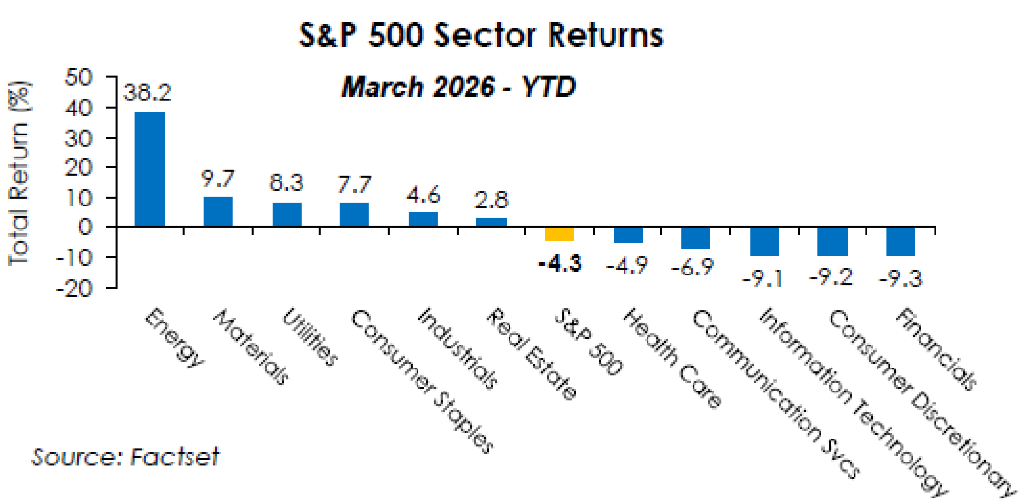
How can investors deal with this? We've found that a "belt and suspenders" approach to portfolios has been the most effective mitigation strategy. Looking outside the traditional stock and bond allocations (where correlations have been rising) to areas that include real assets and hedging solutions have been the best diversifiers in such a backdrop.

Commodites surged higher in March – led by crude oil and natural gas – as war erupted in the Middle East. Stocks declined with overseas equities being the most negatively impacted due to their greater reliance on foreign energy along with the unfavorable return impact from the strengthening of the dollar. Bonds and REITs also retreated as interest rates increased on renewed inflation fears.

Stocks

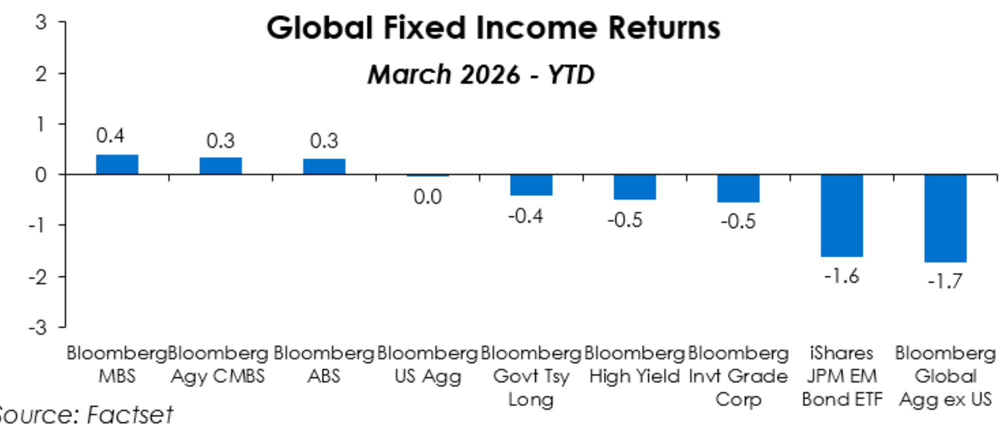


Emerging Markets (MSCI EM) and International Developed Markets (MSCI EAFE) posted significant declines in March due to the effective closure of oil through the Strait of Hormuz. The sharp give back left these markets with approximately flat returns year-to-date. US Large Caps (S&P 500) and Small Caps (Russell 2000) were (relatively) better insulated in March due to less global energy dependence – though were still negatively impacted. Still, the S&P 500 has faced significant valuation compression year-to-date making it the laggard so far for the year. From a sector perspective, year-to-date performance saw a continued rotation out of some of last year's growth leaders – Communication Services and Technology – and into some previous year laggards like Materials, Staples, and Energy. The latter was the only sector with positive returns in March – given the spike in oil prices – and leads all sectors by a wide margin year to date.



Bonds

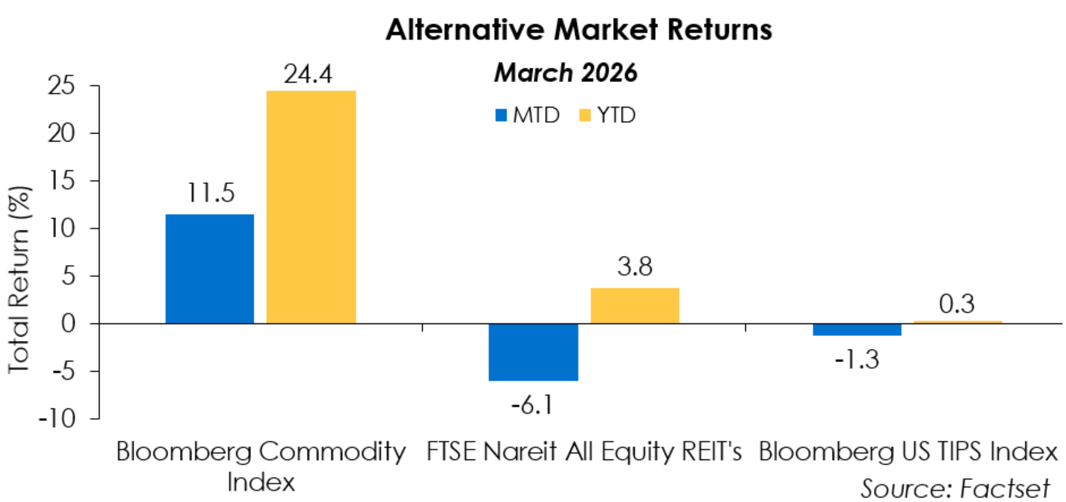
Policymakers continued their cut (2H24/2H25) and pause (1H25/January '26) approach. Following the January meeting, the Fed Funds rate remained unchanged at 3.5%-3.75% with the "dot plot" implying one additional cut (25 bps) this year and next year. Meanwhile, the forward curve of the rate market remains volatile and currently forecasts no additional rate cuts for the rest of this year. With the recently announced Fed nominee (Kevin Warsh) along with the US military action in Iran (lifting energy prices), it will be worth observing how this evolves though it would appear the Fed is on the sidelines for the foreseeable future. Bond returns were more negatively impacted in March as rates backed up and credit spreads widened on increased inflation fears due to higher energy prices. This reset left bond returns flat to slightly down for the year. Asset Backed Securities (Bloomberg MBS, Bloomberg Agy CMBS, Bloomberg ABS) held up best due to their high quality and tangible collateral. Meanwhile, International bonds were the laggard given the stronger dollar impact.



Source: Factset

Alternatives

REITs posted strong returns to begin the year though gave back gains in March in sympathy with Stocks amid higher rates. Commodities were the outlier in March – led by surging energy prices – resulting in robust returns that provided beneficial portfolio diversification. Finally, year-to-date returns on Treasury Inflation-Protected Securities (TIPS) outperformed nominal Treasuries as inflation expectations rose amid the Middle East conflict.



Source: Factset

Market Outlook

"There are two kinds of people in this world: those who believe there are two kinds of people in this world and those who are smart enough to know better."

– Tom Robbins (1980)

<u>We came into 2026 with the tactical vantage point that this year would require the awareness of more nuanced views and the avoidance of oversimplification. To us, this meant that flexibility would be at a premium resulting in "strong convictions, loosely held".</u> Below is a framework for how we compared the generalized consensus view to the more nuanced views that investors have been grappling with thus far.

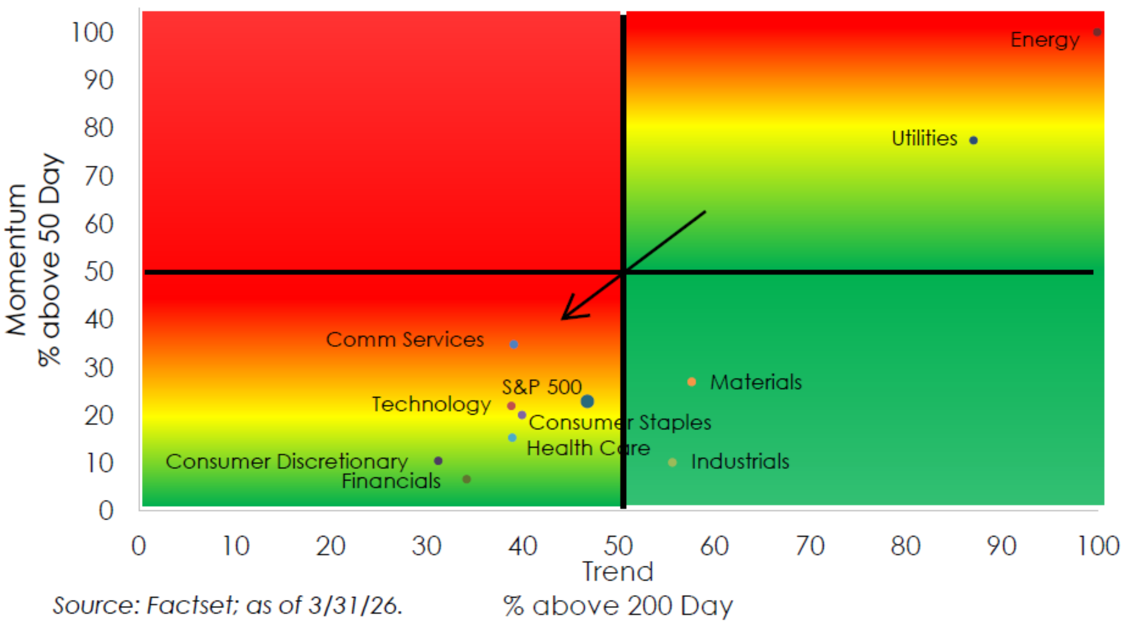
2026 - The Year of the "Definitely, Maybe"

	Generalized View	Nuanced View	
Consumer	*"The consumer remains resilient."*	*High-income consumers maintain strong spending power from the wealth effect*	*Low and middle-income households struggle from affordability pressure*
Labor	*"It's a no-hire, no-fire labor market."*	*Structural tightening results from aging demographics and immigration policy*	*Structural loosening results from AI productivity initiatives*
Profits	*"Profits are solid."*	*Earnings growth is improving for the small and mid-caps*	*Earnings growth is leveling off in the larger cap companies*
Fed	*"The Fed is getting more accommodative."*	*Lowering interest rates loosens policy to improve affordability as inflation cools*	*A new Fed chair is often tested by the market resulting in a tightening of financial conditions.*
Policy	*"Fiscal stimulus will be a tailwind."*	*Midterm election years often coincide with accelerating economic growth resulting from policies of the incoming Administration*	*Midterm election years tend to usher in above average intra-year volality as markets "buy the rumor and sell the news"*
Markets	*"The AI story is early innings."*	*AI promises to be a transformative application*	*Leading edge AI stocks might be pricing in a lot of the good news*

Of the generalized/consensus views in the table, we think the two that are the most in question are in the Fed and Policy categories. Given the inflationary tenor, markets are now pricing in a Fed that's expected to be less accommodative this year and – as a result of higher gas prices – fiscal policy may be less of a tailwind than originally thought (i.e. tax refunds get eaten up at the pump). This also likely has ties to the resilience of the US consumer though that also hinges on the dynamics of the labor market and the wealth effect.

We're also watching the market for messaging that might suggest more subtle changes elsewhere. Internal measures for the S&P 500 has our attention and what it might be hinting at regarding corporate profits. We like to break down the S&P 500 by sectors and track the number of stocks in each group that are trading favorably (or not) from both a momentum and trend perspective. As can be seen below, we break this analysis down into a four quadrant matrix. From left to right determines the number of stocks in long-term uptrends (as measured by the number of companies trading above their 200 day moving averages). From bottom to top determines the number of stocks that are exhibiting shorter term acceleration (as measured by the number of companies trading above their 50 day moving averages). The top left quandrant indicates stocks rallying within a downtrend and bottom right quandrant indicates stocks moderating within an uptrend. The bottom left and upper right quadrants are areas of oversold (in a downtrend) or overbought (in an uptrend) conditions, respectively. Just as important as where the majority of sectors – and thus the market – reside (currently in the lower left quadrant), is observing which sectors are where. Our take is that investors have started to prefer later cycle cyclicals and defensive sectors. This generally would be consistent with the market's view that corporate profit growth might be close to its peak as we transition to the deceleration phase of the profit cycle.

Trend vs Momentum by S&P 500 Sector

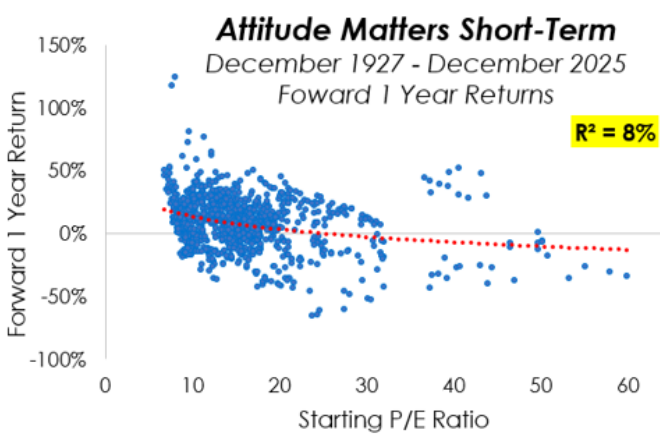


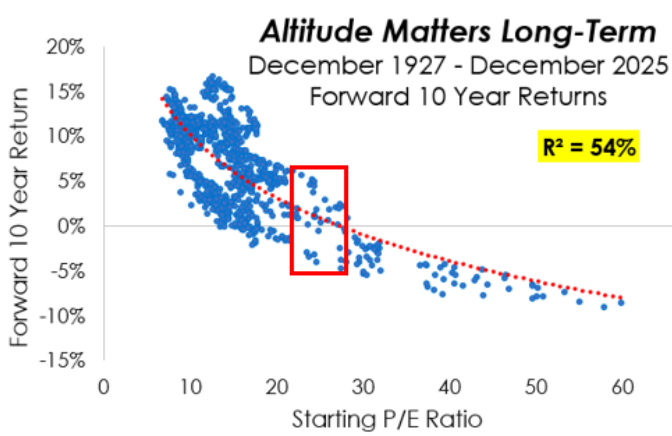
Source: Factset; as of 3/31/26.

<u>The market action remains at odds with the bottom-up analyst views pointing to an earnings growth acceleration for the S&P 500. We're staying tuned in to this tug of war by maintaining a mix of some offense and some defense in portfolios.</u>

<u>While the tactical frame means having a more flexible view of where opportunities and risks might be, the strategic frame requires the discipline to "keep the main thing the main thing".</u> As much as we opine on the factors that influence the shorter term setup, the fact remains that starting valuations tend to be the most influential factor for long-term returns. In short, what you see is what you get. In the past, we've described this as, "Attitude matters in the short run, but Altitude matters in the long run."

Please see the charts below for context. In the short run (chart on the left), S&P 500 returns measured over a one year period have very little to no relationship with the starting price-to-earnings valuation multiple. Investor opinion – driven by a number of factors – can shape popularity for markets and drive short term results that can be both expected and unexpected. However, the chart on the right shows that the S&P 500 returns measured over a much longer ten-year period have a much more important relationship with the starting price to earnings valuation multiple. We think remembering this concept is an important step to maintaining discipline as a long-term investor.





Source: PE ratios were calculated monthly based on the value of the S&P 500 and trailing 12-month S&P 500 Normalized Earnings. Normalized Earnings were calculated by determining the constant long-term growth rate that best fit actual S&P 500 earnings. This process is meant to smooth out short term fluctuations in earnings caused by the business cycle. Forward returns are price appreciation only and do not include dividends. Historical S&P 500 data was gathered from Robert Schiller's website (http://www.econ.yale.edu/~shiller/) and Factset.

So what are the implications and key takeaways for portfolios?

- We think 2026 will require more of a chess than checkers mentality in understanding that nuanced views might mean multiple paths to an outcome. This means that shorter term decisions demand some degree of flexibity given the "K-shaped" dichotomies that exist.
- Having a <u>balanced portfolio with some defense and offense may be helpful with diversification representing a compelling "twofer" (two for one) opportunity – risk reduction and upside optionality.</u>

- Investors' long-term discipline will continue to be tested and will likely require going against the grain (looking different than the benchmark).
- As the pendulum swings to one side, limiting exposure where the risk/reward is less favorable (and concentration risk is high) should be top of mind and lends itself to diversification.

Please see the summary table at right.

2026 KEY TAKEAWAYS	
Be flexible with regards to views **in the short run**	"K shaped" nature of backdrop requires loosely held convictions
Diversification with a **mix of offense and defense** remains a compelling opportunity	"Twofer" benefit of risk reduction and upside optionality
Stay disciplined and keep the "main thing the main thing" **in the long run**	Don't let short run dynamics dictate long run decisions
Limit exposure to speculative areas and lean into diversification	Returns are highest where capital is scarce and lowest where capital is abundant

From a portfolio positioning perspective, we continue to emphasize the importance of diversification and balance. Our flagship strategies – which we sometimes refer to as our "belt and suspenders" approach – have benefited from their allocation to Alternatives. This exposure is designed to better help preserve the purchasing power of the portoflio when historical correlations between the more traditional asset classes break down. As a result, this exposure has provided a nice counter balance to the negative returns recently experienced in both Stocks and Bonds. Managers that provide hedging characteristics have been beneficial during this period of market volatility and exposure to real assets like real estate and commodities have been among the best defenders of value. While we remain overweight this area, we also recognize that some of these segments are likely overbought in the near term. Meanwhile, we remain relatively neutral in equities (with increased diversification) and slightly underweight to fixed income (though sourced mostly through our higher risk High Yield allocation). See more specific detail below:

Within equities, our positioning incorporates balance geographically and within our US Large Cap exposure especially (away from the top of the market). Our bias has generally been to have more exposure to less expensive areas (down market cap). As such, we've maintained a larger OW in Cyclical Value and Defensive sectors combined with a smaller sized cap bias. We remain UW the most concentrated and expensive (albeit less so) Cyclical Growth areas.

Within fixed income, we remain biased toward the higher quality US Core Fixed Income segment – where we're slightly longer in duration for diversification purposes. We've maintained an EW to International Fixed Income, where the end of negative interest rate conditions has led to more attractive opportunities. Maintaining a higher quality bias means that we still remain UW the most expensive part of the bond market (High Yield) where (still) tight spreads have made this unattractive in our view.

Within alternatives, we remain fairly balanced though overweight in both Commodities and Diversified Alternatives. Last year, we adjusted our mix in the latter in order to provide greater insurance against market volatility by emphasizing income and short exposure – areas that can benefit from choppy market conditions like what we've recently experienced.

Thanks for giving this a read.