

What is the most important issue to monitor in 2026? Geopolitical Risks

There's a first time for everything. This is the first time we will start our Quarterly Commentary with the same title for our opening paragraph as the previous quarter. Regarding 2026, we stated, "This year, and perhaps for some time moving forward, we are focused on potential disruptions and their negative impacts on global businesses, economics, and markets. Everything from political events, regime conflicts, and international tensions, ranging from war and terrorism to trade disputes and policy shifts, has the potential to effect global stability, supply chains, and investment. It's a broad concept encompassing military actions, political instability, shifts in power, cybersecurity threats and economic sanctions creating uncertainty and volatility for global operations and finance." Since the publication of the above referenced quote, the U.S. has started a war with Iran, resulting in the closure of the Strait of Hormuz. Daily ship traffic through the strait averaged 83 ships per day under normal conditions but since the attack the average for the last month has been less than 1. Yes, geopolitical risks are indeed the most important issue to monitor during 2026.

The war/excursion potentials impact on the U.S. economy

We, nor any other reputable investment institution can say with any certainty what the war's economic impact will be in the short or long-term. When events impact our domestic economy, we would try to go through many outcomes and arrive at a hypothesis for the most likely outcome and economic impact. This time is different. We have entered uncharted territory and the best we can do is form a "guestimation".

Based on the administration's description, the purpose of the war was to eliminate any immediate threat that Iran posed to the United States through the development of a nuclear weapon and the facilitation of a regime change. The definitive elimination of the nuclear threat will likely not be known until Iran agrees to again permit the return of inspectors to conduct on site detection surveillance as was the case prior to the Trump administrations withdrawal from the Joint Comprehensive Plan of Action on May 8th 2018.

Regarding regime change, on February 28, 2026 it was confirmed that the Ali Khamenei had been killed in a joint American-Israeli airstrike on his compound in Tehran. Since that time, leadership in Iran has been widely debated. Does this constitute a definitive regime change? In a traditional sense this remains uncertain. The removal of top officials was a necessary, but insufficient step.

Historically, the U.S. has extended timeframes and goals for the "completion" of the last two wars in the Middle East. The current administration's short timeframe (measured in weeks) for certain Iranian commitments suggests a shorter war is preferred. However, what is certain is that the war will not end until the Iran "leadership" decides that they can no longer withstand the unrelenting bombing or when its ability to retaliate in a meaningful manner is no longer available.

Artificial Intelligence's impact on productivity: Stop overreacting to onetime surges; look over the longer term, not on a quarterly basis.

Below is an AI generated explanation of productivity and how the data should be interpreted. We don't generally have any issue with the AI generated response and agree with all of it (with one exception - see note), but it saved us some time typing it up, boosting our productivity.

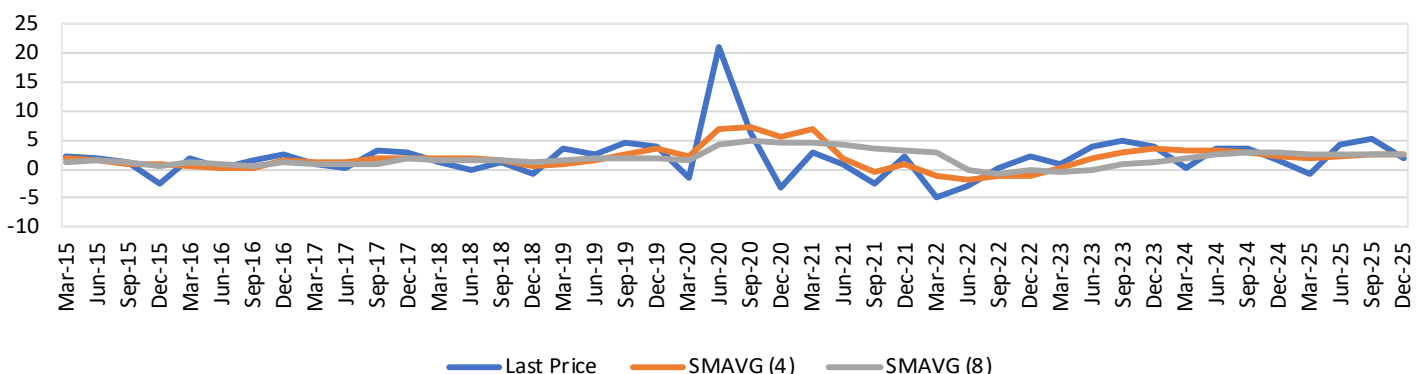
U.S. labor productivity "output per hour" is measuring how efficiently the economy turns hours of work into real output, and it is mainly informative over multi quarter and multi year horizons, not from a single quarterly spike. What "output per hour" measures? The standard series (nonfarm business sector) is defined as real output divided by total hours worked, so it tells how much inflation adjusted output is produced per hour of labor input. Conceptually, a change in labor productivity reflects the part of output growth not explained by changes in hours, capturing things like technology, capital deepening, management, and worker skills.

The Bureau of Labor Statistics (BLS) publishes productivity growth quarter to quarter (annualized) and year over year (versus same quarter a year ago). The BLS explicitly notes that quarter to quarter changes are very volatile, while year over year and multi year averages provide a clearer view of the underlying trend." **Only if elevated readings persist over multiple quarters or years can one confidently conclude that trend productivity — and therefore potential output and sustainable real income growth — has improved.**

In practice, a single quarter's spike (as we saw in the third quarter) should be treated as a piece of high frequency noise or a possible early signal, to be confirmed or faded using year over year productivity, multi quarter averages, and corroborating data (real GDP, unit labor costs, profits, investment).

Monetary Policy: At their March 18th meeting, the Federal Reserve kept the Fed Funds Target Rate unchanged at 3.50%–3.75%. The decision itself was never in question amid elevated uncertainty, little change to labor market conditions, firm inflation readings and upside risks to the inflation outlook. The statement, updated projections and press

US Labor Productivity – Total Real GDP per Hour Worked (QoQ%, SAAR)



Source: BLS.

conference emphasized uncertainty and provided little clarity about the course of policy in upcoming meetings. Chair Powell showed little conviction around the updated projections, emphasizing that “we just don’t know” how geopolitical events will evolve. Chair Powell also addressed his future with the Fed saying he would stay on as chair pro-tempore if a successor is not confirmed by the time his tenure ends on May 15th. He added that he would remain a Fed governor until the DoJ’s investigation is “well and truly over with transparency and finality.” He left open the possibility of staying on the board until his term as governor ends in 2028.

Interest Rates: The oil shock introduces genuine downside risk to growth alongside its more visible near-term inflation effects. The market appears to be focusing on the inflation impact thus far, and ignoring the growth impact. We admit it’s too soon in the conflict to quantify the likely impact on growth or inflation, but it is clear that growth will be weaker and inflation higher in the coming quarters. Subsequently, we no longer expect multiple cuts in 2026; however, we do take a more dovish view than the market because historically commodity shocks either subside or macro/growth concerns become more elevated, both of which are positive for rates. We expect the 10-year Treasury yield to end the year between 4.00% - 4.25%.

Investment Grade Corporate Bond Outlook: We believe fixed-income remains an attractive asset class as investors have opportunities for potential increased income and yields in the future. Corporate spreads are tight to comparable U.S. Treasury securities but we expect fundamentals and technical factors to remain supportive throughout 2026. We continue to believe credit selection will be paramount as the focus shifts toward the ability of corporates to navigate macro uncertainty. Based on current market conditions, in our opinion, the securities we hold are well positioned to weather the current market cycle. Capital preservation continues to be our foremost priority followed by seeking to generate income consistent with the strategy’s objectives.

High Yield Bond Outlook: Spreads have steadily widened since reaching recent tights on January 22nd of 250 bps, ending the quarter at 328 bps. All disruption and private credit fears drove spreads wider in February, followed by the war in Iran and higher oil prices in March which will keep spreads pressured until there is resolution. Despite these headwinds, we expect the default rate to remain in check due to corporate balance sheet strength and minimal refinancing needs.

Investment Grade Corporate Bond First Quarter Performance: The markets ended March on weak sentiment with geopolitics at the forefront of market concerns. Interest rates moved higher with the Fed currently in a holding pattern. The target fed funds rate remained at 3.50%-3.75%. The Bloomberg Aggregate Index returned -1.76% in March and now -0.05% year-to-date. The 2-year Treasury yield ended March at 3.79%, 41 basis points (bps) higher in the month. The 10-year Treasury yield ended March at 4.31%, 37 bps higher while the 30-year Treasury yield ended the month at 4.91%, 29 bps higher. Given the shift in risk sentiment, corporate bonds slightly underperformed U.S. Treasury securities in the month and the quarter, however, corporate demand remained strong on the back of attractive all-in yields.

High Yield Bond Sector First Quarter Performance: High yield fixed income

returns were negative after a strong start to January, returning -0.55% during the quarter. High yield spreads widened during the quarter, starting at 281 bps and ending at 328 bps as the growth outlook muddled due to the war in Iran and higher gas prices. For the quarter, the -0.55% total return was comprised of 1.63% from coupon and a -2.18% price return. From a quality perspective, all BBs and Single-Bs performed comparably, returning -0.38%, and CCCs underperformed in the risk-off environment by returning -2.21%. High yield bond data is representative of the U.S. High Yield Corporate Bond Index which is designed to track the performance of U.S. dollar-denominated, high-yield corporate bonds issued by companies whose country of risk use official G-10 currencies, excluding those countries that are members of the United Nations Eastern European Group (EEG).

Thank You

We hope you will be pleased by how your OIM fixed income portfolios performed under our watch during the first quarter of 2026. Volatility across the entire yield curve was significant, but as we looked over our portfolios, we felt very comfortable. In addition, we believe our clear and deep understanding of our credit exposures contributed to attractive returns. Holding through volatility is the way to win for clients.

If you have any questions on strategy, performance, or business development, please do not hesitate to contact us.

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