

INVESTMENT OUTLOOK

A PEAPACK PRIVATE PUBLICATION

FIRST QUARTER 2026 INVESTMENT OUTLOOK: SHOOTING OURSELVES IN THE FOOT?

Part of diplomacy is to open different definitions of self-interest.

–Hillary Clinton

In the first year of its second term, the Trump Administration evidenced a strong commitment to clearly articulated goals. Amongst those well-defined objectives: reducing the US trade deficit with a weaker US dollar, reducing energy costs, and reducing borrowing costs. These and other steps taken to accelerate US economic growth would then be reflected in rising stock prices.

The broader rubric overarching such policy ambitions is the concept of “America First” in all matters economic and geopolitical. The pursuit of America’s interests included President Trump’s pledge to keep the US out of new wars. And then came Iran.



Since the Iran war began in late February, economic indicators for the president’s agenda have been pointing in the wrong direction. The US dollar has strengthened by better than 2%. The price of Brent crude oil has skyrocketed by more than 40%. The 10-year US Treasury yield has risen by half a percent (0.5%). And the NASDAQ index has shed 10%, landing in correction territory.

Of course, the intervention in Iran didn't represent the first break with President Trump's campaign promise to avert foreign entanglements. Apart from military strikes in Iran last June, the Trump Administration has launched attacks in Yemen, Nigeria, Syria, and Venezuela.

None of this is meant as a critique of the Administration or its muscular stance on foreign policy matters. Rather, it's noteworthy that financial markets—famously averse to uncertainty—have been caught off guard by downstream economic effects of the president's geopolitical actions.

SOLDIERING THROUGH

Is it really true that political self-interest is nobler somehow than economic self-interest?

—Milton Friedman

It was clearly in investors' self-interest to favor well diversified portfolios this quarter, in contrast to the dominance of US large cap growth stocks in the last three years. Returns on US stocks were disappointing, especially for the technology-laden NASDAQ Composite index.

Asset Class	Index	1st Quarter Returns
US Large Cap Stocks	S&P 500 Total Return	-4.3%
US Large Cap Stocks	S&P 500 Equal Weight	0.1%
US Large Cap Stocks	NASDAQ Composite	-7.0%
US Small-Mid Cap Stocks	Russell 2500	-2.0%
International Developed Markets Stocks	MSCI EAFE	-1.2%
Emerging Markets Stocks	MSCI EM	-0.2%
Real Estate Securities	MSCI US REIT	4.8%
Commodities	Bloomberg Commodities Futures	24.4%
Bonds	Bloomberg Barclays US Aggregate	-0.1%
Cash	FTSE USBIG 1-Month Treasury Bill	0.9%

SOURCES: THE WALL STREET JOURNAL, STANDARDANDPOORS.COM, FTSE, MSCI, BLOOMBERG

Investors fared somewhat better with overseas investments, but their returns were modestly negative, too, in part due to US dollar strength. The real winner? Commodities. Energy prices, of course, soared, with Brent crude oil up 67.5%; liquefied natural gas skyrocketed up 90%, but numerous other commodities also jumped. Wheat futures rose 20.2%, aluminum was up 20.1%, and gold climbed 9.5%.

Real estate securities notched a solid gain, as real estate is often viewed as an inflation hedge. Bonds were essentially flat for the period, as falling bond prices offset interest income.

GEOPOLITICAL CONFLICT SPAWNS ECONOMIC UNCERTAINTY

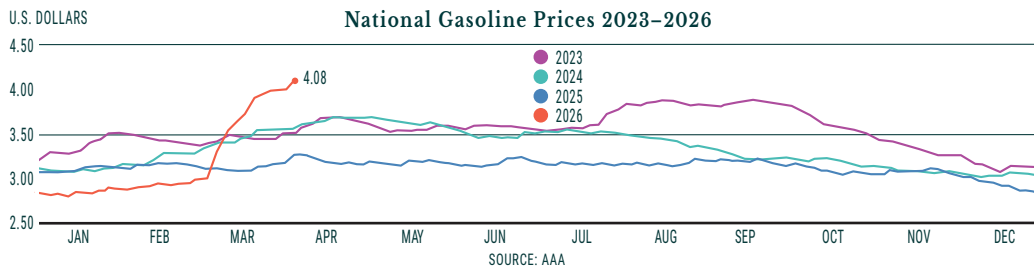
*The punters know that the horse named Morality rarely gets past the post,
whereas the nag named Self-interest always runs a good race.*

—Gough Whitlam

Donald Trump has frequently characterized the role of the Federal Reserve Chair, currently held by Jerome Powell, as one of the easiest jobs in Washington—Trump has mocked the position as requiring minimal effort, such as "showing up to the office once a month and flipping a coin," while receiving high praise.

It's an easy observation that the Fed Chair's job became a lot more challenging in light of the economic fallout from the Iran war. The Fed, established by Congress in 1913, has dual mandates—namely, price stability and full employment. The primary measures for evaluating progress toward these objectives are the inflation rate and the unemployment rate.

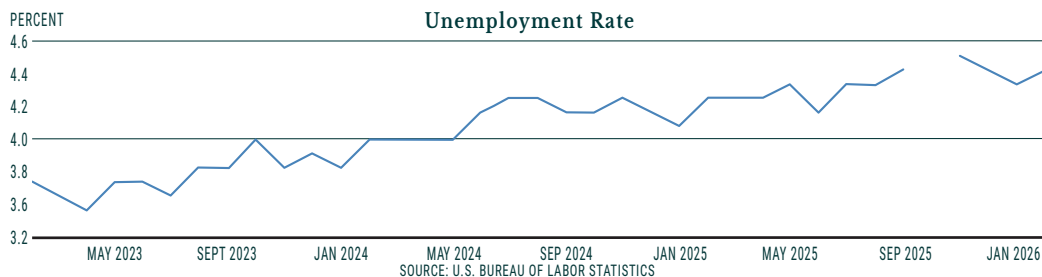
As for the first mandate, inflation has exceeded the Fed's 2% inflation target for four years and counting. Its preferred gauge, core Personal Consumption Expenditures (PCE), rose at a 3.1% annualized rate in the most recent reading in January. (Note that core PCE excludes food and energy costs, which are notoriously volatile.) Also noteworthy, the Producer Price Index in February was up 3.4% on an annualized basis. These elevated inflation readings were recorded before the start of the war with Iran.



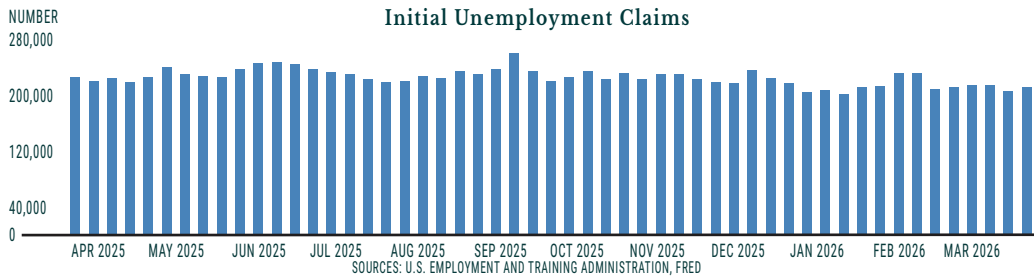
Dramatically higher energy prices are likely to push up inflation data further. And it's not just higher energy prices: the effective closing of the Strait of Hormuz has acted as a supply shock, given reduced exports of liquefied natural gas, fertilizer, aluminum and helium—all of which are commanding higher prices. Dow Chemical announced it is doubling the price of polyethylene. Toyota Motor has indicated it will implement three price hikes in 2026. Maersk, the global shipping giant, implemented emergency freight surcharges of up to \$4,000 per container.

With mounting inflationary measures, small wonder that the Federal Open Market Committee (FOMC) held rates steady at its March meeting, and market expectations for rate cuts this year have been pushed back.

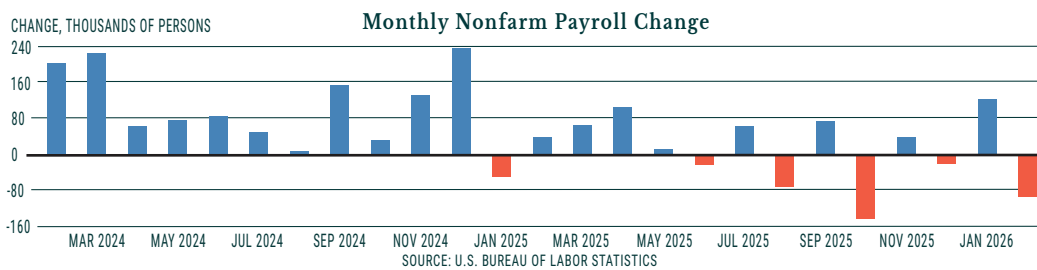
As for the Fed's second mandate, the labor market has been somewhat resilient but shows signs of cooling. The unemployment rate edged up to 4.4% in February, and has been slowly drifting up over the past three years. Arguably, the rise in the unemployment rate represents a normalization, following a period of extraordinarily tight labor conditions following the pandemic.



That said, employers in the aggregate have not been laying off staff—new claims for unemployment insurance have consistently ranged between 200,000 and 240,000, and in recent weeks have hovered at the lower end of this range.



More concerning is that job creation has been moribund. In five of the last nine months, total nonfarm payrolls shrank.



The chart above reflects some anomalous events, including the DOGE-related government employee reduction in force, the federal government shutdown, and healthcare worker strikes. That said, the data clearly suggest some weakness in the labor market. Concerns regarding potential job losses due to artificial intelligence have also contributed to some angst in the labor market.

All in, the US labor market is stable, but also evidences some fragility, with risks perhaps skewed to the downside if companies seek to protect margins through reductions in force.

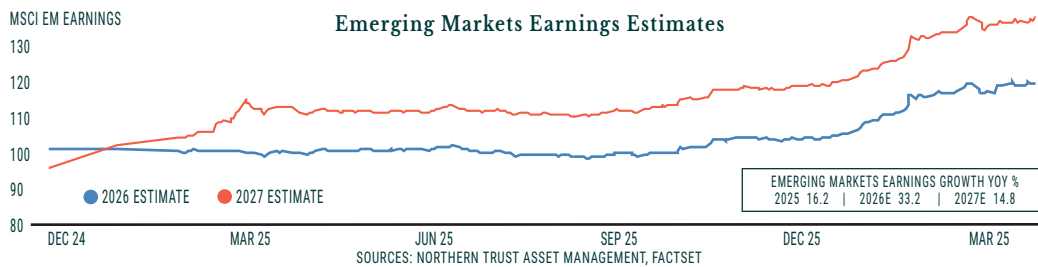
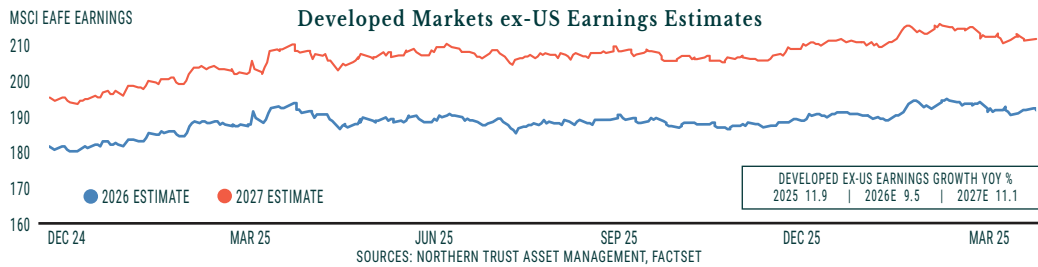
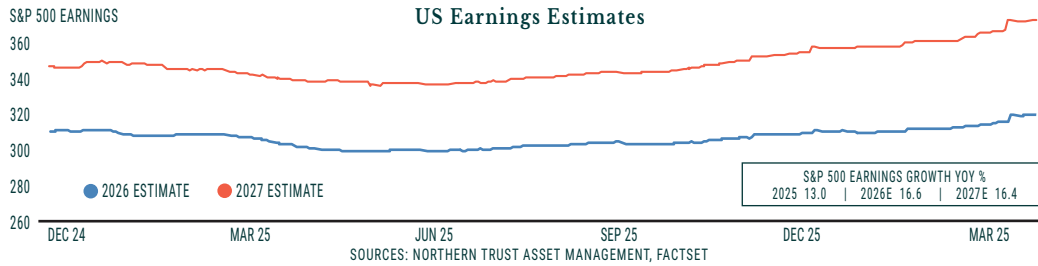
And so the Fed is in a quandary. If inflationary pressures prove persistent, the policy prescription is to raise interest rates. If the labor market experiences further deterioration, the policy prescription is to lower interest rates. Life is simpler for the European Central Bank, with its single mission to maintain price stability.

THE ACCIDENTAL MISSILE

Buy at the sound of cannons, sell on the sound of trumpets.
 –attributed to Lord Nathan Rothschild

Precision-guided missiles are smart weapons designed to destroy specific targets with high accuracy while minimizing collateral damage. But sometimes collateral damage is unavoidable. Whatever the mission for the Iran war, financial markets have experienced collateral damage.

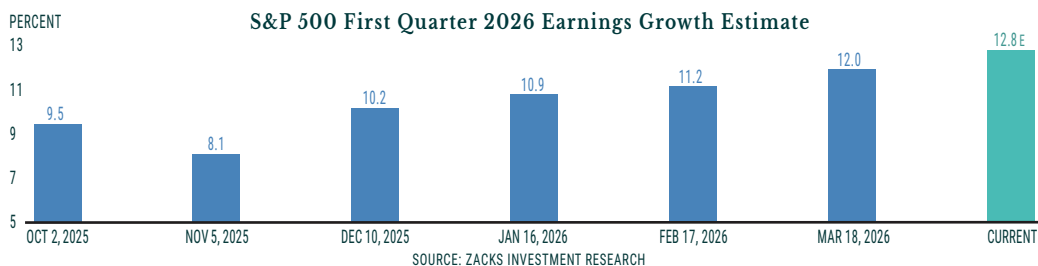
From its peak in February, the S&P 500 fell 10%. The fallout has been even greater overseas: international developed markets fell 13.2%, and emerging markets fell 12%. Across all markets, the war-driven drawdowns were a function of valuation re-rating, not earnings downgrades. As the chart below shows, analysts continue to modestly increase earnings expectations, reflecting a constructive view of company fundamentals. Analysts are particularly enthusiastic about the earnings outlook for US equities.



With earnings estimates holding up, the market decline is attributable to compressed multiples (that is, investors reduced the amount they are willing to pay for future corporate profits, not their estimates of future corporate profits themselves), a sign that market participants effected a risk-premium reset.

The combination of rising earnings expectations and lower stock prices results in less elevated equity valuations. The price/earnings ratio of the S&P 500 has fallen from 22 times to less than 20 times. While this valuation level remains above the 30-year average of 17.2 times, it is in line with the 5-year average, and may prove sustainable if and as geopolitical tensions subside.

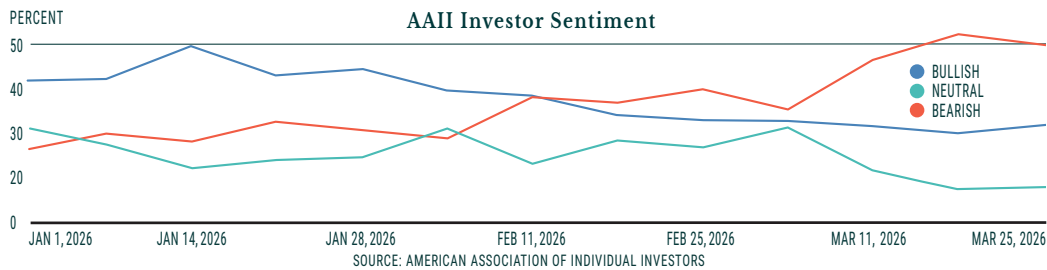
The best prop for stock prices is earnings growth, and analysts expect the just-completed first quarter to produce the sixth consecutive quarter of double digit growth.



Earnings growth for the remainder of the year is projected to accelerate, reaching 17.1% for the full year. On top of that, earnings are anticipated to grow another 13% in 2027. Perhaps this robust corporate profit

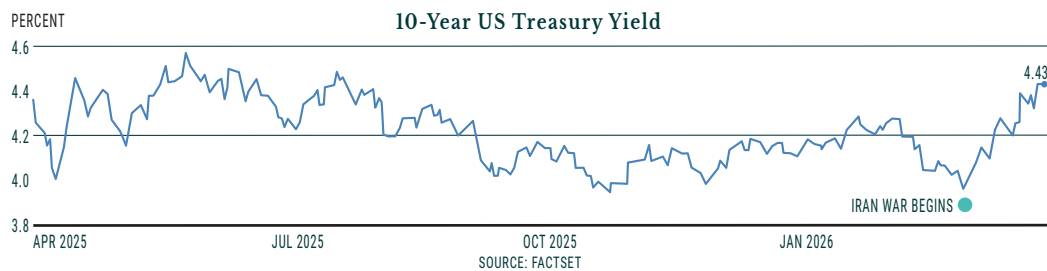
growth narrative explains the relatively modest market declines in response to the biggest global energy crisis since 1973. Risks to the downside for earnings acceleration are slower economic growth and higher input costs that pressure margins.

Another constructive factor for equity markets is investor sentiment. Investor sentiment is generally viewed as a contrarian indicator—that is to say, when the majority of investors are optimistic and fully invested, it often indicates a market peak, as little buying power remains to drive prices higher. And, on the flip side, deep pessimism often indicates potential market bottoms, as the market usually reverses from overextended sentiment.



As the chart above indicates, investor sentiment turned down sharply coincident with the Iran war, with bearish sentiment topping 50% recently. For context, historic averages are 37.5% bullish, 31.5% neutral, and 31% bearish. Such an elevated current level of bearishness is, as noted, consistent with better market returns ahead.

The Mideast crisis has been equally disconcerting for bond market investors. As the chart below shows, interest rates rose sharply when the hostilities began.



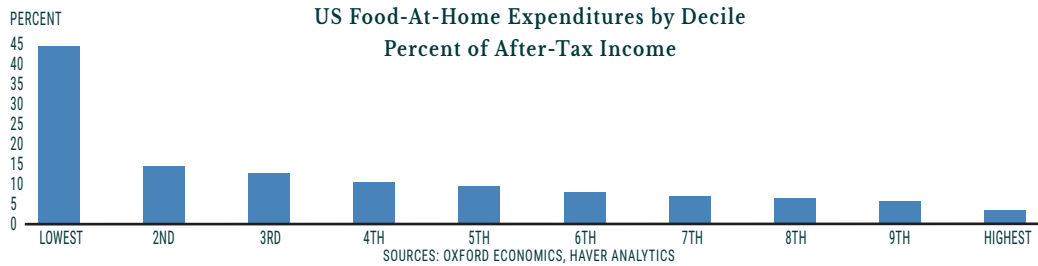
Investors have been demanding higher yields because of inflationary risks from higher energy prices. In the near term, borrowers’ hopes for lower interest rates—at the start of 2026, fixed income markets projected at least two rate cuts this year—have been dashed. Other things being equal, voters on the FOMC will want to see a number of months of data before they are convinced that the spike in the price of crude oil is both temporary and contained. Having said that, a rapid resolution of the war in Iran will have a more immediate effect on bond yields, as fears of war-induced inflation recede.

ENDING THE WAR: WHEN, AND TO WHAT EFFECT?

The cost of leadership is self-interest.

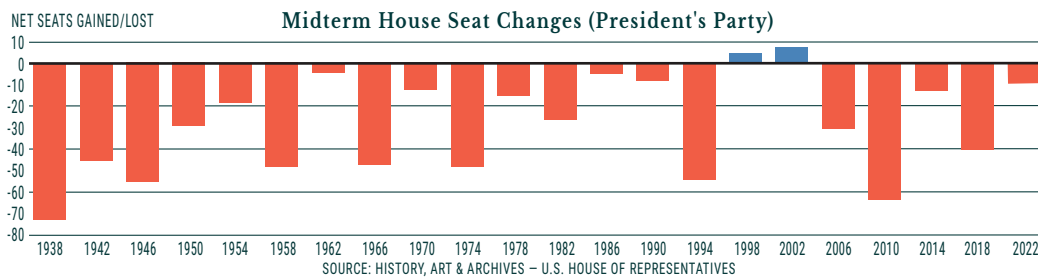
—Simon Sinek

The Fed may look through food and energy costs when contemplating inflation, but consumers don’t. Food and energy are frequent purchase items, as consumers grocery shop and refill their gasoline tanks every week. Food costs constitute more than 10% of household budgets for the three lowest income deciles, and better than 40% for the lowest decile.



With midterm elections a mere seven months away, affordability is sure to be on the ballot. And there is good reason to believe that President Trump is extremely focused on the midterms. While the President is hardly loath to issue executive orders, many of his initiatives will require legislative approval. To advance the Administration’s agenda, it will be critical for Republicans to retain control of Congress. The President has also expressed a fear that if Democrats take the House, he will once again face impeachment charges.

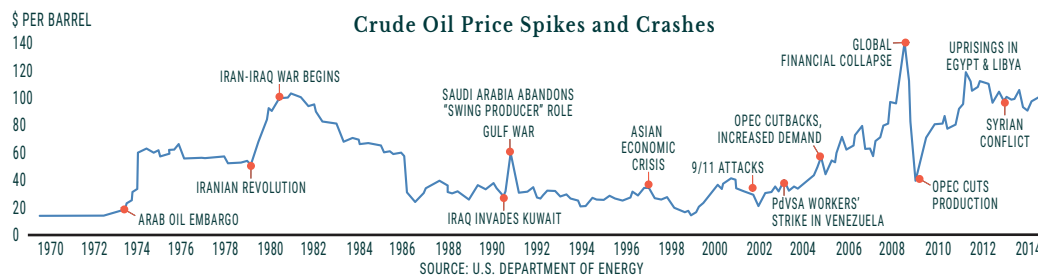
In midterm elections, the president’s party typically loses ground in the House—it did so in 20 of the last 22 midterm elections. The average loss is 28 seats—and the Republicans’ margin today is a mere 3 seats.

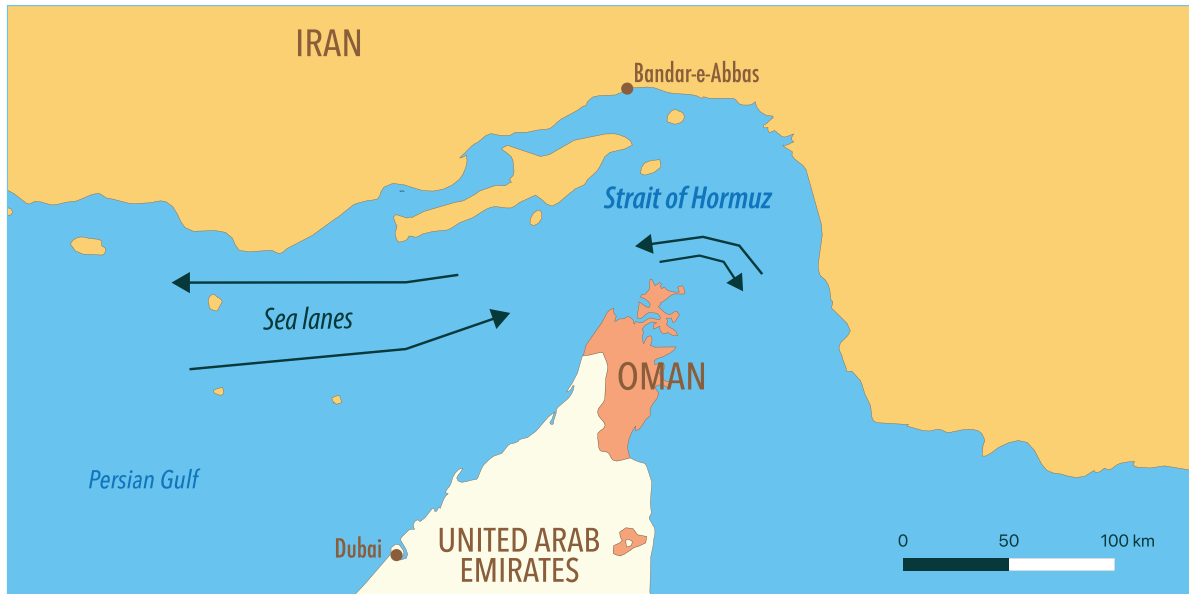


The president’s job approval has a strong impact on the outcome of midterm elections for both the US House and Senate. In the most recent Fox News poll, President Trump had a 59% disapproval, RealClearPolitics’ polling showed a 57% disapproval, and *The Economist* reported a 57% disapproval.

So, it is profoundly in the president’s self-interest to address the affordability issue and lift his approval rating. That can’t happen if the US is bogged down in a protracted war in Iran—it is politically exigent that President Trump finds an off-ramp, and finds it soon. Thus, it is more likely that it is days and weeks, not months, till a means is found to extricate ourselves from the Iran war. Even if the path to get there isn’t clear today, the destination is.

It is reasonable to expect that with a cessation of hostilities, energy prices will at least partially mean-revert. Crude oil and other commodities will, once again, pass through the Strait of Hormuz to ports in Asia and elsewhere. An inflationary pulse will be felt in global economies but may be short lived and limited in magnitude. Historically, rapid crude oil price increases reverse and unwind quickly too.





As of April 2026, during the ongoing conflict and subsequent ceasefire, shipping traffic through the Strait of Hormuz has dropped to roughly 5 to 19 vessels daily, a sharp decline from the normal daily rate of approximately 130 to 140 ships.

When the conflict with Iran stops being front page news, favorable fundamentals will return to the forefront. A refresher: those fundamentals include fiscal stimulus and deregulation, the explosion of capital spending on artificial intelligence investments, and robust corporate profit growth.

In such an environment, GDP growth may be expected to reaccelerate, yields may re-trace their recent rise, and the US dollar rally might reverse. Such developments would be favorable for international equities and for US small cap stocks. Within the US large cap space, cyclical and value stocks might re-take leadership in a re-broadening of the market.

For the bond market, risk aversion may also dissipate, with yields backing down again. Municipal bonds, which underperformed the taxable bond market, sport attractive relative yields.

For investors generally, it remains in their self-interest to continue to focus on long term goals and to avoid the day to day distractions of geopolitical headlines and market gyrations. Markets are not linear, and in the immediate near term the crisis could become more severe before it abates. But things that can't be sustained, won't be sustained. And investors who stay the course will ultimately be rewarded.



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