



# Charts and Smarts®

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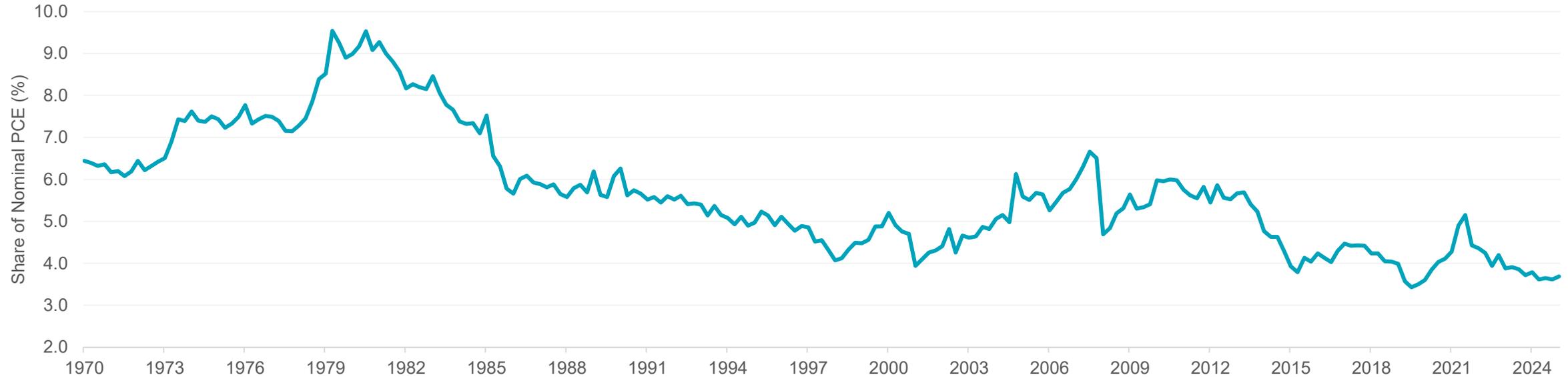
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# Texas Flood

## Energy Goods & Services Spending Share of Nominal PCE (12/31/70–12/31/25)



Another March, another crisis. COVID, Ukraine, the regional bank “crisis”, tariffs, and now Iran. Maybe we should consider taking the month off and coming back in April. Or maybe mid-April just for good measure... And not only have we been fortunate enough to face these crises and attempt to price their fallout in financial markets, but four of them, including the current conflict in Iran, have been negative supply shocks. Four negative supply shocks is pretty tough luck for a Fed that has already faced a challenging task so far this decade. But not all shocks are the same, not even wars involving key energy exporters that threaten disrupting the global flow of oil and other energy products. As we always stress: Initial conditions matter, and perhaps the most important fact to remember when considering the potential fallout of an energy price shock is the fact that the US economy is far less sensitive to fluctuations in energy prices than it has been in the past. For starters, the fact that the US is now a net exporter of oil in some ways has changed the US Dollar into a petrodollar. Gone are the days when stronger oil meant a weaker dollar. And while the US is not immune to the effects of higher oil prices, energy price shocks now represent a positive terms of trade shock for the country, which supports a stronger dollar and helps to mute at the margin the effects of higher prices. But the more important point: Technological improvements mean that the economy as a whole is far less energy intensive. In other words, the amount of energy it takes to generate a given unit of output has fallen dramatically. Put away those 1970s double inflation wave shocks - this is not 1979. US energy intensity has fallen 63% since then. And it's not even like 2022, as US energy intensity has fallen a further 7% since then. The result? Energy goods and services expenditures as a share of total consumer spending sits close to the lowest level on record. Energy prices shocks are indeed real incomes shocks. But the direct fallout is far more limited than in the past, thanks to the relatively smaller exposure of US households to energy prices.

Source: Portfolio Analysis & Consulting. Bloomberg. PCE represents Personal Consumption Expenditures.

# Crossfire

## Inflation Expectations (1/2/24–3/17/26)

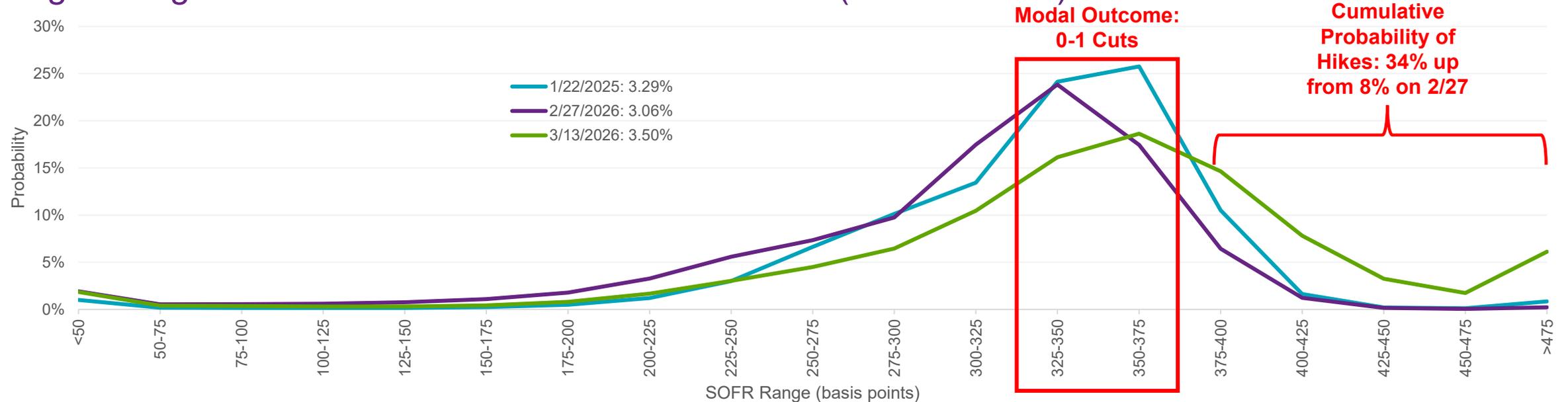


Oil prices may have retraced meaningfully from the overnight panic highs of nearly \$120 a barrel on Sunday March 8. But a plethora of questions remain regarding the duration of both the hostilities and the effective closure of the Strait of Hormuz, the degree of oil infrastructure damage, and the speed at which supply can resume at pre-conflict levels. The answers to those questions will help inform the influence of both residual physical supply disruptions and risk premiums on the level and shape of crude and natural gas curves. With the pullback in crude prices and some jawboning from the administration, fears of a stagflationary outcome have tempered. But the market seems to have never fully embraced that view to begin with. Just as we saw with the tariff shock last year, despite the sharp repricing of the path of policy rates, markets don't expect the shock to elicit a durable inflationary impulse, as evidenced by the growing divergence between 1Y inflation swaps and 1Y1Y forward swaps. Markets are pricing the inflationary impacts of higher energy prices to show up over the coming year, before ultimately fading in the following one-year period. In other words, markets expect this to be a one-time, dare I say, transitory shock. The real risk, however, isn't a stagflationary outcome, but rather a negative growth shock as rising energy prices represent a tax on households with little in the way of material buffers to offset that real income hit. Faith in TACO (Trump Always Chickens Out) runs deep, and is likely a key reason why 1Y1Y forward inflation swaps have remained benign. But should the crude curve settle in higher for longer, concerns will likely continue to shift to the growth backdrop pressuring those swaps lower, as the market prices in the disinflationary effects of demand destruction. For now, TACO continues to reign supreme.

Source: Portfolio Analysis & Consulting. Bloomberg.

# Tightrope

## Target Range Probabilities for December 2026 SOFR (As of 3/13/26)

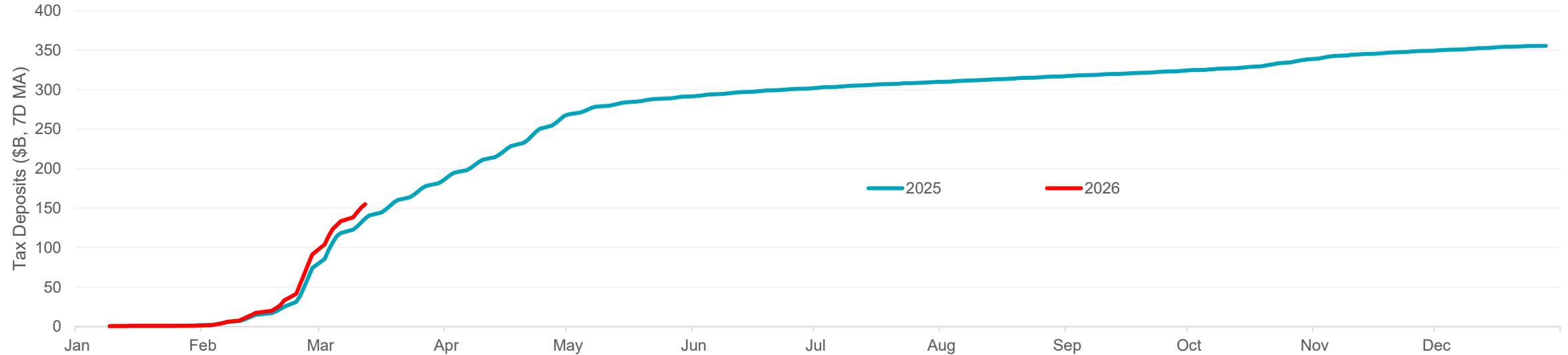


While AI disruption, private credit, and now the conflict in Iran have dominated the majority of the headlines in 2026, the rates market has been hard at work discounting the potential outcomes of these forces. The reacceleration narrative reached a zenith in late January, as the market priced out cuts in anticipation of a stabilizing labor market, delayed effects of prior rate cuts, deregulation, and most importantly, the stimulative effects of the One Big Beautiful Bill Act. But that reacceleration narrative quickly hit an AI disruption wall in February, which quickly prompted a sharp rally across the curve as the market priced cuts back in on the back of fears of a white-collar jobpocalypse. It should come as no surprise that the surge in oil prices in the wake of the hostilities in Iran has prompted another repricing of the rate path. As the Fed faces its fourth negative supply shock in the past six years, at a time when the hawks were already gaining the upper hand, it's no surprise that markets have priced out and pushed out the terminal rate into 2027. Markets believe the Fed will be unable to look through the energy shock for the time being. Given all the crosscurrents at play, there's perhaps no better time than now to remember that market pricing doesn't reflect a single discrete outcome. Rather, it reflects the probability-weighted distribution of all potential outcomes. While the average number of cuts priced by the market has moved around over the past few months, the modal outcome has remained remarkably stable as the market's base case has remained centered on zero to one cut for 2026. The tails, however, have done some heavy lifting, with the market taking down the odds of a continued easing cycle, while now pricing a 23% probability of a hike by year end. With growing labor slack and softening wage growth likely to short circuit any inflationary impulse, market pricing of the policy path now looks overly hawkish.

Source: Portfolio Analysis & Consulting. Federal Reserve Bank of Atlanta. SOFR represents secured overnight financing rate.

# Taxman

## Cumulative Individual Income Tax Refunds (2025 vs 2026)

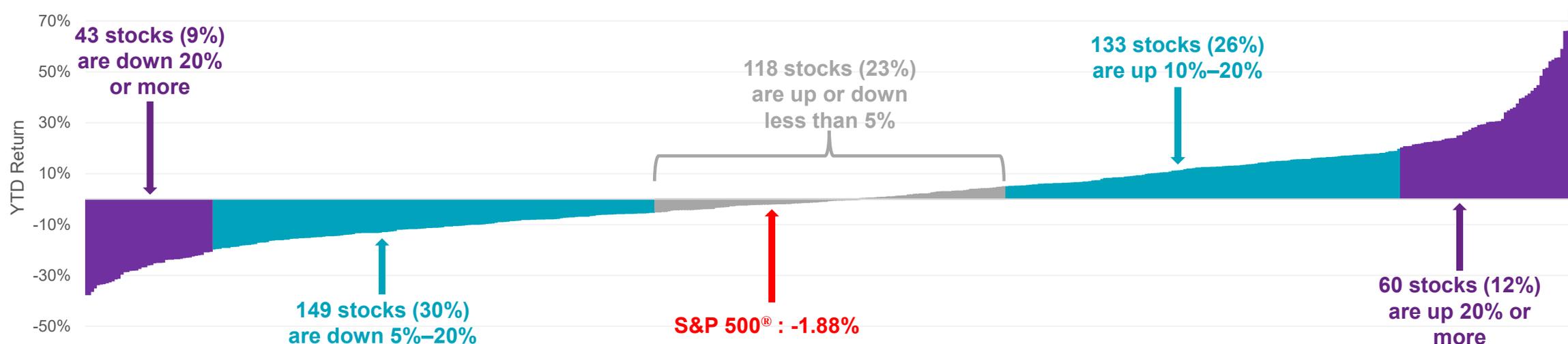


While the market's focus on a stabilizing labor market and reaccelerating growth backdrop has taken a backseat to the hostilities in Iran and the magnitude of the potential fallout from oil and gas disruptions, the debate still has important implications for the outlook. First and foremost, should we see a rapid deescalation as markets expect, with oil shipments resuming and prices settling down, the market's focus will quickly shift back to the domestic backdrop and the outlook for the consumer. But should physical disruptions persist, lingering shortages of crude and distillates will likely continue, keeping energy prices elevated for the foreseeable future. In that scenario, initial conditions within the US economy and labor market become ever more critical, as the strength of both the economy and households dictates the ability of the economy to withstand the price shock. Some optimism around the reaccelerating growth and labor market narrative has been wrung out to start the year as labor market data has failed to decisively signal firming. But the risk remains that the consensus is overly sanguine on the health of the labor market and its impact on consumption and growth. As we've stressed for months now, the narrative that the Big Beautiful Bill would provide a meaningful fiscal impulse was misplaced, as those refunds would be skewed toward upper income households with a higher propensity to save. Lower income earners would likely use a larger share than expected to save or pay down debt. So far, the refund season has been underwhelming to say the least. Lower income consumers who rely upon refunds and would be the most likely to spend that incremental income tend to file earlier in the tax season. And while it remains somewhat early in the tax filing season, tax refund data from the US Treasury suggest a growing risk that the fiscal impulse is set to disappoint. Through early March, cumulative refunds issued are running just \$14B ahead of last year's pace. Even if all of that incremental income were to be spent, it represents just 7 basis points on consumer spending. Either way the conflict in Iran goes, the consensus likely has further to go to reassess the growth outlook.

Source: Portfolio Analysis & Consulting. US Treasury. As of 3/13/26.

# Change It

## Year to Date Returns for S&P 500<sup>®</sup> Constituents (12/31/25–3/16/26)



With all that has unfolded to begin the month of March, it feels like a lifetime ago that markets were myopically focused on the AI disruption narrative that triggered a massive rotation in the market through a wave of rolling selloffs. SaaS (software as a service) names have been at the heart of the AI disruption theme that kicked into high gear with the launch of Anthropic's Claude Cowork. But through the month of February, we saw the AI specter move industry by industry punishing names with workflow-heavy business models that were perceived to have significant disruption risk from new AI tools. In just one week in mid February, each day brought with it a new target for the market to punish. Monday was insurance brokers, Tuesday was financial advisory firms, Wednesday was commercial real estate brokers, Thursday was transportation and logistics. And every day that ended with 'y' was software. And of course, throughout it all, the Magnificent 7 have looked anything but, falling 5.6% in aggregate year-to-date, as the tug of war for AI supremacy continues to hold the cohort back. While the trigger of these moves has certainly been fundamental in nature as investors grapple with the potential disruption to top and bottom-line growth, the magnitude of the moves has been amplified by elevated sentiment and crowded positioning from both fundamental and systematic strategies entering the year. The result? A massive de-rating for yesterday's crowded winners and a significant re-rating for yesterday's laggards and areas of the market perceived to be immune from AI disruption despite little change to forward earnings estimates for either cohort. Perhaps the multiple driven repricing is a function of the market front running changes in earnings estimates. Or it could be the fact that the earnings impairment is likely to be more a function of out years and the terminal value. Or perhaps, it's just another case of the market extrapolating and overshooting. Either way, perversely, this rotation has perhaps made the market somewhat more insulated from the current energy shock risks. While the consensus may yet need to reprice the growth backdrop whichever way the conflict settles, the de-rating of the broad market, as the AI disruption has rolled through nearly every pocket of crowding, has helped to clean the slate. This may limit downside and clear the way for gains on the other side of the conflict.

Source: Portfolio Analysis & Consulting. Bloomberg. Performance data shown represents past performance and is no guarantee of future results.

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