

First Quarter 2026 Letter



Figure 1 – S&P 500



Figure 2 – U.S. 10-Year Treasury Yield

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Market Recap

The first quarter of 2026 began with the continuation of trading seen at the end of 2025, with small companies and international stocks posting solid gains. However, sentiment shifted after the start of war with Iran and the closing of the Strait of Hormuz. Stocks sold off as oil prices spiked along with rising geopolitical tension. Some large oil importing countries began energy conservation and rationing in anticipation of fuel shortages. Affected businesses, including airlines, began to pass costs on to customers. Towards the end of the quarter, stocks appeared to stabilize and recover, as hopes for a lasting ceasefire grew.

Stock returns were mixed. The S&P 500 index (**Figure 1 – S&P 500**) of large cap U.S. stocks fell 4.3%. Other U.S. indices fared better. The S&P 600 Small Cap rose 3.5% and S&P 400 Mid Cap added 2.5%. Value stocks (+0.0%) held up better than growth (-8.1%), mostly on the strength of the energy sector. International stocks fell marginally, with emerging markets -0.2% and MSCI's Europe, Australia and Far East Index -1.2%. Fixed income index returns were close to flat. Bond yields rose (**Figure 2 – U.S. 10-Year Treasury Yield**) in response to inflation fears, pushing prices down and offsetting the quarter's interest payments.

S&P 500 earnings grew 13.7% in the fourth quarter on 9.1% revenue growth, slightly lower than the third quarter's +13.9% growth, but much better than the +6.9% expected prior to last earnings season. We also track the percent of companies that topped analyst estimates, as a measure of earnings momentum across the economy. Last quarter 74.8% of companies beat estimates, lower than the previous quarter and the 5-year average of 77.9%. Technology, aerospace and financials continued to post the strongest earnings growth. For the first quarter, technology and finance are expected to grow earnings close to 20%. However, analyst estimates may not have adjusted to the recent oil price spike, which will have an outsized impact on energy earnings and may reduce growth in other sectors. S&P 500 Q1 earnings are expected to grow 12.0%, a much higher bar than the expectations in 2025. As companies report earnings, analysts will be focused on their exposure to the ripple effects from higher energy prices, and on guidance for the 2nd quarter.

Economic Perspective

The U.S. economic picture was mixed. Gross Domestic Product (GDP) grew 0.5% in the 4th quarter, a sharp decline from the 3rd quarter's solid 4.4% growth. Consumer spending and investment grew but were offset by lower exports and the

record-setting government shutdown. Current forecasts call for improving growth of 1.3% in the first quarter that just ended. The manufacturing sector showed signs of strengthening, with readings of purchasing manager surveys indicating growth the past 3 months. Surveys of the service sector also improved, with pronounced strength in new orders. Construction spending was weaker in January, apparently constrained by tight labor supply, although multi-family housing starts improved. At the end of the 1st quarter, mortgage rates popped higher on war-related inflation fears, potentially impacting home affordability.

Hiring remained tepid but improved. U.S. employers added an average of 68,000 jobs per month in the 1st quarter after an average loss of 38,000 jobs in the 4th quarter of 2025. The unemployment rate in March was 4.3%, an improvement from November's recent peak of 4.6%. The economy appeared to absorb many recent federal layoffs, and some potential workers may have elected to retire given the uncertainty caused by the war and the rise of AI. Average hourly earnings growth of 3.5% was the weakest since May 2021, increasing concerns about the health of the mighty U.S. consumer.

While wage growth slowed, inflation spiked in March, driven higher by oil prices after the start of war with Iran and the closing of the Strait of Hormuz. The headline consumer price index (CPI) rose 3.3% in March, the highest increase since April 2024. Core inflation, which strips out food and energy, rose 2.6%, slightly less than feared, suggesting that the impact of higher oil prices on the rest of the economy has been limited. However, inflation fears have risen. The University of Michigan's Consumer Sentiment index for April was the lowest ever recorded, and year-ahead inflation expectations jumped to 4.8%.

Looking Ahead

Financials (**Fig. 3 – iShares Financials**) have been among the worst performers year-to-date. Concerns about rising delinquencies and fears about private credit lending have weighed on the sector. The private credit sector has grown rapidly, now comprising over \$1 trillion in loans. These loans are mostly made by non-bank lenders, which may not be subject to the same degree of regulatory scrutiny as banks and insurance companies. The lack of transparency and liquidity in these loans have led many investors to try to exit private credit funds. As of this writing, the sector does not seem likely to lead to systemic problems. Ownership is generally restricted to high net worth and institutional investors. Also, while large, the private credit sector is relatively small compared to the mortgage or government bond markets. Financial stocks may recover as worries recede and investors begin to reward lenders that have maintained their quality standards.

The year began with strong gains from emerging markets stocks (**Figure 4 - iShares Emerging Markets ex-China**). While many of these countries may be more vulnerable to oil shocks than the U.S., these stocks have remained relative outperformers and seem likely to benefit from the nascent ceasefire.



Figure 3 – Financials



Figure 4 – iShares Emerging Markets ex-China

The war with Iran has been terrible in many ways, but the impact on investors has been limited. While stock volatility rose sharply, actual losses have been comparable to routine market pullbacks. As of this writing, the S&P 500 is only 2.6% from

its all-time high, and our markets have a strong track record of recovering after the start of hostilities. Patient investors may once again be rewarded for staying with their long-term plan.

Best regards,

A handwritten signature in black ink that reads "Kenneth M. Bernard". The signature is written in a cursive style with a large initial 'K'.

Kenneth M. Bernard, CFA