INSIGHTS

April 8, 2026

Surface Tensions

by Ryan Seale, BBA, CIM – Chief Investment Officer with PMI

By now, most investors should be aware of the two key topics shaping the current macro environment. The first is the potential for an energy-driven inflation shock from Middle East tensions (US & Israel/ Iran War), the second is the rising scrutiny around private credit, though this has temporarily taken a back seat to developments in the Middle East conflict.

The Strait of Hormuz, the world's most critical oil chokepoint, is back in sharp focus. Nearly 20 million barrels of crude (roughly 25% of global seaborne supply) pass through the Strait of Hormuz each day, the vast majority headed for Asia with few viable alternative routes. Markets for the time being are pricing in near-term disruption risk, not prolonged disruption.

The resulting supply shock has pushed Brent crude into the $90 to$115+ range (at time of writing), while also driving a meaningful widening in crack spreads for refined products such as diesel amplifying downstream cost pressures.

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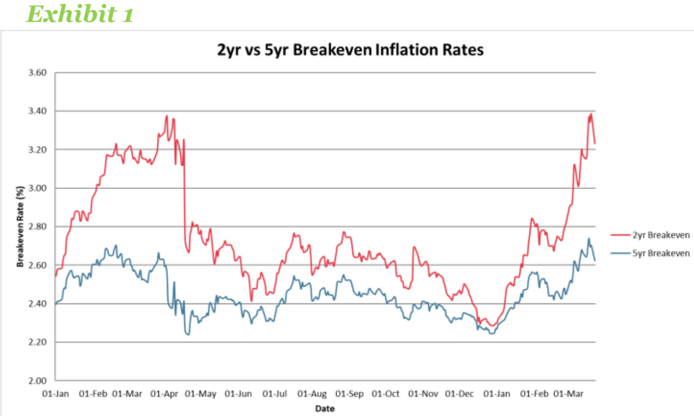
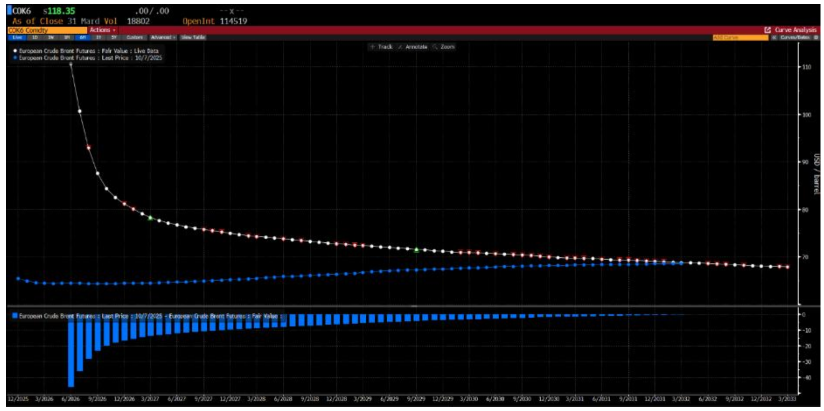
Exhibit 1



Source: Bloomberg/PMI

Headline inflation expectations have moved higher, particularly at the front end ***(See Exhibit 1)***, with the two-year breakeven rising significantly more than the five-year. At the same time, the oil futures curve ***(See Exhibit 2)*** has shifted from slightly contango just 6 months earlier into pronounced backwardation, with near-term prices well above longer-dated contracts. Taken together, these signals point to a front-loaded, temporary supply shock rather than a structural shift in inflation.

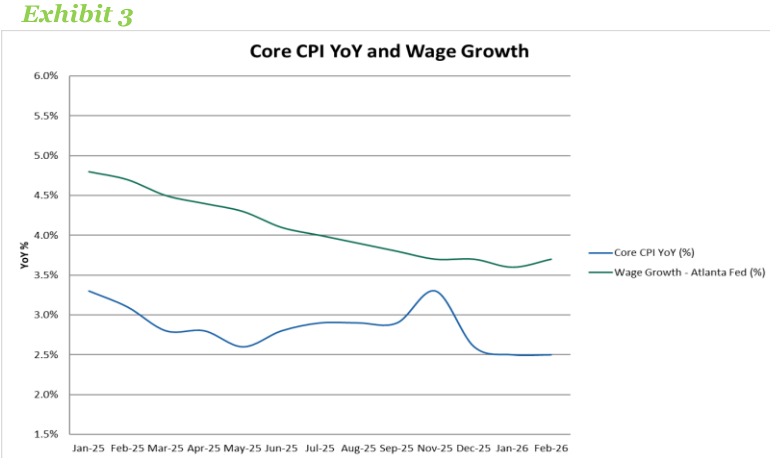
Exhibit 2



Source: Bloomberg

While the oil shock is expected to contribute to near-term upside in headline inflation, underlying price pressures were already firm heading into the disruption. Core PCE inflation (the Fed's preferred gauge) rose to 3.1% year-over-year in January 2026 and has shown stickiness, even as some broader core CPI measures have eased toward the mid 2% range. Wage growth according to the Bureau of Labour Statistics (BLS) continues to moderate but remains elevated around 3.75 to 3.8%, core services inflation has proven resilient, and the labour market has shifted into a "low hire, low fire" equilibrium ***(See Exhibit 3).***

Exhibit 3



Source: Bloomberg

The Atlanta Fed's GDPNow estimate for Q1 2026 (as at April 2nd, 2026) has also been revised lower, recently hovering near 1.6%, adding to clear signs of softening growth.

This puts the Federal Reserve in a particularly delicate position, with potentially early stagflationary concerns. Growth is already slowing and the labour market has cooled noticeably, so tightening policy in response to an energy-driven supply shock would risk amplifying downside risks to the economy. Historical episodes, including the 1970's oil shocks, demonstrate that aggressive monetary tightening in the face of temporary supply-driven inflation tends to exacerbate output declines and can tip the economy into recession.

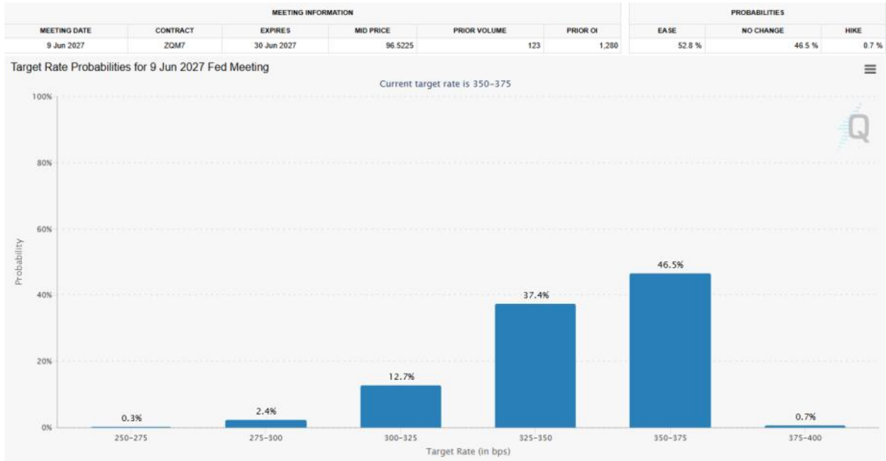
Given the current backdrop and high uncertainty around the duration of the Middle East conflict, we expect the Fed to adopt a cautious "wait and see" approach. ***Exhibit 4*** highlights that the Fed Funds Futures shifted from signaling an 86.50% chance cut by Dec 9, 2026 just one month ago, to now reflecting a 64.20% chance of no cut this year.

Exhibit 4

Meeting Date	Probabilities		
9-Dec-26	Ease	No Change	Hike
Now	34.80%	64.20%	1.00%
1 Month Ago	86.50%	13.50%	0%

Source: CME

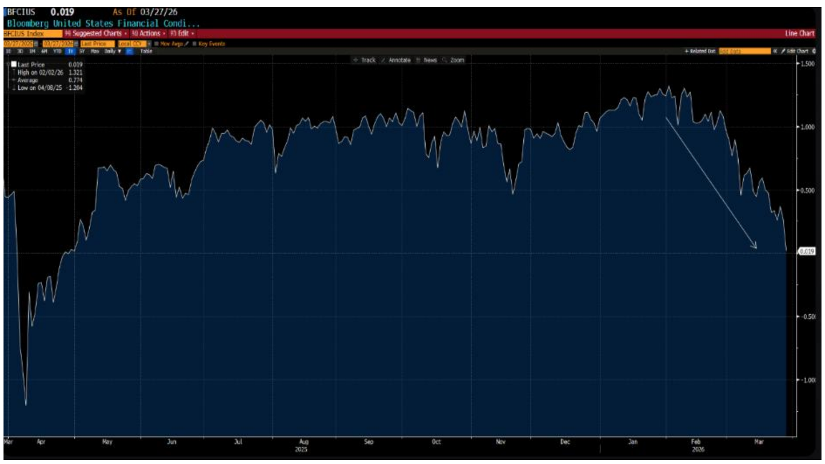
Exhibit 5



Source: CME

Furthermore, the futures now indicate that there is a 52.8% chance that the first cut will occur on the 9th June 2027 meeting ***(See Exhibit 5).***

Exhibit 6



Source: Bloomberg

The Bloomberg US Financial Conditions Index ***(See Exhibit 6)*** highlights financial conditions (above zero equals Easy/Loose Conditions and Below zero equals Tight Conditions) have already tightened organically, providing some additional restraint without further policy action and reinforcing the case for a near-term pause.

Private Credit

The second area of focus is private credit, a market that has grown rapidly in recent years and warrants close monitoring as financial conditions continue to tighten.

Non-bank lending has expanded significantly, particularly in vehicles that offer periodic liquidity while holding inherently illiquid assets. This structural mismatch has gone largely untested through the current cycle but becomes increasingly relevant as borrower profiles concentrated in highly leveraged, rate-sensitive segments of the economy that are also facing growing disruption from Artificial Intelligence come under greater pressure.

The key risk is not credit losses in isolation, but the liquidity transmission channel through which stress could propagate. The most likely trigger would be a refinancing shock or a meaningful rise in default rates, with liquidity stress acting as the amplification mechanism rather than the initial catalyst. Under this scenario, redemption pressure could force asset sales into thin secondary markets. Managers may liquidate higher-quality liquid assets first, creating broader valuation spillovers and stress could ultimately extend into syndicated loans and public credit markets.

That said, official assessments remain measured. Both the Bank for International Settlements (BIS) and the U.S. Office of Financial Research characterize current risks as modest and contained, while acknowledging the potential for amplification through bank-nonbank linkages and synthetic exposures in a stress scenario.

Private credit is therefore not an immediate systemic trigger, but it represents a risk that could escalate quickly if the oil shock proves persistent, growth continues to disappoint, or refinancing conditions deteriorate further. It bears watching.

Equities

Since the start of the conflict, U.S. markets have begun to outperform global equities on a relative basis ***(see Exhibit 7)***. This pattern reflects a clear investor preference for liquidity and earnings visibility, particularly as European and Asian markets face greater exposure to potential energy cost shocks. With a higher dependence on energy flows through the Strait of Hormuz, these regions are more vulnerable to margin pressure should disruptions persist, reinforcing the relative resilience of U.S. equities.

Exhibit 7

	YTD (%)	Rank	% Chg 1 M	Rank
IBOVESPA	13.06	1	-3.5	1
CSI 300	-2.75	7	-4.42	2
Nasdaq	-7.89	13	-5.56	3
S&P 500	-5.38	11	-5.84	4
Dow Jones	-4.38	9	-6.16	5
HANG SENG	-2.65	6	-6.3	6
S&P/TSX Comp	0.56	3	-7.14	7
S&P/ASX 200	-2.27	5	-7.42	8
IBEX 35	-3.1	8	-8.6	9
FTSE 100	-0.05	4	-8.96	10
NIKKEI	6.03	2	-9.31	11
CAC 40	-5.39	12	-10.1	12
Euro Stoxx 50	-5.05	10	-10.35	13
DAX	-8.99	14	-11.76	14

Source: Bloomberg/ PMI

Data as at 3-27-26

Exhibit 8

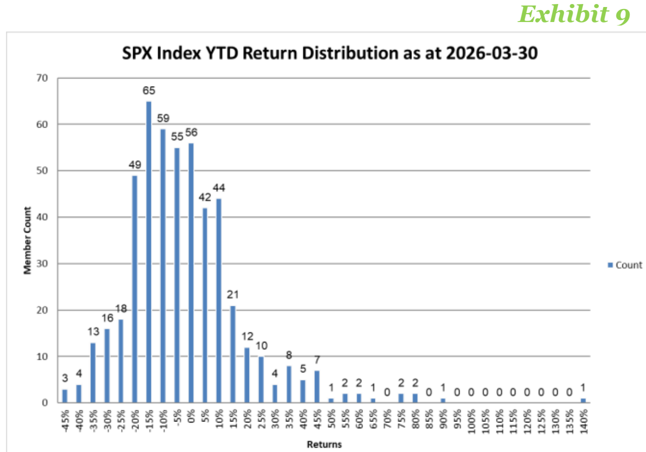
Rank	Sector	YTD Return	Jan 2026	Feb 2026	Mar 2026
1	Energy	34.62%	12.04%	4.26%	9.40%
2	Cons. Staples	5.73%	7.69%	1.73%	-4.28%
3	Materials	5.68%	7.02%	4.61%	-1.78%
4	Utilities	5.01%	0.13%	9.68%	-2.46%
5	Industrials	2.09%	4.65%	2.18%	-4.91%
6	Real Estate	0.58%	2.69%	4.62%	-5.63%
7	Healthcare	-6.23%	-0.62%	1.49%	-4.33%
8	Cons. Disc.	-8.47%	2.87%	-0.89%	-4.54%
9	Comm. Svcs	-8.98%	6.10%	-0.81%	-7.64%
10	Info Tech	-9.85%	-1.74%	-2.66%	-4.10%
11	Financials	-10.60%	-2.82%	-5.25%	-2.63%

Source: Bloomberg/PMI

While the SPX Index is down 8.8% (as at 3-30-26) from its recent highs, internally the picture is significantly weaker. The average member is down -20.6% from its high. This 11.8% gap can be viewed as the index masking effect as large cap winners in Energy and defensive sectors offset the widespread drawdowns in Financials, IT and Consumer names ***(Exhibit 8)***

Exhibit 9 shows the YTD return distribution with the highest concentration of names i.e. 65 (out of 503) are down -15%. The Volatility Ratio (calculated as Avg 30 Day Realized Volatility of the SPX Index 503 members/ SPX 30D Realized Vol) is 2.33x. A ratio above 2x strongly favours stock selection over passive index exposure (sell beta, buy alpha). This creates alpha generating opportunities especially when coupled with extreme oversold conditions.

Exhibit 9



Source: Bloomberg/PMI

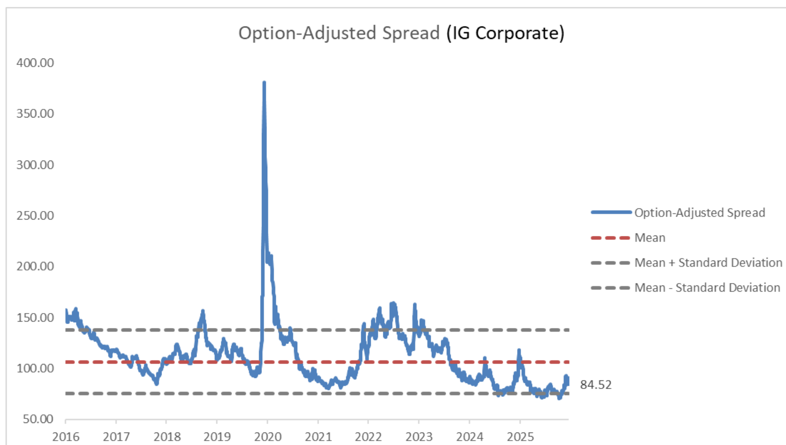
With short-term rates likely to remain anchored in the near term, longer-term yields face upward pressure from persistent core inflation, fiscal expansion, and rising term premia driving a gradual bear steepening of the yield curve absent a sharp shift in monetary policy.

In this environment, financial conditions are likely to tighten gradually, which should reinforce the current high-dispersion rotation regime. Defensive and inflation sensitive sectors such as Energy, Materials, and Utilities are well positioned to continue outperforming. Financials may see selective support from a steeper curve through improved net interest margins. Even though Technology is a classic long-duration sector vulnerable to rising long-term yields, it stands out as a relative bright spot given the sector's high earnings growth. According to FactSet's latest Earnings Insight report, the S&P 500 is expected to deliver 13.0% year-over-year earnings growth in Q1 2026, with the Information Technology sector remaining the dominant contributor at a projected +45.1% (by far the strongest of any sector). This robust earnings momentum should provide some cushion for select high-quality Tech names, particularly those tied to AI infrastructure, even as the broader sector faces valuation pressure in a mildly higher-rate environment.

Fixed Income

While OAS spreads have widened modestly from end-January levels, at 84.52 bps ***(See Exhibit 10)*** they remain historically tight and well below their long-term average.

Exhibit 10



Source: Bloomberg/PMI

Exhibit 11

Source: Bloomberg/PMI

The breakeven spread (the amount spreads can widen over the next 12 months before IG corporates begin to underperform Treasuries) is just 12.46 bps ***(see Exhibit 11)***. This suggests that even a modest further widening would likely lead to IG underperformance, with total returns becoming increasingly compressed and potentially flat, depending on the path of interest rates.

In the bear steepener environment, we favour a moderately short duration, targeted around 4 years and concentrated in the short to intermediate part of the curve (primarily 3-to-6-year maturities).

We maintain an underweight position in investment grade corporates, focused on the short end of the curve to capture credit carry while minimizing spread-duration risk. This is balanced by a core Treasury allocation laddered across the 3-to-6-year term spectrum. The overall structure provides a prudent balance between income generation and protection against gradual upward pressure on longer-term yields.

Conclusion

The market is approaching an inflection point, shaped by risks that remain manageable but unresolved. An energy-driven supply shock comes at a time when core inflation was already proving sticky. This leaves the Federal Reserve with limited room to maneuver with the expectation of them adopting a cautious "wait and see" approach as tightening further risks overtightening into a slowing economy, while holding back risks allowing inflation pressures to reaccelerate.

Despite these cross currents, markets have remained relatively resilient to date amid the elevated level of volatility, reflecting a prevailing view that these risks have not yet escalated into a systemic disruption.

The defining feature of this environment is duration uncertainty in respect to the length of the war and the strait being re-opened, the path of inflation, and whether Fed patience is ultimately vindicated or tested.

A swift resolution to the conflict would likely trigger a sharp rotation into market laggards particularly rate-sensitive and consumer-facing sectors that have been disproportionately punished as energy prices retrace and near-term inflation expectations decompress. This would give the Fed greater confidence to resume its easing path, pulling short-term yields lower and steepening the curve from the front end. However, the relief rally in rates would likely be partial rather than complete. Structural pressures on the long end (elevated Treasury issuance, persistent fiscal deficits, and a term premium) that has been repricing higher independent of the energy shock would act as a ceiling on any bond market rally. The net effect would be a more supportive environment for equities broadly, but one where the magnitude of rates relief is constrained, and where the quality of the earnings recovery matters more than the mere removal of the geopolitical risk premium.

Beneath the surface, dispersion is already extreme. The average S&P 500 constituent is down more than 20% from its highs even as the index sits less than 9% off its peak, a divergence that rewards stock selection over passive exposure.

With the Volatility Ratio above 2x, outcomes will hinge less on any single macro call and more on disciplined rotation across asset classes.

PMI continues to capitalize on this environment by targeting the dislocations created by elevated dispersion and volatility, overweighting sectors and individual securities where earnings resilience and pricing power are mispriced relative to current valuations. At the same time, we tactically rotate exposures as macro signals evolve, ensuring positioning remains aligned with shifting market conditions and emerging opportunities. PMI