



Financial Markets Perspective

April 2026

A Fork in the Road

The war with Iran has changed the economic and financial market outlook for the balance of 2026 and beyond. The circumstances are changing daily, and there is no way to predict the outcome. As March ended, financial markets remained in a downtrend amid growing uncertainty about what would happen next. There could be multiple outcomes, but they probably boil down to two alternatives. The first could be the high road, in which Iran comes to terms with the US proposals and avoids further conflict. Such an outcome would put the US and the world economy back on a growth path. The second option could be the low road, where the Iranians persist in blocking the Gulf of Hormuz, the US and others prosecute the war to a costly conclusion, and the rest of the world suffers from higher prices for many oil-related commodities. Further complications regarding the Iranian proxies in Yemen (Houthis) and Lebanon (Hezbollah), who continued to pursue the bombing of Israel. This low road will also complicate the US mid-term elections, where support for continuing the conflict is shrinking. The outcome of that election could severely undermine the US's ability to successfully conclude the war. Over the next few weeks, we should be able to see what road we take.

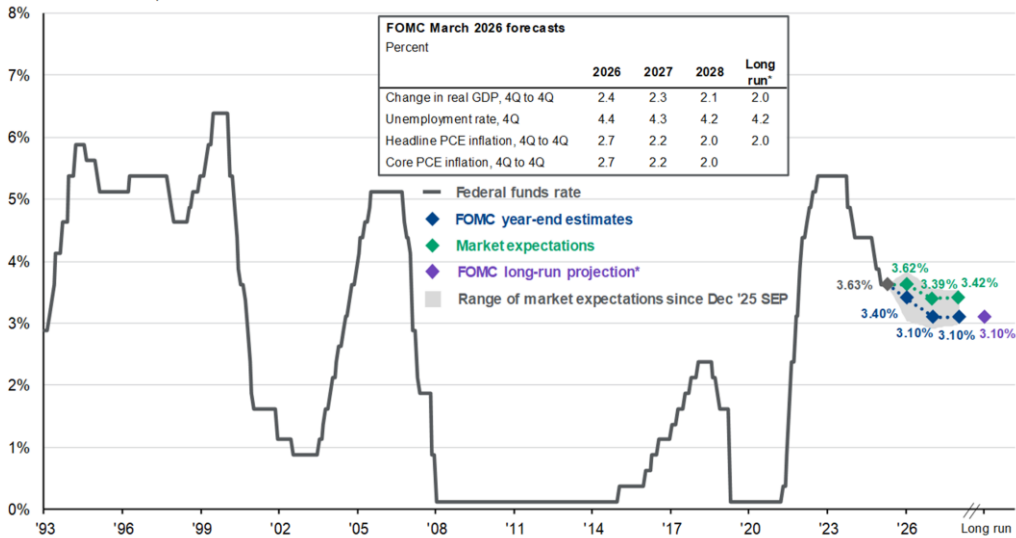
For financial markets, the beginning of 2026 seemed to indicate another strong year for stocks and a continued downtrend in interest rates in response to the Fed's plans to lower the fed funds rate throughout the year. For those who are not aware of the Federal Reserve's role, its job is to contain inflation while keeping unemployment in check. The Fed does this by manipulating short-term interest rates to shift the economy toward higher or lower growth. Lowering interest rates is one way to jump-start borrowing and spur economic growth. However, one economist compares this effort to sitting in the back seat of a car and trying to steer by leaning from side to side. Success can be fleeting.

In any case, the Federal Reserve has been gradually reducing short-term interest rates, making them less volatile. This relative stability is probably good for the economy because stable rates provide certainty for borrowing and lending plans, especially for long-term commitments. At the beginning of the year, conditions were right for continued reductions in the fed funds rate. However, the expected number of reductions was reduced due to stubborn inflation that has not returned to the Fed's 2% target. So far this year, we have had one 25-basis-point reduction in the federal funds rate.

This stability in interest rates is good for the economy and financial markets. On the equity side, the stock market got off to a fast start early in the year making steady progress through January and February, partly due to the expectation that interest rates would trend downward throughout 2026 and generally favorable expectations for corporate profits.

Federal funds rate expectations

FOMC and market expectations for the federal funds rate

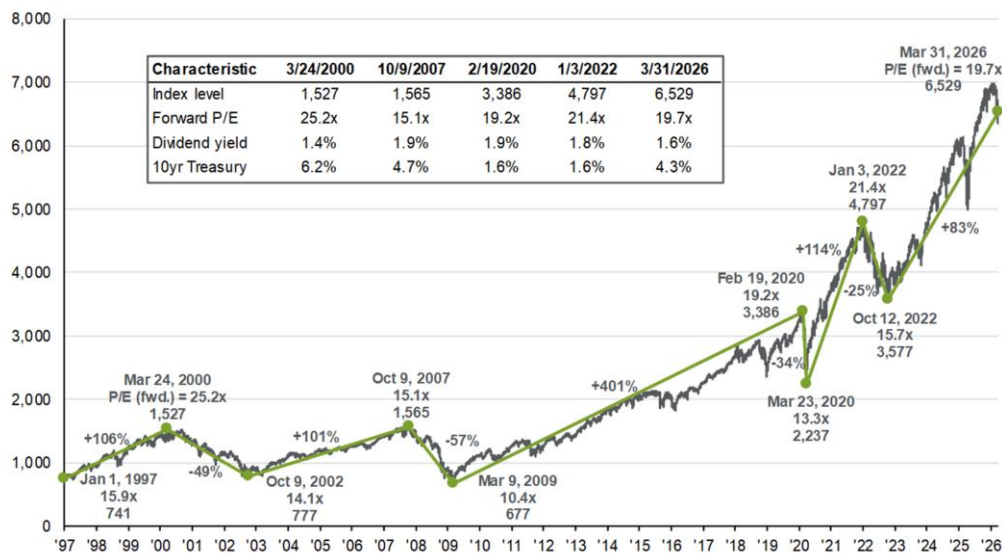


Source: JPMorgan

The sudden shock of the Iran conflict seemed to have little effect on interest rates. There was some increased volatility, but one would expect higher rates given a reset on inflation expectations due to higher oil prices. So far, the market appears to expect higher inflation to be temporary. However, persistent inflation will pressure the Fed to keep interest rates where they are or even raise them.

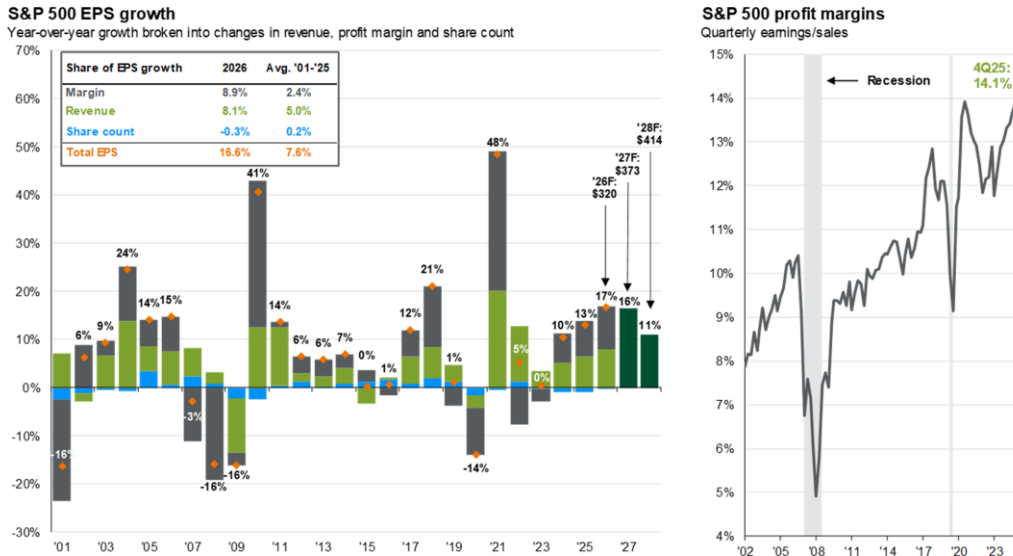
In response to the war, equity markets sold off, as they usually do when uncertainty rises sharply. This is especially true in the first quarter, when the stock market was booming due to rapid advances in artificial intelligence and the construction of large data centers across the country.

S&P 500 Price Index



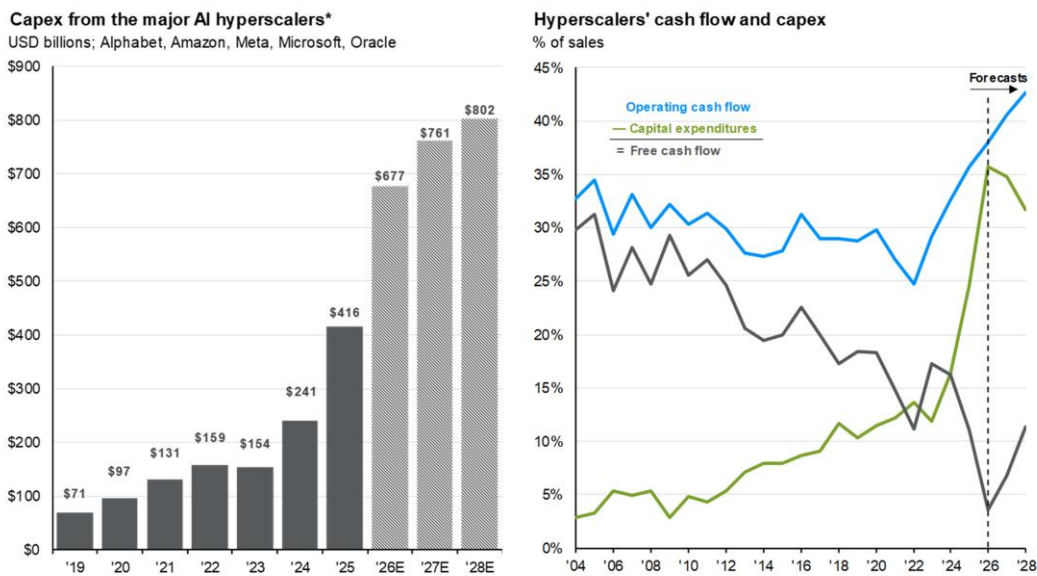
Source: JPMorgan

As the stock market becomes more volatile amid global uncertainty, investors worry about a continued decline if the war persists. However, the fundamentals suggest that the stock market should rally as the war's outcome becomes clearer. The following exhibit presents S&P 500 profit margins and the sources of earnings. As of the fourth quarter of 2025, companies were at record levels. For 2026, profit margins are expected to be about 8.9%, compared with an average of 2.4% over the prior 25 years! Expectations for double-digit profit margins in '26 and '27 may provide the necessary impetus for broadly higher stock prices.



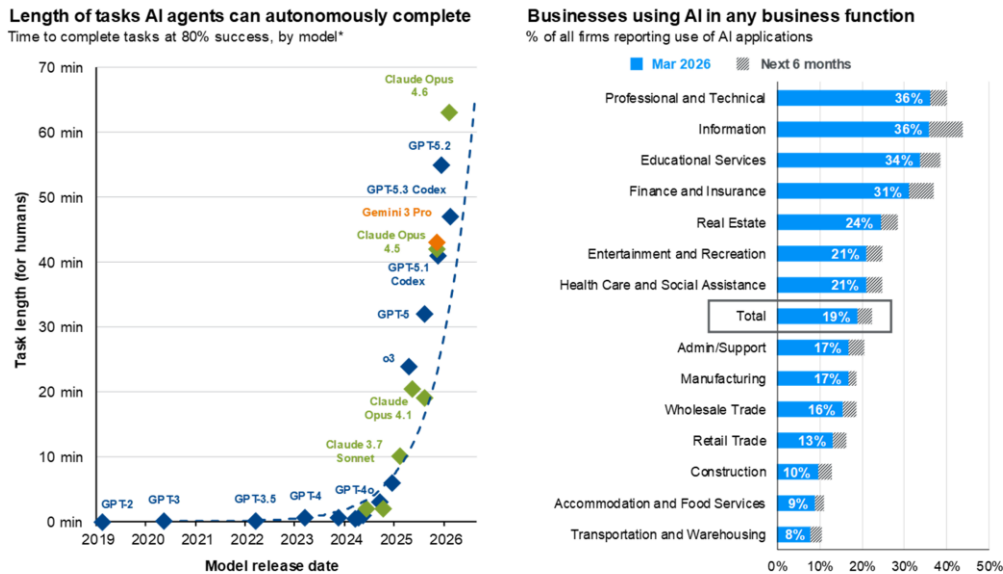
Source: JPMorgan

The primary driver of continued margin expansion is the adoption of artificial intelligence across industries. The investment in AI facilities, primarily data centers, is nothing short of monumental. Otherwise known as “hyperscalers,” these companies have committed hundreds of billions of dollars to build these data centers.



Source: JPMorgan

This spending will provide an enormous boost to local economies where these centers will be built, increasing economic activity, jobs, and local tax revenues. The question many investors have asked is: Will there be enough demand for all that artificial intelligence? The challenge, then, is to determine who will use all this computing power. One way to do this is to identify which sectors are using AI today and whether they plan to use it in the near future.

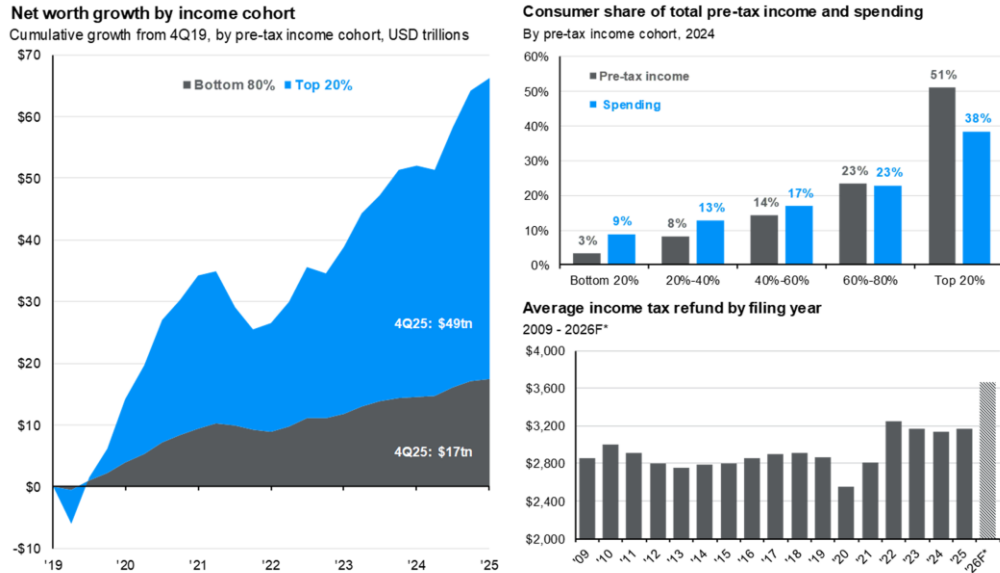


Source: JPMorgan

As the graph above indicates, demand for AI is increasing, especially as it gains acceptance and utility. One unknown is the growing capability of these models, and the competition to provide the “best” model is intense. This growing utilization will also help improve productivity across the economy.

We are into tax season, which may be good news for consumers and the economy. Recent low levels of consumer confidence could be related to feelings about the war, the government shutdown, the impact of air travel, and the actions of ICE in the identification of illegal aliens. However, the good news is that last year's tax law changes will benefit consumers in the coming weeks, as tax refunds will be substantial. In addition, Trump’s tax reductions in his first term were set to expire in 2025. If he had not been reelected, not only would there be few, if any, tax cuts, but there would also be a tax increase as those tax cuts expired. One estimate puts that tax reduction at about \$450 billion per year!

While high-income consumers are the key drivers of consumer spending due to rising net worth, there is a rising net-worth component among low-income consumers. This component should benefit from the expected increase in tax refunds resulting from the tax reductions implemented for the 2026 tax year. Over the next three to six months, we expect to see higher consumer spending due to these refunds and improving economic indicators.



Source: JPMorgan

Conclusions:

The conflict with Iran introduced greater uncertainty in financial markets, but indications that the war may be over gave the stock market a push higher, taking the S&P 500 to record highs on April 15th. The fact that the US economy is energy self-sufficient lessens the pain of rising oil and gas prices. Also, other countries’ energy needs have propelled liquefied natural gas exports to become a major export, bolstering our trade balance. The US dollar has strengthened in global markets, attesting to its role as the world’s reserve currency.

The Federal Reserve’s plan to lower interest rates over the balance of 2026 appears to be on hold, as higher oil prices and related commodities, such as fertilizer, may push inflation higher. In the short term, rates should stabilize at the short end and continue to rise gradually until the war ends definitively.

The artificial intelligence boom should remain a major driver of economic growth. Corporations will benefit as continuous innovations through AI will contribute to rising productivity. Even though there is some consumer and government resistance to AI's advances, the opportunities it creates will be hard to measure. In any case, like the Industrial Revolution, the AI revolution is changing our way of life for the foreseeable future.

Diane V. Nugent
President/CEO

Thomas E. Nugent
Executive Vice President