



Traphagen Q1 2026 Newsletter

The first quarter of 2026 proved to be one of the more eventful and volatile periods in the past couple of years. After finishing 2025 on a strong note, markets were quickly confronted by a convergence of geopolitical shocks, a landmark Supreme Court ruling on trade policy, a pivotal change at the Federal Reserve, and intensifying debate over the long-term impact of artificial intelligence on the economy. Despite the noise and volatility, Traphagen portfolios held up well — meaningfully outperforming major stock and bond benchmarks — a direct reflection of our diversified construction and allocation to alternative/private investments. This newsletter provides our in-depth review of the quarter, our current thinking on the key themes, and an update on portfolio positioning heading into the second quarter.

Economic & Market Update

The first quarter of 2026 began constructively. January brought continued economic momentum off the back of a strong 2025, with the S&P 500 rising approximately 1.4% in that month alone, while gold reached new all-time highs above \$5,400 per ounce and corporate earnings estimates for Q1 were revised higher throughout the period. However, the quarter took a sharp turn in late February and March following two major shocks that dominated investor attention and drove meaningful market volatility.

The S&P 500 finished Q1 2026 down 4.3% in total return terms, while the Nasdaq declined roughly 7.0% and the ACWI (our main benchmark) decreased 2.2%. By contrast, and consistent with some of our recently added holdings, US value/dividend stocks (SCHD) gained approximately 10.6%, foreign developed stocks (FENI) was just above breakeven, and our total infrastructure allocation was up more than 12%. Physical and more 'old economy' sectors including utilities, industrials, materials, and consumer staples posted positive gains, while technology, communication services, and consumer discretionary were the underperformers.

The US Dollar Index edged modestly higher after its significant decline in 2025. Gold, after starting 2026 with a remarkable run above \$5,400 per ounce, experienced a sharp reversal in late January when it traded more like a risk asset amid leveraged position unwinds, ultimately finishing the quarter near \$4,660 per ounce. The US Bond Aggregate (AGG) was essentially flat for the quarter, with almost all other categories of publicly traded bonds also near breakeven or down less than 1%. This is a direct reaction to the 10 Year Treasury yield creeping up through the quarter from 4.19% on January 1st to 4.31% at the end of the quarter. The contrasts with all our private credit/debt funds, which continue to outperform with returns between 1% - 2%.

Sector Performance: Q1 2026

Sector	Q1 2026 Return	Key Drivers
Energy	+ 35%	Iran conflict, oil price surge, physical, AI energy use
Materials	+ 9%	Commodity/energy price tailwind, physical
Utilities	+ 7%	AI power demand, defensive rotation
Consumer Staples	+6%	Defensive rotation, no AI disruption risk
Industrials	+3%	Defense spending, infrastructure build, AI
Real Estate	+ 1%	Slightly higher rates, no AI disruption risk, physical
Healthcare	- 5%	Mixed earnings, higher GLP-1 competition
Communication Services	- 5%	Slightly higher rates, had a large run prior
Consumer Discretionary	- 8%	AI disruption fears, oil/consumer spending fears
Technology	- 8%	AI disruption fears, valuation reset, AI trade rethink
Financials	- 10%	Credit concerns, AI concerns, rising rates

Bond Market Insights

After a solid year for bonds in 2025 — with Treasury yields drifting down to the 4% range and the US Bond Aggregate returning approximately 7%, the first quarter of 2026 was more complicated. Bonds ultimately ended the quarter essentially flat in return terms, but the path was volatile.

The primary driver of bond volatility in Q1 was the surge in energy prices stemming from the US-Iran conflict (detailed below). Rising oil prices quickly reignited near-term inflation fears, pushing back the anticipated timeline for Federal Reserve rate cuts and causing short-duration bonds to sell off along with longer duration bonds. As a corollary to this, mortgage rates, after dipping briefly below 6%, have now risen back to about a 6.4% national average.

Our traditional fixed income strategy performed as expected with minimal volatility. Our AAA/A rated corporate and securitized loan positions (JAAA, JSI) continue to exhibit near-zero interest rate sensitivity with solid yields around 5.0% to 5.5%. Our private credit suite (detailed below in the alternatives section) also continued to outperform public fixed income by a wide margin, as it has done consistently since 2021. This is despite a slug of negative headlines and articles focusing on the asset class during the quarter.

Looking ahead to Q2, we remain cautious on any large allocation to long-term Treasury bonds with moderate yields and very high-interest rate sensitivity/uncertainty. We do have some allocation to a unique option writing Treasury ETF (TLTW) with a near 10% yield, but outside of that we continue to favor shorter-duration, high-quality public credit and our unique private credit suite as the core of our fixed income allocation.

Real Estate and Alternatives

Our private/alternative suite (TRPALTS) continued to be the most important differentiating element in client portfolios in Q1 2026. While public stock markets were down between 2% and 7% and the bond market was choppy, our alternative suite provided the cushion and stability that allowed clients to weather the quarter with near breakeven or modest positive returns. TRPALTS is already up over 2% for most clients this year despite traditional markets down across the board.

Private credit, which has been a core holding for Traphagen since 2020, continued to deliver consistent, solid returns with almost no volatility. Over the period from January 2022 through March 2026, our private credit funds in aggregate returned approximately 44.5% (approximately 9.7% per year net of fees), while public investment grade bonds and Treasuries are down between 3% and 6% cumulatively over that same period — a remarkable differentiation.

Many of you may have seen recent negative headlines and/or articles on private credit over the past couple of months. We have vetted our managers diligently over the years and are extremely comfortable with our current allocation. It is heavily tilted to physical assets (equipment, inventory, real estate, infrastructure, etc.) and well diversified across 1000's of credits. Although anything is possible, we view 2026 as likely another year of upper single digit returns/cash yield for the asset class.

Insurance Linked Securities (ILS), including catastrophe bonds, continued to perform well as an uncorrelated income source, with our ILS allocation delivering a total return since 2021 of approximately 76.7% versus the global stock market's 65.0% over the same period — with a fraction of the volatility. Within space, we have moved away from Cat Bonds (SHRIX/CBYYX) and more into ILW/QS (XILSX/SRRIX) due to better return potential.

Our private real estate holdings continue to perform positively in 2026 (after a volatile Q4 2025 with the Bluerock conversion to BPRE), but we believe this asset class has now largely stabilized, produces cash flows of 4% - 7% (largely tax-deferred), and in the case of KRSTX should show a large gain as we approach June of 2027.

Private equity (held for return enhancement, not specifically for risk reduction) has grown nicely with returns over the past year between 12% and 25%.

Economic Indicators

Despite the market turbulence in Q1, the underlying US economy showed continued resilience through much of the period. Corporate earnings for Q1 2026 are currently estimated at approximately 13% year-over-year EPS growth, which would mark the sixth consecutive quarter of double-digit earnings growth for the S&P 500. Net profit margins for the index stood at approximately 13.2%, above both the prior year and the five-year average.

GDP growth, however, showed signs of softening as the quarter progressed. February GDP growth came in below expectations, and the combination of the oil price shock, tariff-related uncertainty (discussed below), and tighter financial conditions began weighing on forward estimates. Consumer confidence pulled back as energy prices rose. We continue to monitor these trends closely, but as of now the current estimate for 2026 US GDP growth is 2.3% on a real basis or roughly 5% on a nominal basis (assuming close to 3% inflation). If the above mentioned earnings and GDP growth come to fruition it would be tough for the stock market (despite elevated valuations) to experience a sustained 15% - 20% or more drawdown.

The labor market remained stable through most of Q1. Unemployment, although still quite low, has inched up from 4.2% in the middle of 2025 to 4.3% in March of 2026. Job creation figures have continued to also show modest slowing on a trend basis. We are looking at employment data carefully; with a sustained move above 4.7% accompanied by other weakening indicators prompting us to take further protective action in portfolios.



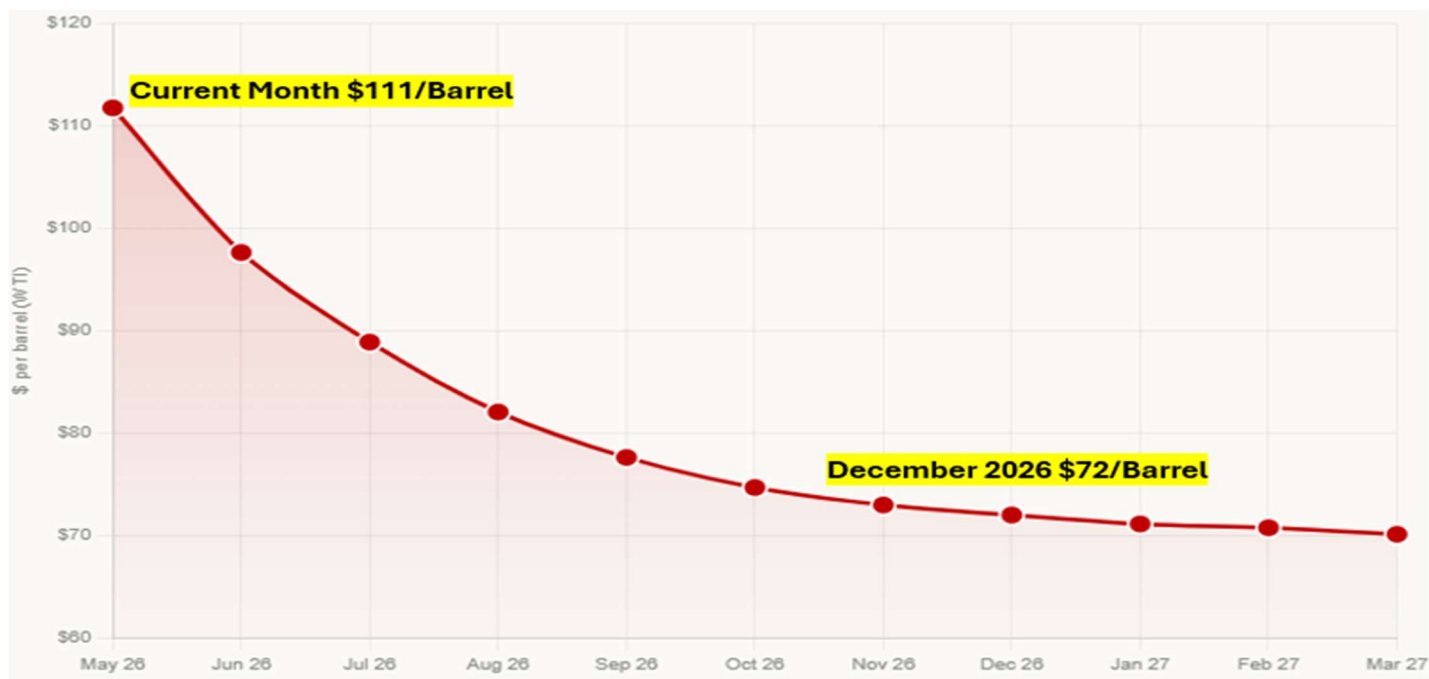
Above: Chart of market inflation expectations over the past five years (10-year average inflation)

Inflation, as measured by the Consumer Price Index (CPI), showed headline CPI rising 2.4% year-over-year in February, while core CPI increased 2.5%. These numbers were measured before the full impact of the Iran conflict-driven oil shock was felt, suggesting headline inflation could move materially higher in March and April data. The Fed's preferred gauge, the Personal Consumption Expenditures (PCE) price index, had been tracking near 2.5%, but upward pressure from energy is a concern. Longer term market inflation expectations remain well anchored at around 2.3% (above chart)

Major Factors Shaping Q1 2026

1. The US-Iran Conflict and the Oil Price Shock

Starting on the 1st of March, the military conflict between the United States and Iran, became center stage in terms of the economy/markets, oil prices, and the financial markets. The conflict sent immediate shockwaves through global energy markets. Brent crude oil surged from below \$61 per barrel at the start of 2026 to approximately \$118 per barrel by quarter's end, while WTI crude closed the quarter near \$101 per barrel. As we write this newsletter, WTI is trading at about \$111/barrel, and the situation remains highly fluid. That said we are comforted by forward contracts for oil by the end of the year back in the low \$70/barrel range (*see chart below*).



The economic implications are significant, though importantly asymmetric. As the world's largest oil and natural gas producer, the United States is far more insulated from this energy shock than Europe or Asia. For European economies — heavily reliant on natural gas imports — the shock is materially negative, with the OECD lowering its eurozone growth forecast for 2026 to 0.8% from a prior estimate of 1.2%.

From a market perspective, the conflict triggered a sharp rotation in sector leadership. Energy stocks surged dramatically, conversely, technology, consumer discretionary, and other rate-sensitive sectors that had led markets in recent years experienced material declines. This is a rotation that Traphagen has been positioning for — our infrastructure, regulated utility, and pipeline holdings provided meaningful protection and positive contribution during the quarter. Our infrastructure holdings (both private and public) were up a combined 8% - 14% in the quarter depending on the exact portfolio.

Going forward, we expect this war (like others) to be more of a short/intermediate term event for the US stock market, and over the course of the next 2-4 months, stock and oil prices are likely to normalize.

2. The Supreme Court Tariff Ruling and the New Trade Framework

On February 20, 2026, the United States Supreme Court issued one of the most consequential economic rulings in years. In a 6-3 decision the Court held that the International Emergency Economic Powers Act (IEEPA) does not authorize the President to impose tariffs. The ruling invalidated the broad tariff framework that had been in place since 2025.

The fiscal implications are substantial. IEEPA-based tariffs had collected an estimated \$175 to \$180 billion through early 2026, at an annualized run-rate of \$300 to \$350 billion. The ruling potentially creates large refund claims from affected importers, with the process expected to be complex and drawn out.

President Trump moved swiftly to preserve tariff revenue. Within hours of the ruling, he invoked Section 122 of the Trade Act of 1974 — a separate statutory authority that does authorize the President to impose tariffs of up to 15% for up to 150 days to address balance-of-payments issues.

For our client portfolios and the stock market, the net impact of the above is actually fairly minimal. Although meaningful for certain companies (especially smaller goods-related firms), in terms of the

overall stock market and the economy relative to other events, tariffs do not seem to be a large risk in terms of inflation or reduced profit margins as originally feared.

3. The New Federal Reserve: Kevin Warsh and What It Means for Markets

An important but less volatile development of Q1 2026 was President Trump's formal nomination of Kevin Warsh to succeed Jerome Powell as Chair of the Federal Reserve. Powell's term ends next month. There has been some political complication since the nomination, mostly surrounding Powell, but at some point within Q2 2026 it is likely Warsh will be confirmed.

Warsh is a former Federal Reserve Governor (serving 2006–2011), former Morgan Stanley investment banker, and he served as the Fed board's liaison to Wall Street during the 2008 financial crisis. In recent years, he has been highly critical of the post great financial crisis-era Fed, calling for "regime change" and arguing that the central bank strayed far beyond its core mandate under Powell's leadership. He has recently embraced the idea that AI-driven productivity gains can help keep inflation in check while allowing for lower rates — a view that aligns with President Trump's desire for more aggressive rate cuts.

The potential market implications of a Warsh-led Fed are significant. Three themes stand out. First, markets anticipate a steeper yield curve under Warsh, with lower short-term rates (controlled by the Fed) potentially combined with a reduced Fed footprint in the bond market, which could push long-term Treasury yields higher as investors demand greater "term premium." Second, Warsh's skepticism of "forward guidance" means the Fed will likely provide fewer signals about future policy moves — an "opacity" that could increase market volatility as traders react sharply to each data release rather than anchoring on Fed communications. Third, the era of the 'Fed put' — the expectation that the Federal Reserve will aggressively intervene in market downturns — may be significantly reduced.

Traphagen views the nomination, and likely confirmation, of Warsh as an important development. His views align with a Fed less likely to intervene in markets and likely to pull back some of the post GFC 'support' the markets have gotten used to over the past 15 years. We will be watching to see if once he is confirmed and on the job, if the market 'tests' him and how he reacts and governs when seated. This could be a source of some volatility in the shorter term.

4. Artificial Intelligence: From Infrastructure Build-Out to Disruption Fears

If Q1 2026 had a dominant investment theme beyond geopolitics, it was the dramatic shift in how markets are pricing artificial intelligence — from a generational tailwind to a more nuanced and complex two-sided story. Early in the year, continued AI momentum and strong earnings from the hyperscalers kept markets constructive. But by February and March, the narrative shifted materially. Two related forces drove this change: the rapid advance of agentic AI capabilities and the growing realization that AI is not just building new industries — it is disrupting existing ones.

The concept of 'agentic AI' refers to AI systems that do not merely answer questions or generate content, but autonomously plan, reason, and execute complex multi-step tasks on behalf of users — effectively replacing the direct human interaction with software, websites, and business processes that has driven much of the SaaS industry's value creation over the past decade. This has caused investors to rapidly reprice Software-as-a-Service (SaaS) stocks, which were among the highest-valued segments of the equity market. Most software stocks are down 30% to 70% over the past 6 months or so, with even Microsoft down 35% off its recent highs.

Below: SP500 vs. software stock index since October 2025.



At Traphagen, we have been positioning around this transition carefully and have been making material portfolio adjustments to reflect it. Our framework distinguishes clearly between two types of AI exposure:

- **AI Disruption Risk (Avoid or Underweight):** This includes traditional SaaS and application software, public information databases and analytic firms, many knowledge services including consulting and professional services, certain financial technology companies, and ecommerce platforms where AI agents will increasingly bypass the traditional user interface entirely. These industries face shrinking profit margins and smaller addressable markets as AI matures.
- **AI Beneficiaries and Infrastructure (Emphasize):** This includes semiconductor and memory chip companies, physical AI infrastructure (data centers, high-speed networks, servers), energy and electricity production to power the AI compute buildout, broad infrastructure, healthcare, consumer products, defense, real estate, and more dividend focused companies. These sectors face no meaningful AI disruption threat.

Private Investment Update

(For Accredited Investors Only; \$1M+ with Traphagen)

- **Private Equity (GPB Fund II):** The fund's remaining assets are held in Treasury Bills earning interest while the wind-down process continues. We will communicate separately with all GPB holders as additional distributions are scheduled/confirmed. We expect that to occur sometime in the summer.
- **I-Direct Private Markets Fund (KKR, Vista, Warburg Pincus):** This well-diversified, three-manager direct private equity fund continues to perform solidly (+10.6% in 2025), benefiting from its diversified approach across high-quality business services, technology, and consumer.
- **KKR Private Equity Fund:** Continues to deliver strong results with direct ownership of approximately 65 portfolio companies, the vast majority profitable businesses. Performance through all of 2025 was +16.8%.
- **BREIT (Blackstone):** Up +1.8% through February 2026 and the portfolio is now allocated 24% to data centers. This is likely to grow to near 30% over the next year or so.
- **JPM REIT:** Up 0.8% YTD through February 2026 with a 4.4% annualized yield driven by strong occupancy rates in industrial and multifamily properties.

- **STEPSTONE Funds:** Our Stepstone suite (private equity XPMIX, infrastructure STRUX, and venture capital; SPRING) continues to be among our best performing private holdings. XPMIX is up 1% through February, STRUX is up 4% through March, and SPRING is up 8.7% through February. All far outperforming their public stock counterparts.
- **Cascade Private Equity Fund:** This well-diversified secondary private equity fund continues its outstanding performance trajectory, building on 23% returns in 2025. In 2026, it is up 1.6% through February.

2026 Portfolio Changes & Performance Update

Based on our analysis of the themes described in this newsletter, Traphagen has made the following material changes to client portfolios from 2025 to 2026.

Sector/Asset Class	The Action (Sale/Trim)	Reallocation (The Buy)
Private Credit	Trim 15-25%. Reducing suite of private credit funds after 5 years of strong outperformance.	Move to: Dividend Stocks, AAA/A Public Corporate Credit, & ILS.
Insurance Linked Securities	Trim 50%. Reducing Catastrophe Bond exposure as rates decline.	Pivot to: Better-positioned ILW/Quota share (XILSX/SRRIX).
US Growth Stocks	Trim 25% AVUS. Exit COWG entirely.	Initiate: Purchase GFLW for tactical US Large Cap exposure.
Artificial Intelligence	Strategic Shift: Moving from 'Infrastructure' to 'Adopters.'	New ETF: ALAI. Capturing the value accrual trend for AI beneficiaries.
Infrastructure	Trim: GRID. De-risking aggressive holdings after 2 years of excess gains.	Allocate to: Natural Gas Pipelines & Regulated Utilities (Lower Risk).
New Market	—	First in 10 Years: Taking a position in high-quality Foreign Developed Markets.

Although there is a very high hurdle for Traphagen to allocate to foreign funds, the combination of valuations that are more than 30% below US equivalents, a dollar that remains structurally overvalued relative to most major currencies, 3X the dividend yield of the SP500 (3.1% vs. 1.2%), and increased foreign government spending on defense, etc. is enough evidence to take 10% of our equity allocation out of US large cap and into foreign developed markets.

2026 Market and Economic Outlook

Looking ahead through the remainder of 2026, we maintain a guarded optimistic stance, with a clear eye on the crosscurrents and risks that could challenge markets. Our assessment of the major factors shaping the outlook is as follows:

Factor	Near-Term Impact	Long-Term Impact
US Large Cap Stock Valuations	Negative/Neutral	Negative/Neutral
AI Disruption/Uncertainty Fears	Negative	Mixed/Neutral

Factor	Near-Term Impact	Long-Term Impact
Iran Conflict / Oil Prices	Negative	Neutral to Positive
New Fed Chair (Warsh)	Negative/Mixed	Mixed/Neutral
Trump Admin Net Policy Impact	Positive	Mixed
High Bond/Alternative Yields	Positive	Positive
Corporate Earnings Growth	Positive	Positive
US Fiscal Policy / Liquidity	Positive	Positive

The central question for 2026 is whether the positives — solid corporate earnings, continued AI investment, pro-growth administration policy, and the enormous pool of money market assets looking for better homes as short-term rates decline — can outweigh the headwinds of elevated valuations, geopolitical risk, AI disruption fears, and a Federal Reserve in transition. Our base case remains constructive for the second half of the year, although with continued volatility and lower (but still positive) portfolio returns expected than in prior years.

We believe the portfolio construction we have put in place — diversified across growth and defensive equities, high-quality fixed income, private credit, insurance-linked securities, private equity, and infrastructure — is well-suited for this environment. As we have demonstrated consistently, when stock markets face pressure, our alternatives and defensive holdings absorb the shock and provide the option to deploy capital opportunistically. When markets recover, our equity exposure allows us to participate meaningfully. This ‘offense and defense with the same allocation’ philosophy remains the core of the Traphagen approach, and we believe it is more relevant than ever in the current landscape.

Conclusion

The first quarter of 2026 was a powerful reminder of why willingness to adjust positions, diversification, and a steady investment philosophy matter. While public stock benchmarks fell meaningfully and volatility was elevated, Traphagen client portfolios held up well, reflecting the defensive architecture we have been building over the past several years. Two of this quarter’s key themes —the transition at the Federal Reserve and the accelerating AI disruption narrative — are not temporary distractions. They represent durable structural shifts that will shape markets and the economy for years to come. We have been thinking carefully about each of them and are making deliberate, considered portfolio changes in response.

We are grateful for the continued trust you place in us during uncertain times. As always, our commitment is to protect and grow your wealth with discipline, foresight, and a long-term perspective. We look forward to discussing the contents of this newsletter with each of you in the coming weeks.

Best regards,

Your Traphagen Investment Team