Low Visibility

Introduction

The war in Iran reversed what had been an exceptional rally in January and February. Most major asset classes sold off in March while the dollar and energy assets spiked. Still, Avalon portfolios finished flat to modestly higher for the first quarter of 2026. Our allocation to precious metals, semiconductor company stocks, select international equities, and energy assets more than offset losses from U.S. equities, the weakest asset class for the quarter.

The big question for March and going forward is when we will see a sustainable resolution in the Middle East. A prolonged oil supply disruption has the potential to derail what are strong economic tailwinds. While it is hard to understand the goals within the U.S. administration, there are many other nation-states with both the incentive and the ability to sustain the conflict. Last year's tariff announcement, and after much market damage, subsequent reversal of those policies spawned the term "TACO," for Trump Always Chickens Out. We are not sure TACO matters for this conflict as we are potentially already locked in on a collision course for more conflict, higher oil prices, and economic headwinds.

During the quarter, we increased our already sizeable hard asset exposure in client portfolios, adding energy stocks as well as commodity futures to complement our precious metals holdings. We have also added to our cash position across client portfolios. Both cash as well as energy holdings are a hedge to equities in the event of sustained conflict. While holding cash is never a long-term winner in terms of investment returns, our analysis indicates that the energy sector could be. Energy, along with semiconductors and other data center components, is a key component in the AI buildout. We continue to believe that AI will be the most impactful technology of this decade and have maintained investments in AI infrastructure (semiconductors, data center infrastructure, and now energy) accordingly.

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Asset Class Returns for Q1 2026

Source: Bloomberg

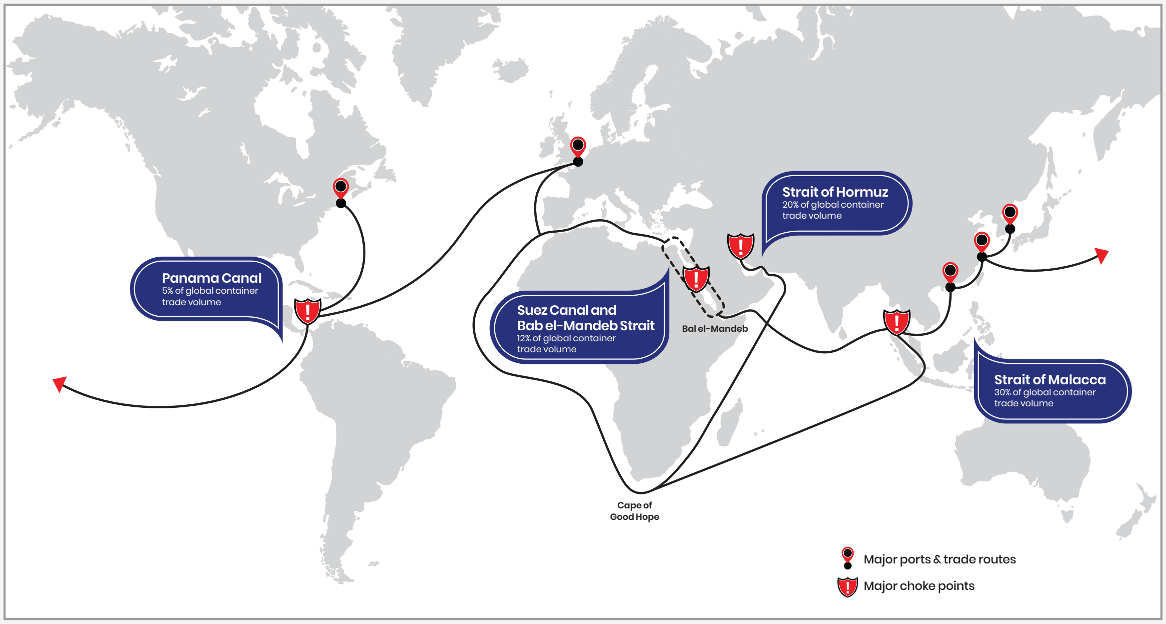
War

The conflict in Iran has exposed the dependence of the global economy on several tightly constrained energy chokepoints for oil and other commodities. Since the 1970s, advanced economies have significantly reduced their energy intensity, using less oil per unit of GDP, as economies have “wrung out” discretionary consumption. Though for vital areas such as petrochemical feedstocks, aviation fuel, grid stability, and agriculture, energy usage is critical to their operations and cannot be easily substituted. The result is that despite lower overall energy dependence, the global economy may be even more vulnerable to disruption today.

Accentuating this risk is that not all energy disruptions are the same. Historically, markets have dealt with supply disruptions. These losses of production were ultimately offset through spare capacity, inventory drawdowns, or rerouting. In those environments, oil price spikes largely reflected a temporary geopolitical risk premium that faded as supply adjusted. Today’s disruption seems different. It is less about production and more about transportation and arterial flow. The Strait of Hormuz, for example, has historically transported approximately 21 million barrels per day. This represents close to 20% of global petroleum liquids consumption. When these arteries are impaired, there is no practical rerouting mechanism to meet global demand. While the selective reopening on March 26 permitted transit of ships flagged to select Iran-friendly nations, the net reduction in flows is still estimated to be over 10 million barrels per day.

There are many questions in terms of the long-term dynamics for oil transit through the Strait of Hormuz, though one likely dynamic is that nations will respond by hoarding oil supply. This shift has the potential to generate a structural premium in energy costs for years to come.

Re-Shoring: Global Supply Chains Run Through Choke Points



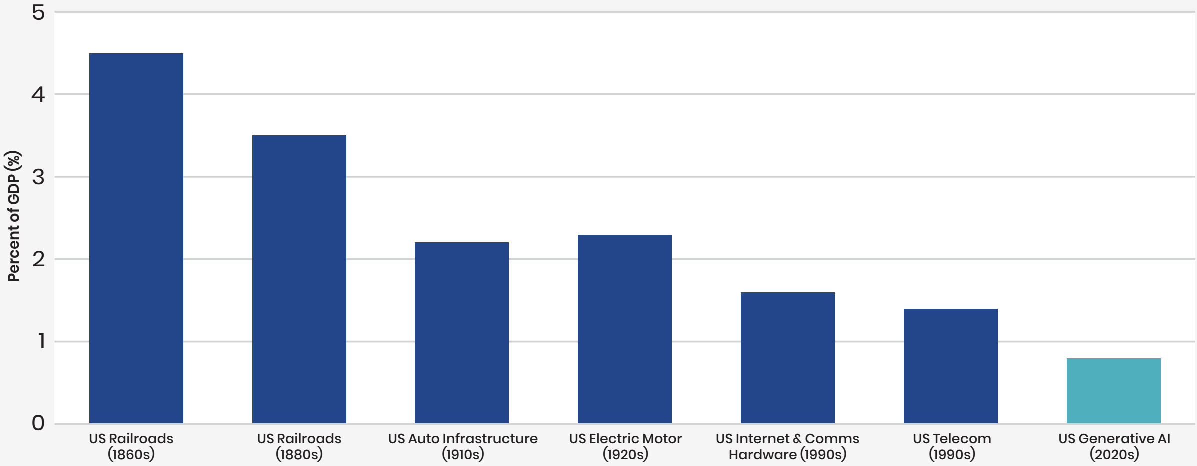
Source: van Eck

AI

Although the war has created a new set of challenges for financial markets, the AI opportunities we have been monitoring throughout 2025 remain compelling. When viewed through a historical lens, current levels of AI investment, while significant, are not unprecedented relative to past transformative shifts. All of the major technological shifts (railroads, electrification, internet) drove substantial gains in productivity as well as long-term equity returns. As illustrated in the below chart, AI spending as a share of GDP still trails these earlier infrastructure waves. We still could be in the early stages of this cycle.

AI Spend, while Significant, isn't Extreme in Historical Context

Peak Historical Investment Impulse of Emerging Technologies



Source: Goldman Sachs Global Investment Research, US Bureau of Economic Analysis.
For illustrative purposes only. US Generative AI data are based on current spend but is expected to increase. Published 10/15/2025.

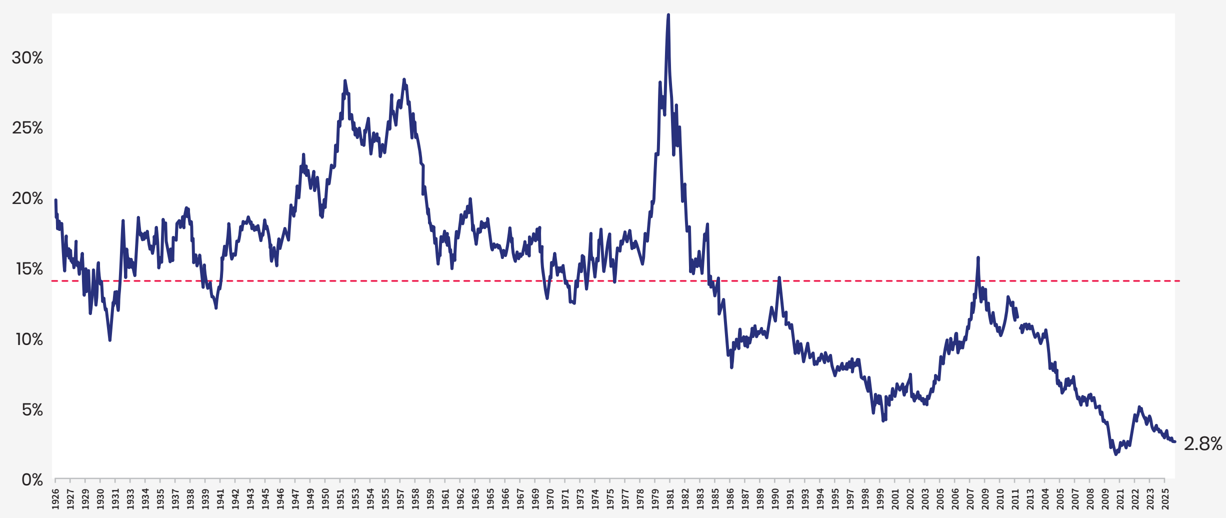
Energy

In an environment where traditional equity leadership has shown increased volatility, energy exposure has served both as a portfolio hedge and an investment opportunity. Natural resource equities tend to act as a ballast to the broader market and have historically provided effective protection during periods of inflation and geopolitical stress.

As we noted in our introduction, this oil shock could be different from the others, meaning the geopolitical risk premium on energy might not just fade away. This would likely be good for energy stocks, though surprisingly negative for holders of the S&P 500 who have historically relied on some energy exposure (which historically averages around 15% in the S&P 500) as an index ballast. That is no longer the case. Today, energy remains significantly underrepresented in major indices and currently comprises under 3% of the S&P 500.

We would note that tightening supply conditions only catalyze what has been a dearth of major investment in energy projects over the last decade. Between the rise of ESG, the push for alternative forms of energy, and the market's fascination with efficiency, oil producers distributed free cash flow to anything but more oil supply. In the long term, that is/was probably the right call, though the long term has not yet arrived. We think that the structure of the industry, combined with what is historically low ownership of energy stocks, creates a setup where energy assets can both buffer portfolios against geopolitical shocks and also lead the equity market as it rotates back towards asset-heavy sectors.

Re-Shoring: Global Supply Chains Run Through Choke Points



Source: Bloomberg and G&R Models. As of 2/28/2026

Gold & Dollar Debasement

Gold's March performance (down 11%), coming on the heels of a 20% rally in January and February, reflected the growing tension between tightening financial conditions and an increasingly unstable macro backdrop. As expectations for near-term Fed rate cuts faded and Treasury yields pushed higher, gold sold off sharply. We would note that some of this sell-off was driven by investor liquidity needs rather than a change in long term fundamentals. This drop (and subsequent rebound back above $4,500) coincided with bearish sentiment and mirrored historical patterns where gold has declined during geopolitical stress. Correspondingly, the dollar, which has been weakening over the past year, found support from higher yields and tighter monetary policy expectations. The ongoing risks of economic stress, mounting deficits, and a reversal in Fed monetary policy would be bearish for the dollar and supportive of gold. In this context, the performance of gold and the dollar appears to be more of a short-term aberration, with gold positioned to benefit from longer term concerns around dollar debasement.

Conclusion

The outlook for how this war resolves is uncertain, which makes any definitive forecasts on the market outlook and global economy a difficult task. As a result, we have been shifting client portfolios towards less reliance on equities, while adding to an overweight position in natural resource assets. The administration swings between military escalation and TACO, where Trump seems to imply an end to the conflict is always near. The market's response has been a selloff in equities over the past several weeks. Even with the sell off, downside risks for global equity markets remain elevated. With midterms looming and his support for the war in question even within the Republican Party, Trump is under increasing pressure to wind down the conflict. The question in our minds is whether that is enough to create some version of stability. In the short run, it is likely that we will continue to see extremes in volatility and market response to geopolitical developments.

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