



Investment Management Group®

The following contains a brief discussion of the equity markets from Chief Investment Officer and Senior Portfolio Manager, Ryan E. Crane.



FIRST QUARTER 2026 MARKET OUTLOOK

MARKET OVERVIEW ¹

It was hard to keep track of everything affecting equity markets this quarter. Two of the biggest themes were Artificial Intelligence's impact on software companies and the conflict with Iran.

As AI models demonstrated continued improvement in software coding and task automation abilities, investors grew increasingly concerned about software issuers. The industry that was once a Wall Street darling quickly began to seem like a goat. Technology sold off and brought with it growth-styled indexes.

The conflict in Iran sent oil prices much higher and investors panicked here too. Volatility and risk sent broad markets lower but boosted energy stocks.

Although there were no big policy changes from the Fed, interest rates fluctuated as risk ramped up and inflation concerns became more complicated. When the dust settled, equity markets finished lower, with the S&P 500® Index losing 4.33% of its value.

OUTLOOK

A lot of what happens in the investment community is the race to figure out the next big idea. Maybe it's about a specific stock or an industry theme. It could be a compelling prediction about monetary policy or geopolitics. The AI investment theme has been a recent and obvious example. Even within the AI theme, we have already witnessed sub-themes and mini-cycles.

Back when I started my career, institutional investors relied on an expensive and well-curated network of firms and people to navigate these ideas. I used to spend an enormous amount of time on the phone. Believe it or not, we didn't have email back then. These investment ideas would circulate around Wall Street in a literal game of telephone. At my previous firm, we paid a lot of money to sell-side firms in hopes that we would be early on the list of clients to call with a hot idea. There was real money to be made as these investment ideas took time to make the rounds.

It's all so different today. I don't spend nearly as much time on the phone, rather it's time spent reading news and research. X (formerly Twitter) and blogs can be a great source of information (only after spending significant time curating the list of whom to follow and pay attention to). In today's world, a single tweet or blog post can have a massive impact on the entire investment community and at break-neck speed.

In January, Dario Amodei, the CEO of Anthropic, made a blog post called [The Adolescence of Technology](#). I think it's safe to say that most professional investors had read (at least the highlights) within 48 hours of it being posted. The ideas and opinions he expressed spread like wildfire. It was apparent in the market, as stocks were getting whipped around. This wasn't the only example this quarter. The Anthropic folks were guilty of moving markets more than a couple times this quarter, with nothing more than a blog post. President Trump easily moves markets with a tweet. I suppose an academic might argue that we have a more efficient market now, as information gets priced in very quickly.

Maybe. The problem is that the information which is moving markets so quickly is usually nothing more than a narrative. The narratives that spread like wildfire do so for good reason: they're cohesive, thoughtful, sound compelling, and in most cases, intuitive. If you've read Daniel Kahneman's *Thinking, Fast and Slow*, then you should remember that System I will devour these types of investment narratives. It's literally what he's referring to as thinking *fast*. (If you haven't read the book, please do. If you don't have time, read [this](#) instead.) That is to say, that these compelling narratives can also be dangerous behavioral traps. Caveat emptor.

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OUTLOOK

In this context, there were two phenomena that really struck me this quarter. The first is not just the speed with which these narratives can spread, but also the speed with which they are replaced by the next compelling narrative. Here is just a sample of some of these narratives, in what I think was chronological order, and only over the last three months.

- Debasement – Erosion in the confidence behind fiat currencies. Gold and silver ↑
- AI Capex Super Cycle - \$660 Billion of spending announced. Data center hardware stocks ↑
- Crowded Mega Cap – Concern Mag7 names had moved too far, too fast. Small caps ↑
- OpenAI losing share to Claude – Claude's commercial success sparked fears that OpenAI was losing share. Stocks levered to OpenAI (e.g. MSFT) ↓
- AI agents – ClaudeCode, ClaudeBots, OpenClaw and the like will take over many responsibilities and functions. AI stocks ↑
- SaaSocalypse – AI generated software and AI agents might replace many forms of software. Software stocks ↓
- Cybersecurity at Risk – These same AI coding tools can also replace security workflows. Cybersecurity stocks ↓
- Private Credit – Years of easy money led to less stringent underwriting standards. Could be a systemic risk. Volatility and Risk Premia ↑
- AI Dystopia – What once was euphoria is now panic, as people consider the potential disruptions from AI. Bonds ↑
- Oil-driven Demand Destruction – Higher oil prices (resulting from the conflict in Iran) will cause demand destruction. Stocks ↓
- Oil-driven Inflation – Higher oil prices will spill over into everything else and drive inflation higher, and central banks won't be able to cut rates. Stocks ↓

It's curious to me that in the last month or so, I haven't seen much of anything on the first four, and even the software narrative feels like it bottomed out. I suspect that most investors can only juggle a few of these at a time. So when a newer, flashier narrative comes along, I think it just crowds out one of the more stale ones – even if it's only a few weeks old.

In my opinion, this is mostly noise. These narratives don't have to be true to have an impact on markets, they only need to be compelling, vivid, and plausible. I am willing to bet that most of these narratives fade away, as they are replaced by more recent ones before there's any real evidence to confirm or refute them. The market is just moving from narrative to narrative in what I imagine looks like a game of Frogger. In as much as this is the case, it makes for a more volatile and *less* efficient market. Opportunity abounds for those that can see through the noise.

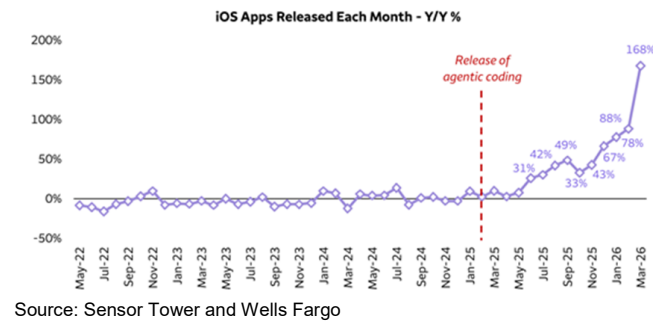
Just to demonstrate how inefficient the market is, some of these narratives are mutually exclusive or at least inconsistent with other clear trends in the market. If higher oil prices are causing demand destruction, then they aren't causing inflation. If AI coding tools make commercial software obsolete (and the software stocks are all selling off), then we will have a sizable economic issue as those companies lay off workers and eventually fail.

One of the other big narratives of the quarter was how AI coding tools could displace software. The latest technology from Anthropic and others has represented a quantum leap in terms of software development. We certainly believe that AI will disrupt and perhaps eliminate the need for *some* software - In the last six months or so, for this very concern, we have completely sold nine software holdings (across all of our strategies).

However, we also believe that this is not true for all software. As the market was painting with a broad brush, and nearly all software companies sold off, we did our best to take advantage of the weakness and add to our software holdings, which we think are relatively immune from the effects of AI. We believe that the characteristics of a defensible software business are those with a combination of the following: mission critical applications, very complex, has a network effect, doesn't have a seat-based pricing model, and relies on proprietary data. For example, I'm pretty sure I won't be replacing my Bloomberg terminal with something we've vibe-coded anytime soon. Oh, and it turns out that Bloomberg has been rolling out some impressive AI tools within the application.

My personal favorite inconsistency and example of opportunity is the puzzle with cyber security. On February 20, Anthropic announced a tool called "Claude Code Security." They claimed it could scan codebases for potential vulnerabilities and recommend patches and improvements. Cybersecurity stocks sold off sharply intraday and continued to trade lower for a few more days. The narrative was that AI tools would replace the need for some cybersecurity solutions.

The problem is if you buy into the idea that everyone is going to be vibe coding software like crazy, and that is clearly happening on some level...



...then we are going to have a lot of new software out in the wild. I don't think it's crazy to think that these coding tools might be inadvertently building vulnerabilities into all the software they design. On top of that, since AI coding tools automate software development and can automate tasks (like trying to hack into a network), they're only making hackers' lives easier.

More recently, Anthropic announced their latest model, Mythos, **which poses such a significant cybersecurity risk, that they cannot release the model to the public**. Apparently the risk is so grave, that they announced [Project Glasswing](#), an effort to bring together the largest tech companies and security platforms to prepare them for the potential security risks that these state of the art models represent. Even the highest levels of the US government have held emergency meetings to deal with this issue.

I'm not sure why the narrative that Claude Code Security is going to make security companies obsolete is somehow dominating the narrative that Mythos (and other frontier models) will severely upset the balance of power in favor of hackers. We spend a fair amount of time meeting with company management teams; and we have yet to find a single CEO or CFO that says they aren't ramping spending on cybersecurity - it is the number one risk many firms face today. Yet somehow, the narrative of AI replacing the need for security persists. Mutually exclusive narratives = great opportunity if you can identify the truth.

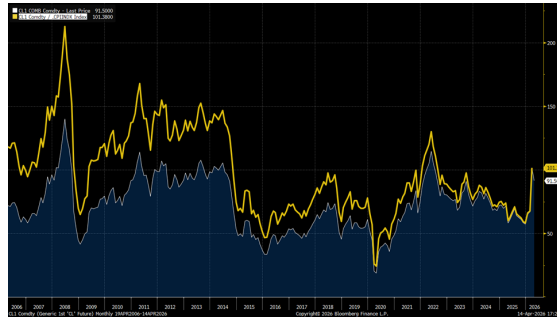
Some of the narratives I mentioned above hinge on the price of oil. So far this year, there has been a strong negative correlation between the market and oil. A linear regression year-to-date shows an r^2 of 0.731, implying that 73% of the move in the S&P 500 can be explained by the price of oil. I certainly get that the conflict in Iran introduces uncertainty and volatility. And for consumers with a constrained budget, higher energy prices will crowd out other spending – this is the demand destruction some have worried about.

I know the media likes to focus on higher prices at the pump. \$4 gasoline makes headlines. \$100 oil makes headlines. Even though producing gasoline is one of the most capital-intensive endeavors out there, it's still one of the cheapest liquids you can buy.

Liquid	Example purchase	Shelf price	Implied \$/gallon
Regular gasoline	1 gallon	\$3.84	\$3.84
Fountain soda	7-Eleven Big Gulp, 30 oz	\$1.79	\$7.64
Bottled water	7-Eleven water, 20 oz	\$1.59	\$10.18
Bottled soda	Dr Pepper, 20 oz	\$3.29	\$21.06
Sports drink	Gatorade Fruit Punch, 28 oz	\$4.79	\$21.90
Beer	Corona Extra, 12 × 12 oz	\$26.39	\$23.46
Hot coffee	7-Eleven Extra Large Colombian, 24 oz	\$4.99	\$26.61
Orange juice	Minute Maid 100% Orange Juice, 12 oz	\$3.19	\$34.03
Milk	fairlife 2% milk, 14 oz	\$3.89	\$35.57
Energy drink	Rockstar Original, 16 oz	\$4.79	\$38.32

Source: ChatGPT, BLS, 7-Eleven

Pundits tend to focus on the *nominal* prices of oil and gasoline. Inflation makes those numbers less relevant except for the psychological impact. The proper analysis is one that is inflation-adjusted. When you factor in the extra bit of inflation we've had lately, it's clear: *\$100 ain't what it used to be*. Here's a chart on the price of oil, indexed in today's dollars (the yellow line).



And the important takeaway is that the recent move in oil prices is still less impactful than the level we saw during the COVID reopening, and nowhere near what we saw in 2008. Fear not! At least not yet.

Speaking of inflation and oil, there's been a lot of sloppy work on this going around. You've heard me say it before, and I'll keep saying it – when the price of one thing goes up, that is **not** inflation. This is true even for a thing like oil, which is a component of many, many things. It's much more like a tax. As of yet, it's not as much of a tax as in times past when it was at similar nominal levels. In this instance, I would only expect inflation if there were some accommodative policy response to "offset the higher cost of energy." Those types of strategies almost always end in inflation.

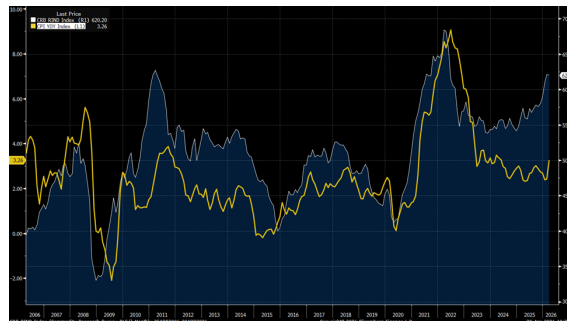
What many forget is how higher energy prices also benefit part of our economy. I know what you're thinking – it's easy for the guy from Texas to say that. And yes, Texas might actually see a net benefit from higher oil prices. But that extra activity and extra profit in the energy space spills over to other areas as well. The U.S. exports quite a bit of crude oil and even more petroleum products. The demand-destruction narrative one is emotional and relatable, but it isn't a complete picture of the impact on higher oil prices for the US in total. The U.S. is in a much better position than many other countries that heavily rely on imports of oil and petroleum products.

As I've said before, there's an incredible and perhaps unprecedented amount of change in the world today. But there's also an unprecedented amount of noise, some of which I've tried to outline above. In an effort to rise above the distraction of the noise, I want to refocus your attention on the important long-term trends.

The improvements in generative AI are still coming at a fast and furious pace. There still seem to be no signs of hitting a wall in scalability. That doesn't mean there won't be one at some point, but it's not today. These improvements are leading to improvements in productivity and, in many cases, profits. I can't rule out stress in the job market, but so far it appears to be minimal. This is great news for the economy and great news for the USA.

The macro backdrop is good. The wave of deregulation hits the market with a lagged effect, and it's still coming. Even though interest rates aren't where President Trump wants them, the Fed is accommodative in other ways. The Fed balance sheet is expanding again, as is the supply of money. M2 is up 4.9% year over year. I created a modified measure of M2 which includes some stablecoins (I think there's a strong argument that stablecoins should be considered when looking at the monetary base, especially since they crowd out instruments and vehicles that are directly captured in M2), and that figure is growing at nearly 5.3%.

We continue to stay super focused on inflation, but I worry that there's so much noise and so many moving pieces, that it will be hard to draw strong conclusions based on short-term inflation data. One of the metrics we watch is the CRB Raw Industrials index. It tracks the price of raw materials for which there isn't a developed futures or financial market (unlike major commodities like oil, steel, copper, etc. which can be influenced by speculators or investors). It's been trending higher and historically it *leads* inflation data by about 4 months.



OUTLOOK

Even with hindsight, it will be hard to figure out precisely what was happening with respect to inflation. AI advancements are deflationary. Immigration policy changes are inflationary (as it shrinks the labor pool) and deflationary (as government support programs are spending less). Tariffs, in isolation, shouldn't be inflationary, but that's messy too. The reversal of globalization is inflationary. Wars are generally inflationary, but this Iran conflict is not a typical war. And now rising oil prices and supply chain disruptions because of the war will probably look inflationary at first, but may crowd out other spending, being deflationary. It's complicated.

Complicated is good, at least it is for us. Volatility, noise, complication, emotions running high, biased reporting, all these things lead to more opportunities. Opportunities usually don't *feel* like opportunities in the moment; they feel painful. They can cause you to question yourself. They test you. Emotions are running hot, and information affects markets before there's any validation. It's why discipline is so important. All money managers throw around the word "discipline" because of all the positive connotations, but let me tell you – not all managers have it. Discipline is doing what *doesn't* come naturally. It's been hard, and we've been busy. I can safely say busier than at any other time in my career. But I'm not looking for sympathy. These are the kind of environments I dream about!

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