MALVERN CAPITAL MANAGEMENT

1sr Quarter 2026 Review and Market Outlook

April 2026

1st Quarter Review

In our year-end market commentary, we projected a stock market correction in the early part of 2026, based on extreme overvaluation of stocks as measured by various metrics. With the onset of a war with Iran, the equity markets turned south. At the end of the 1st quarter, two of the three major indices were officially in correction territory, with the S&P 500 Index on the heels of achieving a correction reading. A market correction is defined as a drop in an index of at least 10% but not more than 20% (over 20% is considered a bear market). Using intraday prices, from their peak in late January to their low point in late March, the NASDAQ had fallen 13.75%. Likewise, the S&P 500 has fallen 9.79%, and the Dow Jones Industrial Average has dropped 10.08% so far. Going into the 2nd quarter, we are not sure that the selling is finished. Although war with Iran was the catalyst for this sell-off, we were not sure exactly what would trigger our anticipated market correction.

Equity markets were off to a good start in 2026 prior to the bombs falling on February 28, 2026. For the full 1st quarter, the Dow Jones Industrial Average fell just 3.19%, and the S&P 500 dropped by 4.33%. The NASDAQ 100 Index gave back 5.82% for the quarter. Small capitalization companies, companies with perceived higher risk, were up for the quarter by 0.89%.

Large-cap growth stocks really took a hit in the 1st quarter by falling 9.78%, led by losses in the so-called magnificent seven companies of Apple, Amazon, Alphabet, Tesla, Nvidia, Microsoft, and Meta. Large-cap value stocks did much better in the quarter by advancing 2.10%.

The bond market was also down for the quarter. High-quality investment-grade bonds, as measured by the Bloomberg Barclays U.S. Aggregate Bond Index, fell by 1.76%. Likewise, lower-quality junk bonds were

Indices Performance

Category	Representative Index	March 2026	1st Qtr 2026	12 Months	3 yr*	5 Yr*	10 Yr*
Mature US Large Companies	DJ Industrial Average	-5.20	-3.19	12.23	13.77	9.11	12.49
Broad US Large Companies	S&P 500 Index	-4.98	-4.33	17.80	18.32	12.06	14.16
US Small Cap Companies	Russell 2000 Index	-5.00	0.89	25.72	13.05	3.77	9.88
US Mid Cap Companies	Russell Mid Cap Index	-5.33	1.29	15.98	13.33	7.26	10.91
Largest 100 NASDAQ Companies	NASDAQ 100 Index	-4.81	-5.82	23.99	22.61	13.53	19.23
Large "Value" Stocks	Russell 1000 Value Index	-4.82	2.10	15.87	14.31	9.43	10.58
Large "Growth" Stocks	Russell 1000 Growth Index	-5.21	-9.78	18.81	21.18	12.76	16.83
Large Cap Stocks	Russell 1000 Index	-4.97	-4.18	17.74	18.14	11.34	13.97
Developed International	MSCI EAFE Index	-10.19	-1.12	21.88	14.19	8.45	8.91
Emerging Markets	FTSE All Emerging Markets	-13.03	-0.10	30.30	15.41	4.16	8.24
Broad US Bonds	Bloomberg Barclays US Aggregate Bond	-1.76	-0.05	4.35	3.63	0.31	1.70
High Yield Bonds	Bloomberg Barclays US Corporate High Yld	-1.18	-0.50	7.01	8.60	4.23	6.12
Commodities	Bloomberg Commodity	11.50	24.41	32.29	13.88	14.04	8.02
Total US Market (all cap stocks)	Russell 3000 Index	-4.97	-3.96	18.09	17.86	10.87	13.72
Real Estate Investment Trusts	Wilshire US REIT Index	-5.74	4.78	6.55	9.71	6.05	5.50
Cash	US T-Bill 90 Day	0.30	0.90	4.22	4.93	3.39	2.26
Dev. International Europe	FTSE Developed Europe	-9.80	-2.68	19.85	13.96	9.47	9.15
Dev. International Asia Pacific	FTSE Developed Asia Pacific	-11.18	1.97	25.49	14.26	6.46	8.46
Japan	Nikkei 225 Index (Yen)	-14.27	0.68	37.16	17.20	6.03	10.08

** 3 year, 5 year and 10 year returns are annualized.*

All periods ending March 31, 2026.

All returns include the reinvestment of dividends.

Source: Morningstar Direct.

down 1.18% during the quarter. The spread between corporate bond yields and their like-maturity treasury bonds is very low historically at 89 basis points (0.89%), indicating less perceived risk in the economy. For junk bonds, the spread is only 317 basis points, again indicating less risk priced into the economy. Further, defaults on junk bonds rated BB were 0% in the last 12 months, and defaults on CCC-rated bonds (the lowest quality junk bonds) was 3.2%. The 25-year average default on CCC bonds is 6.2% per year. The bond market is telling us the economy is in pretty good shape right now.

As we move into the 2nd quarter and proceed through 2026, what are the risks ahead of us, and what are we watching? As follows, we examine the major issues facing investors for the next quarter and beyond.

The Federal Reserve: Rate Cuts or Rate Hikes?

On March 17-18, the Federal Reserve's Federal Open Market Committee (FOMC) met for the second time in 2026. At the conclusion of its meeting, it was announced that it would leave interest rates alone at the then-current range of 3.50% to 3.75%. Federal Reserve Chairman Jerome Powell cited the committee's concern with persistent inflation but acknowledged its balancing act between managing inflation and a healthy labor market. It also released its Summary of Economic Projections for March. It now projects that inflation will not return to its target rate of 2.0% until 2028. It further assumes that inflation will slightly increase in 2026 and 2027 before returning to its target rate, with the Core PCE Inflation rate at 2.7% in 2026. The FOMC projects that the unemployment rate would level off at 4.4% in the 4th quarter of 2026 but fall to 4.3% in 2027 and 4.2% by 2028. As for the real Gross Domestic Product (GDP), its median forecast for 2026 is 2.4%, followed by 2.3% in 2027 and 2.1% in 2028. Powell also discussed the FOMC's concerns regarding current geopolitical events and those events' impact on inflation and the economy.

Powell came across with a somewhat "hawkish" tone, leaving investors with the feeling that the Fed has a bias toward raising interest rates. Going into 2026, investors were confident that the Fed would cut interest rates at least two times in 2026. But with concern about inflation, as of late March, the Fed Funds futures market is now projecting a 52% probability of a rate increase in 2026. With a jobs market showing signs of modest strength, a rate hike could cause the economy to slow. The current increase in the price of a barrel of oil and the corresponding jump in gasoline prices have raised the odds that the economy could slip into a recession. We do not expect a rate increase in 2026, but we also do not see any Fed Funds rate cuts this year either.

With the War on Iran and its impact on oil and the economy, longer-term market-driven interest rates have risen in the quarter. The yield on the 10-year U.S. Treasury Note ended 2025 at 4.163% and rose to 4.311% by the end of the 1st quarter of 2026. The yield did reach a high of 4.484% on March 27th before retreating in the last few days of the quarter.

What do higher interest rates mean for equity prices? Higher rates undoubtedly will put pressure on equities and may partially be the reason the market is experiencing a correction at this time. If the War can end soon, we expect longer-term interest rates to begin to come down and level off around 4.0%.

The U.S. Economy

After increasing by 4.4% in the 3rd quarter of 2025, real Gross Domestic Product (GDP) growth was just 0.7% in the 4th quarter. Consumer spending and investment were the main contributors to the real GDP growth, while the detractors were government spending and exports.

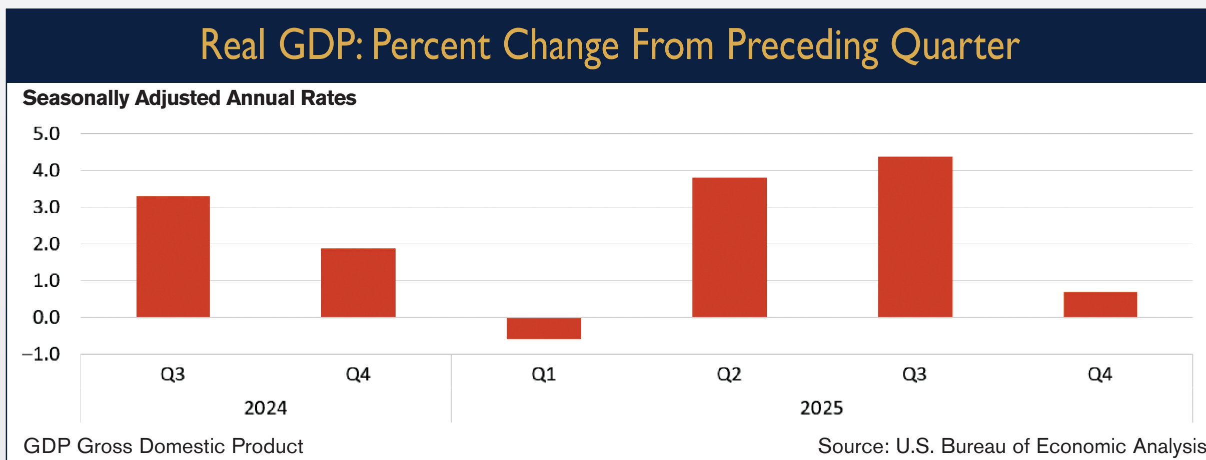
The impact of tariffs is still causing uncertainty centering around the economy. Some positives for the economy were seen in the latest monthly jobs report for March, when 178,000 non-farm payroll jobs were created. The unemployment rate remained at a rather low 4.3%. The all-important reading of average workweek hours ticked down 0.1 hours to 34.2 hours. There were revisions to both the January and February

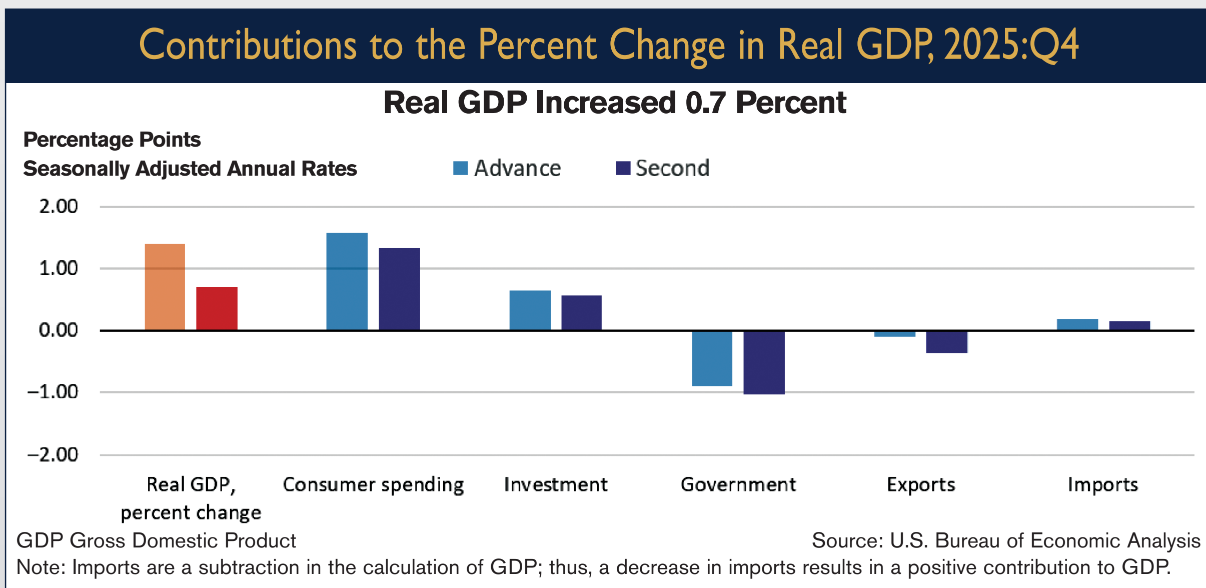
reports. January was revised upward by 34,000 to 160,000 total jobs, while February was reduced by 41,000 to a loss of 133,000 jobs.

The Conference Board's Leading Economic Index (LEI) fell in January by 0.1%. For the six months ending January 2026, the LEI fell 1.3%. However, the current LEI reading is not sounding any alarm bells regarding the economy.

The Institute for Supply Management – Manufacturing Purchasing Managers Index (PMI) for the month of March had a reading of 52.4, above the recession warning line of 50%. The key takeaways from the latest report were that new orders are growing, production is increasing, and employment is contracting. Also, prices are increasing, and both imports and exports are growing. For the ISM – Services PMI report, the reading for March was 54%. This was the 21st consecutive month that the index has shown expansion. Both ISM reports present a positive outlook on the economy.

The Fed's favorite gauge of inflation, the personal consumption expenditures (PCE) price increase rose by 2.9% in the 4th quarter and by 2.8% in January 2026 (the latest reading). The PCE was up 2.7% in the 4th quarter when removing both food and energy. The other inflation measure, the Consumer Price Index (CPI), jumped 2.4% in February. Core CPI (extracting both food and energy) was 2.8% annualized in February. Inflation is still stubbornly high, well above the Fed's target inflation rate of 2.0%. This adds further fuel to the fire of the no-rate-cut cries from some members of the FOMC.





Recession Odds Increase with the Oil Shock

History shows us that there is a strong correlation between oil shocks and U.S. recessions. We define an oil shock as any increase greater than 50% in the price of oil in a short period of time, with that time being one to two months.

Further analysis of past oil shocks suggests that other factors may have been in play that also contributed to a recession. Such other factors may not exist today. Some previous oil shocks include the following:

1) **1973 Arab Oil Embargo:** The OPEC nations cut production of oil and stopped oil from being shipped to the United States and other countries because the U.S. and others had supported Israel in the Yom Kippur War. As a result, the price of oil skyrocketed by 300%. At the same time, the U.S. was embroiled in the Watergate crisis and suffered through years of mounting costs from the War in Vietnam. All these events led to a slowdown in the economy, and high oil prices kicked off a bout of inflation, which was later referred to as "stagflation."

2) **1979 Iranian Revolution:** Oil prices increased by 149% following the Iranian Revolution, bringing instability to the oil-producing region of the world. In addition to the high price for oil, Americans felt defeated because of the Iranian Hostage Crisis, whereby 52 Americans were held for 444 days by Iranian militants. The weakness Americans felt was further underscored by the failed attempt to rescue the hostages by the U.S. military. The U.S. was in recession.

3) **1990 Iraq invasion of Kuwait:** In August of 1990, Iraq invaded Kuwait, causing oil prices to jump over 140%. Further, the U.S. and other countries would go to war and spend accordingly to finance the war. A recession followed.

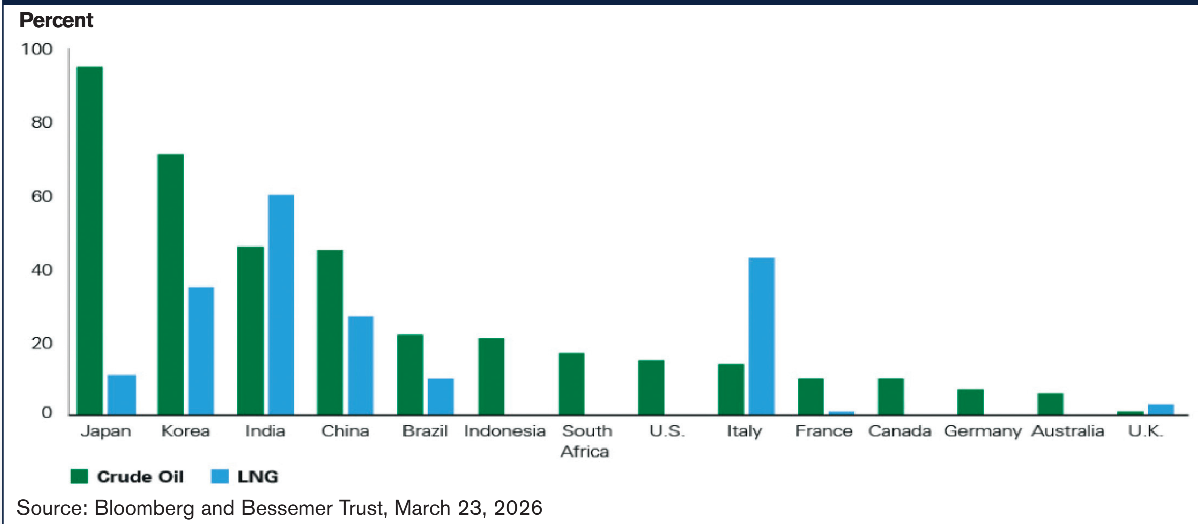
4) **2007 and 2008 oil demand surge:** Oil usage surged as China and other countries began to industrialize plus production slowed. Oil prices quadrupled over this time period. A recession followed, but that was most likely brought on by the subprime mortgage crisis; certainly, high oil prices contributed to the economic downturn.

5) **2020 Covid shutdown:** Oil did not directly impact the Covid recession, but after the world seemed to shut down, in February 2022, Russia invaded Ukraine. Oil prices spiked, contributing to the global economic malaise.

Although, as of the end of the 1st quarter 2026, the conflict with Iran was still going on, oil prices had jumped some 57% in the month of March. While we see an oil price surge, we see respectable job numbers and decent economic growth, but with inflation above the Fed's target. However, Moody's now places the odds of a U.S. recession at approximately 49% in the next 12 months.

Perhaps this time the oil shock may be different, and a recession can be avoided. Provisions in the One Big Beautiful Bill Act (OBBBA) increase the size of tax refunds, providing Americans with as much as $150 billion. These tax refunds will be paid out through April and May of 2026. According to Bessemer Trust, if the oil price increase can level off at approximately $100 per barrel for six months, less than half of the refunds would go toward the higher prices of gasoline. Even if the oil price is much higher than $100 a barrel for six months, there is still room to cover consumers' additional energy costs.

These tax refunds were originally intended to boost the economy by as much a 0.9% to the GDP, but are now largely going to offset the higher price of oil.

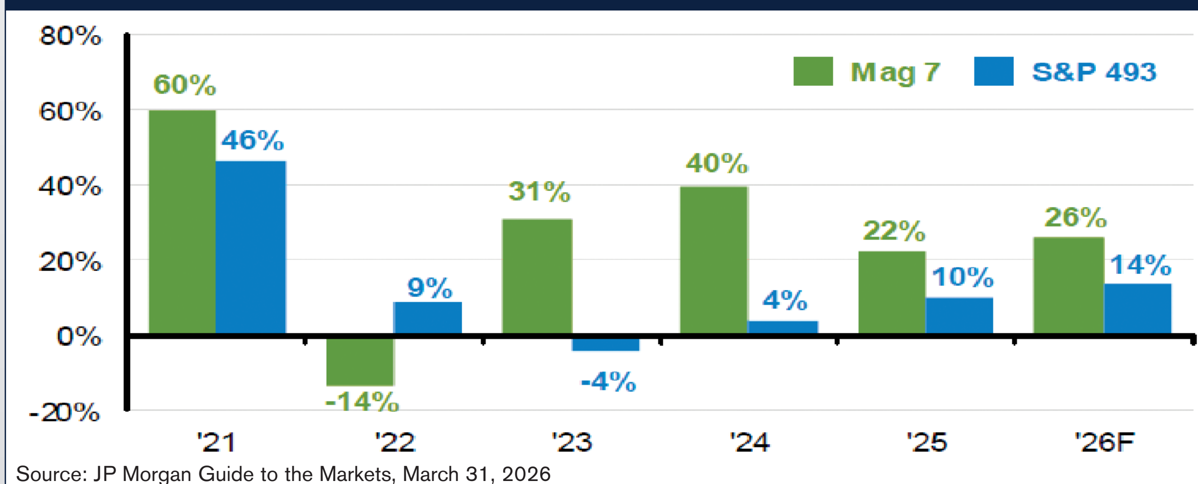


Source: Bloomberg and Bessemer Trust, March 23, 2026

Corporate Earnings

Corporate earnings paint a bright picture for the health of corporate America. Analysts' consensus earnings estimate over the full year of 2026 for the S&P 500 Index is $322.74 per share. For the full year of 2025, the consensus estimate is $271.29 per share, representing healthy growth in earnings between 2025 and 2026. Looking ahead, forward earnings for 2027 are expected to grow to $377.12 per share. Lastly, 12 months ahead earnings (March 2026 through March 2027) are $336.33 per share. Higher oil prices are not yet showing in the earnings estimates. Further, earnings growth is dominated by the Magnificent Seven stocks despite their lackluster performance so far in 2026. The Mag 7 stocks are expected to grow earnings by 26% in 2026, versus the remainder of the Index growing by just 14%.

In addition to corporate earnings, profit margins are impressive. The operating profit margin for the S&P 500 Index as of the 3rd quarter of 2025 was 13.7%. Profit margins have been increasing dramatically in recent years, likely aided by spending and usage of artificial intelligence and lowered corporate income tax rates. The 12-month forward operating margin is projected to be 15.2%.



Source: JP Morgan Guide to the Markets, March 31, 2026

Market Valuation

At the end of 2025, we calculated a forward price-to-earnings (P/E) ratio of 22.0 times, which we said gave us an expensive market. With the current forward earnings estimate of $336.33 per share and a recently declining value of the Index, we now calculate a forward P/E ratio of 19.4 times. Although some would say it is still expensive, the P/E reflects a much more reasonably valued market.

Some other measures tell a different story. If we take inflation into consideration, the Shiller Cyclically Adjusted Price to Earnings (CAPE) Ratio says the market is still expensive. The current CAPE Ratio is 37.2 times, while the 30-year average CAPE ratio is 28.7 times. It was 39.8 times on December 31, 2025, however. Also, the dividend yield on the S&P 500 Index is currently at 1.6% versus a 30-year average of 2.0%. The lower dividend yield is a sign of an expensive market.

The Fed Model (which has nothing to do with the Federal Reserve) tells us that if the 10-year U.S. Treasury Note yield is less than the earnings yield on stocks, the market is undervalued. If the yield is greater, stocks are overvalued. Currently, the 10-year Note Yield is 4.311% (3/31/2026). The earnings yield on the S&P 500 Index is 4.55%. With the 10-year yield less than the earnings yield, stocks appear undervalued by this measure.

Where do we stand for our year-end target return for the S&P 500? At the end of 2025, we forecasted a total return on the S&P 500 Index of 15.6% in 2026. We justified a higher trailing P/E ratio on the market than we do now because we felt the Fed would cut rates at least twice in 2026. We now do not expect any cuts. We expected a market correction in early 2026, which we seem to be getting right now. As such, based on earnings estimates of $322.74 per share for 2026, and an assumed trailing P/E ratio of 24.0 times, we expect to see a market value of around 7,746.00. If we assume reinvested dividends this year, we project finishing the year with a total return of 14.8%, slightly below our prior forecast. We now have a higher earnings estimate ($322.74 per share) for the S&P 500 than we did at the end of 2025 ($310.84 per share), but we have lowered our expected price multiple due to no anticipated rate cuts. Hence, a slightly lower return forecast.

Private Credit Woes

Private credit is a term used to describe loans to small and mid-sized businesses made by non-bank lenders. Non-bank lenders include hedge funds, pensions, endowments, and private equity funds. Individuals often invest in private credit through investment vehicles such as “interval” funds or publicly traded business development companies (BDCs). Interval funds are funds with a similar structure to a mutual fund but with liquidity limited to just quarterly, versus the daily liquidity of mutual funds. These loans typically have floating rate yields but offer quicker and more flexible financing terms to the borrowers than loans offered by traditional banks.

Since the 2008 banking crisis and the increased regulatory burden that has followed, traditional banks have been more stringent with their lending standards. Private credit allows firms easier access to credit. Many of the borrowers also have difficulty meeting traditional bank lending requirements. These loans are customizable to meet the borrowers’ needs. Investors in the loans earn higher interest rates than interest paid on bank loans or public securities, but have to agree to take on less liquidity and greater risk of defaults. Private credit funds often include the use of leverage to enhance returns.

In recent years, private credit has become more widely used. We have seen countless interval funds coming to the market offering investments in private credit. Private credit is attractive to investors due to the high-income payouts these loans offer, but often the risks that go along with private credit are ignored. In the United States, private credit investments are about $1.3 trillion, growing from just $500 billion five years ago. This market is only expected to grow. Moody’s estimates that the private credit market will grow to $3 trillion by 2028.

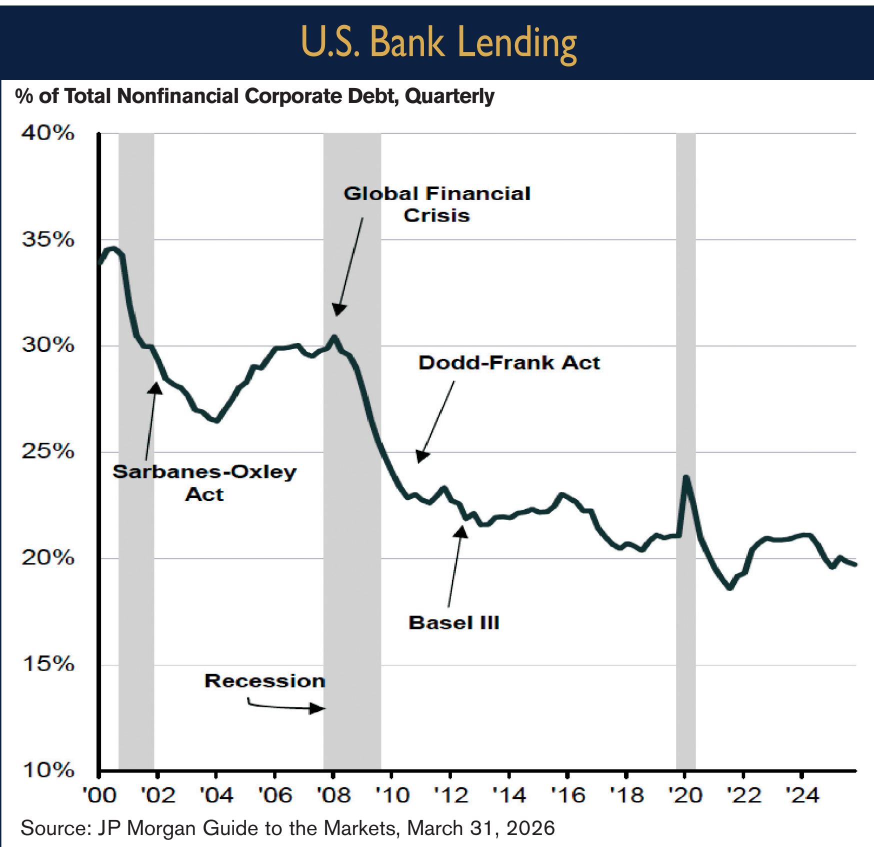
Are cracks in the system beginning to develop, and do they have the potential to take down the whole economy? Due to the nature of the investment, high floating interest rates, illiquidity, use of leverage, and

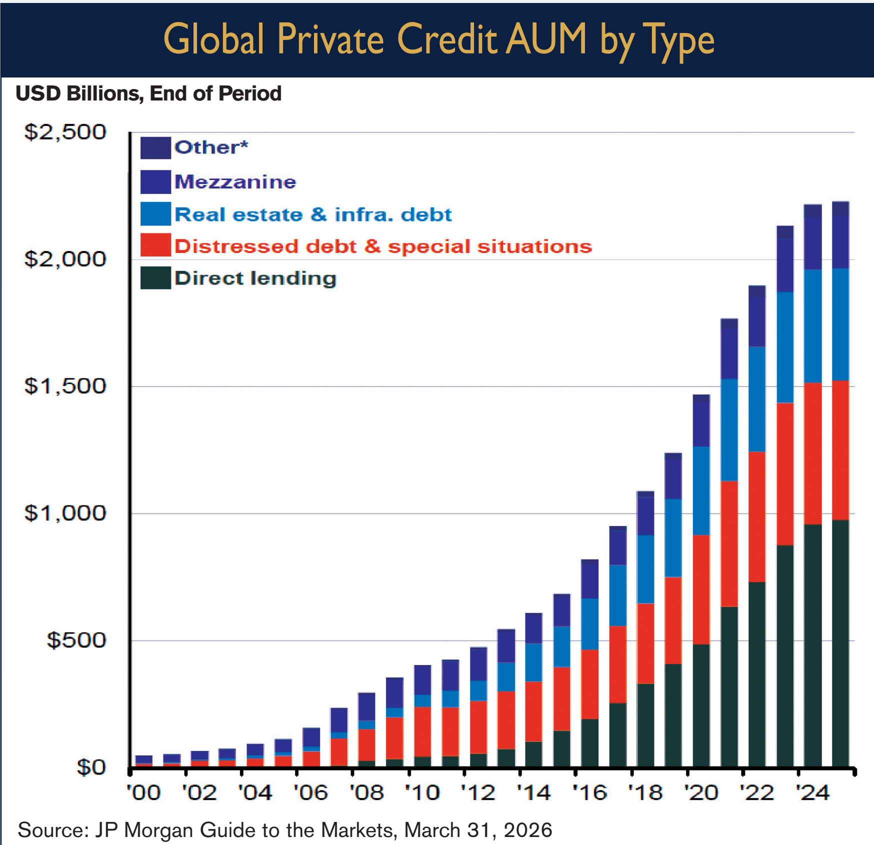
reduced credit standards, any slowdown of the economy and/or increase in interest rates can adversely affect these products. Some of the largest firms on Wall Street are recognizing the potential risks. JP Morgan and Goldman Sachs have set up hedge funds to "short" sell private credit. Private credit funds are sitting on over $5 billion of redemption requests that have been unfulfilled so far.

Can the private credit market potentially lead to a downfall of the economy like the subprime market did in 2008? In 2008, the subprime market was upwards of $2 trillion by some estimates. The private credit market is growing, and although not yet as large as the subprime market, it is moving toward that size.

The things that are concerning us the most are the proliferation of private credit funds coming to the market, the lowered credit standards on private credit loans, the potential for higher interest rates in the economy, along with the floating rate nature of these products, and the inability of investors being able to get their money out of these investments when redemptions are requested. There is also a heavy concentration of lending to one industry, the software industry.

We remain cautious of the private credit market, and we sold a BDC fund out of our portfolios, which we held at the end of last year. Early signs of private credit demise beyond the current liquidity issues would be an increase in defaults. We are monitoring this market closely and will be as proactive as we can, should events warrant such action.





Summary

The bombs started falling over Iran on February 28, 2026, and that sent the market averages downward. At the end of the quarter, we were hovering around correction territory. It does not appear as if the Federal Reserve has any intention of bailing out the equity markets. At its last meeting in March, the FOMC left interest rates unchanged and gave guidance that left many thinking that the Fed's next move could be a hike, not a cut.

The economy is on solid ground with many positive indicators suggesting that it should continue to grow. The March jobs report was surprisingly good. Economists predicted contraction in the jobs market, and they were surprised to see 178,000 jobs created. However, inflation is still a problem, and the inflation rate remains stubbornly high. The recent rise in oil prices will certainly not help the inflation rate decline, and history tells us that oil shocks often lead to a recession. Maybe this time is different, as Americans will find fiscal stimulus when they file their tax returns for 2025, which will help offset the rising cost of gasoline.

Corporate earnings continue to grow. The consensus estimates for earnings for the full year 2026 are $322.74 per share on the S&P 500 Index. The projected consensus estimates for full-year 2025 earnings are $271.29 per share. Valuation measures for the market show a mixed bag of over-valued and under-valued readings. With the recent market decline, the forward P/E ratio for the S&P 500 Index is 19.4 times, which does not suggest an overly expensive market, but not inexpensive either. We have made a slight adjustment to our year-end market forecast, and we are now projecting that the S&P 500 Index will return approximately 14.8% for 2026. This will represent the fourth straight year of double-digit returns should we achieve our forecast.

Lastly, we are concerned with the private credit market. Many investors have been lured to invest in private credit, chasing attractive yields. But credit and liquidity concerns have increased the risk of these investments. With a market nearing the size of the subprime mortgage market in 2008, we sold our position out of the BDC fund at the end of 2025, which was held in certain investment portfolios. Could blow-ups in private credit sink the whole economy as the subprime market did? It will depend on how much impact they have on the banking system. We are closely monitoring the situation.

As such, we are here to listen, counsel, and provide direction to all our clients.

Olsen, CFA, CFP®
President & Chief Investment Officer

Michael P. Czajka
Chief Executive Officer

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