



Capital Markets Performance

Global capital market volatility intensified during the first quarter. Early in the quarter, concerns over private credit defaults and the Supreme Court ruling that President Trump's tariffs were illegal led to a pickup in market volatility. In February, a research piece on the potential implications of artificial intelligence, increased market volatility, which peaked in late February and into March as the war with Iran began. The S&P 500 ended the first quarter down 4.3%. Market performance continued to broaden out in the first quarter as value stocks outperformed growth stocks across market caps. Small-Cap Value stocks were the best performers for the quarter, up 5.0%, while Large-Cap Growth stocks lagged (-9.8%). Six of the eleven S&P 500 sectors were positive for the quarter, led by Energy (+41.0%) and Utilities (+7.6%). Financials (12.2%) and Consumer Discretionary (12.1%) were the weakest relative performing sectors.

International stocks were relative outperformers versus the U.S. in the first quarter as the MSCI All Country World Index ex USA lost -0.7% while the MSCI Emerging Markets Index was down -0.2%. The USD dollar index strengthened by 1.7% in the first quarter as investors sought a safe haven as geopolitical tensions grew. Gold sold off from its record high in the quarter, but still ended the quarter up 7.1%, while crude oil (WTI) jumped by 77.6% as the Iranian War choked global supplies.

U.S. Treasury yields were also volatile in the first quarter, increasing as markets priced out additional Fed rate cuts because of uncertainties with the Iranian War. The yield curve flattened as shorter-dated Treasury yields moved higher. Credit spreads widened out from record tight levels on increased economic growth uncertainty. The U.S. Aggregate Index was down -0.1% in the first quarter, with three out of six sectors recording gains, led by Mortgage-Backed Securities (MBS) and Corporate Bonds lagging. Aa rated bonds and shorter-dated Treasury bills were relative outperformers for the quarter. Interest rates moved higher in Europe as the European Central Bank concluded its rate-cutting cycle and cited the Middle East conflict as creating upside risks to inflation. Rates in Japan increased due to higher inflation expectations and the Bank of Japan's intention to normalize monetary policy.

U.S. Economy and the Federal Reserve

The U.S. economy grew by approximately 2.1% in 2025, which is near the average annual trend growth rate since the turn of the century. This compares with annual real GDP growth of 2.8% in 2024 and 2.5% in 2023. Economic growth last year grew due to resilient consumer spending and business investment, especially in artificial intelligence. Higher energy prices due to the war in Iran will slow economic growth this year, with the magnitude tied to the duration of the War. We estimate that every \$10 increase in the barrel of oil is about a 0.1% drag on economic growth. On the positive side, higher tax returns because of last year's tax reform will be a boost to consumer spending and the

economy in the first half of 2026. Any potential tariff rebate checks later in the year would provide additional support to consumer spending.

The U.S. job market remained choppy in the first quarter, with both labor demand and supply slowing. The participation rate continues to move lower, which puts pressure on productivity gains to drive economic growth.

Job gains averaged 68,000 a month in the first quarter as compared with an average of 15,000 per month last year. The unemployment rate drifted lower in the first quarter to 4.3%. We continue to view the job market as frozen, with companies not looking to add or reduce staff because of economic and political policy uncertainty.

Headline inflation trends continued to moderate in the first quarter prior to the Iranian War. Higher energy prices due to the conflict should keep headline inflation above 3.0% until oil prices retreat. Personal Consumption Expenditure, excluding food and energy, also remains elevated and has been above the Federal Reserve's 2.0% target for the past five years.

The U.S. Federal Reserve held rates steady at its two first quarter meetings. The Fed has cut rates by 1.75% since September 2024. The Fed maintained its forecast for one twenty-five basis point cut in 2026 and an additional cut in 2027. The Fed appears willing to allow inflation to remain above its 2.0% target with a focus on its maximum employment mandate. The duration of the Iranian War and its inflationary pressures will dictate the next move by the Fed. Current market expectations are for the Fed to remain on hold through the remainder of 2026.

Outlook and Portfolio Positioning

Markets do not like uncertainty, and the outcome of the geopolitical tensions in the Middle East remains unknown. We still expect the U.S. economy to grow in 2026, with the job market remaining soft and inflation moderating as tariff pressures and shelter costs ease year-over-year. The wildcard for economic growth and headline inflation remains the price of oil. Sustained elevated energy costs will be a drag on global economic growth. Market positives include fiscal support, along with still strong corporate earnings. Market risks in the U.S. include elevated valuations, especially for Large-Cap growth stocks, geopolitical tensions around the world and political and policy uncertainty as we head into the midterm elections later this year. History shows that market volatility tends to be elevated during midterm election years. So far, in 2026, this has been the case.

There is a market saying that investors should hedge against the risks they know and diversify against the risks they do not know. We believe investors should maintain a disciplined and well-diversified approach. That is why we remain balanced in our equity exposures across growth and value styles, market capitalizations and global regions. Market rotation remains evident this year, with value stocks outperforming growth stocks and international stocks continuing to outperform U.S. markets. A weaker U.S. dollar, fiscal stimulus and still attractive relative valuations remain catalysts for international equities, in our view. In the U.S., value and mid- and small-cap stocks remain relatively attractive versus growth and larger capitalization stocks.

We continue to expect interest rates to remain range-bound in 2026 and believe investors should focus on the income return of their fixed income holdings. The current yield to maturity of the U.S. Aggregate Index is approximately 4.3%, which is a good starting point to think about potential fixed income returns. The ability to add additional credit and interest rate risk could boost returns.

Despite market uncertainty and volatility, it remains critical to stay diversified and committed to long-term investing. Market history shows that time in the markets produces better outcomes than attempting to time the markets.

As always, we thank you for your continued support and trust in Newport Capital Group.

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