

The War Drags On

Contained Crude Oil Prices Mask Downstream Stress

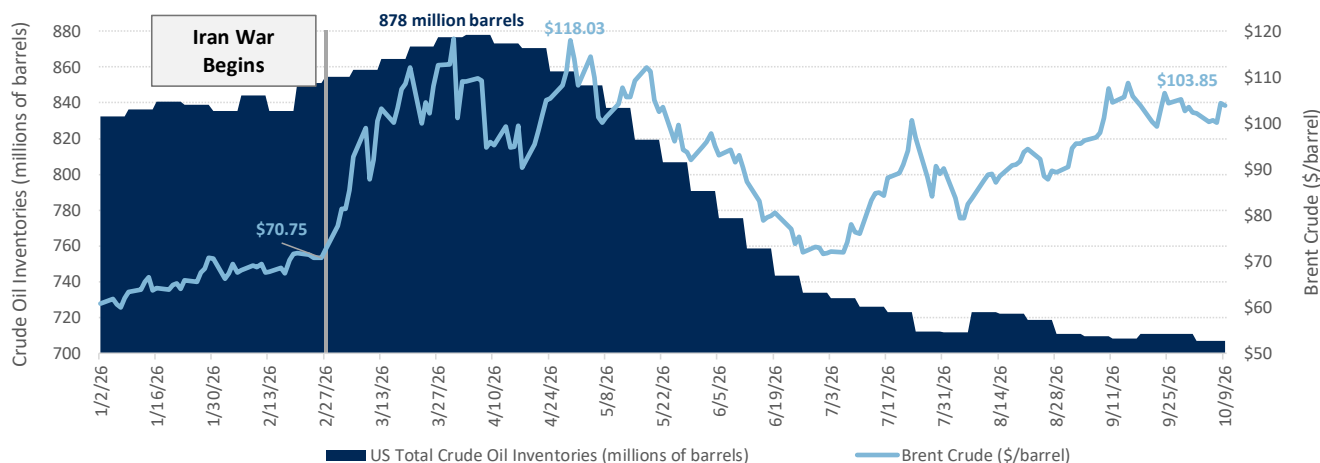
The worst-case scenario for oil prices has been avoided thus far, but disruptions across the broader energy complex have had negative implications for consumers. The U.S. economy has been resilient, but inflation pressures and higher interest rates may constrain future growth.

Energy Pressures Persist

While headlines largely focus on crude oil prices, refined product prices like gas and diesel are telling a different story. Refining capacity in the Middle East has been taken offline as a result of the continued conflict. While crude prices are a direct input to the headline Consumer Price Index (CPI), refined product prices indirectly drive goods inflation and may keep core CPI well above the Federal Reserve's (Fed's) target. Without progress in peace talks, we expect investors will grapple with volatility while consumers and businesses feel the effects of higher distillate prices.

Crude oil prices have plateaued following the initial spike and subsequent fall in the spring. A significant drawdown of oil inventories has cushioned the supply shock. Global oil demand has also declined due to rationing and a meaningful pullback in China's purchases.

Inventory Drawdowns are Cushioning the Supply Shock

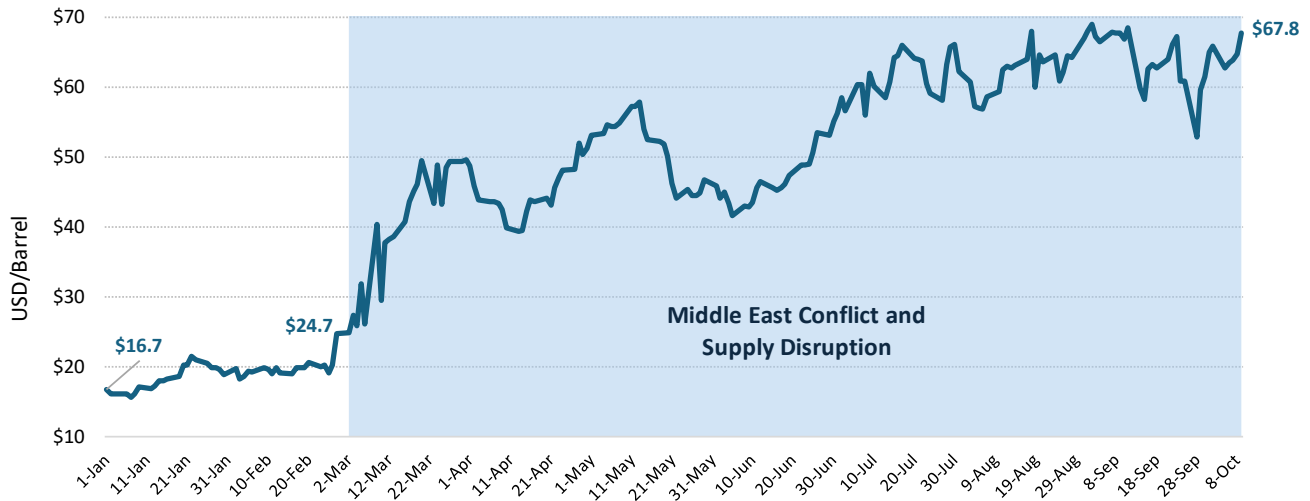


Source: Energy Information Administration (EIA), Bloomberg.

Although oil price gains have been contained, recent attacks have led to extensive infrastructure damage and a notable decline in global refining capacity, causing much larger price spikes for refined products. Crack spreads, a measure of a refiner's margins for converting crude oil into refined products including gasoline and diesel, have subsequently surged. Heightened crack spreads will lead to higher prices for consumers at the pump and higher energy costs for businesses. It is this dynamic that transmits higher energy costs to end users, not just via the price of crude oil. In response to the consumer pressure, the Trump administration recently pushed the Group of Seven nations to release additional oil and refined product reserves and struck a deal with Russia to supply more diesel to the global market.

2026 Energy Market Dislocation Drives Refining Margins Higher

US Gulf Coast WTI 3-2-1 Crack Spread (\$/Barrel)



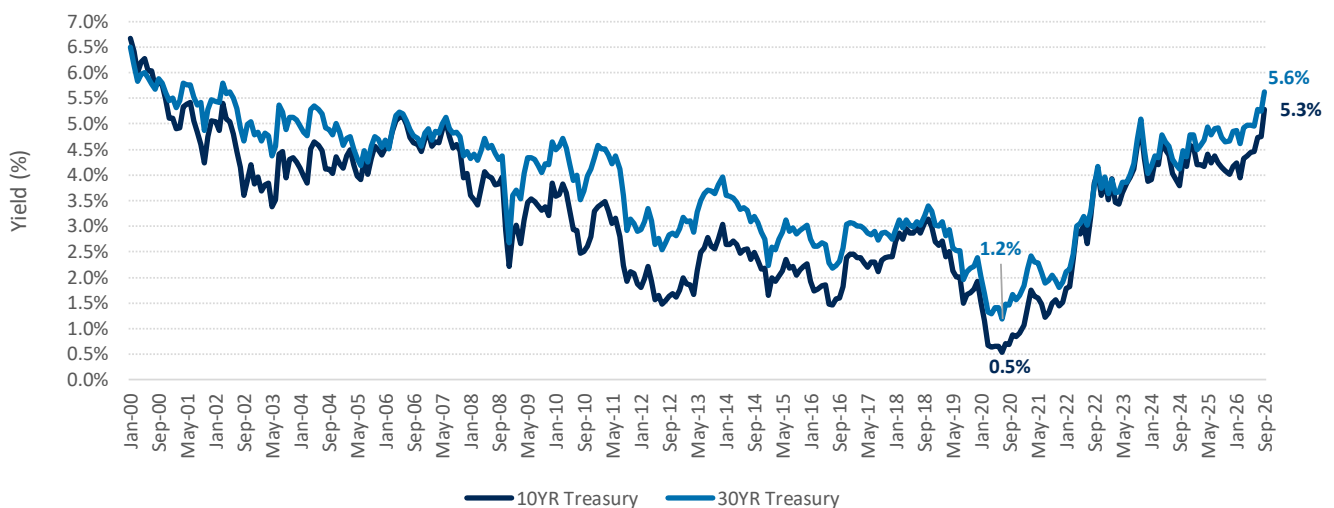
Source: Bloomberg. The 3-2-1 crack spread measures the margins of turning three barrels of crude oil into two barrels of gasoline and one barrel of diesel.

The transmission of higher energy costs into higher interest rates occurs through four channels:

- **Headline CPI:** Year-over-year headline CPI remains high because of base effects and the sustained increases in energy costs during 2026. The consistently strong headline CPI number forced the Fed to stop "looking through" inflation that was initially believed to be short-term in nature.
- **Core CPI:** Upward pressure on energy prices and transportation costs impacts both core goods and services prices, as businesses pass on price increases to consumers.
- **Consumer Demand:** Higher prices have not yet led to consumer demand destruction. Strong consumer spending could drive more inflation and force the Fed to hold its hawkish stance.
- **Term Premium:** Higher energy prices can contribute to continued deficit spending and higher Treasury issuance, placing upward pressure on long-term bond yields.

High refined product prices are likely to keep headline and core inflation readings elevated, putting upward pressure on interest rates. Higher financing costs are likely to weigh on mortgage and business activity. Sustained high interest rates could lead to a demand slowdown for both businesses and consumers, ultimately cooling the economy.

Treasury Yields March Higher



Source: Bloomberg.

Macro/Markets Update

Monetary and Fiscal Policy

The Fed unanimously raised interest rates in September for the first time since July 2023. Chair Warsh reiterated that inflation is “too high and has been for too long.” The Fed’s Summary of Economic Projections (SEP) indicated that 16 of 18 participants expect at least one more hike this year, with four seeing two hikes. A projected resumption of the rate hiking cycle caused short-term rates to jump and reignited equity volatility, dynamics that could persist as the market digests more inflation and growth data.

Expansionary fiscal policy continues to influence economic activity. The deficit is tracking near 6% of GDP for an economy operating at full employment. Gross national debt crossed \$40 trillion and net interest has cleared \$1 trillion. The debt ceiling, expected to be breached in 2027, brings risks as the current continuing resolution runs until December 11, 2026. Midterms will have an impact on further spending plans, but regardless of the outcome, there is no clear path to fiscal prudence and reduced deficit spending.

Consumer Resiliency in the Face of Inflation

Headline CPI bounced 0.4% and 0.6% in August and September, respectively, while core CPI increased by 0.3% in each month, bringing year-over-year core CPI to 2.6% in September. Rising energy prices continue to drive the headline CPI number, while core CPI shows gains in services categories, illustrating that rising energy prices are bleeding into other areas.

U.S. consumer spending has remained resilient despite the weight of inflation and higher interest rates. Q2 GDP growth was revised upward to 2.2%, and retail sales sharply rebounded in August with a 1.2% month-over-month gain. Upper-income cohorts continue to drive spending while the lower-income groups are struggling, leading to increased reliance on debt. This can be sustained with a fully employed labor force, but job losses would exacerbate the situation.

What We are Keeping an Eye On: The Fiscal Crowd Out

Loose fiscal policy has increased competition between government and corporates for financing. Heightened Treasury issuance coupled with an AI-driven surge in corporate borrowing has pushed interest rates higher, posing headwinds to the economy.

To meet government obligations and fund expenditures, the Treasury is selling about \$1 trillion of new debt every three to five months. In addition, hyperscaler corporate credit issuance has scaled up significantly to fund AI-related capex, which is estimated to reach \$800 billion in 2026 and \$1.1 trillion in 2027. This additional supply of bonds has led to an increase in both the risk-free rate and the credit spread that these corporate issuers have to pay their lenders.

Higher financing costs have significant implications for corporate activity. Certain planned projects may be postponed or canceled, as returns on investment may not look as attractive in a higher rate environment. Companies that do make these investments will need to pay more in interest to fund them, limiting other growth opportunities. Higher borrowing costs will also weigh on company balance sheets, particularly lower quality companies with predominantly floating-rate debt issuing in the leveraged loan market.

The effects of higher interest rates are already being felt in more rate-sensitive areas of the economy. Construction activity has been tepid, and the housing market has been anemic for some time. While the AI buildout has supported the economy in aggregate, the boom masks the credit stress that is building beneath the surface. Allocations to high-quality fixed income can benefit from higher yields, avoid credit deterioration, and provide portfolio protection if the economy begins to slow under the weight of higher interest rates.

Asset Class Detail

This chart outlines OAM Research & Investment Management’s macroeconomic and asset class views. Asset class views reflect a medium-term outlook by OAM Research based on macroeconomic trends, valuations, and technical indications and are intended to advise allocation tilts relative to an appropriate strategic asset allocation.

● Underweight ● Slightly Underweight ● Neutral ● Slightly Overweight ● Overweight

Global Equity

	U.S. Large Cap Earnings growth within large cap equities remains strong. Valuations appear only modestly elevated due to strong AI-related earnings growth, though expectations for growth remain very high. Higher-quality companies may see their fundamentals improve in a prolonged inflationary environment due to positive operating leverage. Companies that possess healthy balance sheets may be able to pursue growth opportunities in an uncertain economic environment.
	U.S. Small-Mid Cap Small and mid-cap stocks face difficulty from higher interest rates. Companies linked to the AI trade underperformed in the quarter, and high-quality companies can continue to outperform if interest rate concerns linger and volatility persists.
	International Developed International equities offer attractive valuations and can benefit from fiscal reforms and potential dollar weakness. Developed international indices provide more diverse sector composition than domestic indices, offering diversification benefits if the AI trade unwinds.
	Emerging Markets Certain emerging market companies have been at the forefront of the AI trade and remain expensive, yet there are other opportunities across the asset class. Investors can utilize active managers who aim to capitalize on other themes and idiosyncratic drivers of returns.

Global Equity - Alternatives

Long/Short Equity is considered part of the strategic asset allocation for equities based on each fund’s underlying investments.

	Long/Short Equity Heightened market volatility presents opportunities to managers that can navigate the current headline-driven market. Many managers were caught offside in the momentum-unwind that occurred in July. Dispersion should present alpha opportunities on both long and short trades.
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Global Fixed Income

	U.S. Core Fixed Income The rise in Treasury yields has persisted as inflation pressures drove a hawkish pivot by the Fed. High starting yields should help to cushion further price losses, while bonds should provide portfolio protection if the AI buildout stalls. Corporate spreads are still tight, reflecting investor preference for credit rather than duration risk.
	High Yield Credit Spreads have slightly widened in 2026 but remain historically tight. Lower quality borrowers in the high yield and private credit markets continue to face stress from higher rates even as defaults and leverage remain muted in aggregate. Pressure on private credit funds may contribute to broader weakness in the asset class.
	International Fixed Income International bond performance was negative in the quarter due to inflation risks and geopolitical concerns. Emerging market debt offers attractive yields but may underperform if global growth slows.

Diversifying Strategies

	Real Assets Inflationary tailwinds may continue to favor real asset strategies relative to stocks and bonds. Midstream stocks have benefited from elevated energy prices and the AI infrastructure buildout. Utilities and infrastructure should prove defensive if the economy turns, but they are sensitive to interest rate increases. REITs are also impacted by higher interest rates, though fundamentals are improving.
	Event Driven/Uncorrelated Event-driven strategies can serve as an effective diversifier in an uncertain economic environment with positive stock/bond correlations. Deal activity was generally strong in the first half of 2026 but may disappoint if geopolitical and interest rate headwinds remain.

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Market and Economic Measures

Brent Crude Oil: Brent crude oil is a widely used international benchmark for crude oil pricing. Brent crude prices are influenced by global supply and demand, geopolitical developments, production decisions, and other market factors.

U.S. Crude Oil Inventories: U.S. crude oil inventories represent reported stocks of crude oil held in the United States. Inventory levels are monitored as an indicator of supply and demand conditions in the energy market. Data referenced in this report are sourced from the U.S. Energy Information Administration (EIA).

West Texas Intermediate (WTI) 3-2-1 Crack Spread: The 3-2-1 crack spread is an industry measure used to estimate refining margins based on processing three barrels of crude oil into two barrels of gasoline and one barrel of distillate fuel, commonly diesel. The spread is an illustrative measure and does not represent a refiner's actual profitability or operating costs.

U.S. Treasury Yields: The 10-year and 30-year U.S. Treasury yields represent market yields on U.S. government debt securities with the respective maturities. Treasury yields fluctuate based on interest rate expectations, inflation, economic conditions, and market demand. Bond prices generally move inversely to yields.

Consumer Price Index (CPI): The Consumer Price Index measures the average change over time in prices paid by urban consumers for a representative basket of goods and services. CPI is a commonly used measure of consumer inflation.

Core Consumer Price Index (Core CPI): Core CPI measures changes in consumer prices excluding food and energy components, which can experience significant short-term volatility. Core CPI is commonly used to evaluate underlying inflation trends.

Risk Factors

The success of an investment program may be affected by general economic and market conditions, such as interest rates, the availability of credit, inflation rates, economic uncertainty, changes in laws and national and international political circumstances. These factors may affect the level and volatility of securities prices and the liquidity of a portfolio's investments. Unexpected volatility or illiquidity could result in losses.

Investing in securities is speculative and entails risk. There can be no assurance that investment objectives will be achieved or that an investment strategy will be successful.

Special Risks of Foreign Securities

Investments in foreign securities are affected by risk factors generally not thought to be present in the United States. These factors include, but are not limited to, less public information about issuers of foreign securities and less governmental regulation and supervision over the issuance and trading of securities. International investments may involve risk of capital loss from unfavorable fluctuations in currency values, differences in generally accepted accounting principles, or economic or political instability in other nations.

Special Risks of Small- and Mid-Capitalization Companies

Investments in companies with smaller market capitalization are generally riskier than investments in larger, well-established companies. Smaller companies often are more recently formed than larger companies and may have limited product lines, distribution channels, and financial and managerial resources. These companies may not be well known to the investing public, may not have significant institutional ownership, and may have cyclical, static, or moderate growth prospects. There is often less publicly available information about these companies than there is for larger, more established issuers, making it more difficult for an investment manager to analyze their value.

The equity securities of small- and mid-capitalization companies are often traded over-the-counter or on regional exchanges and may not be traded in the volume typical for securities traded on a national securities exchange. Consequently, an investment manager may be required to sell these securities over a longer period of time, potentially at less favorable prices, than would be the case for securities of larger companies. In addition, the prices of small- and mid-capitalization securities may be more volatile than those of larger companies.

Special Risks of Fixed Income Securities

For fixed income securities, there is a risk that the price of these securities will decline as interest rates rise. Another risk is credit risk, which is the risk that an issuer of a bond will not be able to make principal and interest payments on time. Liquidity risk is the risk that an investor may not be able to buy or sell investments quickly at a price close to their underlying value. When a bond is considered liquid, there is generally an active market of investors buying and selling that type of bond.

Fixed income securities markets are subject to many factors, including economic conditions, government regulations, market sentiment, and local and international political events. Further, the market value of fixed income securities will fluctuate depending on changes in interest rates, currency values, and the creditworthiness of the issuer.

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