

PORTFOLIO CONSTRUCTION

What Markets Know That Headlines Don't

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The escalation in U.S.–Iran tensions has pushed oil prices up 53% this year to \$87.36 per barrel, reintroducing inflationary pressures and tempering expectations for near-term rate cuts. While the inflationary impulse is notable, history suggests such energy-driven shocks tend to be episodic rather than sustained. Past events—including the 1973 oil embargo, the 1979 Iranian Revolution and the 1990 Gulf War—triggered sharp spikes in oil prices and inflation, but market impacts proved transient once supply adjusted and uncertainty began to fade.

Despite these headwinds, equity markets have remained resilient. The S&P 500 has rallied 19.7% from its March low, delivering an 11.2% year-to-date return. While this sharp rebound has raised concerns around valuations, fundamentals remain supportive. Earnings growth for S&P 500 companies reached 28.6% (Q1 2026)—the strongest since 2021—underscoring the strength of the current profit cycle.

A key differentiator in this cycle is the scale and speed of artificial intelligence (AI)-driven investment. The buildout of AI infrastructure is providing a meaningful offset to higher input costs, reinforcing both corporate profitability and broader economic activity. Global AI-related capital expenditure is expected to approach \$1 trillion annually—a very large figure, but still modest relative to the roughly \$60 trillion spent each year on operating expenses such as leases and labour. This gap highlights the potential for significant productivity gains as AI adoption accelerates, echoing past technological inflection points such as electrification and the rise of the internet.

While geopolitical uncertainty—particularly around the Strait of Hormuz—remains a risk, markets are increasingly treating it as a supply shock rather than a structural disruption. In parallel, the investment cycle in AI continues to strengthen, reshaping competitive dynamics across industries. The divide is no longer just between companies and people, but between those that effectively leverage AI and those that do not.

Periods of disruption have historically created both volatility and opportunity. The current environment is no different. While risks remain elevated, the combination of resilient earnings and a powerful structural growth driver in AI suggests the medium-term outlook for equities remains constructive.

Glossary

Volatility: Measures how much the price of a security, derivative, or index fluctuates. The most commonly used measure of volatility when it comes to investment funds is standard deviation.



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