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Markets can absorb good news, and markets can absorb bad news, but markets often struggle when expectations shift quickly. That dynamic defined the first quarter of 2026. Entering the year, investors anticipated a favorable backdrop characterized by moderating inflation, the Fed rate cuts, and continued economic expansion. Instead, geopolitical conflict in the Middle East introduced a meaningful source of uncertainty, disrupted expectations for monetary policy easing, and triggered a sharp rotation in market leadership.

The S&P 500 declined more than 4% during the quarter, marking the weakest quarterly performance since 2022. Energy and defense stocks were notable outliers, benefiting from a surge in oil prices as markets reacted to supply concerns. Investors began to contemplate the possibility that sustained higher energy costs could pressure consumer spending and potentially slow global economic activity. As a result, expectations for the Fed easing shifted meaningfully. Prior to the onset of conflict, markets were pricing in a high probability of multiple rate cuts in 2026; by quarter end, expectations for near-term policy easing had diminished.

Even with heightened geopolitical uncertainty, corporate earnings remained a bright spot. The S&P 500 is expected to deliver its sixth consecutive quarter of double-digit earnings growth for the period ending Tuesday, March 31, 2026. Yet valuations have compressed meaningfully, particularly among the largest technology companies that have led markets in recent years. Despite the first quarter market decline, underlying earnings continued to grow at an attractive pace. This combination of improving fundamentals and moderating valuations has helped reset expectations across several segments of the market.

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Leadership broadened during the quarter as performance shifted away from mega-cap technology companies toward more economically sensitive and

value-oriented sectors. Rising interest rates contributed to this dynamic, as higher discount rates tend to place pressure on longer-duration growth stocks. Smaller capitalization companies also outperformed larger peers. The outperformance of value stocks and small caps may signal renewed investor interest in areas of the market that have lagged in recent years.

Looking ahead, earnings growth remains a constructive foundation for equities. Current forecasts call for approximately 13% earnings growth for the first quarter of 2026, supported by resilient consumer demand and continued corporate investment. Companies are increasingly focused on deploying artificial intelligence to enhance productivity, improve decision-making, and expand operating margins. We are seeing early evidence that AI adoption is enabling companies to streamline processes, reduce costs, and strengthen competitive positioning.

Periods of uncertainty often create opportunities for long-term investors willing to maintain discipline and a focus on fundamentals. As valuations adjust and expectations reset, companies with durable competitive advantages, strong balance sheets, and consistent earnings growth potential are often positioned to benefit most.

At Riverbridge, our investment philosophy remains centered on identifying high-quality businesses capable of compounding earnings across a variety of economic environments. We believe that companies demonstrating pricing power, strong customer relationships, and mission-critical offerings are best equipped to navigate periods of volatility. Importantly, many of our portfolio companies are not only implementing AI within their own operations, but also providing products and services that help their customers improve productivity and efficiency.

While geopolitical developments can influence short-term market movements, long-term equity returns have historically been driven by innovation, productivity gains, and earnings growth. We remain confident that maintaining a disciplined investment approach focused on durable growth businesses positions our portfolios well for the years ahead.

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