

ECONOMIC OUTLOOK & INVESTMENT PERSPECTIVE

SECOND QUARTER, 2026

THE ECONOMY: WHAT A DIFFERENCE A WAR MAKES

Prior expectations were for accelerated economic growth as tax cuts, more favorable financing conditions, and headwinds from tariffs and inflation ease. By contrast, now with the U.S. Israel War with Iran ongoing, our concerns are for potential stagflation, the mixture of higher inflation and stagnant growth with the possibility of higher interest rates. If there are signs of weakness in business activity, it will unlikely result in lower interest rates. As surging oil prices push inflation expectations upwards, looser monetary policy appears increasingly improbable.

U.S. nonfarm payrolls rose a seasonally adjusted 178,000 in March, a reversal from the 133,000 decline in February. The unemployment rate edged lower to 4.3%, though that was largely from a sharp reduction in the total labor force. As has been the case, health care was responsible for much of the growth, adding 76,000 jobs. By contrast, unemployment remains steady at 5.9% in the European Union.

U.S. Manufacturing performance improved in March with growth solid and picking up from February amid better gains in both output and new orders. However, with tariffs continuing to negatively impact new export sales, growth was principally driven by higher domestic demand. The seasonally adjusted S&P Global U.S. Manufacturing Purchasing Managers Index (PMI) recorded 52.3 in March versus 51.6 in February. This was the eighth successive month the PMI posted above the 50.0 no change mark indicating positive growth. However, international sales continued to decline as tariffs and shipping challenges weighed on foreign demand. However, the PMI for services fell to 49.8 points in March from 51.7 in February, its first contractuary reading since January 2023. The fact that business confidence dipped but did not slump is a sign that businesses are hopeful of a swift resolution of the war.

The Strait of Hormuz closure from the Iran War effectively shuts off 20% of the world's oil supply. As a result, oil prices have surged with Brent Crude up 50% since military strikes began on February 27th to \$109.05 and West Texas Intermediate priced at \$111.54 a barrel. Many other vital commodities are being constrained, including petrochemicals, fertilizers, and sulfur.

As a result of the Iran War and the inflated price of oil, U.S. GDP growth is now projected to take a 40 basis point hit to 2.3% for 2026. The U.S. inflation rate is now forecast to reach 3.6% in 2026, up from 2.8%. Harold Davidson & Associates, Inc. (HDA), is of the opinion that if the Federal Reserve were to lower the federal funds rate now 3.5% – 3.75%, it is likely to be toward the end of 2026 after the war is concluded and inflation has moderated.

In March 2026, the U.S. housing market faced a widening buyer seller mismatch with a record number of old listings, as home sales fell 3.1% year over year in February and continued to face

low demand due to high mortgage rates. While inventory is slowly recovering and acting as a buyer's market, prices in some regions remain elevated, and buyers are more selective, often waiting for better affordability. The recent rise in interest rates is holding back some would-be sellers as well.

The U.S. automobile market is on track for a 2.6% drop in 2026 as the War and tariffs cloud the outlook. Cox Automotive projects 15.8 million new vehicles sales this year, down from 16.2 million vehicles in 2025. Their forecast has remained constant since the beginning of the year. Expectations are that Detroit brands will take the biggest hits and electric vehicles will lose ground to hybrids. President Trump's One Big Beautiful Bill Act has fueled decent first quarter sales for automobiles. An interesting statistic, Cox Automotive estimates tariffs in 2025 cost automakers and suppliers \$35 billion, with the auto industry absorbing \$3,800 per vehicle that consumers otherwise would have paid. Complex tariff policy this year continues to befuddle automakers with the 25% tariff on import parts and 50% on imported steel and aluminum pressuring new vehicle prices.

What about Global economic growth? The U.S is fractionally higher given its high degree of energy independence which includes relatively higher cost fracturing which is not so high cost considering the price of oil today. Europe sees the largest downward revision to growth, due to the inflationary impact of higher energy prices, especially gas. Japanese growth is supported by a previously announced 1% of GDP fiscal boost, and by "fiscalizing" higher energy prices by preventing a pass-through of costs to consumers. East Asia is benefitting immensely from tech exports, while India, which had a very strong carryover from late 2025, is subsidizing fuel and fertilizer and enjoys strong balance sheets.

Chinese GDP growth should slow by 20 basis points to 4.8% for 2026 and energy levels appear robust for now. By contrast, U.S. GDP growth is expected to fall 40 basis points because of the war. China has stockpiled enough oil to cover demand for at least four months should it prove necessary. Also, China relies on several energy suppliers outside the Middle East, including Russia, Australia, and Malaysia. For China, the Iran War is likely to exacerbate existing economic issues, including a lack of domestic consumer demand and deflation.

THE STOCK MARKET: RESILIENCE AMID VOLATILITY

The first quarter of 2026 reflected a more volatile start to the year, as markets adjusted to evolving expectations around interest rates, geopolitical developments, and global growth. Despite a steady flow of negative news headlines, underlying economic and corporate fundamentals remained relatively stable.

The S&P 500 Index declined approximately 4% during the quarter, while the Dow Jones Index was down approximately 3%, and the Nasdaq Composite was down 7%, as early-year gains were offset by increased volatility later in the period. Technology and communication services experienced pressure following strong prior-year performance, while energy, industrials, and

select defensive sectors helped provide relative stability. Market breadth remained mixed, reflecting a more balanced and selective environment.

At the same time, capital investment trends remain a key support for the broader economy. Spending related to artificial intelligence, energy infrastructure, and defense continues to expand, contributing to a more durable and less cyclical growth backdrop. HDA is of the opinion that this ongoing investment cycle remains an important driver of economic resilience.

Technology and innovation-driven companies continue to play a central role in long-term growth. While questions persist regarding the scale and return of AI-related investment, early evidence suggests these expenditures are increasingly contributing to both revenue growth and operating efficiency.

During the First Quarter, HDA initiated a new position in a global healthcare services company and established a new position in a telecommunication infrastructure company. Conversely, HDA divested out of three different software products/service companies and one financial service platform firm. As of quarter end, HDA's asset allocations were as follows: cash or cash equivalents 2%; municipal bonds 6%; corporate bonds 10%; equity mutual funds 10%; common stocks 57%; real estate 13%; and unit investment trusts 2%.

THE BOND MARKET: STABILITY WITH SELECT OPPORTUNITIES

Fixed income markets experienced a more stable environment during the first quarter, as investors balanced moderating inflation trends with the potential for near-term inflation pressures stemming from higher energy prices.

The Bloomberg U.S. Aggregate Bond Index was relatively flat during the first quarter, supported primarily by income generation as interest rates remained relatively range bound. Bond markets generally interpreted recent developments as inflationary rather than recessionary, resulting in some upward pressure on shorter-term yields.

Short-term yields remained attractive, continuing to provide compelling income opportunities. HDA maintained its focus on short-duration, high-quality corporate and municipal bonds yielding approximately 4%–5% before tax, complemented by short-term Treasuries and money market instruments for liquidity.

REAL ESTATE: COMMERCIAL REAL ESTATE SHOWS SIGNS OF STABILIZATION AMID RISING TRANSACTION VOLUME AND A FLIGHT TO QUALITY

The U.S. commercial real estate market is showing signs of stabilization and early recovery. Improving capital markets, moderating interest rates, and renewed investor confidence are supporting increased transaction activity. While valuations appear to have bottomed, capital remains highly selective, reinforcing a clear flight to quality across asset classes and favoring well-leased, institutionally positioned properties.

Across sectors, performance remains uneven. Multifamily is stabilizing as demand remains healthy, though recent supply has tempered near term rent growth, particularly in overbuilt markets. The office sector continues to face headwinds, with high quality buildings in prime locations gaining traction while older properties face ongoing challenges and require repositioning or conversion. Industrial remains resilient, supported by logistics demand and e-commerce, even as it works through recent supply additions. Retail has strengthened, benefiting from limited new development and increased demand from service-oriented tenants. Alternative sectors such as data centers, student housing, and senior living continue to attract investor interest due to durable demand drivers.

Key market dynamics continue to shape the recovery. A wave of upcoming debt maturities presents refinancing challenges, while financing costs and lender selectivity persist. Development remains constrained by construction costs and insurance pressures, limiting new supply and supporting fundamentals for well-located, high-quality properties.

Looking ahead, the outlook for 2026 remains cautiously optimistic. The market is transitioning from correction to recovery, with opportunities strongest in high quality assets and select distressed situations as investors position for the anticipated next phase of the cycle, with an emphasis on disciplined underwriting and long-term value creation.

SUMMARY AND CONCLUSION:

As we move further into 2026, our outlook remains constructive yet disciplined. While markets continue to navigate geopolitical developments, energy price volatility, and evolving monetary policy expectations, the underlying fundamentals of the economy remain supportive.

HDA is of the opinion the current economic environment reflects a market balancing both solid earnings growth and strong investment trends against a backdrop of elevated uncertainty. While volatility may persist, these conditions are consistent with a mid-cycle expansion. Moderating inflation, stable employment, and continued corporate earnings growth should provide a foundation for both equity and fixed income markets.

At Harold Davidson & Associates, we remain committed to a strategy anchored in quality, diversification, and risk control—positioning portfolios for sustainable, long-term growth while preserving capital in an ever-changing global environment.

CLIENT REFERRALS

We greatly appreciate the referrals of new business that we continue to receive from our clients. If you have acquaintances, who in your opinion can benefit from receiving this investment newsletter, please contact Doreen at (310) 553-5551 or email dferritto@hdainvest.com.

Harold A. Davidson, DBA
President and CEO

Craig E. Farkas, CFP
Executive Vice President

Vick Khoboyan, Vice President
VP and Chief Investment Officer

