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# Q2 Investment Perspectives | 2026

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## Executive Summary

**Q1 '26 Recap** – In Q1 '26, broad global equity markets were mixed, reflecting an economic backdrop where strong 12% year-over-year corporate earnings growth is offset by weak GDP, persistent inflation, and declining employment. Beneath the headline performance, there is significant divergence as U.S. large-cap and growth stocks lag, while value stocks, defensive sectors (utilities and consumer staples), and the Pacific-Asia region post gains. Meanwhile, the recent spike in oil prices has driven strong positive returns across commodities, energy equities, gold, and inflation-linked bonds, though broad fixed income returns remain muted.[1]

**The Big Picture** – Major tech companies are projected to spend trillions on AI infrastructure over the next five years in a series of "circular" investment structures, increasing market risks. U.S. foreign policy has become increasingly unilateral and transactional, utilizing trade tariffs to force international compliance. The U.S. is aggressively using military pressure in Venezuela and Iran, as well as signaling ambitions to acquire Greenland, and increasing pressure on Cuba.

**AI** – Multiple key large language model releases have created market disruptions. In order to better understand the potential impact on various industries, we examined various frameworks that have been put forward and developed our own categorization of industries based on potential impact from AI. As proof of the current impact, labor markets have again weakened with the February jobs report.

**Iran and Oil –** Coordinated U.S. and Israeli military strikes against Iran killed senior Iranian officials, prompting retaliatory attacks and severe disruptions to energy shipping through the Strait of Hormuz. Brent crude prices surged over 30% and marine war-risk insurance premiums skyrocketed, rendering many Gulf voyages uneconomic in the near term. While a permanent oil shock is not our base case, in our view, a sustained price increase could add up to 0.4% to headline inflation.

**Private Credit –** Private credit is experiencing the trifecta of increasing "shadow defaults", excessive loans to AI disrupted sectors like software, and growing retail redemption requests from liquidity mismatched vehicles. Although this retail-driven liquidity squeeze will likely increase borrowing costs and force actual defaults higher, we believe that the overall private credit market does not yet pose a systemic risk to the broader economy.

**Positioning** – We maintain a conservative positioning with selective tilts in portfolios. Key exposures include equal-weight S&P allocations, international diversification, and a focus on real assets. Where appropriate, we are also deploying option hedges across the richer parts of the equity market and allocating to liquid alternatives.

[1] YTD return numbers are from yCharts as of 3/31/26. All forecasts are expressions of opinion and subject to change without notice and are not intended to be a guarantee of future events. Past results do not guarantee future results. Real results may vary.

## Q1 2026 Market Review

"… Despite all the major AI and geopolitical news, broad market indices were mixed for Q1 2026..."

Despite all the major AI and geopolitical news, broad market indices were mixed for Q1 2026. The real economy paints a mixed picture as Q4 2025 GDP came in at 0.7%, while inflation is still above the Fed's 2% target (2.4% in February). Employment has been very weak, with February Nonfarm Payrolls coming in negative and the 6-month moving average is now close to zero. On the earnings side, Q4 2025 earnings season proved to be better than expected, with S&P 500 EPS of just under $76 and growing 12% YoY.[2]

As it stands currently, global equities (ACWI) are down 2.2% YTD. US large cap equities (SPY) are down 4.4% while Pacific-Asia (VPL) is up 8.1%. Growth (IWF, -9.8% YTD) has suffered as the Mag7 names have lagged, while value has outperformed (IWD, +2.0% YTD). Divergence across sectors was large with materials (XLB, +10.7% YTD) and utilities (XLU, +8.2% YTD) performing well, while consumer discretionary (XLY, -8.6%) and financials (XLF -9.4%) suffered.[3]

Fixed income returns were flat. Credit spreads have widened slightly, while inflation-linked bonds (TIP) had small gains +0.4% with the spike in Oil. Broad-based commodity indices are up +29.5% (DBC) drive by the oil spike, which has also supported energy producers (XLE, +37.9%) and MLPs (MLPX, +23.5%). Gold (GLD) continues its strong performance from last year, +8.6% YTD.[3]

| Asset Class | Ticker | YTD 2026 | 2025 | '08-'24 Ann |
|---|---|---|---|---|
| Short Municipal Bonds | SHM | 0.11% | 3.95% | 1.92% |
| Long Municipal Bonds | MUB | -0.37% | 3.78% | 3.41% |
| US Aggregate Fixed Income | AGG | 0.03% | 7.19% | 3.13% |
| Short US Treasury Bonds (1-3y) | SHY | 0.27% | 4.95% | 1.64% |
| Intermediate US Treasury Bonds (7-10y) | IEF | -0.13% | 8.03% | 3.40% |
| Long US Treasury Bonds (20y+) | TLT | 0.18% | 4.25% | 3.88% |
| US Investment Grade Bonds | LQD | -0.38% | 7.90% | 4.78% |
| US Treasury Inflation Linked Bonds | TIP | 0.41% | 6.77% | 3.63% |
| US High Yield Bonds | HYG | -0.35% | 8.60% | 5.16% |
| Convertible Bonds | CWB | 2.85% | 16.61% | 14.72% |
| USD EM Bonds (JPM) | EMB | -1.61% | 13.85% | 4.55% |
| Alerian MLP Index | MLPX | 23.50% | 4.93% | 9.34% |
| US REITs (MSCI REITs) | VNQ | 1.32% | 3.26% | 6.38% |
| Commodities | DBC | 29.47% | 8.06% | -0.72% |
| Gold | GLD | 8.57% | 63.68% | 8.37% |
| Energy | XLE | 37.90% | 7.88% | 4.07% |
| Agriculture | DBA | 7.05% | -0.58% | 0.61% |

| Asset Class | Ticker | YTD 2026 | 2025 | '08-'24 Ann |
|---|---|---|---|---|
| MSCI All Country All World | ACWI | -2.21% | 22.41% | 7.86% |
| US Large Cap (S&P 500) | SPY | -4.37% | 17.72% | 10.84% |
| US Small Cap (Russell 2000) | IWM | 0.93% | 12.66% | 7.88% |
| US Value Equities (R1000 Value) | IWD | 1.97% | 15.68% | 7.57% |
| US Growth Equities (R1000 Growth) | IWF | -9.83% | 18.33% | 13.74% |
| Canadian Equities | EWC | 1.59% | 35.92% | 4.21% |
| European Equities (FTSE Europe) | VGK | -0.94% | 35.85% | 3.33% |
| Pacific Equities (FTSE Pacific) | VPL | 8.11% | 32.64% | 2.98% |
| Emerging Market Equities (MSCI EM) | VWO | 0.54% | 25.58% | 1.88% |
| Consumer Discretionary | XLY | -8.56% | 7.36% | 14.17% |
| Consumer Staples | XLP | 6.13% | 1.52% | 9.84% |
| Financials | XLF | -9.40% | 14.89% | 5.18% |
| Health Care | XLV | -4.90% | 14.50% | 11.67% |
| Industrials | XLI | 4.55% | 19.33% | 9.75% |
| Materials | XLB | 10.67% | 9.92% | 6.86% |
| Technology | XLK | -7.58% | 24.60% | 15.65% |
| Utilities | XLU | 8.24% | 16.00% | 7.31% |

*Source: yCharts.com. All YTD 2026 numbers are as of 3/31/2026. For illustrative purposes only. All returns are gross of fees.*

**For illustrative and informational purposes only.** [2]Factset Data as of 3/31/2026 [3]All YTD return numbers are from yCharts as of 3/31/2026. Equities are proxied by the ACWI ETF. US Equities are proxied by the SPY ETF. Europe equities are proxied by the VGK ETF. Asia equities are proxied by the VPL ETF. Growth stocks are proxied by the IWF ETF. Value stocks are proxied by the IWD ETF. Small cap stocks are proxied by the IWM ETF. Financial stocks are proxied by the XLF ETF. Utilities stocks are proxied by the XLU ETF. Health care stocks are proxied by the XLV ETF. Fixed income is proxied by the AGG ETF. Credit is proxied by the HYG ETF. Duration is proxied by the TLT ETF. EM bonds are proxied by the EMB ETF. Commodities are proxied by the DBC ETF. MLPs are proxied by the MLPX ETF. Gold is proxied by the GLD ETF. All forecasts are expressions of opinion and subject to change without notice and are not intended to be a guarantee of future events. The market returns presented herein are gross of fees and do not account for any management fees, advisory fees, trading costs, or other expenses that may be incurred in the management of an investment portfolio. As a result, the actual returns experienced by an investor will be lower than the gross returns presented. Investors should consider the impact of fees and expenses on their investment returns and consult with their financial advisor. Past performance is not indicative of future results.

## Big Picture

As the world normalized after COVID, consumers—flush with cash from government stimulus—spent at unusually strong levels even as supply chains remained strained. Those dynamics pushed inflation to its highest level in roughly 40 years and prompted central banks to raise interest rates aggressively to slow demand and ease price pressures. Higher rates moved through the economy with long and variable lags, and although global growth slowed, it did so in a surprisingly measured way while inflation moved closer to normal levels.

"The major players in AI are estimated to spend more than $3 trillion over the next five years on AI infrastructure. These arrangements deepen interdependence among firms and amplify the risks created by already elevated market concentration…"

The major players in AI are on track to spend well over $500 billion in 2026 alone, and some estimates imply more than $3 trillion over the next five years on AI infrastructure.[4] These "circular" arrangements—in which one company invests in another, and the proceeds are then used to purchase the first company's products—deepen interdependence among firms and amplify the risks created by already elevated market concentration. The spending surge is also transforming formerly capital-light businesses into more capital-intensive ones at a time when the returns on AI capex remain uncertain. In addition, AI is already changing how companies organize work and make hiring decisions, which could create longer-term pressure points in labor markets.[5]

Since "Liberation Day" in April 2025, U.S. policy has become more unilateral, combining tariffs, and direct pressure abroad in ways some analysts view as reminiscent of a modern Monroe Doctrine.[6] U.S. trade policy has increasingly used tariffs to encourage domestic production and penalize countries whose behavior Washington wants to change. In Venezuela, the United States has recently expanded waivers to allow more oil and fertilizer to reach global markets, partly to ease price pressures tied to Middle East disruptions. In Iran, Washington has tightened pressure on oil and weapons networks, with the stated aim of constraining Tehran's nuclear and regional capabilities. President Trump has also signaled interest in pursuing U.S. control of Greenland on strategic grounds, while Cuba has faced heightened economic pressure in the context of broader regional policy shifts.

In our view, the key to investing in times of increased volatility is sticking to core principles. We believe investors should also focus on putting a premium on liquidity, which can often get ignored in the race to invest in new technologies. We believe that having a risk framework which considers not only historical portfolio moves but also stress tests those portfolios to potential future volatility is paramount to endure the appropriate level of risk.

[4]Source: https://www.goldmansachs.com/insights/articles/why-ai-companies-may-invest-more-than-500-billion-in-2026
[5]Source: https://www.ey.com/en_us/newsroom/2025/12/ai-driven-productivity-is-fueling-reinvestment-over-workforce-reductions
[6]Source: https://www.nytimes.com/2026/01/05/us/politics/trump-venezuela-monroe-doctrine.html

## AI

*Introduction*

Multiple key large language model ("LLM") releases in February have created market disruptions, the pace of which may increase. Anthropic's Claude Opus 4.6 and OpenAI's GPT 5.3 Codex were released.[7] The Claude release featured large advancements in Claude Code and strong results in Humanity's Last Exam, an exam created by 2500 experts on a variety of subjects that are designed to be "search proof" where previous models struggled to score more than 50%. OpenAI 5.3 Codex is a specialized coding model aimed at end-to-end software work. The key takeaways were that many of these models are now capable of acting as agents, performing multi-step reasoning, and working on local hardware.

"… Multiple key LLM releases have created market disruptions, the pace of which may increase… many of these models are now capable of acting as agents and performing multi-step reasoning… Almost any business, no matter how stable or profitable, is an advancement away from losing its edge..."

Not surprising, this had large market ramifications in sectors such as software, financial services and office REITs. Sector and company exposure to AI disruption will vary greatly and should be an important consideration impacting portfolio positioning going forward. Many businesses, even those that are stable or profitable, face ongoing pressure to adapt to technological advancements, which can impact competitive positioning over time. In what follows we will explore several leading firms and their frameworks for thinking about the impact of AI, as well as present our own.

*AI Frameworks*

As a starting point, we reviewed various firms and their published research on AI and its impact on various industries. The summary below is meant to be high level.

- Sequoia frames AI as a "cognitive revolution" and a roughly $10T services opportunity, arguing AI will industrialize knowledge work, much like factories industrialized manual labor. GPUs and frontier models are like steam engines, while the bulk of value creation lies ahead as startups specialize them for concrete vertical use cases (e.g., legal, healthcare, industrial operations) and integrate them into production workflows. Disruption will happen in traditional professional services such as legal, accounting, and consulting, as well as in software development and IT.[8]
- a16z argues AI will massively augment human intelligence, accelerate scientific discovery, and drive productivity growth. AI won't just advise but will act, turning workflows into AI-native software. They want to invest in AI infrastructure and agents, AI-native cores in finance and enterprise, and AI-driven industrial and defense platforms.[9]
- Accel's AI thesis highlights three big buckets: infrastructure (automation, orchestration, low-code/no-code), horizontal transformation tools, and verticalized AI applications that embody domain expertise with a specific focus on AI in financial advice and healthcare.[10]
- Benchmark has been making concentrated bets on AI infrastructure such as frontier AI/agent companies globally, suggesting a belief that next-gen compute and core models will remain very valuable.[11]

[7]Source: https://www.anthropic.com/news/claude-opus-4-6
[8]Source: https://sequoiacap.com/article/ai-in-2025/, https://sequoiacap.com/article/generative-ai-act-two/
[9]Source: https://a16z.com/who-owns-the-generative-ai-platform/
[10]Source: https://www.accel.com/noteworthies/accel-2025-globalscape-race-for-compute
[11]Source: https://www.theinformation.com/articles/benchmarks-ai-pressure-test-high-prices-smaller-stakes-poached-star

GT's AI framework tiers assets into Tier 1 assets you want to own that provide real assets and human experiences, Tier 2 which you want to be opportunistic with as AI will create large disparity between winners and loser, and Tier 3 assets which are prone to disruption and investors should avoid.

*GenTrust's Framework*

- Tier 1 (Core/Own): Real Assets & Human Experience. Low disruption or enablers. Production of physical essentials where AI is an efficiency lever, not a product replacement. Data centers, energy (oil & gas), utilities, industrials (chemicals, steel, mining), consumer staples (restaurants, household products, beverages).
- Tier 2 (Opportunistic): Scientific & Complex Manufacturing. Industries where AI is a "super-tool" that accelerates R&D and design but does not replace the physical end-product so idiosyncratic company volatility is likely to be high although sector performance may be unaffected. Semiconductors, Biotechnology, Drug Manufacturers, Medical Devices, electronics, defense/aerospace, autos, retail, transportation, and machinery.
- Tier 3 (Avoid): Prone to Disruption. Industries where the core product can be created or heavily automated by AI, forcing a fundamental business model overhaul. Software, professional services, legal, accounting, consulting, content generation, asset management, insurance, banks.

*For illustrative and educational purposes only; actual results may differ materially from this example. This information is not intended as investment advice or a recommendation to buy or sell any security.

*Current pricing for certain Tier 1 assets*

Should investors move all their investments to Tier 1 assets or has the market priced this outcome already? In our view, much of the increase in market value of the largest companies of the S&P500 is due to anticipated capital expenditures on AI infrastructure buildout. These companies today face a classic Prisoner's Dilemma around infrastructure spending: individually, they would all be better off not overspending, but each firm's dominant strategy is to invest aggressively or risk being left behind. Estimates of AI infrastructure spending range from $3 to $7 trillion over the next 5 years.[12]

Does massive spending mean good returns on those investments and the companies undertaking them? In our view, definitely not. In fact, we would argue the return on these AI capex investments is likely to disappoint based on the sheer size of investments being proposed. Consider the following:

- Taking the lower end of estimates at $3 trillion invested in AI spending by 2030
- If these investments target a 15% return on invested capital (ROIC) = $450bn in annual profit
- If the investments operate on a 30% net margin = $1.5 trillion in annual revenue to data centers (30% is Google's current margin)
- Assume compute is roughly 40% of revenue = $3.8 trillion in annual revenue needs to be generated by AI investments by 2030. In 2025, the total revenue of all AI related services totaled roughly $60 billion.
- To further put this required revenue number in context, U.S. GDP is currently (2024) $30 trillion and if it grew 5% per annum then it would be roughly $38 trillion in 2030.

***Under these assumptions, this would imply 10% of all spending by 2030 would need to go to AI to justify these investments.***

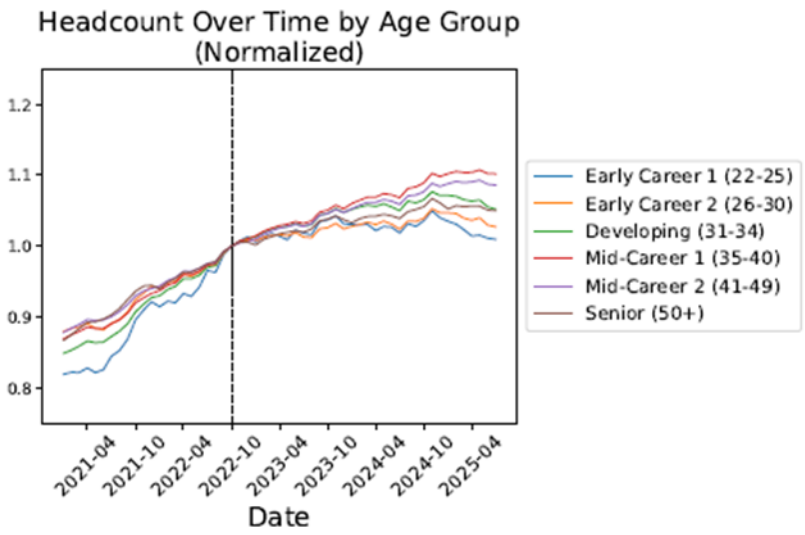
This example is based on hypothetical assumptions for illustrative purposes only and does not reflect actual or expected market outcomes.

[12] Source: https://www.mckinsey.com/industries/technology-media-and-telecommunications/our-insights/the-cost-of-compute-a-7-trillion-dollar-race-to-scale-data-centers

*AI Employment Implications*

Beyond all the headlines and potential issues, AI is having a large impact on the real economy as well. An August 2025 paper by Stanford researchers Brynjolfsson, Chandar and Chen examined the change in labor markets for occupations exposed to generative AI using high-frequency ADP payroll data.[13] The paper's key conclusion was that employment for young workers (ages 22-25) had declined markedly in the most AI-exposed occupations. Further, employment declines are concentrated in occupations where AI is more likely to automate, rather than augment, human labor.

"… Our preference is to stay diversified by holding broader public equity market exposures and invest in the growth potential of AI through niche AI venture funds… Given the pricing in options markets, we have found protection in many of the AI related companies to be attractive for investors who share our view…"




Source: Stanford researchers (Brynjolfsson, Chandar, Chen).[13] For illustrative purposes only trends may evolve over time.

Since the use of AI accelerated in 2022 with the release of ChatGPT, the above trends may be in their early stages. The obvious question is how does this evolve over time? While we don't believe the AI revolution will lead to mass unemployment, we do anticipate a challenging transition period. Many workers will need to be retrained for new roles—an adjustment that is likely already underway.

*Investment Implications*

Most portfolios are already extremely exposed to the AI trade with holdings concentrated in the big tech names. Our preference is to stay diversified by holding broader public equity market exposures (equal weight, mid cap, non-us equities) and invest in the growth potential of AI through niche AI venture funds where we see the potential for more upside in providing clients with a diversified way to play this generational shift. Given the sheer size of the large public AI companies, their recent >100%/yr returns are unlikely to repeat whereas the next great AI company is likely not even known yet. Further, given the pricing in options markets, we have found hedges in many of the AI-related companies to be attractive for investors who share our view.

13 Source: https://digitaleconomy.stanford.edu/wp-content/uploads/2025/08/Canaries_BrynjolfssonChandarChen.pdf

## Iran and Oil

On February 28th, the U.S. and Israel launched coordinated strikes against Iran. Forty-seven years of rule came to an abrupt end when Iran's Supreme Leader, Ayatollah Ali Khamenei, along with several other senior political and military leaders, was killed in the attack. The strikes also targeted multiple military and strategic sites across Iran. Iran responded by launching attacks on U.S. forces in the region, including strikes on U.S. embassies and military facilities. Energy flows through the Strait of Hormuz (SoH) were disrupted, and Brent crude rose more than 30% over the week and remains at those elevated levels. Although Iran has not formally declared a closure of the SoH, standard marine insurance that covers ships in normal conditions has effectively become unusable for transits through the Gulf. Shipowners now need to purchase voyage specific war risk coverage.

A frequently cited rule of thumb from Federal Reserve is that a 10% increase in oil prices raises headline inflation by roughly 0.3–0.4%, with somewhat smaller but still meaningful effects on GDP growth.[14] Extrapolated, a sustained 20% move (from $70 to mid $80s) in oil might add on the order of 0.4–0.8% to headline inflation and might shave a few tenths from GDP growth. To be clear, a permanent oil shock is not our base case. Iran is certainly aware of these efforts and likely views constraining oil supply as one of its key levers to pressure the U.S. to de escalate sooner rather than later. In the event oil prices stay high for several weeks, we believe the impact on inflation could be more like an increase of 0.2-0.4%, an unwelcome complication after an especially weak employment report in February.

Historically, a few empirical relationships tend to hold during oil spikes:

- Equities rarely bottom before oil stops rising
- The larger the oil shock, the deeper the typical drawdown in equities
- The longer the shock persists, the more damaging it is for risk assets

We stress test our client portfolios regularly to make sure they are resilient to such shocks as we are experiencing now. One of the stress tests we apply is for an oil shock. The grid below shows what we predicted a full oil shock would do to markets versus what has actually happened since February 28th. As you can see, our stress is very extreme, with oil spiking 150%, equities dropping 28% and bonds selling off 10%. So far various markets have moved 20-40% of the amount we've predicted, with mostly the correct shape across markets. The one outlier is gold which has done extremely poorly.

We have not adjusted portfolio positioning as a result of the strikes. Our view is that many of these price moves are likely to prove transitory. Most of our portfolios have explicit allocations to real assets such as energy producers, MLPs, and gold. We are maintaining these positions given the magnitude of the moves and their role as partial hedges.

| Asset Class | Predicted Oil Spike | Markets Since Feb 28th | % of Predicted Move |
|---|---|---|---|
| **Munis** | -6.6% | -3.0% | 45.4% |
| **US Core Bonds** | -10.2% | -2.7% | 26.8% |
| **TIPs** | -3.8% | -1.8% | 47.4% |
| **EM Bonds** | -21.0% | -4.4% | 21.0% |
| **US Equities** | -28.8% | -6.0% | 20.8% |
| **European Equities** | -32.2% | -11.1% | 34.4% |
| **Canadian Equities** | -16.1% | -7.4% | 46.0% |
| **Pacific Equities** | -20.9% | -12.2% | 58.1% |
| **MLPs** | 95.6% | 6.0% | 6.2% |
| **Gold** | 10.0% | -17.2% | -172.0% |
| **Oil** | 150.0% | 43.2% | 28.8% |
| **Oil Producers** | 50.0% | 10.1% | 20.2% |

Source: GenTrust Risk Scenarios and yCharts.com Asset class returns shown are based on market indices and are provided for **illustrative purposes only and not a forecast from February 28, 2026, to March 31, 2026**. Index performance does not represent the performance of any client portfolio performance and is not an investment recommendation. Discussion in positioning is general in nature and does not indicate portfolio changes.

14 Source: https://www.federalreserve.gov/econres/notes/feds-notes/second-round-effects-of-oil-prices-on-inflation-in-the-advanced-foreign-economies-20231215.html

## Private Credit

"… UBS strategists recently warned that, in a severe AI disruption scenario, private credit default rates could spike toward 15%, versus mid single digit historical norms…"

Private credit became a major lender to software companies over the past decade, attracted by strong historical cash flows, high margins, and recurring revenue models. The recent acceleration in AI-driven disruption has raised questions about the long-term durability of those cash flows and the resilience of existing underwriting assumptions. UBS strategists recently warned that, in a severe AI disruption scenario, private credit default rates could spike toward 15%, versus mid-single digit historical norms.[15] Worsening the issue, most software companies have limited real assets, which generally form the basis for how successful lenders can recover their investment upon a default.

Private credit managers have been quick to defend their portfolios, highlighting the still low level of actual defaults. However, realized defaults are a lagging indicator. The level of "shadow defaults"—situations where borrowers avoid formal default through amendments, payment in kind (PIK) interest, covenant waivers, or repeated maturity extensions—has been rising in recent years. These mechanisms allow loans to remain technically current while effectively masking underlying distress and have become more common as capital chased weaker structures and lower quality deals during the 2020–2023 boom.

A second, and arguably more systemic, issue is the liquidity mismatch between the underlying private loans and the vehicles that package them for retail and wealth management investors. If this sounds familiar, it is because the same dynamic—illiquid assets funded in structures that offered more liquidity than the assets could support—was a major fault line in the global financial crisis. This cycle, the epicenter is semi liquid private credit vehicles marketed aggressively to RIAs and high net worth investors such as business development companies (BDC) and interval funds. These funds were sold as yield solutions and as a supposed replacement for the "broken" 60/40 portfolio. The marketing promise was steady income and periodic liquidity; the reality is that when everyone tries to exit at once, liquidity disappears.

One example we have seen is the Cliffwater Corporate Lending Fund (CCLFX), which is an interval fund known for its retail distribution.[16] CCLFX grew to roughly $33 billion in under five years and allocated about 25% of its portfolio to software companies. Interval funds are explicitly designed to hold illiquid assets; in exchange for that flexibility, they restrict redemptions to a fixed percentage of shares (often 5%) per quarter. In calm markets with inflows, this works reasonably well. When sentiment turns and redemptions surge, investors are forced into a queue, waiting multiple quarters to fully exit. In CCLFX's case, the latest redemption cycle for Q1 totaled 13.95% of the fund's NAV, 7% of which was repurchased, so investors received back roughly 50% of what they attempted to redeem.

Cliffwater is not the only issue. In Q1 2026, Blackstone's Private Credit Fund (BCRED), a non-traded BDC structured as a semi liquid private credit fund, received redemption requests for 7.9% of its shares. Ultimately 100% of the redemptions were honored after Blackstone employees invested additional money to cover the gap. BCRED also has roughly 25% of its portfolio in software and another 11% in professional services.[17] The original spark for the private credit concerns came from Blue Owl Capital Corporation II (OBDC II). In 2025, Blue Owl proposed merging OBDC II (sold through RIA channels) into its listed BDC, OBDC, to create a liquidity event. OBDC II investors would have seen an immediate ~20% hit, prompting the ultimate scrapping of the deal. Blue Owl announced in February 2026 that it would stop taking new redemption requests altogether and instead put OBDC II into a run-off.

[15]Source: https://www.bloomberg.com/news/articles/2026-02-24/ubs-now-sees-private-credit-defaults-reaching-15-in-worst-case
[16]Source: https://www.cliffwaterfunds.com/data/pdfs/literature/CCLFX-Fact-Page.pdf?v=1772913416355
[17]Source: https://www.bcred.com/wp-content/uploads/sites/66/blackstone-secure/Fact-Card.pdf?v=1771971982

"… retail-led "liquidity stress" in private credit markets has the potential to actually create credit issues, although we do not believe it poses a systemic issue to the overall economy…"

To understand where we go from here, we ask (and answer) several important questions:

- *Should we believe managers explanation of "limited current defaults"?* No, shadow defaults are just kicking the can down the road. Anyone who has used Claude, Codex or Cursor knows large parts of the software industry are in real and imminent danger. Loans to these companies are likely to have limited recovery value. Managers that kept software exposure low or have significant collateralization from real tangible assets are, in our view, in a much better position.
- *Can this retail-led "liquidity stress" actually create credit issues that otherwise would not have happened?* Yes. Retail investors have been the marginal buyer of private credit the last 5 years. If those large inflows turn to large outflows, the cost of credit must move materially higher. Funds will naturally provide less forgiveness to borrowers who are struggling and defaults will rise. In our opinion, the fact most of these funds are levered will accelerate these issues.
- *Does private credit pose a systemic risk for the overall economy?* Unlikely. Private credit has grown remarkably, expanding from roughly $200 billion in 2006 to an estimated $3.5 trillion today, although it still accounts for roughly 9% of total corporate borrowing.[18] We believe the biggest risk is likely the growing interconnectedness between private credit and the banking system through warehouse and NAV facilities.
- *Is it time to buy BDCs?* Pricing looks fair if you assume 50% of software loans default with limited recovery value. The average software exposure of BDCs is 30% and most are leveraged of 2:1 ($2 of assets/loans for every $1 of equity). If you assume half their software loans default with limited recovery value, that's a 15% loss on asset value, which is a 30% loss on BDC share price/equity value. The average BDC right now is currently down 30%.

We have long warned of the potential issues of private credit, as far back as early 2025. More recently in our 2026 Outlook, we wrote:

*"Another troubling trend is the growing number of private markets being put into semi-liquid vehicles such as interval funds. Although these structures look like they are here to stay, history has taught us that mismatching liquidity creates a very bad outcome in down markets… we are overall very cautious about how quickly private markets have grown and are being pushed through the retail channels…"*

Consistent with that view, we have steered clients away from these semi liquid private credit products and toward LP structures in real asset strategies (for example, railcars and other asset backed cash flow streams) that target private credit-like returns but typically offer better tax treatment and, critically, liquidity terms that match the underlying assets. As a result, we have very limited exposure to the current issues in the semi liquid private credit complex.

| Ticker | Name | Market Cap (bn) | Assets @ FMV (bn) | % Decline from Peak | % Exposure to Software/Prof Services |
|---|---|---|---|---|---|
| **ARCC** | Ares | 12.7 | 29.5 | -23.7% | 33.2% |
| **OBDC** | Blue Owl | 5.4 | 16.5 | -27.9% | 14.0% |
| **BXSL** | Blackstone | 5.5 | 14.2 | -27.8% | 31.0% |
| **MAIN** | Main Street | 4.7 | 8.8 | -23.5% | 11.0% |
| **GBDC** | Golub | 3.3 | 8.6 | -18.3% | 33.0% |
| **FSK** | FS KKR | 2.8 | 13.0 | -55.7% | 30.0% |
| **HTGC** | Hercules | 2.6 | 5.7 | -27.3% | 44.0% |
| **TSLX** | Sixth Street | 1.7 | 3.3 | -28.6% | 42.0% |
| **PSEC** | Prospect | 1.2 | 3.3 | -39.0% | 21.0% |
| | **Median** | | | **-27.8%** | **31.0%** |
| | **Mean** | | | **-30.2%** | **28.8%** |

[18] Source: https://www.ssga.com/us/en/institutional/insights/2026-credit-research-outlook

Data as of December 31, 2025. Market capitalization figures (in billions) are sourced from YCharts. Assets at fair market value (FMV) are based on publicly available disclosures from the sources linked below. Information is provided for illustrative and informational purposes only and is not intended as investment advice or a recommendation. https://www.arescapitalcorp.com/portfolio, https://www.blueowlcapitalcorporation.com/, https://www.bxsl.com/, https://golubcapitalbdc.com/, https://www.fskkrcapitalcorp.com/about/portfolio/, https://www.htgc.com/m, https://sixthstreetspecialtylending.gcs-web.com/, https://www.prospectstreet.com/portfolio/

## Positioning

From a positioning perspective, we are neutral across asset classes. We have moderate amounts of tilts in portfolios. We have reduced portfolios reliance on the very largest AI companies by holding some of our US large cap exposure in equal weight form and choosing to barbell that with private market exposure to AI companies. We also have positions in an international equity diversification (Switzerland and India) in addition to core non-US holdings, and a real asset bucket that contains energy exposed holdings.

## Summary

In Q1 2026, global equity markets were mixed as robust corporate earnings collided with stagflationary pressures, allowing value and defensive sectors to outperform U.S. growth stocks. Geopolitical escalations, particularly U.S. and Israeli strikes on Iran that disrupted the Strait of Hormuz, caused a sharp spike in oil and commodity prices that could temporarily inflate headline inflation. Concurrently, massive AI infrastructure investments and rapid software advancements are disrupting labor markets and heavily affecting software companies, which is exposing shadow defaults and retail liquidity mismatches within private credit vehicles. To navigate these compounding macroeconomic and structural risks, portfolios are positioned conservatively, emphasizing diversified exposures that include equal-weight U.S. equities, international diversification, and real assets and strategic option hedges.

[14] Source: https://indexes.morningstar.com/insights/analysis/blt6f59cc3327974375/when-public-meets-private-rethinking-the-modern-market

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