

WARMART

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April 2026

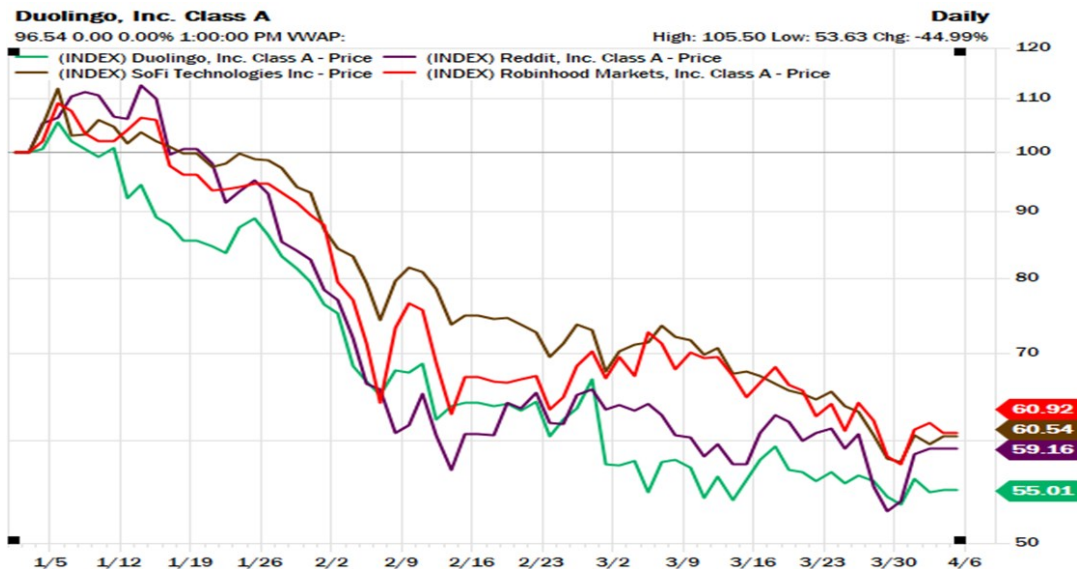
With all of the negativity surrounding the Iran conflict, there is actually a positive side effect.

The conflict in Iran has caused many negative repercussions, from recession and inflation fears due to the nearly 100% spike in oil prices year-to-date, to the overall economic uncertainty caused by this event with no specific ending date.

While the short and long-term merits of reducing or eliminating the future probability of Iranians having dangerous nuclear weapons can be debated, along with the methodology in which this elimination is achieved, one positive side effect of this mission has surfaced.

Not only has the war let the air out of a number of 2025's ever-inflating bubbles, along with completely popping many of 2023-2024's bubbles, but the latest equities market correction has normalized valuations for major indices like the S&P 500 as prices have fallen while earnings rose in the first quarter. We had previously discussed the need for these speculative bubbles to deflate so markets could avoid a major future bear market. The war has become the antidote. Let us examine what occurred in three short months so far in 2026.

First, over 100 companies in the Russell 1000 index (1000 largest companies in the U.S.) are down at least 25% this year after only three months. The list of these companies is a who's who of previous speculative bubbles. Cohorts include boutique software companies that traded at 20, 30, or 40+ times revenue, and private credit companies that could provide investors with fixed income that generated the returns of stocks, until they didn't. Additionally, remember the hot "buy-now pay-later" companies? Well they are in that group too, along with yesteryear's hot IPO darlings like Reddit, Duolingo, Robinhood, and SoFi. The best performer of these IPO darlings is down over 50% from recent highs. Rough start to 2026:



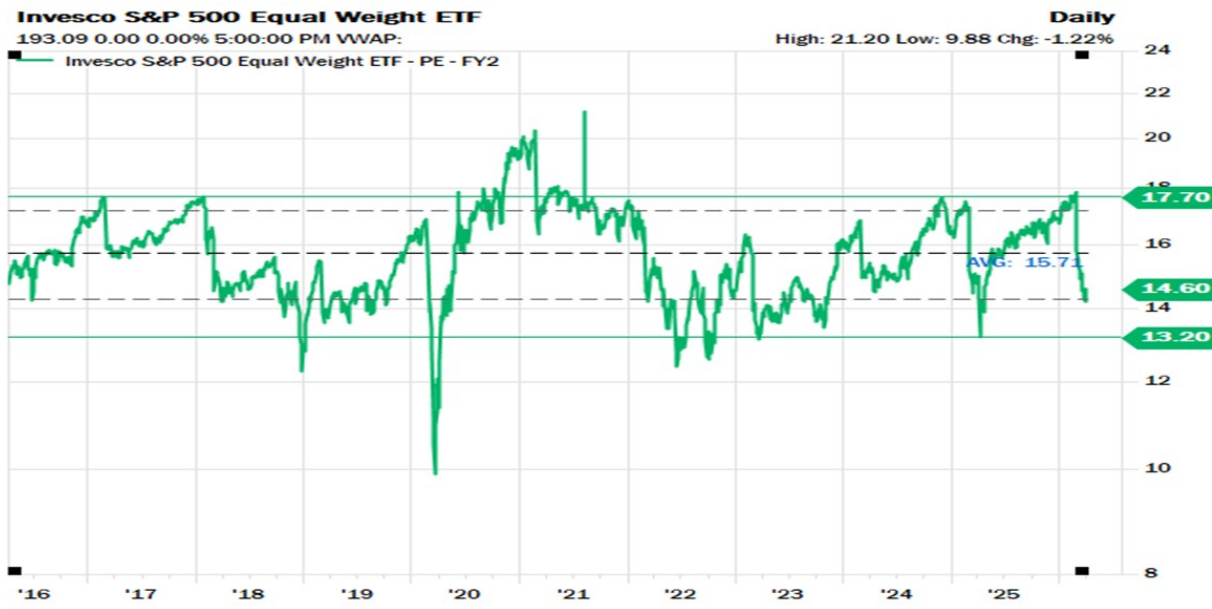


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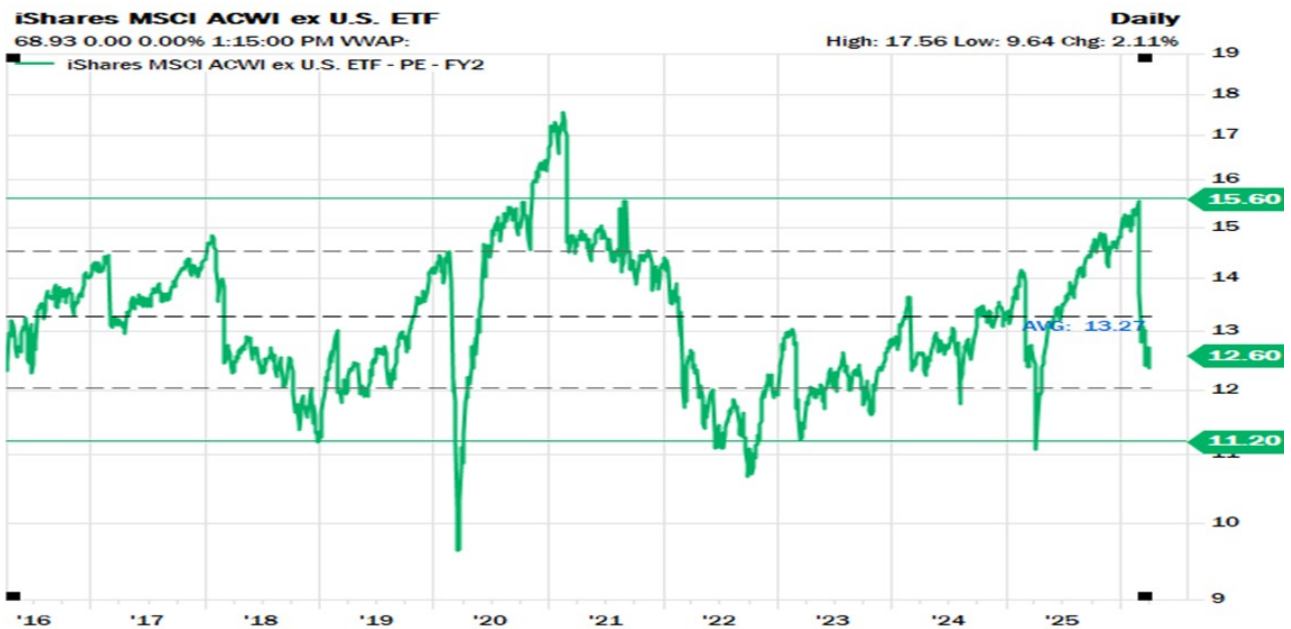
Next, as explained late last year, AI is starting to crack. Most of the well-known AI companies have not made new highs in 6-9 months, while the largest AI ETF has corrected 15%, as top holdings have fallen 20-30%.

Finally, the correction has spread to the larger indices where valuations were not terribly excessive such as the S&P 500 Equally Weighted Index and the ACWX Foreign Equities index. No bubble here at 14.6x earnings – a full standard deviation below the ten-year average of 15.7x.



Strong outperformance in 2025 for foreign equities with no valuation issues.

Source: FactSet



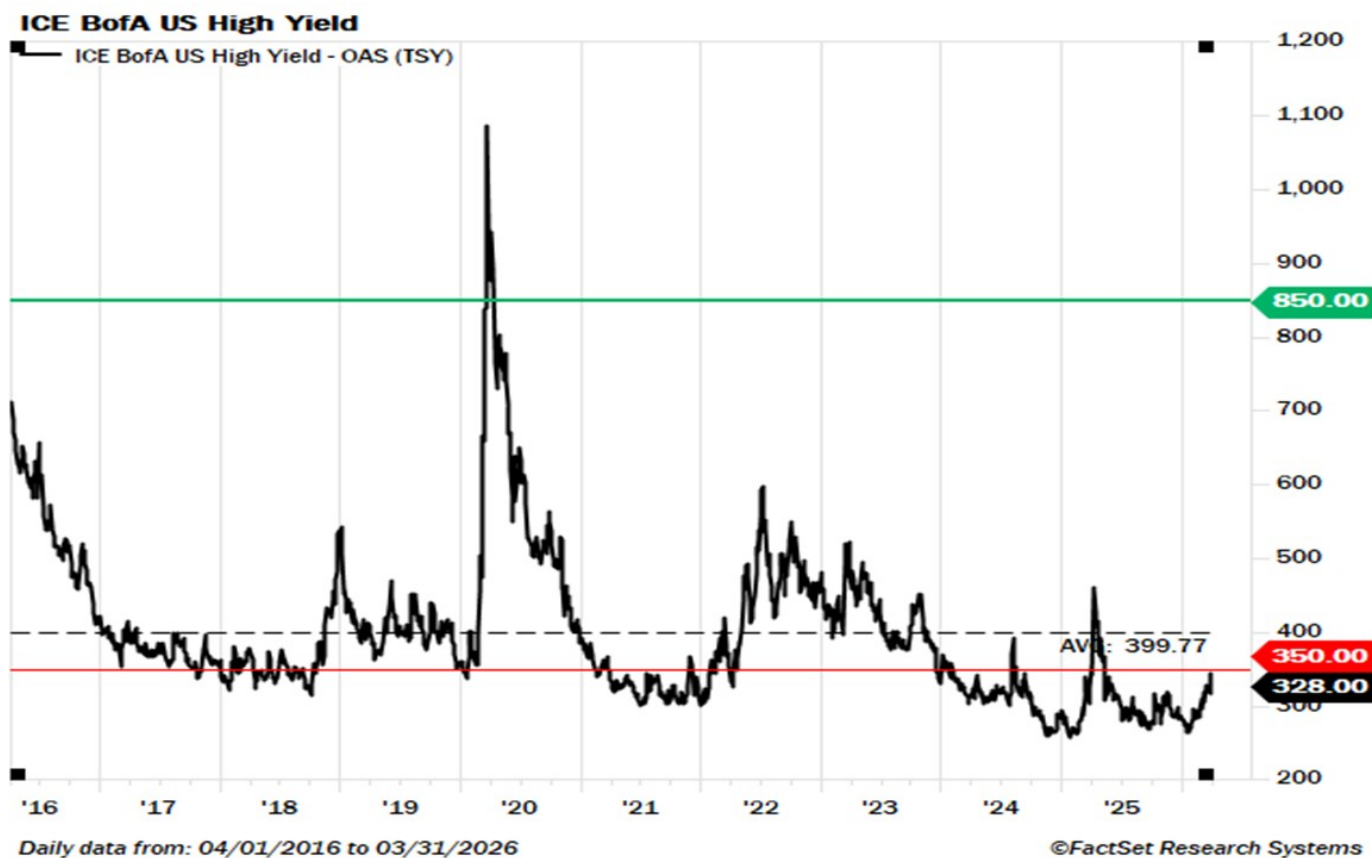
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The recent war-induced correction has not only popped and deflated numerous speculative bubbles, but has reduced global stock valuations to reasonable levels. So what are the next hurdles on the horizon?

We have spoken a number of times about the probable increase in volatility during the middle of 2026 due to the mid-term elections in November and markets becoming comfortable with the new Fed Chairman, Kevin Warsh. Meanwhile, the Iran situation continues, along with increased fears of a recession and future inflation. Although it is impossible to perfectly gauge these probabilities, two indicators can guide us to proper conclusions over the next few months.

On the recession side, closely monitoring high-yield spreads is important. We monitor high-yield credit spreads for recession probabilities because they act as a leading indicator of corporate solvency and overall economic health. The “spread” is simply the yield premium required by investors to hold riskier corporate debt versus simply owning Treasuries. Wider spreads (above around 5%) are pricing in default risk and tighter lending conditions. So what do spreads indicate today? Well, not much. Although they are off the absolute low of 2.70%, they are well below average at only 3.28%.

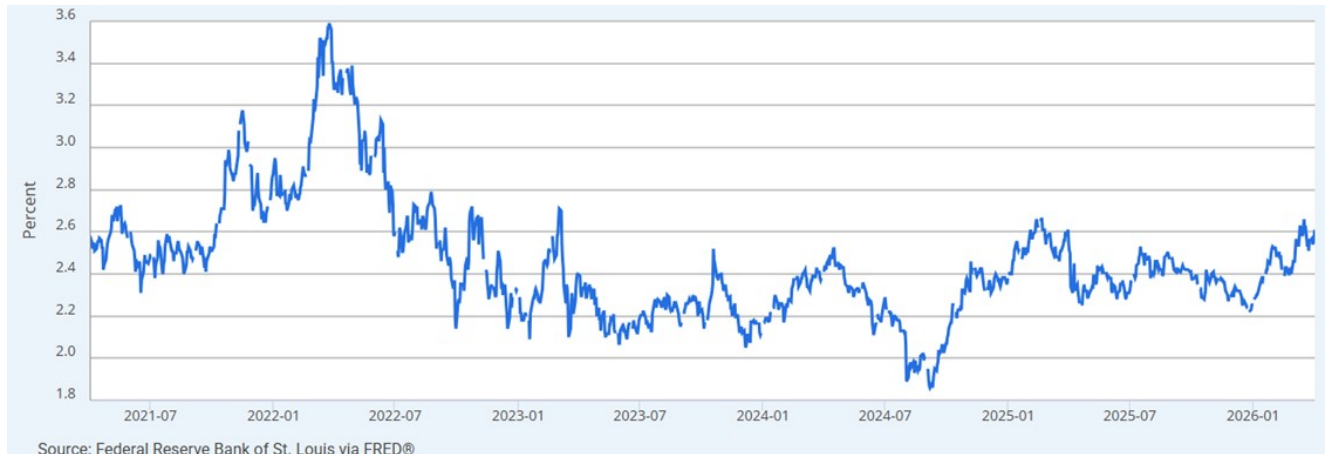




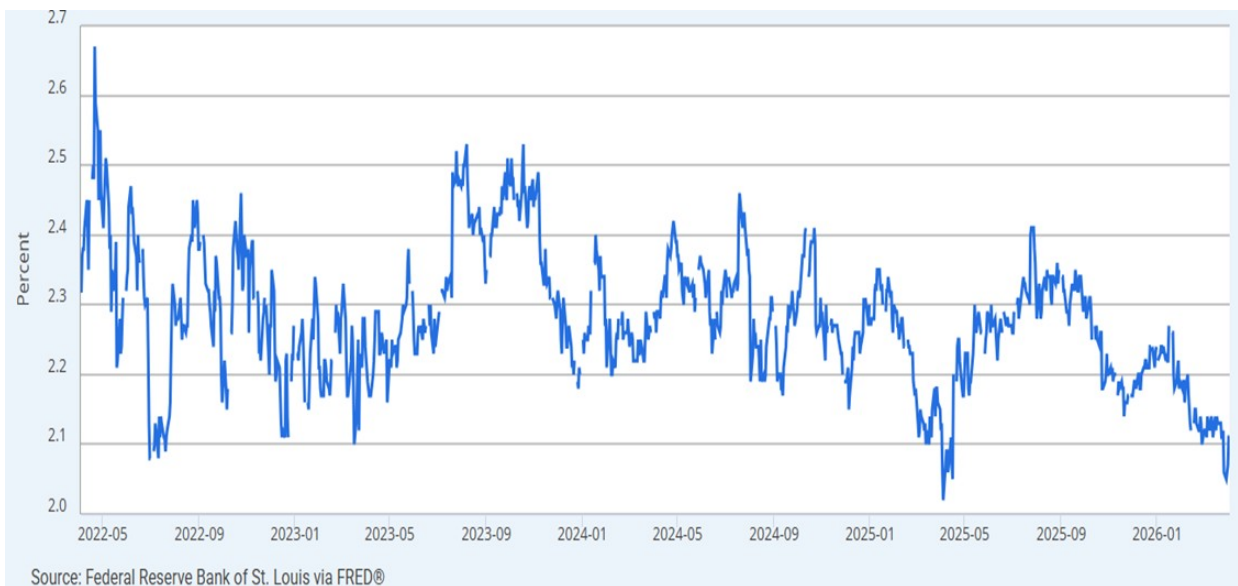
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On the inflation side, the 5 year breakeven inflation rate has ticked higher, but sits in the middle of the 5 year range.



However, longer-term inflation is even more tame, hovering near the Fed's 2.00% target. Below is the 5 year breakeven inflation level 5 years from now. We calculate this by comparing the yields of nominal and inflation-protected bonds (TIPS) in maturities from 5 to 10 years. Nothing to see here so far.



What can we conclude from everything discussed? First, popping and deflating bubbles is healthy, especially when the bubbles are isolated to small speculative cohorts. The reason why deep fundamental and valuation analysis is so important lies in the fact that on average, over 50% of public companies delist every twenty



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years. Second, the more AI continues to crack, the better off the rest of markets are over the longer-term, as rational markets are healthier than speculative ones. Third, recession and inflation indicators are tame at this point. And fourth, unless the war becomes prolonged, it is likely the recent correction that nearly reached 10% for the S&P 500 (and far more for other segments), could be ultimately limited to something less than a full bear market of 20% or more during 2026, even with the shorter-term election and Fed headwinds. ■

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