

## Q1 2026 Market Update

Financial markets entered 2026 with elevated volatility, driven by a mix of political, geopolitical, and economic crosscurrents. Treasury yields declined through January and February amid growth concerns, before reversing sharply higher in March as geopolitical risks intensified. This whipsaw leaves Treasury yields higher since the start of the year but despite this shift, bond markets have remained relatively resilient.

### **Policy and Market Environment**

Policy uncertainty has been a major market driver. Escalating tensions in the Middle East, particularly U.S. and Israeli military activity involving Iran, have disrupted global energy markets, including the effective closure of the Strait of Hormuz. This has pushed oil prices higher, increasing inflation concerns and weighing on growth expectations. With no clear diplomatic resolution, markets remain highly sensitive to further developments.

Trade policy has also added volatility following a Supreme Court ruling that invalidated certain tariffs. The decision has forced policy adjustments and introduced uncertainty around trade agreements and potential financial implications, leaving markets to navigate an evolving framework.

### **Federal Reserve and Interest Rates**

The Federal Reserve faces a challenging environment, balancing persistent inflation above its 2% target with signs of economic softening. As a result, the Fed left the Federal Funds rate unchanged at the start of the year. Adding to the uncertainty, rising energy prices risk sustaining inflation even as growth slows. The Fed's toolkit has limited options for responding to a supply shock.

On a more positive note, Kevin Warsh's nomination to replace Jay Powell is an encouraging development for markets. His strong credentials and reputation help reinforce confidence in Federal Reserve independence, which had come into question over the past year amid administrative pressure on Chair Powell.

Market expectations remain fluid, with investors weighing the possibility of both rate cuts and hikes. We believe the balance of risks leans toward a rate cut if growth continues to moderate, though uncertainty remains around policy timing and leadership dynamics.

### **Economic Trends**

The economy presents a mixed outlook. Layoffs are rising, particularly in the technology sector, as firms increasingly prioritize AI-driven efficiencies; paradoxically, these same companies continue to invest heavily in AI infrastructure. Consumer spending is also diverging with higher-income households remain buoyed by asset gains, while lower-income consumers face pressure from persistent inflation. Furthermore, while recent tax law changes offer a modest tailwind for corporations and individuals, these gains may be largely offset by rising energy prices.

## Portfolio Positioning and Outlook

At AMI, Fixed Income portfolios entered the year with a lower-than-normal risk profile. Compensation for risk remains near the low end of its historical range, while volatility has increased. Uncertainty around the economic outlook, geopolitical tensions in the Middle East, elevated deficit spending at both the federal and municipal levels, and unresolved questions surrounding AI have led us to prioritize safety. Following the market selloff related to Iran, we are closely monitoring for mispriced opportunities and will look to add risk if compensation becomes more attractive.

## Taxable Fixed Income

Taxable accounts remained flat in the first quarter, performing roughly in line with the index's 0.03%<sup>1</sup> return. Performance across taxable municipal bonds, corporate bonds, and Treasuries was mixed as interest rates moved higher during the quarter. Given the heightened market volatility, we are maintaining a cautious stance in taxable portfolios, favoring intermediate Treasuries over corporate bonds, which currently offer low excess yields.

## Tax-Exempt Fixed Income

Municipal accounts posted modest gains in the first quarter, slightly outperforming the benchmark, which declined -0.17%. The California municipal market also recovered some of its prior underperformance relative to the broader national market. Headwinds from the Los Angeles fires, elevated issuance, a sizable state budget deficit, and negative headlines surrounding State and Federal relations have begun to ease. We remain focused on essential service sectors such as water and sewer utilities, as well as Mello-Roos bonds supported by stable property tax revenues and limited pension liabilities.

## High Yield Fixed Income

High Yield accounts posted small declines in the first quarter, but outperformed the index, which fell -0.34%<sup>3</sup>. This performance was primarily driven by an overweight position in higher-rated corporate bonds, reflecting our cautious outlook on the economy. With additional yield for lower-rated corporate bonds at near historic lows, our focus remains on higher-quality bonds, which we believe will be more resilient to economic pressures.

Sincerely,

Your AMI Investment Management Team

**Disclosures**

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1. Figures presented on page one are from the ICE BofAML 1-10 Year US Corp and Government Index as of 3/31/26.
2. Figures presented on page one are from the ICE BofAML 3-7 Year US Municipal Securities Index as of 3/31/26.
3. Figures presented on page two are from the ICE BofAML 1-10 Year US High Yield BB-B Index as of 3/31/26.