

## No Rest for the Weary

Easter week is usually quiet for markets. Not this year. “Volatile” continues to be the most applicable word, and it is likely to stay that way until there is more clarity on how the Iran conflict resolves.

We are probably past the point where rhetoric from the administration makes much of a difference in markets. Investors are now much more oriented toward what actions are actually taken rather than what is said, and that shift has created a dynamic of anxiety and uncertainty.

A good example is SOFR futures, which the market uses to forecast the Fed’s next moves on short-term interest rates. They are now pricing in no rate cuts or increases over the next 12 months. Last week they were forecasting a hike. The week before, a cut. It is very unlikely to actually play out that way, but it illustrates how uncertain markets are right now when trying to forecast the near future. The signal is the noise.

### What Has Moved

That uncertainty has not prevented some significant moves since the conflict began as investors have tried to position for different outcomes. Brent crude oil is up almost 50% and retail gasoline is close to \$4.00 per gallon.<sup>1</sup> Gold, typically a safe haven, is down 15%. The 10-year Treasury yield has risen 41 basis points. Two-year inflation breakevens, which reflect the market’s expectation for average inflation over that period, are up 38 basis points to 2.95%.

Also since February 27, the S&P 500, Nasdaq 100, and Russell 2000 are all down between 7.8% and 8.3%. The VIX, a widely followed measure of expected volatility in the S&P 500, has increased from 19.9 to 30.6. And the implied correlation for the S&P, which measures the degree to which stocks are moving together rather than on their own fundamentals, has jumped from around 15% before the conflict to roughly 38% today.<sup>2</sup> When correlation is that elevated, it implies that macro forces are driving almost everything, and individual stock picking becomes less effective in the short term.

These are real moves, but similar to the tariff-driven volatility in 2025, it is increasingly difficult to handicap the specific timing of the administration’s decisions on the conflict.

### Our Base Case

Our view remains that the administration is unlikely to risk the midterms and the President’s legacy with \$5 gasoline and a long-term ground presence in Iran. That will create a difficult path and continued volatility, but we believe the pressure and incentive to find a way to exit under what will be framed as reasonable terms will only increase every day. And we believe it is likely to happen in weeks from now, not months. That timeframe would be generally constructive for equity markets.

### The Range of Outcomes

Outside our base case, from here the range of outcomes is wide and the paths to get there are volatile. Right now, S&P 500 bottom-up forward earnings estimates beginning April 1 are around \$337 per share, which puts the index at roughly 18.9x price-to-earnings. That is our starting point.

If the conflict resolves quickly and the economy stays on a positive earnings trajectory, generating \$360 to \$370 in forward earnings by year end, then at recent 22x to 23x multiples the index could reach 7,900 to 8,500, with a midpoint around 8,200. That would represent roughly 29% upside from here.

The opposite is true as well. If things do not return to normal for many months, earnings will drop and multiples will compress. At \$270 to \$280 in earnings and a 17x to 18x multiple (or lower), the index could fall to 4,590 to 5,040, with a midpoint around 4,800. That would be roughly 24% below current levels.

## Positioning

This is not a hero's market. Trying to call a top or a bottom with such disparate scenarios is very difficult. Instead, we think the right approach is to maintain high-quality, long-term core positions and monitor closely, while constantly updating the mosaic of information for higher or lower probabilities of these outcomes. That way, investors can adjust positioning as things change and take advantage of volatility as it undoubtedly continues.

## A Note on Munis

While monitoring equities, there are some interesting risk-reward opportunities in the municipal bond market worth highlighting. For someone in Florida, Texas, or another state with no state income tax, a AA-rated muni portfolio with a 7-year modified duration and a 3.65% to 4.00% yield to worst is generating a taxable equivalent yield of approximately 5.79% to 6.34% for someone in the highest federal tax bracket. That equivalent yield would be even higher for residents of states with income tax. Even after the big move in Treasuries, that muni spread over comparable government bonds is more than 144 to 179 basis points. For investors looking for high-quality income with tax efficiency, munis are offering some of the best relative value we have seen in some time.

### Source

Factset unless otherwise stated.

1 AAA.com

2 CBOE.com

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