

## Touch of Grey

Last week was a fully loaded week. The Senate confirmed Kevin Warsh as the next Fed Chair on Tuesday, the President returned from Beijing on Friday with more optics than outcomes, and first-quarter earnings season is now mostly behind us. Although AI has been the headline story, the underlying issue remains Iran, and the inflation prints and Treasury yields that go with it.

### A New Chair, an Old Problem

Warsh was confirmed 54 to 45, and his first FOMC meeting falls on June 16 and 17. We continue to believe his combination of crisis-era experience from 2008, and his more conventional time as a governor before and after that, makes him the right person for the seat. His thinking on Fed reform, particularly around the balance sheet and the policy framework, is cogent and worth a real hearing. The trouble is that the framework debate is not the debate the market is having this week.

The bond market has effectively done his job for him. With headline CPI back to 3.8% year-over-year, the highest reading since May 2023<sup>1</sup>, and PPI at 6.0%, the highest since December 2022<sup>1</sup>, fed funds futures have ruled out further cuts this year and are pricing in some probability of a hike before December. On paper, that is the kind of setup that vindicates someone who leans hawkish.

We are not convinced the market has Warsh quite right. He has spent a decade arguing the Fed has been too easy, but he has also been clear about which inflation series he watches. Warsh prefers the Dallas Fed's trimmed mean PCE, which excludes the most volatile components, and that measure sat at 2.4% through March<sup>2</sup>, much closer to the 2% target than headline CPI. The new Chair may end up looking more patient than his reputation, and current market pricing would imply.

We do not view his confirmation as a market negative. We view it as a market clarifier. The reaction function that was priced in for two cuts this year on the way in is now priced for zero on the way out, and the difference is mostly inflation, not the new Chair.

### Iran and the Math of Hormuz

The conflict in Iran is now in its third month, and the Strait of Hormuz remains effectively closed. Both sides are visibly looking for a way out, but neither can afford to be the one to flinch first. The administration would like to wind this down. Tehran knows that which is why oil keeps doing the work that diplomacy is not.

The two points the US most needs are not yet being offered. Free passage through Hormuz, which carries roughly 20% of global oil supply, and a credible cap on the nuclear program are theoretically non-negotiable for Washington, and so far, neither has been conceded. An expanded military option is back on the table, though we read most of that language as posturing rather than intent. Until Iran shows up with something tangible, volatility in oil should keep grinding higher, not lower.

In the short term this is a math problem. Brent crude oil has mostly traded over \$100 a barrel since the conflict began, and with supplies continuing to draw down, the path is more likely to accelerate higher than to flatten. National average gasoline is at \$4.50 a gallon, up over 50% since the conflict began in late February<sup>3</sup>. The longer-term question is demand destruction, which is harder to model and almost always shows up later than the oil bulls hope.

All that calculus is showing up in the negotiators' game theory, and on balance we still see resolution arriving sooner rather than later.

## What the Bond Market is Telling Us

Equities have been remarkably calm. The S&P is digesting a hot CPI print, a hot PPI print, and an open-ended Middle East conflict by trading slightly higher, which says a lot about the durability of the AI capex theme and the strength we just saw in earnings. The bond market is telling a different story.

The 10-year Treasury closed near 4.59% on Friday<sup>1</sup>, it's highest since January 2025, and roughly 24 basis points wider in the past week alone<sup>1</sup>. The Freddie Mac 30-year mortgage rate is back to 6.36%<sup>4</sup>, and the AAA national average for regular gasoline is up \$1.50 since the conflict began<sup>3,5</sup>. Five-year breakevens, which measure the gap between nominal and inflation-linked Treasuries and serve as the market's read on future inflation, now sit at 2.70%<sup>6</sup>, with the ten-year at 2.49%<sup>6</sup>. Both are north of the Fed's 2% target, and both are rising.

Wednesday's \$25 billion auction of 30-year Treasury bonds priced at 5.046%<sup>7</sup>, the first time the Treasury has had to pay over 5% to borrow for that long since just before the 2008 financial crisis. Demand at the auction was visibly soft, and the bond market is telling the Treasury something.

We have written before that the bond market is usually the more honest of the two when they disagree, and we see no reason to revise that view here. Whether the next move in yields comes from a hawkish Warsh, a stickier inflation print, or the supply story we have been watching for two years, the path of least resistance for the long end appears to be up, not down.

## What the Trump-Xi Summit Did Not Deliver

The Beijing summit was expected to be a catalyst. Going in, the market was hoping for tariff relief, a clearer line on chip exports, and, more than anything, visible Chinese pressure on Tehran. Coming out, the headline deliverables were \$17 billion a year in agricultural purchases through 2028 and a 200-jet order at Boeing, against a 500-jet number that some had floated. Boeing traded down 4% on the news.

The bigger miss was on Iran. The two leaders did issue joint language that the Strait of Hormuz must remain open and that Iran cannot have a nuclear weapon, but China stopped well short of any visible pressure on Tehran. For a summit that some in the administration had positioned as the catalyst for ending the conflict, "the Strait must remain open" is unfortunately closer to a press release than a policy. The market noticed.

## Earnings Are a Bright Spot

First-quarter earnings season is largely complete, with NVDA, ORCL and retailers the most notable names still to come. According to FactSet, blended year-over-year earnings growth for Q1 came in at 27.7%<sup>1</sup>, well ahead of the 13.1% expected at quarter end<sup>1</sup>. That has been the cleanest positive in an otherwise messy backdrop.

The story under those numbers continues to be AI. The hyperscaler capex cycle, and the semiconductor and power names that sit downstream of it, have driven a disproportionate share of both the earnings beats and the rebound off the spring lows. Strip out a handful of names tied to the buildout and the picture is more ordinary, with growth roughly in line with what consensus expected at quarter end. We have flagged the concentration risk before and will again, but the capex is real, and the earnings on the other side of it are now showing up in the reported results.

On the back of those upward revisions, consensus has full-year 2026 earnings growth at 21.5%<sup>1</sup>, which puts the S&P forward twelve-month P/E at 21.4<sup>1</sup>, against five- and ten-year averages of 19.9 and 18.9 respectively<sup>1</sup>. Multiples are tight relative to history, but they are not at the extremes we saw in late 2021. The 2027 estimate, which is what most equity desks are now valuing off of, takes the multiple back into the high teens. Earnings are doing the work valuation cannot.

## At the End of the Day

All of these events last week were mixed but do add certainty long-term for markets. Warsh got confirmed, earnings closed out strong, and the summit from Beijing was less than the market had hoped for. None of those is the reason the 10-year is trading today close to 4.59%<sup>1</sup>.

The reason is Iran and the associated inflation, and the two are now the same trade. Our base expectation remains that the administration may not get exactly what they want, but will find enough for a deal in Iran. However, we are watching the spread between equity calm and Treasury alarm closely. It rarely stays this wide for long.

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