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From the front page of Wednesday's WSJ:

## Furious Rally Caps Weak First Quarter

BY HANNAH ERIN LANG AND JACK PITCHER

The stock market ended the first quarter on a high note, with all three major U.S. indexes posting their best showing of 2026 on the last day of March.

For weeks, the U.S. war with Iran weighed on markets, dragging stocks to their worst quarter in nearly four years. But on Tuesday, investors got a glimpse of a potential offramp for the conflict—and they pounced.

President Trump told aides that he is willing to end the war without fully reopening the Strait of Hormuz, the narrow waterway that handled about a fifth of global energy flows before the conflict. Stock gains accelerated throughout the day, with headlines circulating that Iran, too, could be open to ending the conflict. ...

The S&P 500 rose 2.9% on Tuesday. The Nasdaq composite led gains, surging 3.8% while the Dow Jones Industrial Average advanced 2.5%, or 1,125 points.

It was still a grim quarter for stock investors.

The technology-heavy Nasdaq fell into correction territory on March 26, meaning it had fallen 10% below its recent high. A day later, the Dow (a benchmark for the real economy) joined it. Despite Tuesday's rally, the Dow and the S&P 500 still suffered their worst quarter in nearly four years.

Flashback to December: Economic growth was accelerating, the Federal Reserve appeared poised to make further interest-rate cuts, and markets had moved past the uncertainty created by the U.S.'s disputes with its international trading partners.

Together, they offered the potential for double-digit returns, and investors came into 2026 confident the rally was about to sweep up many of the stocks that sat out the rise of big tech companies, Nvidia and the artificial-intelligence boom. ...

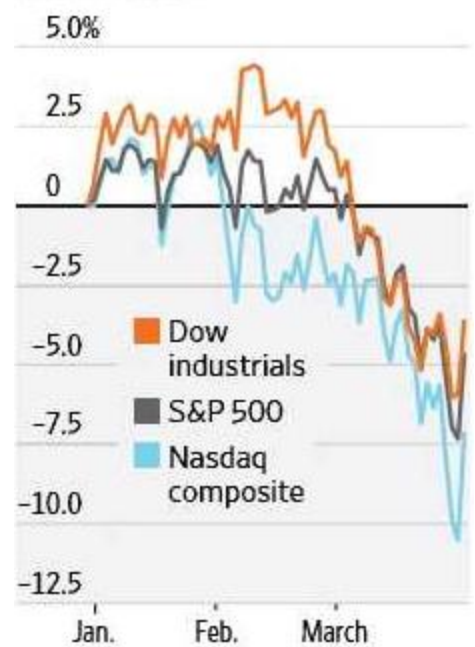
What changed was war in the Middle East. Since Feb. 28, when the U.S. and Israel launched a series of strikes on Iran, oil prices have surged 63%, gold is tumbling and bond yields have climbed sharply. The S&P 500 has erased all of its gains for the past seven months.

In March, the market did experience a broadening many investors had foreseen, though not in the direction most wanted: 10 of the S&P 500's 11 sectors declined by an average of 6.2%. Energy was the lone exception.

For the quarter, the S&P 500 fell 4.6% and the Nasdaq dropped 7.1%. The Dow industrials slid 3.6%.

The war has jacked up the price of oil and snarled supply chains for a variety of other important commodities, from aluminum to urea. That has raised the prospect of higher inflation and upended bets that the Fed will move to cut rates this year. Before the conflict broke out, roughly a month ago, traders priced in a nearly 80% chance that the Fed would cut rates

Index performance, year to date



Source: FactSet

twice by the end of the year. Now, those odds have dropped to less than 5%. Stock indexes posted relatively modest declines in the opening week of the war, reflecting expectations that any disruption to oil exports through the Strait of Hormuz would be short-lived. As that disruption enters a second month, Wall Street is having to confront a darker scenario.

“If a prolonged conflict means that we never get any more oil out of the gulf, we will absolutely have a global recession,” said David Kelly, chief market strategist at J.P. Morgan Asset Management. “But I think both the U.S. administration and the Iranians will at some stage want to find an off-ramp.”

As stock declines accelerated in the back half of March, the worst rout in Treasuries since last April meant investors who hoped their bond portfolios would serve as a hedge found little relief.

BlackRock’s Larry Fink, head of the world’s largest investment firm, sounded the alarm on the high stakes of the Iran conflict last week. If Iran is accepted back into the global trading community after the fighting, the resulting supply would lower and stabilize global energy prices, Fink told the BBC. But if Tehran remains a threat, he fears years of oil prices well above \$100 a barrel.

“The \$40 oil implication is one of abundance and growth,” Fink said. “The other one is an outcome of probably stark and steep recession.”

By some measures, stocks are still on solid footing: Analysts are projecting a sixth straight quarter of double-digit earnings growth for S&P 500 companies during the first three months of 2026, according to FactSet. ...

But the pressures on markets are mounting, and in recent days traders have found it more difficult to shrug off the conflict the way they did in the days following the initial attack, when they seemed to follow the TACO, or “Trump Always Chickens Out,” playbook learned during last April’s tariff drama. ...

The recent volatility has minted some winners—stocks in the S&P 500 energy sector are up 37% this year, on track to notch their best quarterly performance on record. Other “asset heavy” industries like materials also outperformed, as investors look for companies that would be tough for AI to disrupt.

And many analysts are sticking to their original targets of modest stock-market gains for the year ahead. But those projections rest on the assumption that the conflict in the Middle East is relatively short-lived—and the impact to the global economy is still contained. ...

There was a time, before Trump, that this form of corruption would have resulted in DOJ and Congressional investigations: <https://www.youtube.com/watch?v=cNcEQGrEva0> (>4 min.)

From Friday’s Global Investment Strategy:

## **Second Quarter 2026 Strategy Outlook: Unhappy In Its Own Way**

### **I. Macroeconomic Outlook**

Tolstoy’s novel Anna Karenina famously begins with the sentence “Happy families are all alike; Every unhappy family is unhappy in its own way.”

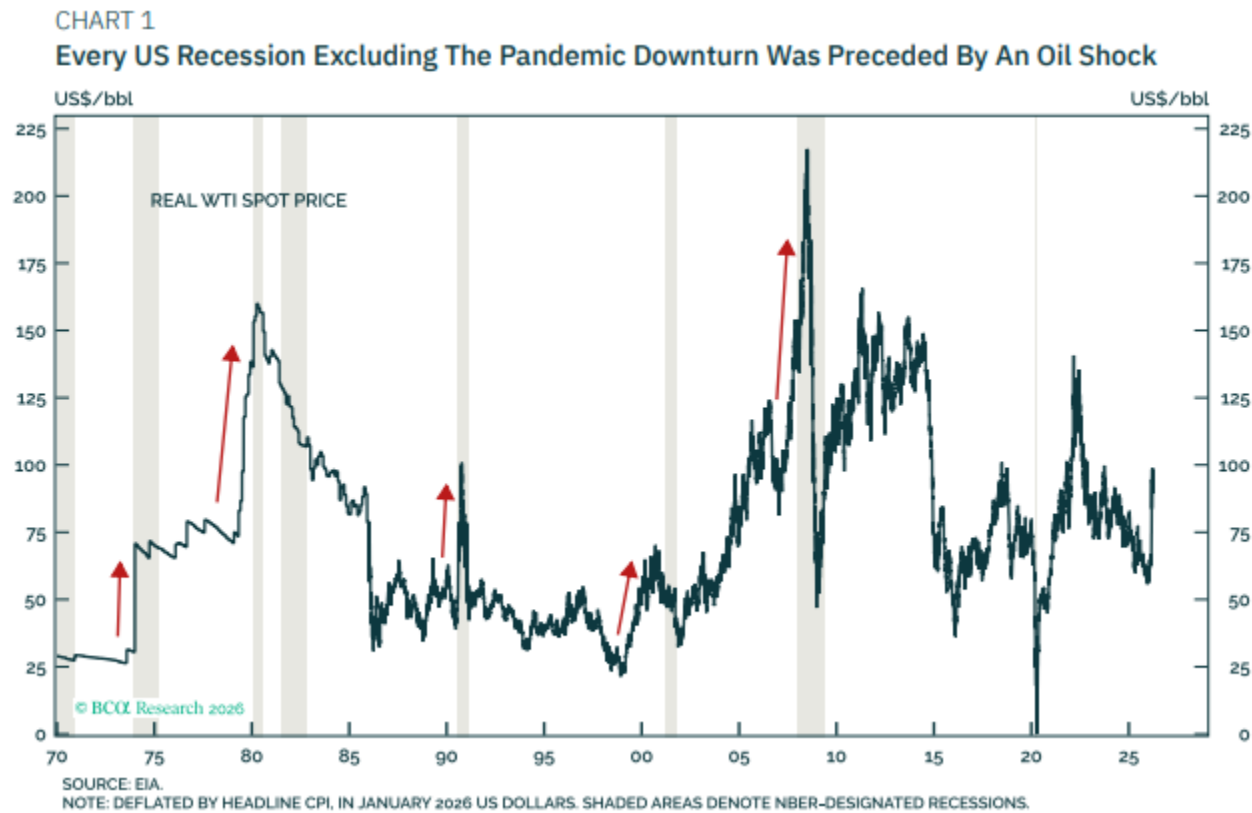
The same can be said for booms and busts. Every boom feels great, but the source of the misery behind each bust can differ dramatically from one episode to the next.

Today's environment is reminiscent of the early stages of past busts in several respects:

## 1. Oil Shock

Beginning with the 1973 downturn, every recession in the US excluding the pandemic downturn has been preceded by an oil shock (**Chart 1**).

Although a lot can still change over the coming days and weeks, today's oil shock is as bad as any of the previous ones. Even though Iran continues to export crude and some oil is making its way through pipelines to the Red Sea and the Gulf of Oman, about 12% of global oil supply is currently offline.



Oil demand is very price-insensitive in the short run. ... swings in prices have very little immediate impact on how much Americans drive.

Over the long run, drivers can switch to EVs or buy more fuel-efficient vehicles, but with the average age of US vehicles now up to 12.8 years from 9.6 in 2002, this is not something that can happen quickly.

Most estimates suggest that the elasticity of demand for oil in the short run is between -0.05 and -0.1. This means that every 10% increase in oil prices reduces demand by only 0.5% to 1%. Thus, to cut demand by 10%, prices would need to double and possibly triple. In that context, it is not difficult to see oil prices rising to over \$200/bbl.

Higher oil prices damage the economy in three ways:

One, they increase input costs for producers. If oil prices remain elevated, everything from the cost of plastics to the cost of fertilizer will rise. The price of urea, a fertilizer manufactured using natural gas, has already risen 37% since the start of the war. Diesel and jet fuel prices have jumped, raising the cost of transportation (**Chart 3**). Helium, which is a byproduct of natural gas production, has become increasingly scarce.

Two, higher oil prices reduce real incomes, leading to less spending on non-energy related items. According to the CPI swaps market, expected 1-year inflation has risen by 67 bps in the US, 145 bps in the euro area, and 157 bps in the UK since the conflict began.

Three, higher oil prices could prompt central banks to hike interest rates in order to quell inflationary pressures. Going into the war, the market expected 72 bps of cuts from the Fed over the next 12 months. Now, it is discounting 10 bps of hikes. Likewise, the markets have swung from expecting 13 bps of easing from the ECB to 91 bps of hikes. Investors expect 69 bps of hikes from the Bank of England; prior to the war, they expected 59 bps of BOE cuts. Investors also expect higher rates in Canada, Australia, New Zealand, and Japan.

## 2. Looming Tech Bust

The 2001 recession largely stemmed from a collapse in tech capex amid the bursting of the dotcom stock market bubble. There is a risk that something similar happens to AI.

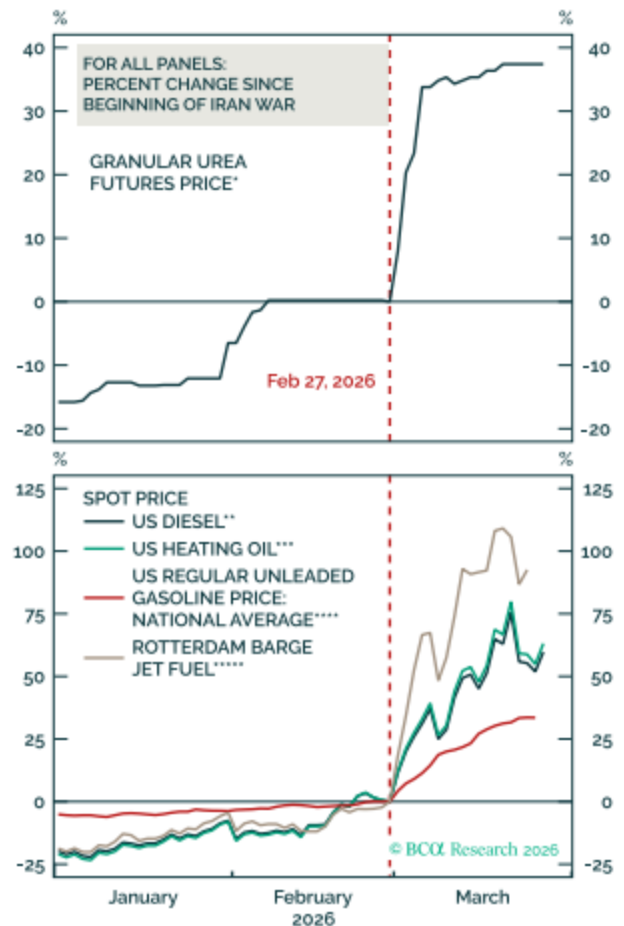
The issue is not so much around whether AI will prove to be transformative. It will. The issue, as was the case in 2001, is whether all the recent investment will be successfully monetized.

Over the past 25 years, internet traffic has grown at an annualized pace of 42%, for a cumulative increase of half a million percent. Yet, despite this rapid traffic growth, investment on internet hardware has sagged. In 2025, the five biggest US telecom companies – AT&T, Verizon, T-Mobile, Comcast, and Spectrum – collectively incurred \$71 billion in capital expenditures. Compare that to the \$600 billion that just one company, OpenAI, is planning to spend by 2030.

Advances in fiber optic technology and compression algorithms permitted more data to be transmitted over the internet at a lower cost. It is possible that something analogous happens to AI. Token prices are already falling quickly. At some point, we may realize that an AI-enabled economy does not require trillions of dollars in new data centers.

Admittedly, it is too early to call the end of the AI capex boom. GPU rental rates have risen over the past few months, as use of Agentic AI has soared. Memory chip prices remain in the stratosphere.

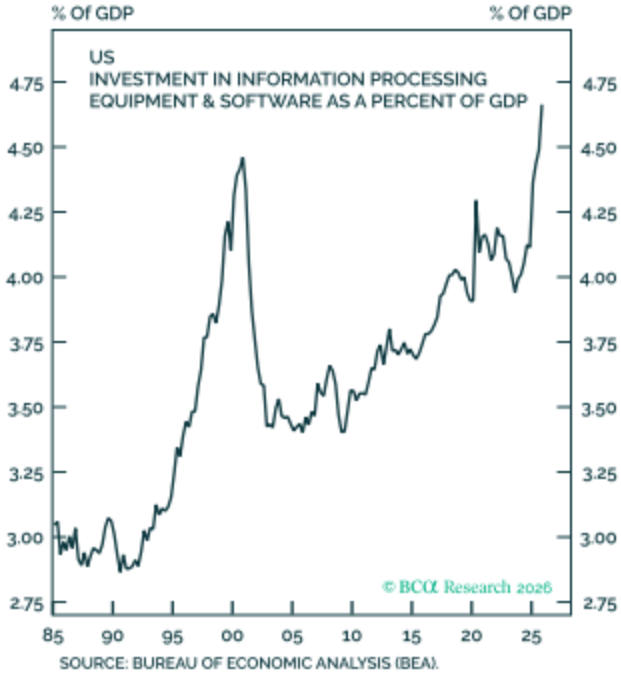
CHART 3  
Energy-Related Input Costs For Producers Have Risen



\* UREA FROM THE PERSIAN GULF ON A FREE ON BOARD BASIS. SOURCE: CME.  
\*\* NY HARBOUR LOW SULPHUR DIESEL PRICE. SOURCE: EIA.  
\*\*\* NY HARBOR HEATING OIL PRICE. SOURCE: EIA.  
\*\*\*\* SOURCE: AMERICAN AUTOMOBILE ASSOCIATION.  
\*\*\*\*\* SOURCE: BLOOMBERG FINANCE L.P.

CHART 10

**As A Share Of GDP, Spending On IT Software And Hardware Has Surpassed Its 2000 Peak**



Nevertheless, the AI boom is probably entering its final innings. As a share of GDP, spending on IT software and hardware has already surpassed its 2000 peak (**Chart 10**).

Companies that investors once swooned over for their capital-lite models are spending like crazy. The so-called hyperscalers – Amazon, Google, Microsoft, Meta, and Oracle – are expected to spend \$678 billion on capex this year, up from \$412 billion in 2025. Although their operating cash flow is still rising, their free cash flow – which strips out capex – is plummeting.

Investors are getting nervous: Starting late last year, a net majority of respondents to the BofA Fund Manager Survey began saying that US companies are investing too much. The shift in sentiment on this question perfectly matches the relative peak in tech stocks.

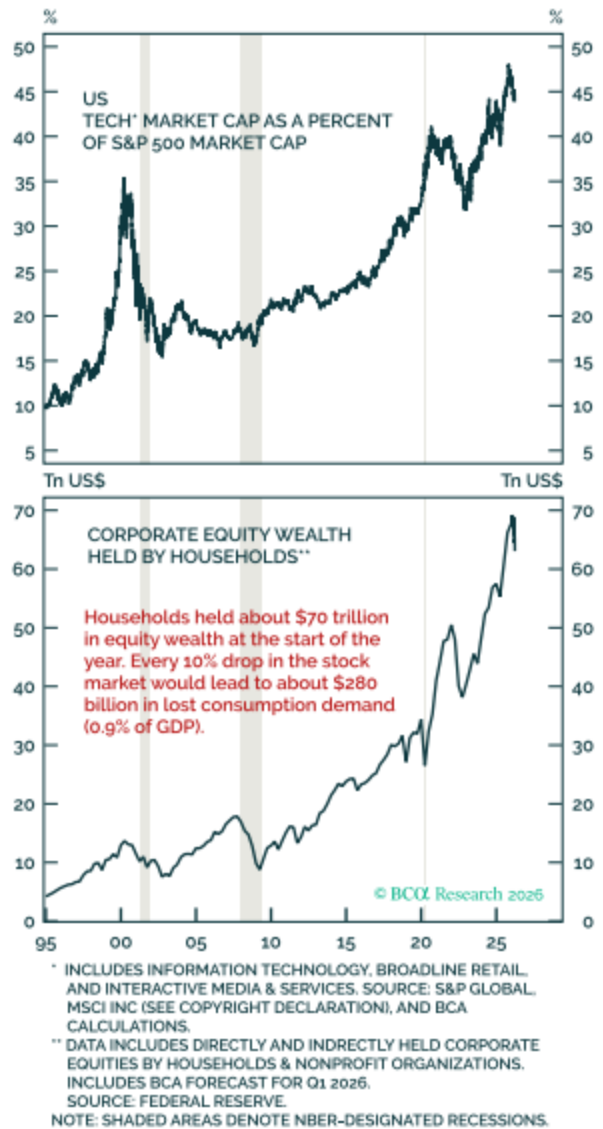
Lower spending on AI hardware would be bad news for companies such as Nvidia. In contrast, it might be good news for the hyperscalers, whose capex bills will go down.

The problem is that such an outcome would undercut the very reason that the hyperscalers are called hyperscalers, which is that these companies can scale up their operations so much and so quickly that smaller companies cannot compete.

The risk is that AI becomes like electricity. Access to electricity makes a company more efficient but does not necessarily make it more profitable if all its competitors also have access to electricity.

CHART 13

**A Decline In Tech Stock Prices Could Bode Poorly For Consumption**



We have already seen these dynamics play out in the software space. A few months ago, the conventional wisdom was that AI would benefit software companies by allowing them to slash programming costs. That turned out to be true. But the problem was that AI also lowered programming costs for everyone else, including for the customers of software companies. Investors began to rightfully fear that rather than buying expensive software, more companies would simply ask Claude to code something bespoke for them.

Software companies are not the only ones being disrupted. As we argued in our report “AI Will Kill the Tech Monopolies,” AI could destroy the moats that social media companies currently enjoy. Legal risk, as this week’s adverse ruling against Meta and Google highlights, is another headwind.

Broadly defined, tech accounts for 44% of S&P 500 capitalization, higher than at the height of the dotcom bubble (Chart 13). At the start of this year, US households held about \$70 trillion (220% of GDP) in equity wealth, compared to \$13 trillion (130% of GDP) in 2000.

As a rule of thumb, every \$1 change in equity wealth leads to a 4-cent change in spending. Thus, a sustained 20% decline in stock prices would reduce equity wealth by \$14 trillion. This could lower spending by about \$560 billion (1.8% of GDP), arguably enough to induce a recession.

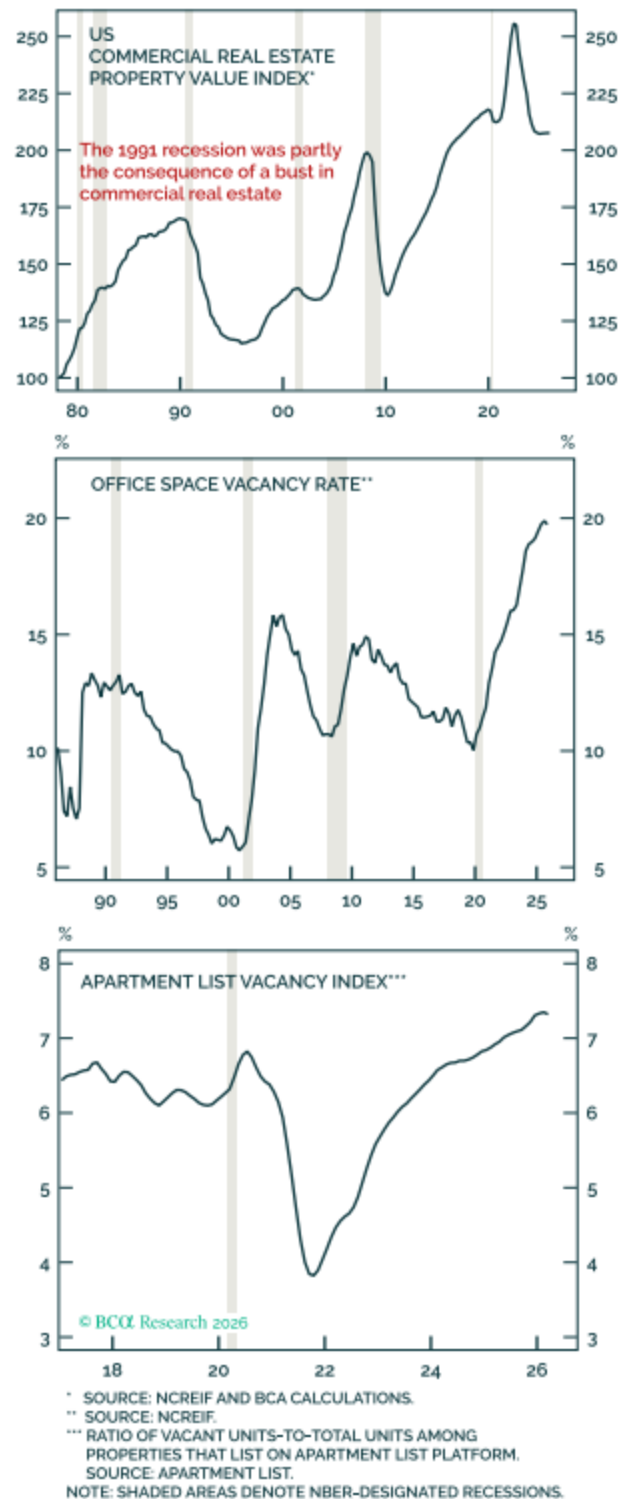
### 3. Real Estate Woes

The 1991 recession partly stemmed from a commercial real estate bust. Today, much of the CRE sector is challenged. The office vacancy rate is at a record high (Chart 14). The multifamily sector is showing signs of stress, with rental growth slowing in many markets. The Apartment List vacancy rate has been trending higher and is now above pre-pandemic levels. CRE loan delinquency rates have risen, although they are still far below the peaks reached in the early 1990s and the Great Recession. Residential real estate is also struggling. New and existing home sales, building permits, and homebuilder confidence are all on the back foot (Chart 16).

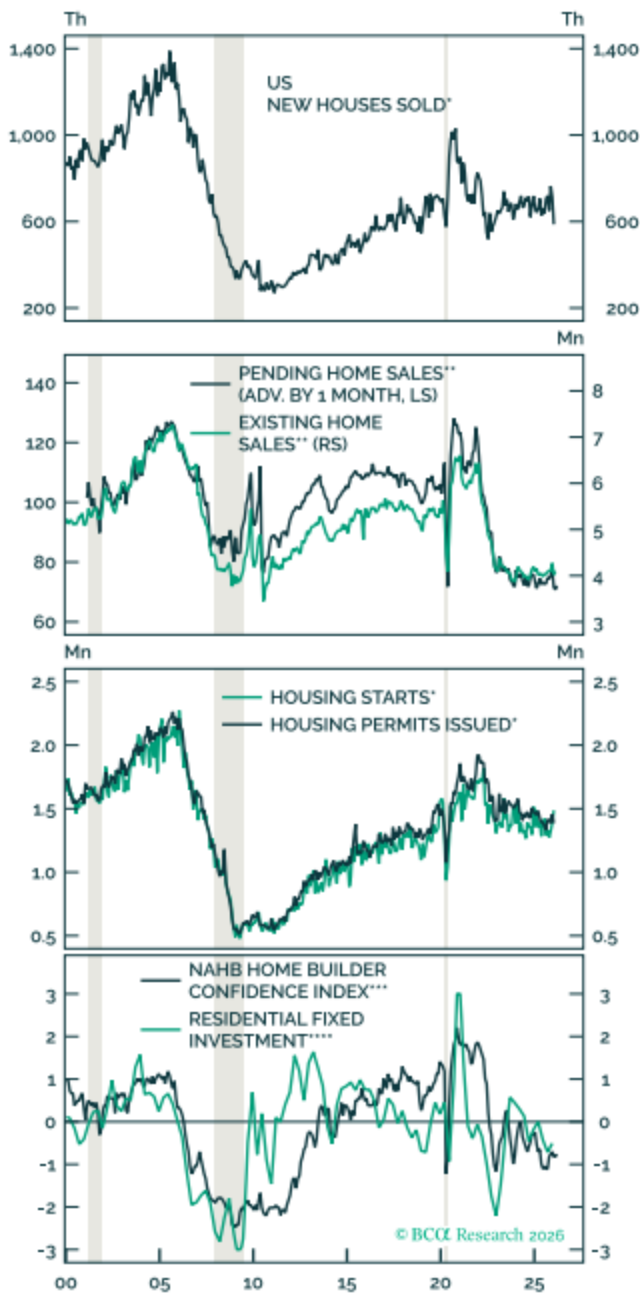
The good news is that the quality of mortgage origination remains sound. Average FICO scores are high and loan-to-value ratios are well below where they stood in the lead-up to the GFC.

Overbuilding is also less of a problem today. Residential investment in the US stands at 3.8% of GDP, below the peak of 6.7% of GDP in Q4 2005. The average age of US homes has risen to 32 years, the oldest since 1947.

CHART 14  
Challenging Times For The CRE Market

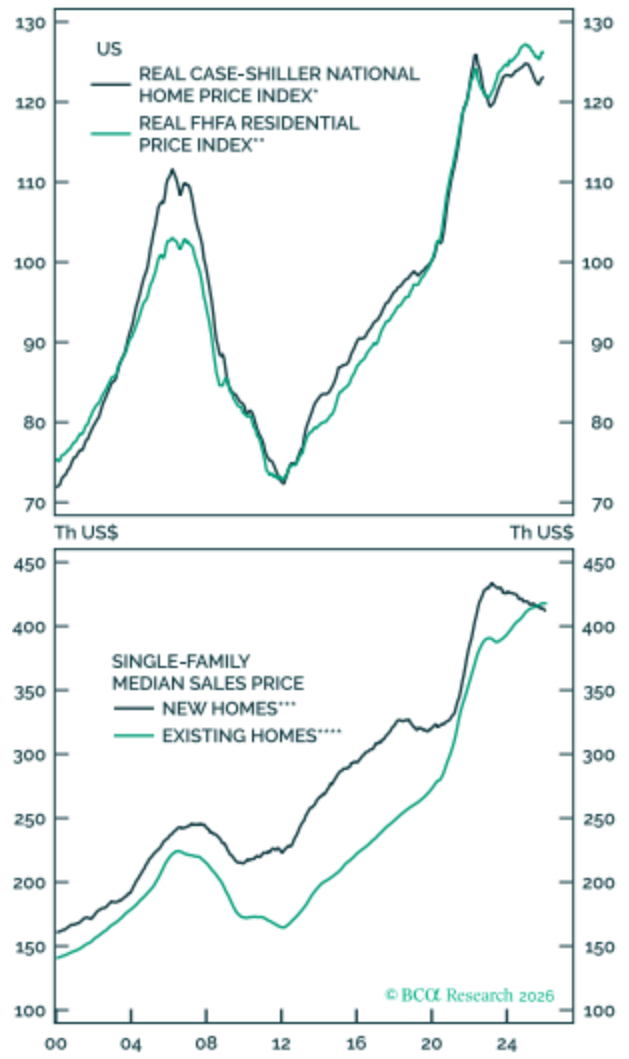


**CHART 16**  
**The US Housing Market Remains In The Doldrums**



\* SOURCE: US CENSUS BUREAU.  
 \*\* SOURCE: NATIONAL ASSOCIATION OF REALTORS.  
 \*\*\* SERIES IS STANDARDIZED. SOURCE: NATIONAL ASSOCIATION OF HOME BUILDERS.  
 \*\*\*\* SHOWN AS 6-MONTH ANNUALIZED PERCENT CHANGE. SERIES IS STANDARDIZED AND TRUNCATED BETWEEN -3 AND 3.  
 NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

**CHART 20**  
**Lack Of Willing Sellers Has Kept Home Prices Elevated**



\* SOURCE: S&P GLOBAL.  
 \*\* SOURCE: FEDERAL HOUSING FINANCE AGENCY.  
 \*\*\* SHOWN AS A 12-MONTH MOVING AVERAGE. SOURCE: US CENSUS BUREAU.  
 \*\*\*\* SHOWN AS A 12-MONTH MOVING AVERAGE. SOURCE: NATIONAL ASSOCIATION OF REALTORS.  
 NOTE: BOTH SERIES IN THE TOP PANEL ARE REBASED TO DEC. 2019 = 100 AND DEFLATED BY HEADLINE CPI.  
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Case-Shiller index is 22% above its pre-pandemic level and 10% above its pre-GFC peak (Chart 20). Many homeowners, having bought their house or refinanced their mortgage during the period when rates were very low, remain reluctant to sell. In contrast, new home prices are sliding, with the median new home price now below the median selling price of existing homes.

Although excess inventories have jumped in some states such as Florida and Texas, the number of vacant housing units for sale in the US is still half of what it was in early 2007.

Where the imbalance lies is in prices. In real terms, the

The average rate on all outstanding mortgages has been trending higher, rising to 4.24% in Q4 2025. However, it is still well below the current mortgage rate of 6.38%, implying that aggregate mortgage payments will continue to rise over time as more people buy a home. This will weigh on discretionary consumer spending.

Home valuations in a number of other developed economies are even more extreme than in the US. This is particularly the case for Canada, Australia, New Zealand, and the UK (Chart 22).

China's housing market has been characterized by both overbuilding and excessively high prices. While housing starts have fallen by 75% from their peak, completions have only dropped by 44%. Developers continue to work through a backlog of projects, some of which were held up due to a lack of funds.

Chinese home prices are tumbling but valuations still remain stretched. Rental yields in many Chinese cities are amongst the lowest in the world.

The demographic outlook for China is ominous. In 2024, the UN projected China's working-age population would drop by about 700 million, or 70%, by the end of the century. This is a much steeper decline than what the agency forecasted just a few years earlier. Demand for housing is unlikely to recover strongly in such an environment.

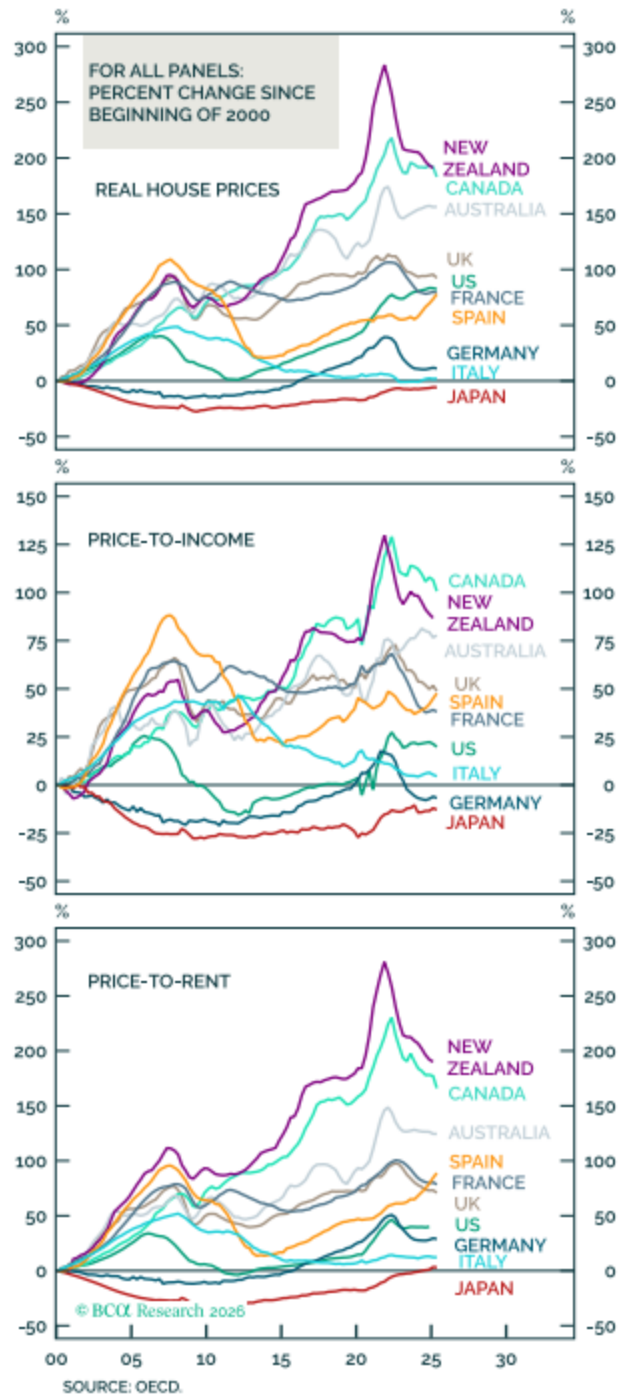
#### 4. Private Credit

The private credit industry has grown rapidly over the past 15 years (Chart 26). Following the GFC, banks became more conservative in their lending practices, a trend that was amplified by regulatory changes such as the passage of the Dodd-Frank Act in 2010.

This created an opportunity for more loosely regulated private credit funds to take market share. Private credit now accounts for 30% of below investment-grade loans, up from around 13% in 2009.

Financial history is littered with cases where fast-growing, risky lenders run into trouble. Parts of the private credit industry may end up being no different. Redemption requests have increased in recent months, notably from fickle retail investors that the industry began targeting in recent years. Direct lenders have especially come under pressure. Their interest coverage ratios have declined materially since 2022, while their credit ratings have deteriorated.

CHART 22  
Home Valuations Are Extreme In Many Developed Countries



The growing use of payment-in-kind (PIK) provisions, where interest payments are paid from the proceeds of additional debt issuance, represents another potential source of vulnerability. In some cases, PIK provisions were inserted midway through a deal’s lifespan, signaling emerging borrower stress. As a result, the “shadow default rate” – defined as the share of companies with these midstream PIK provisions – more than doubled from 2.5% in 2021 to 6.4% in 2025.

We do not think problems in private credit pose systemic risks to the broader global financial system. Despite its rapid growth, the global private credit market is still smaller than the combined high-yield bond and leveraged loan markets. It is also considerably smaller than the US commercial real estate market. US private credit funds hold about \$1.7 trillion in leveraged loans to the corporate sector. While this is a substantial amount, it still equates to only 4% of all household and business debt.

The exposure of US banks to private markets is still relatively low even after years of growing interconnectedness: Lending to private equity funds stood at less than 3% of total bank loans at the end of 2025. A similar share was directed towards private credit entities.

Even if private credit does not pose a threat to financial system stability as mortgage lending did during the GFC, stress in private credit could weigh on the growth outlook, directly through reduced deal activity, and indirectly as traditional banks adopt a more cautious lending stance.

## The Policy Response: Shackled

Policy normally turns more stimulative in response to slower growth. Unfortunately, in today’s environment, policymakers are more shackled than they usually are.

On the monetary front, stubbornly high inflation, exacerbated most recently by the oil shock, is limiting the ability of central banks to cut rates. While we think that rates will ultimately fall, this mainly reflects our expectation that economic growth will surprise on the downside.

On the fiscal front, high debt levels are limiting the room for maneuver. The Congressional Budget Office’s latest long-term forecast, released on February 25, sees both government interest expense and debt levels scaling to new highs over the coming years (**Chart 28**).

This grim outlook does not even account for the Supreme Court’s decision to strike down the IEEPA tariffs, which the CBO estimates will deprive the Treasury of about \$2 trillion over the next 10 years. To some extent, the imposition of Section 122 tariffs can plug the tariff revenue hole. However, the Budget Lab at Yale estimates that even a permanent 10% tariff under Section 122 would produce a \$0.6 trillion shortfall in budget revenues over a 10-year window compared to the tariffs in place before the SCOTUS ruling.

CHART 26

### Private Credit Has Grown Rapidly Over The Past Decade

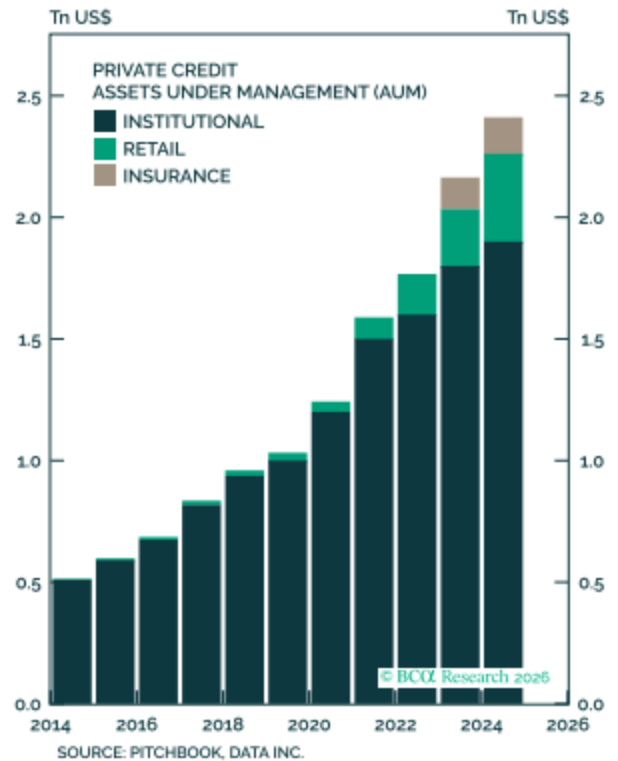


CHART 28

**Both Interest Expense And Debt Levels Are Projected To Reach New Highs Over The Coming Years**

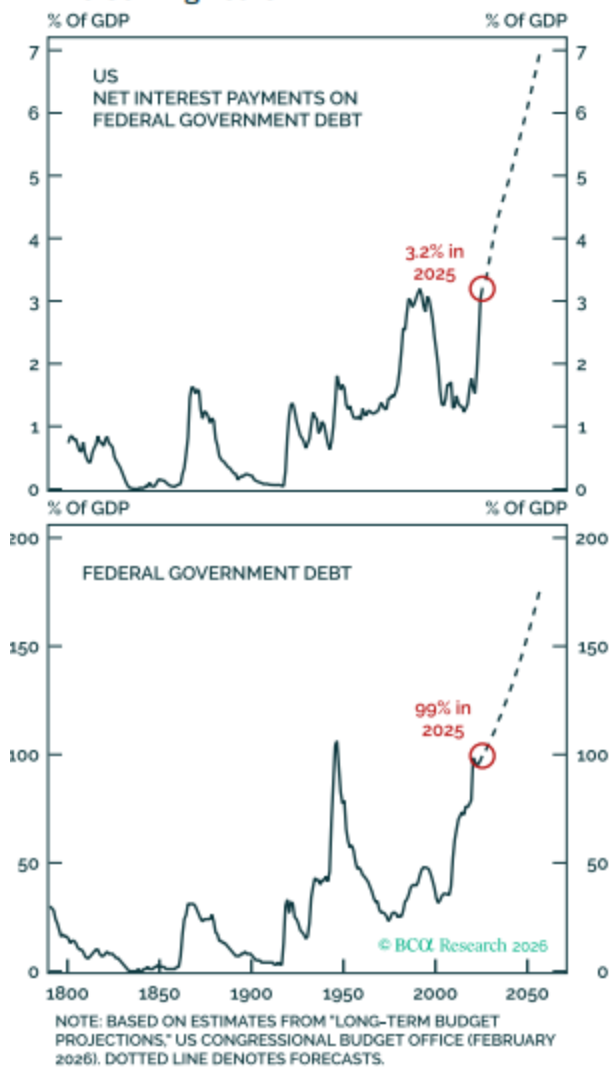
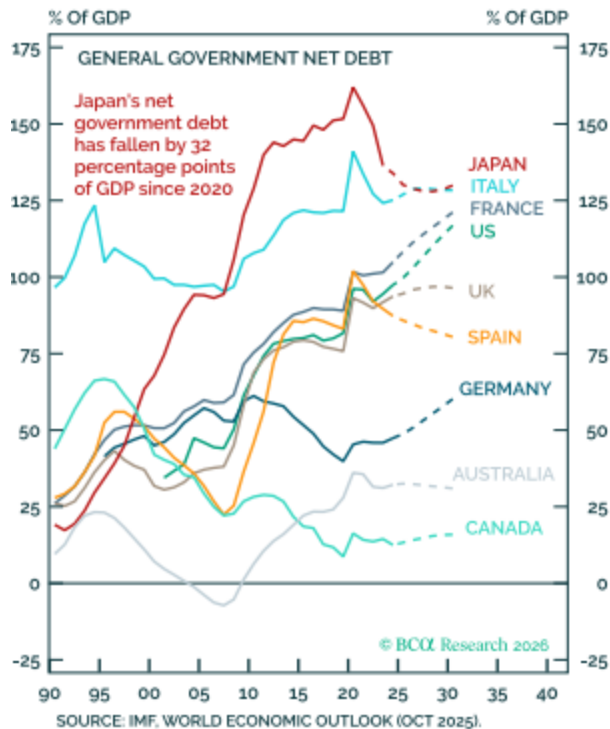


CHART 30

**Government Debt Levels Remain High In Many Developed Economies**



Germany is stimulating its economy. However, the capacity of other European countries to follow suit is limited. Public-sector debt is near or above GDP in major economies such as France, Italy, Spain, and the UK.

- o Japan’s upper house passed a ¥18.3 trillion supplementary budget on December 16, 2025. Prime Minister Takaichi has suggested that an additional stimulus package may be

necessary to counter the oil shock. Although the government debt-to-GDP ratio has fallen over the past five years in response to faster nominal growth, it remains very high in absolute terms (**Chart 30**). This, along with a weak yen and rising inflation, constrains what the government can do.

In China, concerns about overcapacity are limiting the policy response. After jumping last year, the fiscal impulse has sagged. The combined credit/fiscal impulse is barely positive. The government’s “anti-involution policies,” designed to curb excess capacity, are leading to a decline in investment spending across many sectors of the economy.

The bottom line is that global growth risks are tilted to the downside and unlike in the past, policy may be less supportive than normal in mitigating these risks.

We see a 40% chance of a recession in the US over the next 12 months and a 50% chance in Europe and Japan.

**II. Financial Markets**

**A. Global Asset Allocation**

## Underweight Equities, Look to Increase Bond Duration Over the Coming Months

Going into this year, we were neutral on global equities on a 3-month horizon and slightly underweight on a 12-month horizon. We downgraded global equities on a 3-month horizon on March 12 and are now slightly underweight across both horizons.

Stocks have fallen quite a bit since our tactical downgrade and ... are starting to look increasingly oversold in the very near term. Nevertheless, we think global equities will end the year below where they currently stand.

Mechanically, if one is underweight stocks, one needs to overweight some combination of cash, bonds, or other assets.

Historically, bonds have outperformed stocks when the global economy was weakening (Chart 35). Today's macro landscape is trickier in two important respects. First, a key reason why growth could weaken is because the oil shock could push up inflation, making central banks less willing to cut rates. That is not good for stocks, but it is not good for bonds either. Second, government debt is very high and will only rise further if growth disappoints. That, too, is not good for bonds.

Thus, while we are overweight duration in fixed-income portfolios on a 12-month horizon, we are neutral on a 3-month horizon. We would refrain from increasing duration until clearer evidence of an economic downturn emerges.

### B. Equities

#### Don't Bet on Earnings

CHART 36  
The Forward P/E Ratio For The S&P 500  
Has Decreased Over The Past Few Months  
But Remains High By Historic Standards



CHART 37  
Forward Earnings Estimates Tend To  
Lag The Stock Market

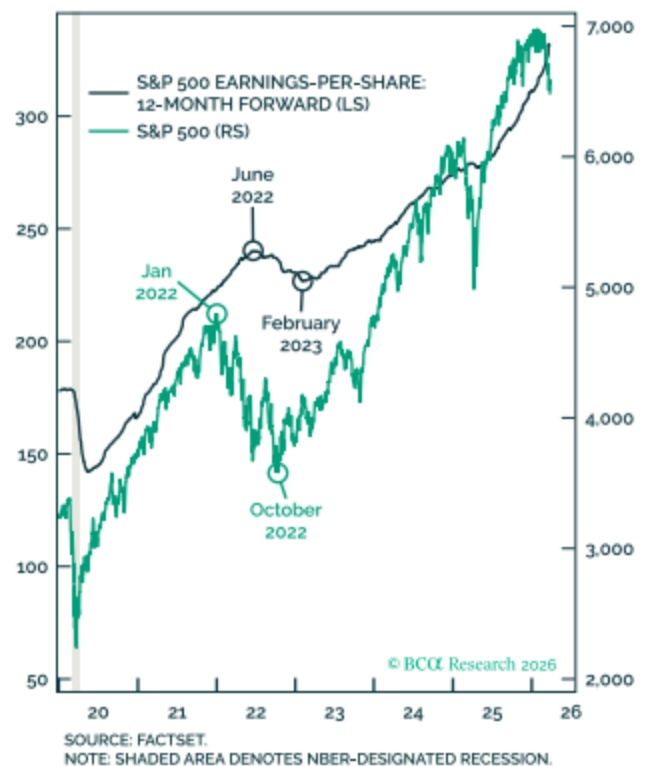


TABLE 2

## Since 2010, Stocks Have Done Much Better When Forward Earnings Estimates Were Trending Lower

	AVERAGE SUBSEQUENT 1-MONTH RETURN OF S&P 500 BASED ON CHANGE IN 12-MONTH FORWARD EPS (NTM EPS) OVER VARIOUS HORIZONS (PERCENT, NON-ANNUALIZED)								
	1985 - PRESENT			1985 - 2009			2010 - PRESENT		
	NTM EPS INCREASED	NTM EPS DECREASED	NET DIFFERENCE	NTM EPS INCREASED	NTM EPS DECREASED	NET DIFFERENCE	NTM EPS INCREASED	NTM EPS DECREASED	NET DIFFERENCE
OVER PAST 1 MONTH	0.80	0.90	-0.10	0.78	0.55	0.22	0.82	2.19	-1.37
OVER PAST 3 MONTHS	0.97	0.37	0.60	1.01	-0.04	1.05	0.92	1.58	-0.66
OVER PAST 6 MONTHS	0.92	0.52	0.40	0.93	0.11	0.82	0.91	1.61	-0.71
OVER PAST 12 MONTHS	0.82	0.85	-0.02	0.80	0.42	0.38	0.86	2.01	-1.15

SOURCE: FACTSET AND S&amp;P GLOBAL.

The forward P/E ratio for the S&P 500 has fallen from a high of 23.1 in late October to 19.5 at present (**Chart 36**). About one-third of the decline in the P/E ratio has been due to the drop in stock prices, with the rest being explained by the rise in forward earnings estimates.

The fact that earnings estimates have continued to increase in the face of growing macroeconomic uncertainty is less reassuring than it might appear. Historically, earnings estimates have lagged broader macroeconomic developments. Perhaps even more importantly from an investment perspective, earnings estimates have also lagged stock prices.

This was most recently visible in 2022/23. S&P 500 forward earnings estimates rose right through June 2022, even though stocks had peaked five months earlier. Earnings estimates then fell until February 2023, bottoming four months after the equity bull market had resumed (**Chart 37**).

Between 1985 and 2010, the S&P 500 rose more when forward earnings estimates had increased over the prior month than when they had decreased. Since 2010, however, stocks have actually fared better when earnings estimates were declining (**Table 2**). This suggests that stock prices could continue to drop if the macroeconomic outlook worsens, even if earnings estimates temporarily remain in an uptrend. ...

From a style perspective, we do not have a strong view on the relative merits of small caps versus large caps at the moment but do favor value over growth. ...

### Neutral US vs ROW Tactically, But Underweight US Cyclically

As long as the oil shock remains front and center in investors' minds, the US will outperform the rest of the world. This is partly because the US is less vulnerable to higher energy prices than most other developed countries except Canada (whose stock market we are currently tactically overweight). It is also because the US dollar will likely strengthen if oil prices rise further, which will benefit US equities in common-currency terms.

Our suspicion is that the oil shock will fade over the coming months, which will cause investors to shift their attention back to the issue of AI monetization. If investors come to the conclusion that AI will not generate a profit bonanza, as we suspect they will, the tech-heavy US stock market will underperform.

Given these considerations, we are currently neutral on the US versus the rest of the world on a tactical 3-month horizon but recommend underweighting the US on a cyclical 12-month horizon. ...

## C. Fixed Income

### Looking for a Better Entry Point to Go Overweight Duration

We think that long-term bonds will outperform cash later this year but recommend waiting until clearer evidence of a recession emerges before shifting to a long duration stance. ...

The Fed's estimate of the neutral rate, as gleaned from the median longer-run dot in the Summary of Economic Projections, is 3.1%. This is still below the current Fed funds range of 3.5%-to-3.75%.

Despite the jump in oil prices, long-term market-based US inflation expectations remain well anchored. Wage growth, which is the most important driver of services inflation, continues to cool (Chart 43). Real-time measures of job openings have moved sideways over the past few months but are likely to decline following the oil shock. As a measure of labor demand, job openings tend to lead wage growth. All this suggests that the Fed's bias will be to cut rates later this year.

Rate expectations also seem excessively hawkish outside the US. In particular, Robert Timper, who leads BCA's Global Fixed Income team, thinks it is highly unlikely that the ECB will follow through with 91 bps of hikes over the next 12 months, as the markets are currently discounting. In addition, he is skeptical that the Bank of Canada will hike rates by 71 bps. ...

### AI and Interest Rates

An additional source of uncertainty is around productivity growth. Even if AI capex stabilizes at a lower level, AI could still have a meaningfully positive impact on productivity growth.

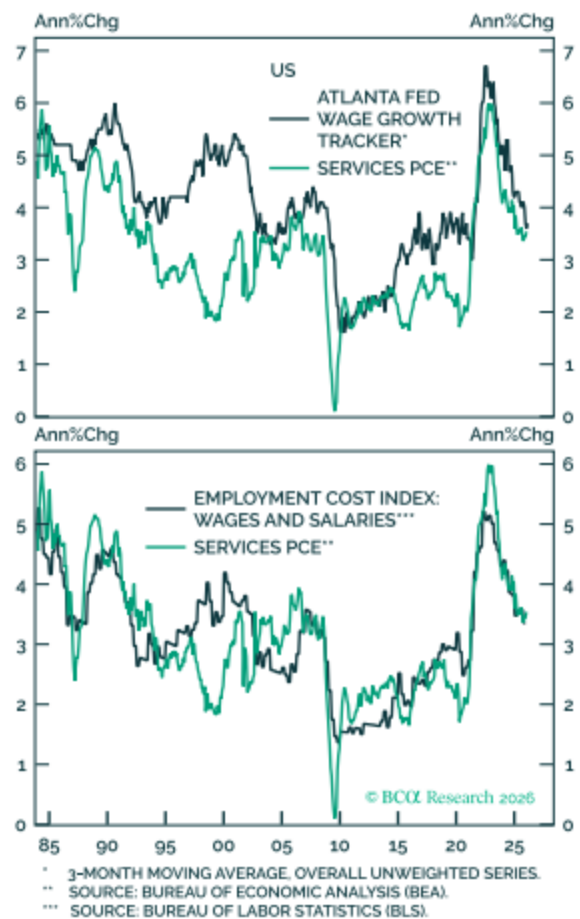
A popular narrative with market participants is that faster productivity growth will push down inflation, thus leading to lower bond yields.

It should be noted that this is exactly the opposite of what the economics textbooks predict. Standard economic theory says that faster economic growth should increase the rate of return on capital, thereby incentivizing more private investment. To the extent that governments compete with private firms for a limited pool of savings, this should lead to higher government bond yields.

In addition, faster productivity growth could cause households to expect more rapid income growth. The desire to smooth consumption over one's lifetime could therefore lead to lower savings today, thereby also pushing up interest rates. Elon Musk's suggestion that people should stop saving for retirement takes this sentiment to the extreme.

To come to the conclusion that faster AI-driven productivity growth will lead to lower interest rates, one needs to make an additional assumption, namely that AI will lead to significantly more income inequality. In

CHART 43  
Wage Growth Continues To Cool



equilibrium, higher output must translate into higher income. However, if that income flows to the very rich who save a large portion of it, this could lead to a shortfall in spending. This, in turn, would require central banks to cut rates in order to raise demand.

We think such an assumption is not implausible, but as we discuss further in the commodity section, the rise in inequality from AI could come from an unlikely source: windfall gains to the owners of land and natural resources.

## ***D. Currencies***

### **US Dollar Benefiting from Improved Terms of Trade**

After falling by 1.9% between the start of the year and January 29, the broad trade-weighted dollar has since gained 2.3%. As a net energy exporter, the US trade balance benefits from higher oil prices. This stands in contrast to most other developed economies, except for Canada, Australia, and Norway.

Nominal rate differentials have generally moved against the US dollar over the past four weeks, as markets have priced in more monetary tightening abroad than in the US. In contrast, real rate differentials have been supportive of the dollar due to the fact that inflation expectations have increased more abroad. At least theoretically, real rate differentials should matter more for currencies than nominal differentials.

So far at least, there is not much evidence of safe-haven flows into the Treasury market. Adjusting for moves in short-term rate expectations, the 10-year yield has risen more in the US than in the Euro Area, UK, Canada, or Australia. This suggests that if the oil shock fades, the US dollar could start weakening again.

### **The Long-Term Picture Remains Challenging for the Dollar**

Structurally, the dollar remains overvalued based on Purchasing Power Parity (PPP) exchange rates. This is still the case even if we adjust for the fact that long-term real interest rate expectations are higher in the US than abroad.

The US has been running current account deficits almost nonstop since 1982. This has resulted in a net international investment position – the difference between a country’s foreign assets and liabilities – of negative 90% of GDP.

Since the US historically earned a higher rate of return on its overseas assets than on its liabilities, it was able to generate a positive net income flow from its overseas investments. This is now changing. We estimate that the US will increasingly need to pay more to foreigners to service its liabilities than it earns from abroad. This is likely to weigh on the dollar over the coming years. ...

## ***E. Commodities***

### **US Shale Remains the Long-Term Anchor of Oil Prices**

It is impossible to know how high oil prices will reach in the near term. What is more certain, however, is that prices will fall over the long haul.

As **Chart 53** illustrates, the 5-year futures price for WTI crude basically tracks the breakeven cost for shale producers.

Admittedly, the relationship between oil prices and costs is somewhat circular in that higher prices incentivize the drilling of higher-cost wells. Nevertheless, given the abundance of shale oil in the US and some other countries, it is difficult to see oil prices staying above \$100/bbl indefinitely.

Ironically, the current oil shock is bearish for oil down the road because it will supercharge demand for EVs. In its 2025 outlook, the IEA projected that EVs would expand their market share from 30% to 42% over the next four years (Chart 54). Those numbers are likely to be revised upwards. As one example, BYD's sales have surged in recent weeks. ...

### Gold: A Bounce is Coming

One might have thought that the war would have caused the price of gold to surge. Although prices have stabilized this week, gold is down 13% since the start of the conflict.

Three forces have hurt gold. First, the dollar has strengthened while interest rate expectations have risen. From a macro perspective, a stronger greenback and higher rates are usually bad news for gold.

Second, gold, and to an even greater extent silver, were technically overbought going into March. As we have seen in past episodes, including in October 2008 when gold fell 21% within the span of two weeks, riskoff episodes can be painful for gold when a lot of hot money is holding the asset.

Third, some governments are cutting back on gold purchases to focus on other priorities. Poland's central bank is reportedly considering selling gold to finance defense spending. Turkey has also been selling gold reserves in recent weeks in an effort to defend the lira. Both central banks were aggressive gold buyers over the past few years. It is also possible that some Gulf states have slowed gold purchases in response to lower export receipts.

Ultimately, we think that all three of these forces will wane. Hence, we remain long-term bulls on gold. ...

CHART 53  
US Shale Has Increasingly Become  
The Long-Term Anchor For Oil Prices

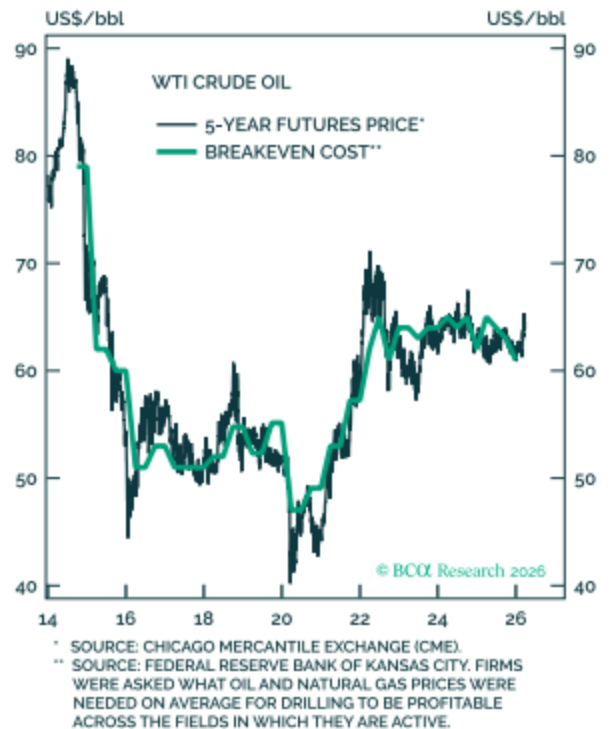
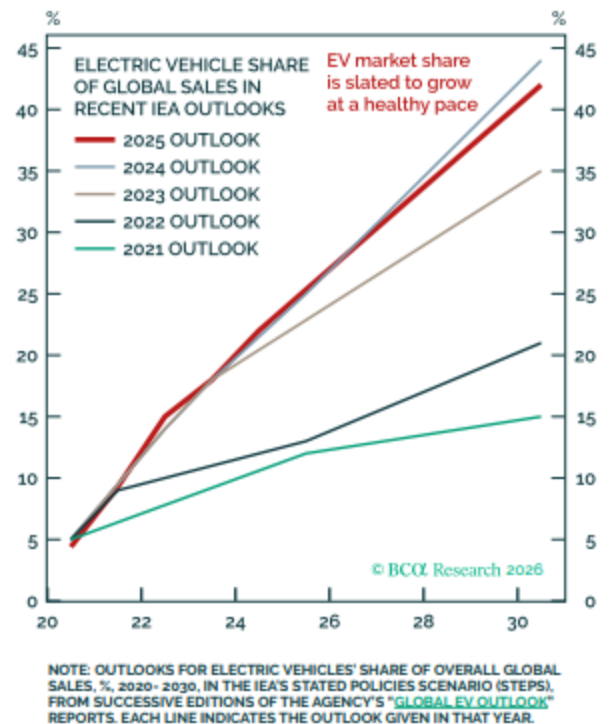


CHART 54  
Projected Growth Rate In EV Market  
Share Remains Solidly Positive



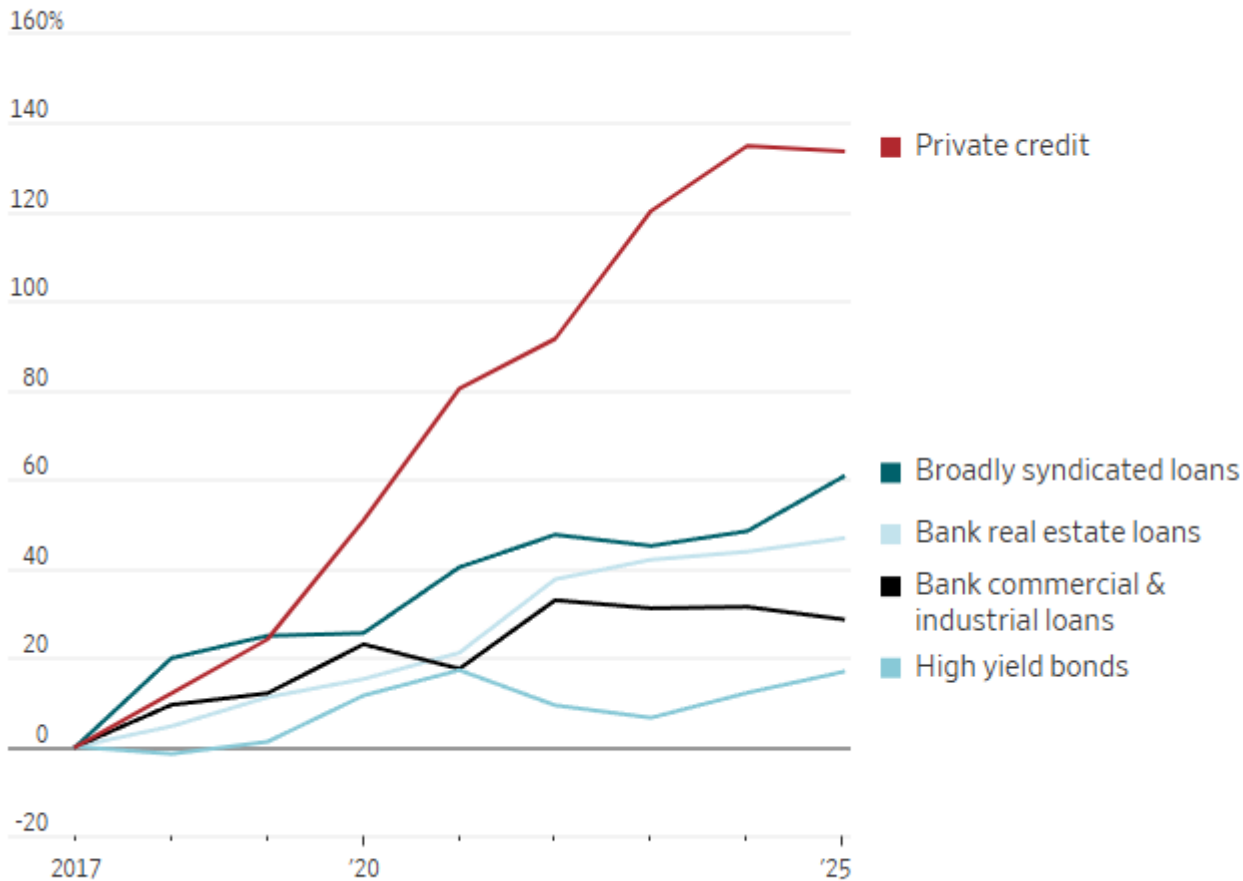
From WSJ:

## Is Another Financial Crisis Lurking in Private Credit?

It is fast-growing, opaque and intertwined with banks but lacks the scale that cashiered the economy in 2007

By Greg Ip  
March 28, 2026

### Change in outstanding volume of credit since 2017



Sources: PitchBook (private credit, broadly syndicated loans, high yield); Federal Reserve (bank loans)

For those with long memories, news that some private credit funds have capped withdrawals brings to mind the summer of 2007, when a [European bank limited withdrawals](#) from funds stuffed with securities linked to subprime mortgages. The global financial crisis had begun.

Like subprime, private credit in just a few decades went from niche to major asset class. And like subprime, private credit is opaque, mostly unregulated and connected to other parts of the financial system including banks.

So do private credit's troubles herald a systemic shock similar to what we saw two decades ago? With the caveat that crises are inherently unpredictable, probably not. The 2007-09 crisis was one of the worst in history, and that alone militates against something as bad.

That said, the crisis taught us which vulnerabilities to watch for in the financial system. Private credit exhibits enough for us to scrutinize what could go wrong, especially in a broader shock such as rising oil prices and interest rates.

Private credit usually refers to a loan by a nonbank lender to a private business (i.e., whose shares aren't listed on the stock market). Like subprime, it grew up in the shadows of established finance. Private-equity managers such as [Apollo Global Management](#) and [KKR](#) started arranging the loans that finance leveraged buyouts. Endowments, pension funds and the like then invested in the loans.

One parallel between subprime and private credit is opacity. Unlike bonds, private credit isn't regulated by the Securities and Exchange Commission—though some private-credit funds, such as business-development companies, are—and unlike bank loans, isn't overseen by the Federal Reserve or other bank regulators. This is a feature, not a bug: Financial innovation is often an adaptation to regulation. Private credit benefited from postcrisis rules that made bank loans costlier.

But this opacity means there is no agreed-on way to define, measure or categorize private credit. PitchBook estimates that total private credit in the U.S. has tripled since 2015 to \$1.3 trillion, including “dry powder” (available, unused capital). Preqin, a unit of BlackRock, itself a major private-credit manager, puts the North American total at \$1.6 trillion. Some analysts toss out figures north of \$2 trillion, but those usually cover the whole world.

By PitchBook's measure, private credit is almost as big as syndicated loans (\$1.5 trillion), which banks originate and then distribute to investors, and high-yield bonds (\$1.8 trillion). Banks' commercial, industrial and real-estate loans total nearly \$6 trillion. Private credit is comparable to subprime, which at its peak totaled roughly \$1.5 trillion, about 15% of all residential mortgages, though that was much larger relative to the economy.

As subprime once did, private credit diversifies the economy's financing channels. “Instead of credit simply coming from the banking sector, the fact you can spread risk...to the full spectrum of the financial system is a plus,” said Fabio Natalucci, who monitored financial stability for the International Monetary Fund and now heads the Andersen Institute for Finance and Economics.

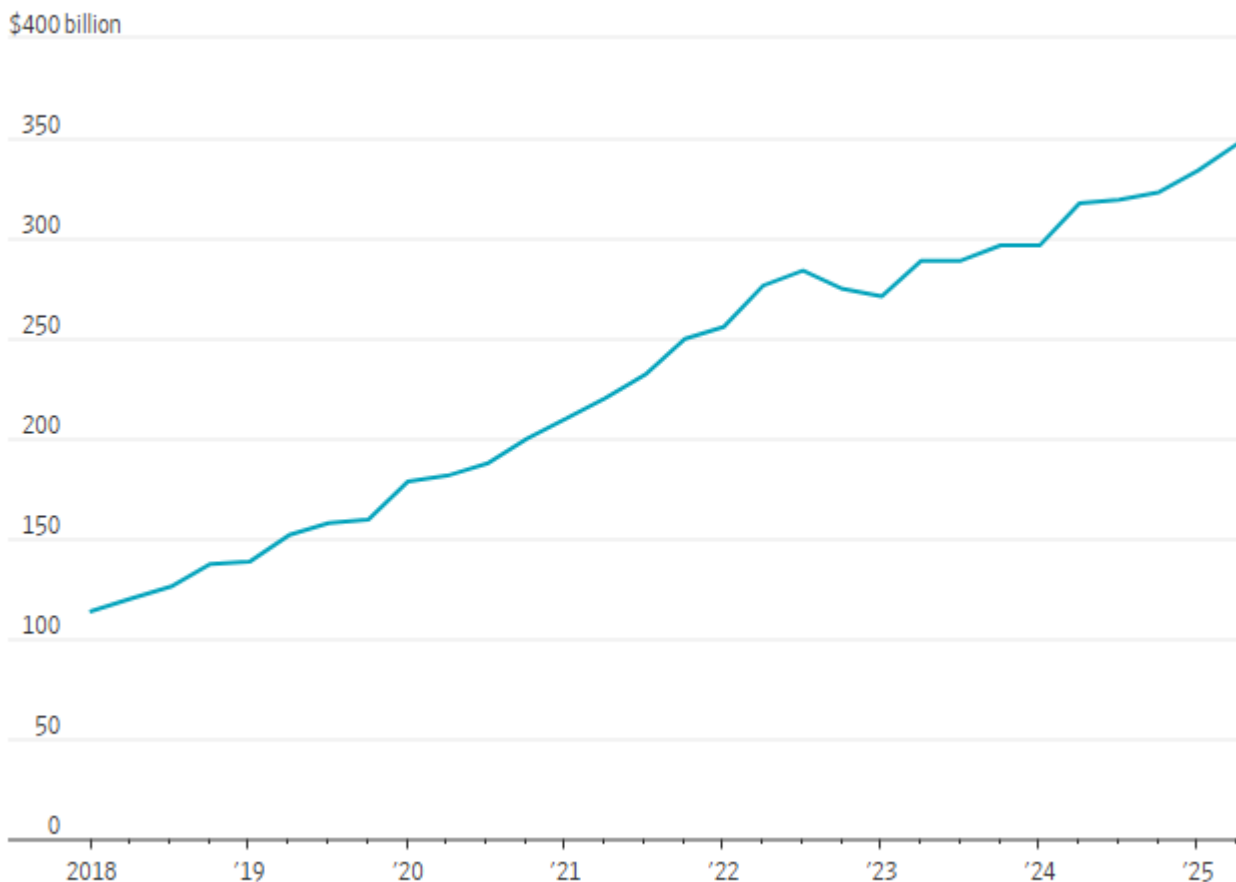
Yet, as with subprime, private credit has become intertwined with other financial players, in particular banks and insurance companies. “This interconnectedness could come back as a weakness,” Natalucci said.

Interconnectedness can propagate and amplify losses through the financial system. Banks, securities dealers, hedge funds, [Fannie Mae](#), Freddie Mac and the insurer American International Group nearly collapsed because of their exposure to subprime-linked loans, securities or derivatives.

Banks have tripled lending to private equity and credit since 2018 to over \$300 billion, part of a broader expansion of lending to financial companies. As a result, funds that invest in highly leveraged companies have themselves become leveraged.

To be sure, banks' exposure is small relative to their total assets. Many have protected themselves through “synthetic risk transfers,” under which they retain the loan but pay someone such as a hedge fund to take the hit if the loan defaults. The IMF estimates that [banks worldwide](#) have transferred the risk on \$1 trillion of assets (not just private credit) this way.

## Bank lending to private equity, business-development companies and credit funds



Source: Federal Reserve

Nonetheless, this ties private credit more closely to other parts of the financial system. For example, a hedge fund might borrow from one bank to take on the credit risk from another bank. These linkages raise “potential contagion risks,” the IMF said.

Life insurers are big investors in private credit, raising several red flags. Many have borrowed to finance their purchases. Some are owned by the private-equity firms, such as Apollo, which originated the loans. They are overseen by [state insurance commissioners](#), who lack the resources and broader mandate of federal bank regulators. This past fall the IMF warned of [inflated credit ratings](#) on life insurers’ private credit holdings, which could result in defaults far exceeding predictions in a downturn.

For all the similarities, the differences between subprime and private credit are just as important. Subprime was more leveraged, and more complex. The loans were typically bundled into mortgage-backed securities, also known as MBS, which were then sliced up into tranches of differing risk. The MBS were in turn bundled into collateralized debt obligations, or CDOs, and sliced up again. Then, “synthetic” CDOs were created by writing derivatives linked to CDOs or MBS. These levels of leverage magnified losses.

Some private credit is packaged into [collateralized loan obligations](#), or CLOs, but they are far smaller and less complex than their subprime forerunners.

The institutions that originated and held subprime debt financed themselves with short-term IOUs. When lenders became nervous, they stopped rolling over those IOUs, the equivalent of a run on a bank. This caused fire sales of securities, driving down values and spreading the losses.

Private credit is much less “runnable.” Unlike mutual funds, credit funds don’t allow investors to redeem their shares at any time. Some funds aimed at retail investors allow periodic redemptions up to a certain cap. Withdrawals recently [hit those caps](#) at funds managed by BlackRock, Morgan Stanley, Apollo and Cliffwater. But such funds only amount to 6% of total private credit, according to PitchBook.

Because private-credit loans don’t trade, their true value is unknowable until they mature or are sold. If investors lose faith in what fund managers claim the loans are worth, withdrawals could accelerate, forcing managers to sell loans, driving values down further.

Subprime, by fueling a massive loosening of credit, became a key driver of housing, and when subprime lending dried up, that killed the housing market and the broader economy. Private credit hasn’t fueled any comparable bubble in business borrowing. If the sector shrinks, businesses have ample alternative sources of credit.

Don’t take too much comfort from that. The private-credit boom has been part and parcel of a broader embrace of risk. Lenders everywhere might have grown lax, which is why fraud-related defaults at some financial companies have rattled [bank stocks](#). An economic shock such as high oil prices could expose fragile borrowers across several markets, private credit included.

The default rate on private credit has drifted up from between 4% and 5% a year ago to between 5% and 6% now, according to Fitch Ratings.

Natalucci said: “If people have doubts about underlying credit quality when the economy is growing like this, a slowdown in the economy because of the [Iran] conflict is going to add to those credit concerns. Even if it doesn’t become a financial crisis, it could become an amplifier of the slowdown.”

Four from WSJ’s Markets A.M. Mar 24<sup>th</sup>:

## **Is the Next War Casualty America’s Balance Sheet?**

By [Spencer Jakab](#)

### **Collateral Damage**

There’s never a good time for a war, but some are worse than others.

With investors glued to headlines last week about attacks on Middle East energy infrastructure, it was easy to miss an economic one: America’s gross federal debt had [just passed \\$39 trillion](#). The next round number could be reached in record time, and the bond market may no longer look bulletproof when the smoke clears.

America is called a superpower because of its military. Another realm where the U.S. has been in a league of its own, though, is its ability to run large overdrafts during geopolitical or economic crises.

The world has regularly obliged by rushing to buy Treasury debt at a lower yield than before the calamity because of the risk-free securities’ haven status. The only exception has been when the event accompanied an energy shock, like today.

Benchmark U.S. Treasury note yields rose from less than 4% before the war to almost 4.4% ahead of [Monday morning's "TACO" rally](#). Washington's gusher of red ink might have played a role in that yield jump too, which is concerning.

The bill for the war comes at the same time as the full fiscal effects of last year's "One Big Beautiful Bill Act" kick in. The Pentagon [has asked for an additional \\$200 billion](#) and the government might owe in excess of \$130 billion in refunds for invalidated tariffs.

[Just last month](#) the Congressional Budget Office projected the current fiscal year's deficit would be \$1.85 trillion or 5.8% of gross domestic product—a [hefty gap](#) outside of a recession. Six weeks later, that forecast already looks low. The jump in borrowing costs will add to Uncle Sam's interest tab, already around \$1 trillion annually.

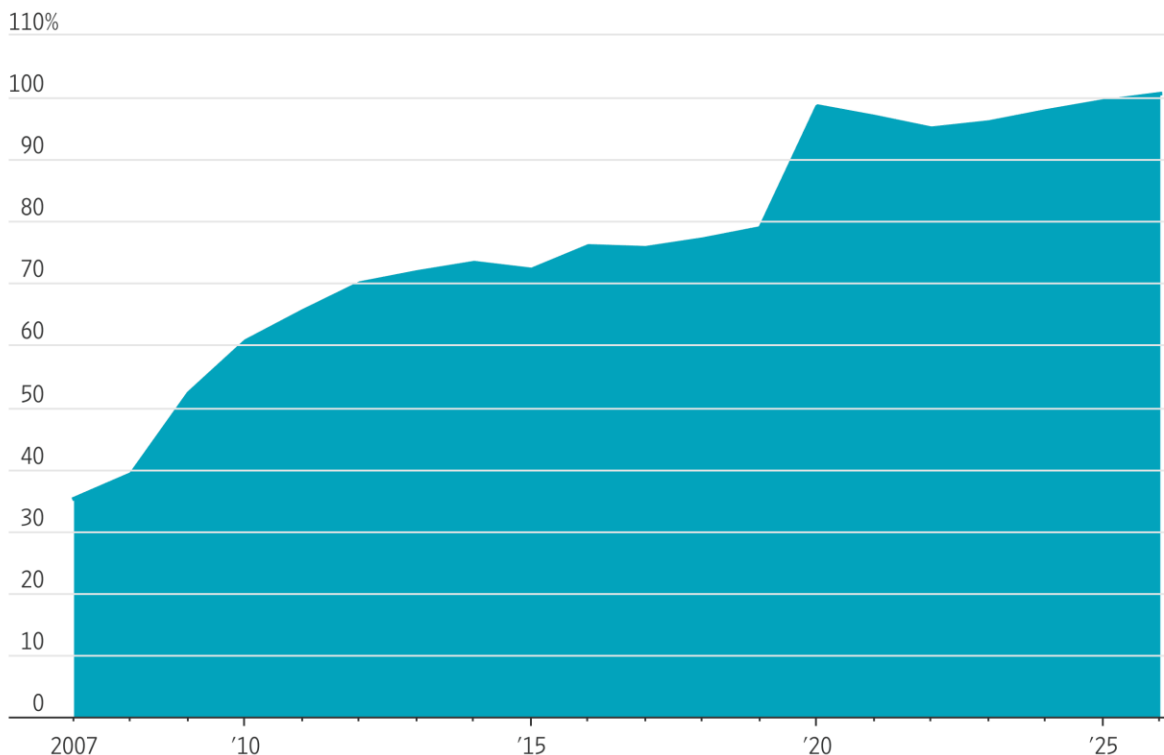
When does it matter to investors? There really isn't a number when federal borrowing suddenly looks unsustainable—any sober analysis today foretells a day of reckoning.

One reason there hasn't been is a lack of alternatives to the deep, liquid market for Treasury debt, but psychology matters too. Dollars are backed by the power of America's economy and also of its aircraft carriers and ICBMs.

With the war having far higher direct and indirect costs than the White House assumed, including bond market jitters, winding it down in a less-than-convincing fashion might be a moment future economic historians look back on as a turning point. America's pocketbook and its military are both showing their limits. This war could be a lot costlier than government bean counters imagine.

## Kicking the Can

U.S. federal debt held by the public as a share of gross domestic product



Note: Fiscal 2026 is a forecast

Source: Congressional Budget Office; Peter G. Peterson Foundation

Mar. 19<sup>th</sup>:

# Don't Grab That Plunging Stock

By [Spencer Jakab](#)

## Falling Knives

Even before Middle East chaos sent it on a roller-coaster ride this month, the stock market was unusually choppy beneath the surface. [The expanding abilities of artificial intelligence](#) sent one blue-chip company's shares after another sharply lower.

A typical headline when that happens goes something like "XYZ stock plunges on massive selling." Of course, every share dumped found a buyer who thought it was attractive at the suddenly discounted price. Were they making a mistake?

One of the oldest pieces of Wall Street wisdom—that you should never try to catch a falling knife—says they mostly were. A mountain of academic data agrees.

Alexander Hübbert, a quantitative researcher working on his Ph.D. at Stockholm University, ran some numbers recently that make it crystal clear. He looked at 4,174 British stocks between 2000 and 2026 that had just dropped varying amounts by the end of a month from their all-time highs—five, 10, 15, 20 percent, and so on—and then measured how they did versus the broad market over the following 12 months.

It's ugly. A stock with a 5% drawdown then underperformed by an average of 6 percentage points; a 10% drawdown by 8.6 percentage points; and a 15% drawdown by 12 percentage points. The faster knives fell, the deeper the wounds.

Momentum is one of the most consistent investing trends both on the way up and down. Other models that look at buying stocks near their 52-week lows have similarly dismal results to what Hübbert observed.

Naturally there are exceptions. In his book "[Mastering the Market Cycle](#)," veteran investor Howard Marks, co-founder of Oaktree Capital Management, writes about catching falling knives and says most professionals are too scared to buy when a stock or bond is still plunging.

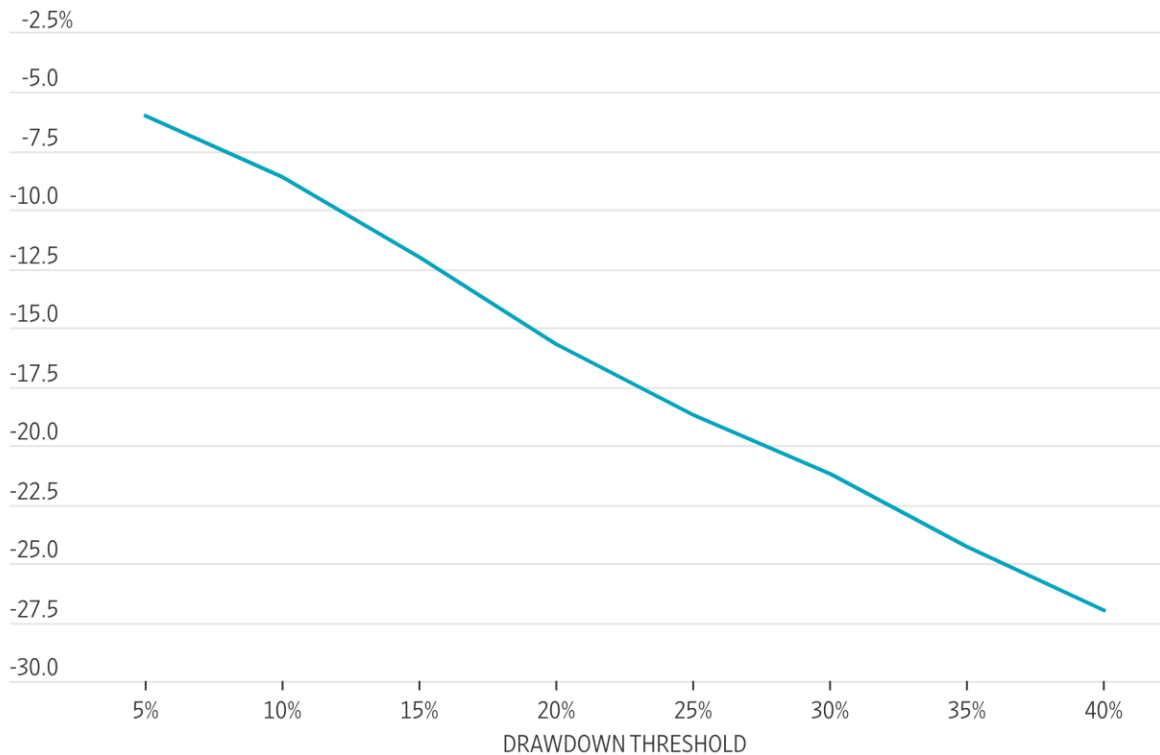
The only problem is that "when the dust has settled and investors' nerves have steadied, the bargains will be gone."

Marks has an exemplary track record of his own in distressed-credit investing and is one of the few people whose writings Warren Buffett says he reads. But that highlights the difference between blindly buying some brand-name stock after it plunges and having a sophisticated view of what it's worth despite the news: You're not Warren Buffett.

"The young man knows the rules, but the old man knows the exceptions."

## Don't Try This at Home

Average one year buy and hold abnormal return over 12 months at each threshold



Note: British stocks 2000-2026

Source: Alexander Hübbert

Mar. 18<sup>th</sup>:

## This Market Massacre Still Haunts the Fed

By [Spencer Jakab](#)

### Oil and Rate Cuts Don't Mix

The “Saturday Night Massacre” sounds like something that happened during a war, but the only blood spilled in October 1979’s emergency Federal Reserve meeting was in the stock and bond markets. Its lessons help explain the recent, odd shift in rate expectations amid the Iran oil price spike.

Inflation surged during the 1970s, stoked by twin energy crises and the Fed’s failure to tackle it aggressively. The economic and political pain of getting it back under control became tough to swallow.

Then-new Chair Paul Volcker, [a personal hero](#) of current boss Jerome Powell, wasn’t squeamish. The price was a double-dip recession, surging Treasury yields and arguably a one-term presidency for Jimmy Carter.

Bond traders mostly agree that the Fed sees the current situation through that prism: An ounce of prevention now is worth a pound of cure. No rate setter wants to later be forced to do what Volcker felt he had to in 1979 to break the back of inflation.

For example, the implied chance of any rate cut by the Fed’s September meeting has gone from about 90% a month ago to just 50%, based on futures pricing. The same pattern holds for every scheduled Fed meeting this

year. Federal Open Market Committee members' economic projections and Chair Powell's press conference [after today's meeting](#) could change that, but don't bet on it.

“While many folks dream of an accommodative Fed in response to an oil shock, the best that is going to come is nothing, and the longer this persists the more likely hikes may be on the horizon,” wrote veteran macro hedge-fund manager [Bob Elliott](#), now chief investment officer at Unlimited Funds.

That's a sharp reversal from the past two years, when investors were handicapping how quickly the Fed would be cutting rates despite stubborn inflation. Even weak economic data, such as the past year's anemic job growth, was often viewed as a “glass half full” reason to keep buying equities.

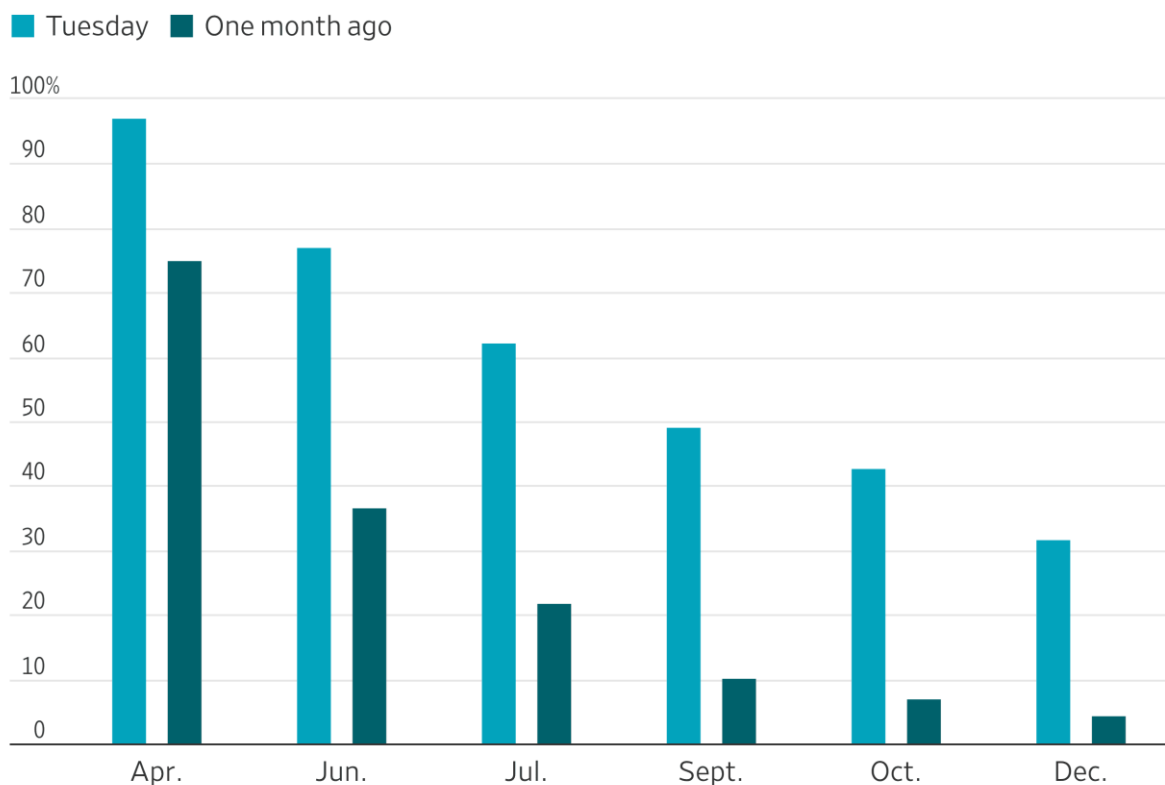
Investors don't all seem to have gotten the memo. The rate-sensitive Nasdaq-100 index of mostly large tech stocks is barely 5% off its all-time high and flat since mid-February, before bombs and rate-cut chances began dropping.

December's quarter-point rate cut, the sixth since the Fed resumed easing in September 2024, could be the last for a while if shortages from the Strait of Hormuz's blockage worsen. With the exception of a small part of the stock market that benefits from higher commodity prices, bad Middle East news will be plain old bad news for stocks.

It'll have to get downright ugly to sway rate setters.

## Over a Barrel

Market-implied chance of no change in rates by date of each Federal Reserve meeting



Source: CME FedWatch

Mar. 17<sup>th</sup>:

## Big Tech's Huge Conglomerate Premium

By [Spencer Jakab](#)

### Everything, Everywhere, All at Once?

Remember when Jack Welch brought good things to life?

Once dubbed “Manager of the Century,” the GE boss [oversaw nearly 1,000 deals](#) during his years atop the conglomerate. But Welch’s legacy took a hit following his retirement as GE went from America’s most-valuable company [to a basket case](#), eventually [splitting in three](#) under an outsider’s management.

Fashions come and go. During their 1960s heyday, conglomerates were even hotter and they took advantage by using their lofty stock prices to buy hundreds of often unrelated businesses. The most successful of them all, Henry Singleton’s Teledyne, then turned around when investors soured on the idea and sold most of them, buying back its own shares cheaply.

“It’s the smart thing to do,” says Que Nguyen, chief investment officer for equity strategies at Research Affiliates. [In a recent paper](#), Nguyen and her colleague Noah Beck point out that conglomerates get overinflated at times but typically trade at a modest “diversification discount” to the sum of their parts.

Now she says they’re back in vogue and bigger than ever. In February, Apple, Amazon, Alphabet and Microsoft collectively were worth \$5.6 trillion more than the sum of their parts based on the price-to-sales multiple of similar businesses—about a 70% premium. Nguyen and Beck argue that they’ve expanded into enough new fields to qualify as conglomerates.

A possible justification for their premium is that tech companies enjoy better synergies than conglomerates of old. Things Google already knows about our search history have made YouTube’s algorithm even more successful, for example. And bundling Apple Pay with a ubiquitous suite of consumer products avoided marketing costs other financial-technology firms might have incurred.

Even adjusting for those, though, the premiums are hard to justify. And there have been expensive sidelines that were money pits.

“Let’s not forget that, for a while there, we thought we were going to get an Apple car,” says Nguyen.

Of course big tech firms still have core strengths—shopping for Amazon, iPhones for Apple, search for Google, etc. Nguyen observes that the premium valuation tech behemoths enjoy could persist for a while but that investors always mistakenly assume top dogs in a given field will stay that way. They never do because that success puts a target on their backs.

So then maybe it makes sense to diversify? Some of big tech’s sidelines and acquisitions have turned into excellent businesses, and those triumphs have burnished the faith we have in their “celebrity CEOs and

celebrity founders.” That sounds familiar.

## Lightbulb Moment

GE’s multiple of enterprise value to sales



Source: FactSet

## Why 'New' Value Stocks Outperform: The Hidden Driver Of Value Investing

March 25, 2026 • Larry Swedroe

On average, about half of value and growth stocks are new each year as they are not categorized as value or growth over the previous two years. This observation led Linda Chen, Wei Huang, and George Jiang, authors of the January 2026 study [“Value vs. Growth: What Drives the Value Premium?”](#) to investigate how the “new” and “old” value and growth stocks performed. They uncovered that the value premium—the tendency for value stocks to outperform growth stocks—is driven primarily by stocks that have *recently migrated* into the value or growth category (value and growth are typically defined by high and low 30%, as in the Fama-French methodology). They also found that there are significant differences in firm characteristics between new and old value stocks and between new and old growth stocks.

### What The Researchers Discovered

The research team analyzed U.S. stock market data from 1970 to 2024 and found that approximately half of all value stocks and growth stocks each year are newcomers to their respective categories. These stocks weren’t classified as value or growth in the previous two years but have now migrated into these groups.

## **The key findings are striking:**

### **The “New” Value Premium Is Significantly Stronger**

When comparing stocks that recently became value or growth stocks (“new”) versus those that have consistently remained in their category (“old”), the researchers found:

- The value premium based on new value and growth stocks delivered 0.326% monthly returns (3.9% annually)
- The value premium based on old value and growth stocks delivered only 0.147% monthly returns (1.8% annually)
- The difference of 0.179% per month is statistically significant and represents more than double the returns

### **New Growth Stocks Are The Main Culprit**

The enhanced performance isn’t driven by new value stocks dramatically outperforming—it’s primarily because new growth stocks significantly underperform:

- New growth stocks returned 0.885% monthly versus 1.016% for old growth stocks, a difference of 0.13% per month, while new value stocks returned 1.21% versus 1.16%, a difference of just 0.05% per month
- New growth stocks posted a negative monthly alpha of -0.084% after adjusting for market factors
- Old growth stocks had a positive monthly alpha of 0.127%

### **Superior Risk-Adjusted Returns**

Beyond raw returns, the new value premium offers better risk-adjusted performance:

- Sharpe ratio of 0.076 for new value premium versus 0.038 for old value premium
- Positive skewness (0.341 vs. 0.052), meaning more upside potential
- Higher excess kurtosis (4.488 vs. 0.704), indicating a fatter right tail, and combined with the more positive skewness means more extreme positive returns

In other words, the new value premium doesn’t just deliver higher average returns—it delivers them with a more favorable return distribution.

Table 3: Value Premium: New vs. Old Value and Growth Stocks Following Fama and French (1993), we divide stocks in our sample into three B/M groups in June of each year based on the NYSE breakpoints of B/M: top 30% as value stocks (H(V)), middle 40%, and bottom 30% as growth stocks (L(G)). B/M and the stock sample are defined the same as in Table 1. Old value stocks (OldV) are those that are classified as value stocks in year  $t$  that are also classified as value stocks in both year  $t-1$  and year  $t-2$ . The remaining value stocks are classified as new value stocks (NewV). Old growth stocks (OldG) are those that are classified as growth stocks in year  $t$  that are also classified as growth stocks in both year  $t-1$  and year  $t-2$ . The remaining growth stocks are classified as new growth stocks (NewG). The table reports the mean, alpha, standard deviation (Std Dev), Sharpe ratio, skewness, kurtosis, and Sortino ratio of value-weighted and equal-weighted monthly returns of new and old value and growth portfolios as well as the spreads between value and growth portfolios. “New-Old” denotes the difference between the value premium based on new value and growth stocks (New(V-G)) and the value premium based on old value and growth stocks (Old(V-G)). Alpha is based on Fama-French five-factor model excluding the value factor and plus the momentum factor, namely market (MKT), size (SMB), profitability (RMW), investment (CMA), and momentum (UMD). The Newy-West t-statistics of the differences are also

reported for the value premium based on old value and growth stocks (Old(V-G)), the value premium based on new value and growth stocks (New(V-G)), as well as their differences (NewOld). \*\* and \* indicate significance at the 1% and 5% level, respectively. The sample period is from January 1970 to December 2024.

	H(V)	L(G)	HML	OldV	OldG	Old(V-G)	NewV	NewG	New(V-G)	New-Old
<b>Panel A: Value-Weighted Monthly Return</b>										
Mean (%)	1.162	0.978	0.184	1.163	1.016	0.147 (0.98)	1.211	0.885	0.326** (3.55)	0.179** (2.63)
Alpha (%)	-0.059	0.083	-0.141	-0.145	0.127	-0.272* (-2.31)	0.049	-0.084	0.133 (0.92)	0.405* (2.32)
Std Dev (%)	5.366	4.900	3.558	5.365	4.877	3.856	5.816	5.608	4.285	0.429
Sharpe Ratio	0.217	0.200	0.052	0.217	0.208	0.038	0.208	0.158	0.076	0.038
Skewness	-0.429	-0.347	0.179	-0.434	-0.287	0.052	-0.306	-0.549	0.341	0.290
Kurtosis	2.919	1.450	1.980	2.208	1.354	0.704	4.003	1.789	4.488	3.784
Sortino Ratio	0.202	0.170	0.075	0.203	0.183	0.054	0.199	0.123	0.113	0.059
<b>Panel B: Equal-Weighted Monthly Return</b>										
Mean (%)	1.516	0.794	0.722	1.581	0.942	0.640** (4.66)	1.446	0.675	0.770** (5.88)	0.131* (2.47)
Alpha (%)	0.474	0.058	0.415	0.442	0.100	0.342** (3.06)	0.484	0.001	0.484** (4.54)	0.142 (1.46)
Std Dev (%)	6.555	6.913	3.186	6.257	6.318	3.529	6.947	7.537	3.363	-0.165
Sharpe Ratio	0.231	0.115	0.227	0.253	0.149	0.181	0.208	0.090	0.229	0.048
Skewness	0.179	-0.097	0.350	0.137	-0.209	0.409	0.266	-0.005	0.306	-0.103
Kurtosis	3.797	2.227	2.757	4.436	1.830	3.797	3.268	2.548	3.365	-0.432
Sortino Ratio	0.253	0.087	0.334	0.279	0.126	0.264	0.226	0.058	0.336	0.072

## Why Do New Growth Stocks Underperform?

The research reveals that new growth stocks have weaker fundamentals despite high valuations:

- Smaller and younger companies on average
- Weaker business fundamentals: lower sales, earnings, and cash flows
- Higher financial leverage and investment rates
- Lower profitability as measured by ROE, ROA, and operating profitability
- Higher valuations despite weaker fundamentals
- Strong recent price appreciation (significantly higher 2-year returns than old growth stocks)

This profile suggests new growth stocks often represent companies whose valuations have run ahead of their fundamentals—a setup for disappointment.

Meanwhile, new value stocks show:

- Stronger profitability than old value stocks
- Higher sales growth
- Better fundamentals relative to valuation
- Poor recent stock performance (significantly lower 2-year returns)

Past poor performance appears to be a key driver of migration into the value category, potentially creating opportunities when the market overcorrects—in other words, a stock tends to become value because its price fell, rather than its book value rising.

### **When Does This Effect Matter Most?**

The outperformance of new value stocks over new growth stocks is not constant—it varies dramatically with economic and market conditions.

The new value premium is particularly pronounced during:

#### **1. Economic Downturns**

During contraction periods, the difference in monthly alpha between new and old value premiums reaches 0.707%—a massive spread. New growth stocks get hammered when economic conditions deteriorate and their optimistic valuations are reassessed.

#### **2. Monetary Tightening Cycles**

When the Federal Reserve is raising interest rates, the difference in alpha is 0.794% monthly. Growth stocks, especially new ones with weaker cash flows, are particularly sensitive to rising discount rates.

#### **3. High Interest Rate Environments**

In periods with high 10-year Treasury yields, new growth stocks underperform significantly as their long-duration cash flows are discounted more heavily.

#### **4. High Uncertainty Periods**

When macroeconomic uncertainty is elevated, investors reassess richly valued growth stocks, particularly benefiting the new value premium.

#### **5. Low Sentiment Periods**

When investor sentiment is pessimistic, the new value premium shows significant outperformance, suggesting new growth stocks are particularly vulnerable when optimism fades.

Note that these findings are consistent with a risk-based explanation of value premium.

### **The Industry Effect Matters**

Interestingly, the researchers found that the outperformance of new value stocks is primarily an across-industry effect rather than a within-industry effect.

When they adjusted for industry effects:

- The within-industry value premium showed no significant difference between new and old stocks
- The across-industry value premium based on new stocks was 0.149% versus -0.109% for old stocks

This suggests that new value and growth stocks capture important cross-industry shifts that drive returns—something traditional intra-industry focused strategies might miss.

### **International Evidence Confirms The Pattern**

The findings aren't limited to U.S. markets. When the researchers analyzed international data from 1991 to 2022, they found consistent patterns:

- New value premium was 0.172% monthly versus -0.016% for old value premium (value-weighted)

- Even stronger results with equal weighting: 0.702% versus 0.227% monthly
- Again, driven primarily by underperformance of new growth stocks

This international confirmation suggests the phenomenon reflects fundamental market dynamics rather than U.S.-specific factors.

Their findings led the authors to conclude: "By recognizing style migration, investors can adopt a more dynamic approach to style-investing by refining portfolio allocation between value and growth and adjusting exposures more effectively over different market conditions."

## **Key Investor Takeaways**

### **1. Not All Value Stocks Are Created Equal**

The traditional value investing playbook focuses on buying cheap stocks. This research suggests you should pay special attention to stocks that have recently fallen from grace and migrated into the value category, particularly if they maintain strong fundamentals despite depressed valuations.

### **2. Be Wary of Newly Minted Growth Stocks**

Companies that have recently migrated into the growth category often represent overextended valuations. These stocks exhibit weaker profitability, higher leverage, and inflated valuations relative to their established growth counterparts—a dangerous combination.

### **3. Timing Matters Enormously**

The new value premium is not a static phenomenon. It becomes most powerful during:

- Economic contractions
- Rising interest rate environments
- Periods of high uncertainty
- Times of low investor sentiment

This research fundamentally challenges the way we think about value investing. The value premium—one of the most studied phenomena in finance—is significantly impacted by stocks in transition rather than by consistent value or growth stocks.

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