



FORTIS FINANCIAL GROUP

April 23, 2026

Dear Clients and Partners:

The first quarter of 2026 brought a mix of continued strength in certain corners of the market alongside rising geopolitical risks that demand our attention. As we have done in prior letters, we want to walk through the key themes we are watching and how we are thinking about positioning portfolios. This letter will focus on three major areas: the evolving conflict in the Middle East and its impact on energy markets, the continued acceleration of AI and its implications for both earnings growth and labor markets, and how we are navigating the intersection of these forces.

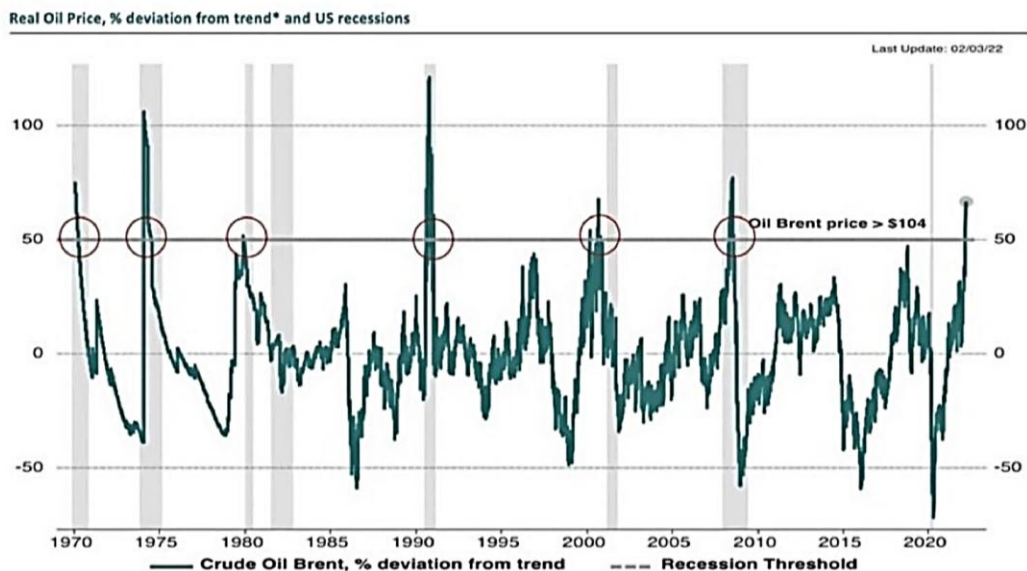
Middle East Conflict and the Oil Market

We will start with what is likely top of mind for most of you. The escalation of the Iran conflict has introduced a level of geopolitical risk to energy markets that we have not seen in quite some time. The chain of events is fairly simple to follow: sustained elevated oil prices feed directly into higher inflation, which keeps interest rates elevated, which in turn reduces consumer and capital expenditure spending, which slows economic growth. This is not theoretical. We are watching it play out in real time.

The Strait of Hormuz situation is particularly concerning. Gulf producers have been forced to shut in millions of barrels per day of production because they cannot export and have run out of storage capacity. These are not wells you can simply turn back on like a light switch. Kuwait Petroleum Corp. estimates full production restoration takes three to four months even after the strait reopens. Wells that have been idled for weeks face real complications: fluid settling, wax and scale buildup, pressure shifts, and water or gas encroachment into production zones.

We are particularly worried about the timing. Summer driving season is approaching, which historically increases domestic gasoline demand meaningfully. If the physical oil market remains tight heading into June and July, we could see a further leg up in prices at precisely the wrong time for the consumer. For reasons we'll elaborate upon in the next section, the lag effect of oil currently in transit could hit domestic markets in the next few weeks if there is no resolution. The effects to the countries that generally receive this oil (China, Southeast Asia, etc.) are likely to be significant as well and have the potential to "break something". With a heavily connected economy, things can break in certain places and spill over which is very hard to predict.

Historically, large upward deviations in oil prices have typically preceded recessions. To be clear, correlation is not causation, but the pattern is notable: energy booms late in the economic cycle tend to be the final tipping point that kills spending and pushes the economy over the edge. Personal spending on energy as a percentage of total spending tends to spike right before recessions, and low-income households bear the heaviest burden, spending approximately three times more of their income on energy than higher-income households.



Source: Pictet, Refinitiv

Why Oil Prices Could Rise More Even With a Quick Resolution to the War

There currently is a substantial disconnect between the oil markets on Wall Street and the physical oil markets representing supply and demand actually happening in the real world. This is worth walking through because it matters a lot right now as it relates to the future.

Think of the oil market as having two layers. There is the “paper” market, which is what most people follow. These are Brent crude futures contracts that trade on the Intercontinental Exchange (ICE). They are financial instruments. Nobody is actually taking delivery of a barrel of oil when they trade these. They are used for hedging and speculation.

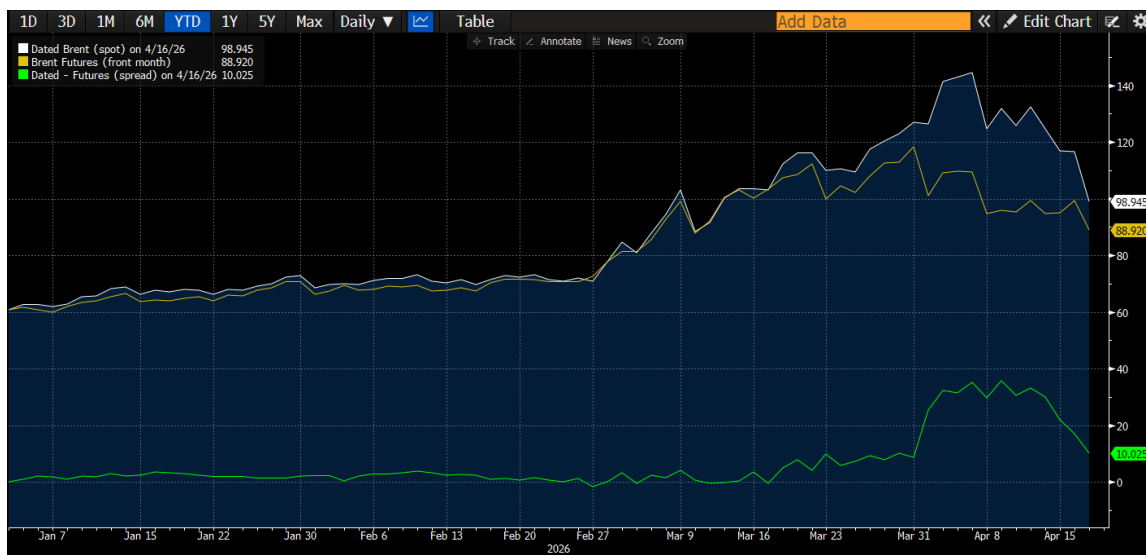
Then there is the “physical” market. This is the actual buying and selling of real crude oil cargoes, with real ships, loading at real terminals. The global benchmark for this is called Dated Brent, which is assessed daily by pricing agencies based on actual trades of specific cargoes with confirmed loading dates. This is where the real supply and demand picture shows up first.

Typically, these two markets’ prices are closely in sync with each other. However, starting in mid March, the amount the physical market was paying for oil blew out to \$20-30 per barrel above where the futures market was trading. This happens because the physical market became very tight with disrupted supply and the futures market didn’t believe the price for physical oil would be that high by settlement of the futures contract.

When a Brent futures contract expires, it does not settle against some theoretical number. It cash-settles against an index that is derived from actual physical trading activity. So if real oil is changing hands at \$130 and the futures are sitting at \$100, every trader holding a short position in that futures contract is staring down a very ugly settlement. They know the contract is going to settle at or near the physical price, so they are forced to buy back their positions before expiration. This creates a wave of buying that pushes the futures price up. On top of that, traders will actively arbitrage the gap. If you can buy a futures contract at \$100 and simultaneously sell a physical cargo at \$130, that is free money minus some transaction costs. Traders pile into that trade, aggressively buying futures and selling physical, which forces the two prices together. This is

textbook arbitrage and it can happen very quickly as the futures contract approaches expiration. However, as mentioned above, part of the reason this gap exists is because futures traders were expecting a deal before the end of April (front month futures contract expiration) and the price of physical crude to drop. This bet proved to at least be partially correct because on April 17th, when Iran announced the Strait of Hormuz will be “completely open”, the spread between physical and futures markets dropped to ~\$10. This is a dramatic example of how quickly the gap between the physical and futures markets can close when the geopolitical picture shifts.

While the April 17th settlement was encouraging, the following day, April 18th, Iran appeared to start attacking vessels and the US announced that we would now be boarding Iranian backed vessels. Needless to say the fog of war is very much upon us now and that is unlikely to lift anytime soon. Given what we described above, wells that take months to restart, damaged infrastructure, and storage that has already been drawn down, we think the physical market is going to be a lot tighter for longer than the futures are currently pricing in.



Source: Bloomberg

While the ceasefire has narrowed the gap between futures and physical prices, the physical supply picture remains challenged. Even if the strait opens up, production recovery takes months or years for very bad damage, not days. So, while futures may look more reassuring today than it did a week ago, the actual price that buyers will pay for physical crude over the summer is likely to remain elevated. That will filter through to gasoline prices, inflation and ultimately impact consumer spending.

With regards to markets, there are two caveats here worth considering. The first is the important nuance regarding who it impacts. Low-income households spend roughly three times more of their income on energy than higher-income households, so the pain is disproportionately concentrated at the bottom. However, the majority of total consumer spending in this country is driven by top earners who are far less sensitive to gasoline prices. So the overall drag on aggregate consumption may end up being more muted than the headlines suggest, even as real hardship increases for a large portion of the population.

The second is that the S&P 500 is very concentrated in the top tech stocks that are benefiting from the AI revolution and the spending behind it. It is entirely possible that these companies continue to perform well,

driven by massive earnings growth from AI, while Main Street struggles with higher energy costs and a slowing labor market. We have seen this kind of divergence before and it can persist for longer than people expect.

The bottom line is simple: the futures market is tethered to physical reality. It has to be. The settlement mechanics of the contracts and basic arbitrage guarantee it. Needless to say, this is a fluid situation that we are monitoring closely. No matter what happens we still have shut-in wells, damaged infrastructure, depleted storage and this does not resolve overnight even in the best case. We remain cautious on energy risk heading into the summer.

AI: Incredible Earnings Growth and Incredible Disruption

Our feelings on AI have not changed. If anything, they have intensified. We said in our very first letter covering this topic that we were on the optimist's side, that the technology is very real, and that it is coming faster than most people realize. Everything we have seen over the past quarter confirms this view.

The most significant development this quarter, in our opinion, was the release of Claude Code by Anthropic and the associated agents / embedding into existing tools (Excel, QuickBooks, etc.). For those unfamiliar, Claude Code is a command-line tool that allows developers to delegate entire coding tasks to an AI agent directly from their terminal. This is not autocomplete. This is not a chatbot suggesting code snippets. This is a system that can autonomously navigate codebases, write and execute code, run tests, create and edit files on your machine and iterate on solutions. Serious software developers are raving about it, and the implications for productivity are staggering.

We mentioned Claude Code in our last letter in the context of the software company sell-off. That sell-off has only deepened the debate about what AI means for the software industry. The narrative around "vibe coding", the idea that natural language can increasingly replace traditional software development, has raised real concerns about future competition for incumbent software companies. Our team has actually gone through the exercise of ranking 118 software companies on their disruptability by AI, and the results are instructive. Some companies are far more exposed than others.

But here is the duality that makes this so fascinating and challenging as investors. AI is simultaneously driving incredible earnings growth in certain areas of the market while driving incredible disruption in others. The hyperscalers, the semiconductor companies, the infrastructure providers, these are seeing earnings growth at a pace we have rarely witnessed. Meanwhile, pure software companies, certain professional services firms, and increasingly, companies reliant on large human workforces are facing existential questions about their business models.

We continue to favor the companies that are building the AI infrastructure and those that can successfully integrate AI into their existing platforms to drive revenue growth and margin expansion. However, there have been a number of software companies that we believe are "babies thrown out with the bathwater". As we noted last quarter, companies like ServiceNow and Salesforce are already demonstrating that they can upsell AI services to offset seat contraction. The winners will be the companies that figure out how to charge more per seat because each seat is dramatically more productive, or that restructure their revenue models to align with increased value add to their customers from AI capabilities.

AI Agents and the Labor Market

This brings us to what may be the most consequential issue we will be discussing in these letters over the coming years. We expect human payrolls to continue to get replaced with AI agents and we will have to watch very carefully for the downstream economic effects.

The data is starting to come in and tech layoffs have been increasing meaningfully. This matters because these are generally high-income workers who punch well above their weight in terms of consumer spending. If you layer on top of that the rising energy costs we discussed above, you have a potential one-two punch to consumer spending that could be significant.

To be clear, we are not predicting a recession. What we are saying is that the interaction between rising energy costs, the Fed being unable to cut rates due to persistent inflation, and the early stages of AI-driven workforce displacement creates a complex set of risks that we need to monitor closely. Fed futures are pricing in far fewer rate cuts this year than expected. There is now even the possibility of a rate hike by year end. This is a meaningful shift from where consensus was just a few months ago.

The economic impact of AI-driven job displacement is going to be uneven. It will hit certain sectors and geographies much harder than others. We are already seeing this in the software industry, but it will increasingly spread to financial services, legal, accounting, customer service, and any knowledge work that involves processing information and making decisions within defined parameters. The speed at which AI agents are improving is not linear. It is exponential.

However, and this is important, we do not believe this is all negative for the economy or for markets over the medium to long term. If AI truly delivers on the productivity gains that appear to be emerging, we could see the kind of economic growth that resolves a lot of problems, including the debt problem we have discussed in prior letters. As Satya Nadella said, the real benchmark is the world growing at ten percent, with the developed world growing at five percent inflation-adjusted. If we get anywhere near that, a lot of the current concerns become very manageable. But the transition period is going to be bumpy, and we need to be positioned for that.

Navigating the Current Environment

We have outlined three potential scenarios for how the current geopolitical situation resolves:

- **Stagflation:** A prolonged Hormuz closure drives sustained crude elevation, triggering cost-push inflation and forcing markets to reprice for a stagflationary regime. In this scenario we would favor real assets, energy, healthcare, and defensive equity exposure
- **Muddle Through:** Hormuz reopens but the three to four month production recovery keeps oil elevated. Growth drag persists near-term but a credible normalization path anchors sentiment. Selectivity is key
- **Positive Resolution:** Swift de-escalation and rapid Hormuz reopening unwind risk premiums. Transient economic impact supports a broad recovery rotation into cyclicals and duration

There are too many uncertainties to predict which scenario plays out. But we can plan for all of them, and that is exactly what we are doing. We continue to maintain hedging strategies including buffered ETFs, structured products, and individual security hedges for concentrated positions where appropriate.

Our long-term view has not changed. We continue to believe that Large Cap companies, particularly those at the center of the AI revolution, will be the best long-term investments. The technology is real. The earnings are real. The transformation is happening. But the path forward is unlikely to be a straight line, and the current geopolitical and macroeconomic backdrop adds a layer of risk that we are actively managing.

Conclusion

We are in a period where two massive forces are colliding. On one hand, AI is creating value at a pace we have not seen since the early days of the internet. On the other hand, geopolitical instability and its effects on energy markets are creating real near-term risks to economic growth. Our job is to navigate both simultaneously.

We encourage you to give us a call if you have any specific questions and we can walk through those. As always, we are available at your convenience.

Regards,
Your Fortis Team

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