



# A Quarter Like No Other

## *Markets, Macro & the Fog of War*

Q1 2026 | A Personal Update from Leonard Watson, Portfolio Manager | Gryphon Investment Advisors Bahamas

Dear Fellow Investors,

There are quarters you file away and quarters that demand you sit down and think carefully about what just happened. This was one of the latter. We entered 2026 facing a trade war that was already reshaping global supply chains and costing American households real money. Then, midway through the quarter, a hot conflict erupted with Iran and closed the Strait of Hormuz — the single most consequential chokepoint in the global economy. Two simultaneous, significant macro headwinds. And yet, when you take stock of where we stand — markets still broadly functioning, inflation not yet spiking, unemployment stable, corporate spending intact — the honest and somewhat unsettling conclusion is this: the world absorbed an enormous compound shock and, so far, has not flinched. Whether that resilience is earned or borrowed, I'll leave you to judge as you read on.

## The Story Begins in the Strait

The defining event of this quarter was the war with Iran and the closure of the Strait of Hormuz. The numbers alone should concentrate the mind: twenty percent of the world's oil passes through the Strait, but so does thirty percent of the world's fertilizer supply and forty-five percent of its sulfur. Airfreight capacity took an immediate hit too, with roughly eighteen percent of belly and charter freight capacity grounded almost overnight.

*"...45% of the sulfur has to go through the Strait, and it's blocked currently. Also, a huge volume of up to 30% of nitrogen is coming from this region."*

— Christian Meyer, Chair — K+S AG

History gives us a partial frame of reference. The oil shocks of the 1970s are the closest analogue, but the comparison only goes so far. Today's global economy is structurally less dependent on fossil fuels than it was fifty years ago. Supply chains, while still vulnerable, are more diversified. And the digital and services economy now accounts for a far larger share of GDP across developed nations. This likely explains why, despite what may prove to be the largest oil shock in modern history, the immediate economic transmission has been more contained than the raw numbers would suggest.

## The Macro Picture: Two Headwinds, One Economy

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To understand where we are, you have to hold two stories in your head simultaneously — because both have been unfolding at once. The Iran conflict is the louder, more visible one. The tariff war is the one that was already quietly doing damage before the first shot was fired.

The tariff story reached a significant legal inflection point on the 20th of February, when the US Supreme Court struck down the Trump administration's IEEPA tariffs in a 6-3 ruling — the broadest legal challenge to the trade war to date. It was, on paper, a victory for importers. In practice, the administration responded within hours by invoking Section 122 of the Trade Act, imposing a flat 10% tariff on all imports, and simultaneously launching new Section 301 investigations against China, Vietnam, Taiwan, Mexico, Japan, and the EU. The architecture of the trade war has changed; the trade war itself has not ended. Before the ruling, the effective US tariff rate had reached its highest level since World War II — representing, by one estimate, the largest tax increase as a percentage of GDP since 1993, and an average additional cost of roughly \$1,500 per US household in 2026. Critically, nearly ninety percent of that burden landed on US businesses and consumers, not on foreign exporters as the administration had argued. That is a meaningful headwind to disposable income that was already in place before a barrel of Iranian oil became a geopolitical flashpoint.

*"The president's trade policies have created more uncertainty than certainty for American businesses trying to plan for the future."*

— Sarah Bloom Raskin, Former Federal Reserve Governor

Layered on top of both of these pressures is the Federal Reserve's posture, which has shifted materially from where most investors expected to begin the year. The rate cuts that many had pencilled in for 2026 have effectively been postponed. With inflation moving higher through the first half of the year — driven partly by energy, partly by residual tariff pass-through still working through the system — the Fed has signalled it will hold rates steady, with the next cut now not expected until late 2026 at the earliest. Powell's language has been carefully calibrated: acknowledge the inflationary pressure from energy, frame it as potentially temporary, and avoid committing to a timeline that events could rapidly invalidate.

*"The implications of events in the Middle East for the US economy are uncertain. In the near term, higher energy prices will push up overall inflation, but it is too soon to know the scope and duration of the potential effects on the economy."*

— Jerome Powell, Chair — Federal Reserve

The phrase I keep returning to came from Morgan Stanley's Daniel Simkowitz: the economic impact 'is not hitting yet — it's still in front of us.' That is both reassuring and sobering in equal measure. Consumer spending is holding at around five percent year-over-year growth according to Bank of America, broadly equivalent to last year's pace. Corporate sentiment, while less bullish than it was at the start of the year, has not capitulated. Markets sold off, but the sell-off has been orderly. The general consensus — investor, corporate, and central bank alike — is that the conflict is temporary and that normal conditions will largely resume once it ends. A Fed on hold longer than expected, however, means that anyone waiting for rate relief in housing, credit, or deal financing may be waiting considerably longer than they planned.

I share the base case that this is temporary. But I have seen enough of history to know that markets in a state of complacency are precisely the markets most vulnerable to negative

surprise. If the Strait remains closed longer than consensus expects, or if the tariff architecture becomes more permanent than the current statutory framework suggests, the effects the Fed and the corporate world are currently looking through will begin to crystallise into very real numbers.

## The Consumer: Resilient at the Top, Stretched at the Bottom

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If there is one theme that runs consistently through everything I read and heard from corporates this quarter, it is the K-shaped economy — and the combined effect of the tariff war and the oil shock has sharpened the divide considerably. Higher energy costs function as a regressive tax. Tariff pass-through on everyday goods — groceries, clothing, cars — hits lower-income households hardest. Those with the least discretionary income are absorbing pressure from multiple directions at once.

*"You do see evidence of a K-shaped economy...wages are growing faster and spend is higher on the upper end than it is on the lower end."*

— Dean Athanasia, Co-President — Bank of America

At the premium end, Norwegian Cruise Line's management were candid: they are simply not seeing stress from consumers. Luxury travel and entertainment continue to benefit from the sustained wealth effect among higher-income households. At the other end, McDonald's described the quick-service restaurant environment across the US and many international markets as 'challenging' — a word that carries significant weight when it comes from a company that built its business model on affordability. Procter & Gamble raised prices on twenty-five percent of its product range due to tariff costs. Dollar Tree is carrying tariff-inflated inventory and flagging additional freight headwinds from the Middle East conflict. The squeeze at the bottom of the consumer distribution is real and getting tighter.

Housing remains its own special category of weakness. With the Fed now on hold through at least late 2026, the rate relief that many buyers and builders were waiting for has been pushed further out. Home sales are running at their slowest pace in roughly thirty years. The mortgage lock-in effect — where homeowners with low fixed-rate mortgages have no incentive to sell — continues to suppress both supply and activity. The Home Depot put it starkly: housing turnover has essentially been frozen for three years, and nothing on the horizon suggests a near-term thaw.

## Technology: Agents, Memory, and a Labour Market Quietly Changing

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Away from the conflict, the dominant story in technology has been the accelerating shift from large language models to agentic AI systems. If the past two years were about demonstrating that AI could reason, this year appears to be about demonstrating that AI can act — autonomously, across complex workflows, at scale. The implications for compute demand, and therefore for the entire technology supply chain, are significant.

*"But the world is now awakened to the agentic AI inflection. The agents are super smart. They're solving real problems."*

— Jensen Huang, CEO — Nvidia

Alphabet's CFO offered a telling anecdote: even within their own finance function, AI agents are being deployed in treasury operations and invoice reconciliation. When the CFO of Alphabet is

describing agent deployments in back-office finance, you have a signal that this is no longer a research project — it is operational reality. Meta's Mark Zuckerberg echoed the same theme, describing 2026 as the year agents 'really work.' The convergence of that ambition across the industry's largest players is not incidental — it represents the next exponential in token demand, and with it, the next leg of the infrastructure build.

The constraint the industry is navigating is memory. It has become the single most acute bottleneck in AI infrastructure. Arista Networks' CEO described shortages expected to last multiple years. Micron acknowledged it can fulfil only fifty to sixty-six percent of key customer demand in the medium term. HP reported memory costs rising approximately one hundred percent sequentially, with further increases forecast. Against that backdrop, data centre capital expenditure continues to climb — with some projections suggesting a 3.5x increase over the next five years, implying something in the order of seven trillion dollars of required investment.

One item worth monitoring closely: OpenAI, the company that arguably set the capex ambition for the entire industry, has shown early signs of narrowing its focus and pulling back on certain expansion initiatives. For now, overall hyperscaler momentum remains intact. But OpenAI's posture is worth watching as a potential leading indicator of where the broader industry cycle is heading.

There is a quieter, slower-burning thread within the AI story that I think deserves more attention than it is currently receiving from investors: what AI is actually doing to the labour market right now. The headline employment numbers look stable — US unemployment is running around 4.4% and has not materially deteriorated. But the composition of that stability is worth examining. The Federal Reserve Bank of Dallas, reviewing wage and employment data through early 2026, found something nuanced and important: in jobs with significant AI exposure, wages are not uniformly declining. For experienced workers, AI appears to be augmenting output and, in some cases, commanding a wage premium. The disruption is concentrated elsewhere — specifically in entry-level and administrative roles, where AI is substituting rather than augmenting. Young workers entering AI-exposed fields are finding hiring rates significantly lower than prior cohorts. This is the same K-shape we are seeing in consumer spending, now showing up in the labour market itself. The net job numbers, for now, look fine. The distribution underneath them is beginning to shift.

## Financials, Capital Markets and Private Credit

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At the start of the year, there was genuine optimism — bordering on excitement — about a meaningful recovery in capital markets activity. That optimism has moderated with the onset of conflict and rate-cut expectations being pushed back. However, the dealmaking pipeline has not collapsed. IPO activity is broadly expected to resume once conditions stabilise, and several of the largest anticipated listings in history — SpaceX, Anthropic, OpenAI — remain on the horizon for the next eighteen to twenty-four months.

*"...it's pretty clear to us that you'll probably see some of the largest IPOs in history in the next 18 or 24 months...especially in the United States, there's a sense that being public is great again."*

— Daniel Simkowitz, Co-President — Morgan Stanley

Private credit remains an area I am watching carefully. It has grown rapidly, it is lightly regulated relative to traditional credit markets, and it carries a meaningful concentration of exposure to traditional software businesses — precisely the segment most susceptible to disruption from AI.

With the Fed on hold and rates remaining elevated, the stress test for private credit is extending in duration. Raymond James's CEO offered some reassurance, noting that credit quality issues observed so far have been relatively isolated to fraud events rather than systemic deterioration. I take some comfort from that, while retaining the view that private credit warrants ongoing scrutiny — particularly as AI continues to erode the revenue assumptions underlying many of its underlying loans.

## International and Industrial: Quiet Signs of Recovery

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Beyond the US, the picture is nuanced but not without cause for cautious optimism. European politicians appear to be engaging more constructively with business on regulatory competitiveness — a notable shift in tone, and one that extends to renewable energy and net-zero policy, where the ideological rigidity of recent years appears to be softening under the pressure of energy security concerns. In Asia, the Chinese consumer recovery continues, albeit at a measured pace. Luxury brands with meaningful China exposure, such as Capri Holdings, are seeing early signs of resumed spending — though consumer sentiment remains fragile relative to the scale of accumulated savings.

The tariff architecture adds a layer of complexity for international investors that was not present a year ago. Trade patterns that shifted dramatically in 2025 — with Southeast Asian manufacturers absorbing China-diverted demand — are now themselves under scrutiny as the administration launches new Section 301 investigations. The USMCA agreement is due for renegotiation later this year, and an unresolved outcome there would have significant implications for North American supply chains. These are not imminent crises; they are background risks that deserve more attention than markets are currently assigning to them.

In the industrial sector, there are genuine green shoots after what has been a prolonged period of weakness. PMIs have moved above 50 in several major economies for consecutive months — a threshold that historically signals expansion. Commentary from 3M and W.W. Grainger suggests a cautious but real improvement in industrial sentiment, with particular optimism in aerospace, construction, and freight. An industrial cycle that has been flat to down for years may finally be turning.

## Energy and Healthcare: Fossil Fuels Return to the Frame

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Energy has not been the dominant sector narrative for several years. This quarter changed that. The conflict has forced a re-engagement with the fundamental reality of global energy dependence — and brought with it a growing recognition that the extraordinary demand for power being generated by the AI infrastructure build-out will, to a significant degree, be met by natural gas and coal rather than renewables alone. PwC's latest outlook notes that residential electricity prices in the US are forecast to rise 4.2% in 2026 as power demand surges — much of it driven by data centre construction. The energy transition timelines remain intact as a long-term thesis; the near-term arithmetic of power demand is simply forcing a more honest conversation about how we get from here to there.

Healthcare presents a more straightforward narrative of recovery. After an extended period of tightness in biotech and pharma capital markets, there are credible signs of improvement. Thermo Fisher's CEO described genuine excitement in their customer base as biotech funding improves. Kilroy Realty noted significant capital inflows and a reopening of the IPO market for life sciences companies. One additional consideration worth flagging: the Trump administration

has signalled that tariffs on pharmaceutical imports could move significantly higher later in 2026 — an outcome that, if it materialises, would reintroduce a meaningful cost headwind for an industry that has only recently found its footing.

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## Closing Thoughts

What this quarter has revealed — perhaps more than any in recent memory — is the extraordinary absorptive capacity of the modern global economy. A war that closed the world's most critical energy and commodity chokepoint, layered on top of a trade war that was already the most aggressive since the 1930s, layered on top of a Federal Reserve forced to hold rates higher for longer — and still, the global economy has not broken. Inflation is moving higher but has not spiked. Unemployment is stable. Corporate America, for the most part, is still operating. Markets sold off but did not collapse.

The honest reading of that resilience is that it may be real. It may also reflect the market's collective bet that all of this is temporary — a bet that is correct until, one day, it isn't. Complacency embedded in consensus is itself a form of risk. The longer the Strait remains closed, the more permanent the tariff architecture becomes, and the longer the Fed stays on hold, the harder it is for markets to keep looking through what is in front of them.

Beneath the stable headline numbers, there is a subtler story developing: a K-shaped economy that is widening, not narrowing. Higher-income consumers and experienced workers are benefiting from asset prices, AI augmentation, and continued spending power. Lower-income consumers, entry-level workers, and small businesses exposed to tariff costs and energy prices are absorbing a disproportionate share of the quarter's shocks. This divergence is politically significant as well as economically important — it is the kind of slow-moving pressure that does not show up in GDP prints until it suddenly does.

My view remains that the base case — conflict resolution, gradual normalisation of trade policy, a Fed that eventually cuts — is the most probable path. But I have to take into account within portfolios, the understanding that tail risks are fatter than usual, that the gap between what markets are pricing and what a prolonged disruption would actually mean is considerable, and that the distribution of outcomes this quarter is wider than at any point in recent years. We will continue to monitor developments closely and will update you as the picture evolves.

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