

Good morning,

What's in this week's Report:

- Three Factors Supporting This Market
- Weekly Economic Outlook – All Eyes on Inflation Data
- Why Kharg Island and Bab el-Mandeb Matter to Markets
- Why Did Stocks Surge?

Markets are trading with a tentative risk-on/"war-off" tone, with U.S. equity futures modestly higher, while oil prices are well off overnight highs amid hopes that a last-minute ceasefire deal will be struck between the U.S. and Iran.

Geopolitically, President Trump reiterated threats to strike Iran's civilian energy infrastructure if a ceasefire deal is not struck by an 8 p.m. ET deadline Tuesday.

However, Axios reported progress towards a 45-day ceasefire deal overnight, which is bolstering hopes for a last-minute U.S.-Iran deal after military strikes persisted over the weekend, with multiple U.S. aircraft notably being shot down by Iran.

Today, geopolitical headlines will remain the primary market focus, and any signs that a ceasefire deal is likely to be reached between the U.S. and Iran could spark a continued relief rally, extending last week's gains in equity markets.

There is, however, one notable domestic economic report to watch, the ISM Services PMI (E: 55.4), and one Fed official scheduled to speak: Barr (9:10 a.m. ET), which traders will keep tabs on as they return to the desk after the long Easter weekend.

Market	Level	Change	% Change
S&P 500 Futures	6,626.50	4.25	0.06%
U.S. Dollar (DXY)	99.79	-0.06	-0.06%
Gold	4,687.72	8.02	0.17%
WTI	110.65	-0.89	-0.80%
10 Year	4.64%	0.017	0.39%

Stocks

Last Week (Needed Context as We Start a New Week)

Stocks rallied for the first time in over a month last week after the U.S. and Iran admitted they were at least partially in contact regarding a potential ceasefire, helping spark an oversold bounce. However, geopolitical risks remained elevated as oil hit new multi-year highs on Thursday. The S&P 500 rose 3.38% on the week.

U.S. equities began the week with a solid risk-on rally last Monday as President Trump noted “great progress” had been made with a “new and more reasonable” regime in Iran. However, uncertainty about whether the “new regime” was in power saw geopolitical fear bids repopulate in the oil market, and WTI futures climbed back beyond \$100/barrel, which saw the early gains in the S&P 500 wiped out and then some, with the index closing down 0.39% at new YTD lows.

Stocks gapped higher on Tuesday, with month-end money flows playing a role in the scale of the morning move, which was well over 1% across the U.S. indexes, as the WSJ reported that President Trump was ready to end the war with Iran, whether the Strait of Hormuz was reopened, within two to three weeks. The early advance accelerated to the upside in afternoon trade after Iranian President Pezeshkian echoed Trump’s tone, hoping to bring the war to a timely end. The S&P 500 sprinted higher to end with a 2.91% gain.

Strong risk-on money flows persisted into Wednesday’s session with the S&P 500 gapping solidly higher for a second straight day at the open amid growing hope that the U.S.-Iran war was on the brink of ending ahead of a planned evening address by President Trump. The S&P 500 rallied beyond 6,600 before the combination of stronger U.S. economic data and increasingly aggressive geopolitical chatter sent Treasury yields off multi-week lows, and stocks pulled back into the close, with the S&P 500 still higher by 0.72%.

In a reversal of the mid-week trend, equities gapped sharply lower on Thursday amid a sharp upside reversal in oil prices thanks to Trump’s vow during his prime-time address to “hit Iran extremely hard” in the coming weeks. Trump also stated no intention of agreeing to a ceasefire until the Strait of Hormuz reopened, contradicting earlier comments while explicitly leaving the future of the critical global oil chokepoint in the hands of allies and other nations who depend on oil shipped through the Strait. The sudden escalation in tone initially sparked “war-on/risk-off” trade across asset classes; however, news that Iran and U.S.-ally Oman had drafted framework for a toll-based system for ships to pass through Hormuz safely triggered a reversal in equities that saw the S&P 500 claw back to end the holiday-shortened trading week with a modest, 0.11% gain on Thursday, despite WTI crude oil surging 11.41% on the day, to end above \$111/barrel, a fresh multi-year settlement high.

News on Iran was mixed over the weekend as the U.S. and Iran traded attacks, but Iraq struck an agreement to safely transit the Strait, potentially easing oil supply concerns.

Three Factors Supporting This Market

Stocks are down YTD and markets have been volatile, but when considering the headlines facing them (oil price spike, AI anxiety handicapping the most important sector in the market, and private credit hampering financials), the fact that the S&P 500 is only down marginally YTD is a testament to this market’s historic resilience. Generally speaking, three factors are helping support this market and keep losses manageable.

First, markets still think the U.S./Iran war will be limited in duration (at least in terms of its impact on oil prices). Hope for a near-term ceasefire faded last week following President Trump’s prime-time address, but despite the rhetoric, markets will view the conflict, at least as it affects oil prices, as limited. There’s proof of that happening: Iran has, over the past few days, reached agreements with Oman and Iraq to ship oil through the Strait of Hormuz safely. Remember, the market only “cares” about the conflict because of its impact on oil prices. If oil shipments through the Strait return to close to normal levels (they’re about 20% below normal now, but at the highest level since the war), then the conflict will no longer be a key market headwind. However, if the market begins to think the disruption to oil prices will last months and quarters, then the outlook for markets becomes much more negative.

Second, solid economic growth. The U.S. economy has proven historically resilient over the past few years (COVID, surge in inflation/rates), and it's doing so again, and that's helping stocks. As long as growth stays solidly positive, the "tide" for all markets will remain stable or slowly rise, which is powerful support for markets driven by geopolitical concerns.

Third, above-average earnings growth. Earnings season starts this week (and ramps up over the next three weeks), and earnings growth remains a critically important part of this resilient market. Earnings estimates for the S&P 500 remain above \$300/share (some as high as \$310 or \$315), and that's critical yet often overlooked support for markets. That means this coming earnings season (which again starts this week but really ramps up starting next week) is important because if companies reiterate guidance, that will push back on macroeconomic concerns.

Bottom line, the market's resilience is a reminder that market headwinds (higher oil, private credit, and AI anxiety) are only demonstrably negative if they reduce economic or earnings growth expectations. If they do not, and economic and earnings growth remain solid, the market will stay more resilient than the headline would imply, which will be the difference between a pullback and a full-blown correction/bear market.

Economic Data (What You Need to Know in Plain English)

Last Week

Looking at last week's growth data, the positive news is that activity was solid across the reports, which pushes back against the "stagnation" concerns. However, price metrics were elevated, so there was no material change to the outlook for Fed rate cuts (currently, no rate cuts are expected for 2026). Bottom line, the data could have made things worse last week if it showed suddenly slowing growth, but that did not happen (which was a relief).

The key report last week was the jobs report, which was stronger than expected and borderline "too hot," though enough mild offsets kept the market reaction from being directly negative. The headline job adds were 178k, far above the 50k expectation, while the unemployment rate was 4.3%, off the recent highs but not at a level that would imply an overheating labor market (which could boost wages).

From a market-impact standpoint, this will (slightly) reduce expectations for rate cuts later this year and, potentially, boost expectations for a possible rate hike, but likely not enough to directly pressure markets. Bottom line, the labor market remains solid, and while that could ultimately mean no more rate cuts, it's more important right now that it signals solid economic growth. That will push back on slowdown fears (which would be a significant incremental negative if investors have to worry about a slowdown, too).

Looking at the other economic reports, the ISM Manufacturing PMI was the key growth report last week and came in better than expected, but it also showed a jump in prices. The headline reading rose to 52.7 vs. (E) 52.3 and remained comfortably above 50 (signaling expansion). The details of the report were also mostly solid, with New Orders (the leading indicator) staying solidly above 50 at 53.5 vs. (E) 54.5. While that was a decrease from February, it was still above 50 and signaling future expansion. Finally, the one negative in the report was the price index, which jumped to 78.3 from 74.0. That's not surprising given the rise in oil prices, and while that jump certainly isn't welcome, we should expect inflation metrics (especially headline inflation) to rise with higher oil prices. Bottom line, the jump in prices isn't going to make the Fed any more likely to hike rates, although it doesn't make cuts any more likely either (so it was basically neutral).

Finally, the ADP jobs report showed 60k jobs added vs. (E) 42k, while jobless claims remain extraordinarily low at 202k, suggesting a “no hire/no fire” labor market. Challenger layoffs rose to 60k from 48k, but aren’t at levels that imply we’re seeing a lot more layoffs. So, the “other” labor market data implied stability, which is a positive given concerns about stagflation.

Important Economic Data This Week

Investors are now focused on the impact of the war on both growth and inflation, which means March economic data is much more important than February data, because March readings factor in spiking oil prices. Because of that, Friday’s March CPI is, by far, the most important economic report this week.

Expectations are that headline CPI will jump from the 2.4% y/y reading in February, almost entirely because of energy prices, but the bigger wildcard will be what happens to Core CPI. Core CPI was 2.5% in February, and if we see a big jump in that reading towards 3.0%, that will be an incremental negative because it’ll further boost bond yields, as Core CPI excludes energy and food and should remain stable. If Core CPI is hot, expect stagflation concerns to rise sharply (and for that to hit stocks).

CPI isn’t the only notable inflation report; we also get the Fed’s preferred inflation reading, the Core PCE Price Index, on Thursday. But this is a February report, so barring a major upward surprise, it shouldn’t move markets materially because it won’t account for the March oil spike.

Turning to growth data, the key report comes this morning via the ISM Services PMI. This is the more important of the two PMIs, and the final of the “Big Three” economic reports for March. Markets will want to see stability in the headline reading and prices. If we see a drop in service activity (which accounts for the majority of the U.S. economy) and a spike in prices (which shouldn’t really happen because services aren’t oil-related), that will seriously compound stagflation concerns and likely weigh on markets.

Turning to the Fed, we’ll get the minutes of the March meeting, and these do matter, because 1) The war had already started by the time they had this meeting, and 2) Markets will be looking for clues about how concerned Fed officials are with higher oil prices and the inflation risk. Remember, fed fund futures are not pricing in any cuts for 2026, so anything that makes cuts more likely will be welcomed. Conversely, if the minutes discuss the potential for a rate hike (if inflation spikes), that will further spook markets and boost stagflation fears. Bottom line, solid activity and stable price data this week would help to support stocks even in the face of additional geopolitical risks.

Special Reports and Editorial

Why Kharg Island and Bab el-Mandeb Matter to Markets

Despite consistent commentary about progress on a ceasefire from the president, the market’s concerns that the conflict between the U.S. and Iran will escalate further are rising. That was highlighted last week as the Houthis attacked Israel, while on Monday, President Trump threatened, again, to attack Kharg Island. Kharg Island is Iran’s main export terminal for oil, and if that attack occurs, it’s reasonable to expect oil to surge towards, and likely through, \$150/bbl, and that would likely hit stocks very hard. As a result, I want to cover what Kharg Island is, the fallout from an attack, and why this would matter for markets.

Kharg Island is a little-known place outside the energy industry, lying 15-20 miles off the Iranian coast. It has been thrust into the spotlight because Iran uses Kharg Island to export nearly all of its oil (more than 90%). Despite the ongoing war, Kharg Island has been allowed to operate generally normally (some military assets were destroyed earlier in the conflict, but none of the oil export equipment was). The U.S. leaving Kharg Island alone was seen as a sign of restraint and an acknowledgment of the global economy's sensitivity to higher oil prices.

That restraint might end soon based on President Trump's comments Monday, where he threatened to destroy the island and Iran's ability to export oil. To be clear, the question for markets is not whether the U.S. can do it. Rather, it's what the implications would be for oil and for the global economy if the U.S. does take out Kharg—and simply put, things would be substantially worse than has been experienced so far.

First, it would further reduce oil supplies. Kharg Island is still exporting between 1.5 million and 1.7 million barrels of oil per day. While that's not a lot compared to global crude production of ~80 million bpd, for a market that's already scared about supply, that loss would provide a shock. Additionally, Kharg Island has a storage capacity of about 30-34 million barrels of oil, and it's estimated to be around 60% full. Presumably, that oil would be destroyed by a large-scale attack, removing even more barrels from the market. The last thing the global oil markets need is less supply, and while none of the numbers emanating from Kharg Island are that big by themselves, it will just highlight falling supply and boost the risk premium in oil.

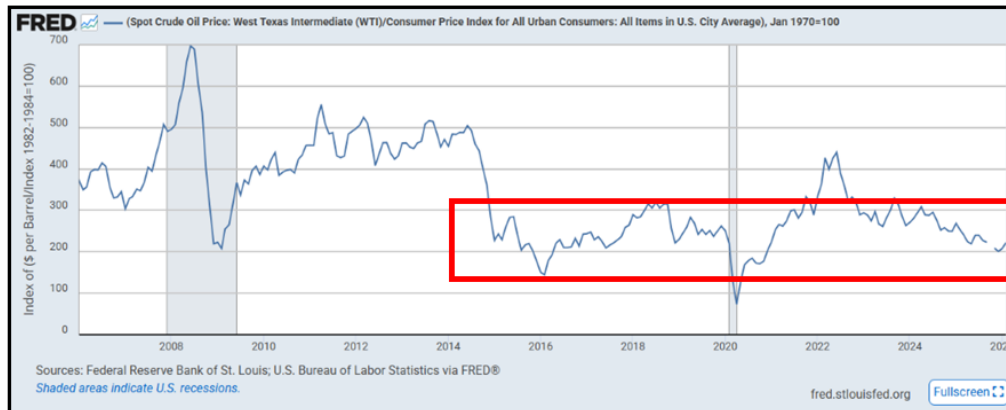
Second, an attack on Kharg Island would dramatically escalate the conflict. If Kharg Island is destroyed, it's reasonable to assume that the Iranians would dramatically increase attacks on neighboring oil and manufacturing infrastructure to drive the price of oil even higher and increase the pain on the global economy. That could include attacks on Gulf neighbors' oil infrastructure, as well as more tanker and pipeline attacks. Those attacks, however prevalent, would only further reduce oil supplies.

Third, it could further complicate global oil transit. An attack on Kharg Island would again effectively close the Strait of Hormuz, but it could also trigger the Houthis in Yemen to begin to hamper travel through the Bab el-Mandeb Strait. The Bab el-Mandeb Strait sees 4 million barrels of oil flow through it daily, so a major disruption would further delay the shipment of oil worldwide and lead to a larger price increase.

Further escalation could make the market decline much worse. Oil hit a four-year high last week, but while those multi-year highs certainly aren't positive for stocks and bonds, the gains in oil, so far, are only modest if we think about the price of oil in terms of inflation and spending power. Consider this: Brent and WTI crude both hit levels last seen in spring 2022, when Russia invaded Ukraine. So, oil has now matched the level hit four years ago. But what's happened to general prices over those four years? Wages and the cost of virtually everything else have risen sharply since then, yet oil is still at the same price it was four years ago (for much of those four years it was lower).

Practically, that means that "\$100 crude" doesn't mean the same thing it did four years ago, eight years ago, or 19 years ago (other periods when oil hit \$100/bbl). That \$100/bbl price is, practically, much lower than in years past. For oil prices to become a major headwind on growth, they have to keep rising (substantially). The "econo-speak" way to describe this concept is to look at the inflation-adjusted price of oil, and the reality is it's still quite low, even with the recent run-up.

The chart here shows the price of oil in inflation-adjusted terms, which drives home how much "pain" rising oil prices inflict on consumers.



Inflation-Adjusted Oil Prices: Oil has risen above \$100/bbl, but on an inflation-adjusted basis, oil prices remain just off multi-year lows (and well below levels of recent conflicts, including Russia/Ukraine).

Looking at this century, even with the recent run-up, oil is still well below levels reached during the Russian invasion of Ukraine and the 2018 oil price rise. In fact, the inflation-adjusted price of oil is still below levels it reached for much of the early 2010s (a period that included the Arab Spring uprising).

The point here is that even if oil stays at current levels, based on the inflation-adjusted price, it shouldn't be a big problem for the U.S. economy. However, if the conflict escalates dramatically and oil prices rise above \$150, towards \$200/bbl, that will become a much bigger problem for U.S. consumers, the U.S. economy, and U.S. markets—and that's entirely possible if Kharg Island is attacked. We'll be watching.

Why Did Stocks Surge?

Stocks surged on the final day of the quarter for several reasons, including quarter-end positioning and positive AI news about CoreWeave (CRWV). Still, the main reason stocks leaped was a *Wall Street Journal* article that stated President Trump would wind down military operations without securing the Strait of Hormuz.

That sparked a large rally for a simple reason: If true, it potentially solves the vice the president found himself in. Based on recent commentary, it appeared that President Trump was trying to achieve two goals that were becoming mutually exclusive: saying the U.S. "won" the war while, at the same time, de-escalating the conflict.

While the dominance of the U.S. military was never in question, markets feared that the administration was being backed into a "escalate to de-escalate" situation, whereby ground troops would be needed to subdue Iran further, increasing the chances of a prolonged conflict and sustainable higher oil prices (which would increase stagflation risks).

The WSJ article, which the president somewhat confirmed Tuesday morning via social media post, implies he would be willing to exit the conflict without further escalation, even if it meant the U.S. didn't accomplish some of its goals. In practice, the article and the president's confirmation reduce expectations that the U.S. needs to escalate the conflict further to achieve its desired outcome, and instead indicate that it is willing to wind down military operations and leave the region. Since further escalation has always been the market's main fear (because it would mean higher-for-longer oil prices and rising stagflation risks), these comments were legitimate positives.

The positive sentiment was then bolstered by unconfirmed reports that the Iranian president was open to ending the war, which is significant because it was the first such acknowledgment that efforts were underway to broker a ceasefire.

From a “what does this mean for markets” standpoint, clearly the bounce was welcomed, especially on the last day of a tough quarter. However, while the surge was a legitimate positive, I would be hesitant to chase stocks based on the headlines aggressively.

Clearly, there are efforts on both sides to de-escalate, but the reality on the ground still matters. Thousands of U.S. troops have been positioned in the region, and while that could be a show of force, that’s not usually how these things work. Additionally, while the Iranian president may want to pursue a ceasefire, it’s still unclear who is running Iran and whether the president 1) speaks for the military and 2) whether the Iranians can control various groups who have just learned that harassing ships in Hormuz is a good way to exert influence over the West.

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