Q1 2026

Everyone hates sad karaoke songs

Iran, Market Financial Solutions, Citrini.

Three of the biggest drivers of returns year-to-date didn't make it into our year-end letter. Because that's the nature of how things break.

In the spring of 2023, I was asked to present at a small roundtable in Austin on the state of the economy and the nature of crises. Silicon Valley Bank had just collapsed. First Republic was in danger. The room wanted to know if this was the beginning of something, or just noise.

What we walked through wasn't a prediction about which bank was next. It was a pattern. Crises follow a remarkably consistent arc: there is no problem; then if there is a problem, it will be contained; then, suddenly, it isn't.

From there, two paths diverge: the pessimists are wrong, things stay localized, and we move on. Or they aren't, and the evolution to "we have a problem" is swift, violent, and broad.

The other common thread is that the actual nature of crisis is unpredictable. By definition, a *shock* will catch people offsides.

It was also at this roundtable we discussed the fact that at karaoke night, people who bum out the crowd with sad songs get booed, and this all sounds like a sad karaoke song.

Apologies in advance.

"Markets are overreacting to what will likely be a 4- to 6-week period of volatility, which will ultimately result in 50 years of stability in oil markets, supply chains and geopolitics."

- Torsten Slok
Apollo Chief Economist

To be clear, consensus has been consistently, and mostly correctly, in the first camp.

Last year, the tariff tantrum was widely dismissed as a TACO (*Trump Always Chickens Out)*, and the market was right.

The discussion around Iran today carries a similar consensus. This is going to be wrapped up soon, oil will fall back to $70 and we'll hit all-time highs by the end of the year. And the consensus is probably right again.

But consensus being right most of the time is precisely what makes it dangerous when it's wrong.

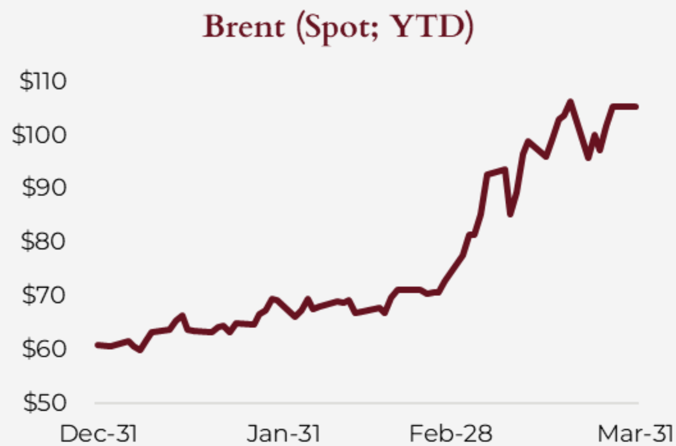
We're not here to pound the table about what breaks next. We don't know, and neither does anyone else. That's what makes a shock a shock. What we do think is worth examining are the places the market has stopped looking: the corners of the investable universe that have been left behind by years of consensus chasing the same handful of themes.

The opportunities we outlined at year-end — energy infrastructure, non-dollar assets, frontier markets, biotech, volatility — don't require anything to go wrong. They just require the world to be a little more complicated than the consensus assumes.

Iran, and the exposed shift in geopolitical order

The IEA has called Iran's closure of the Strait of Hormuz the "largest supply disruption" in the history of the global oil market. Unlike Russia-Ukraine, this is a physical closure. Barclays has estimated a 13-15 million barrel per day loss from the closure.

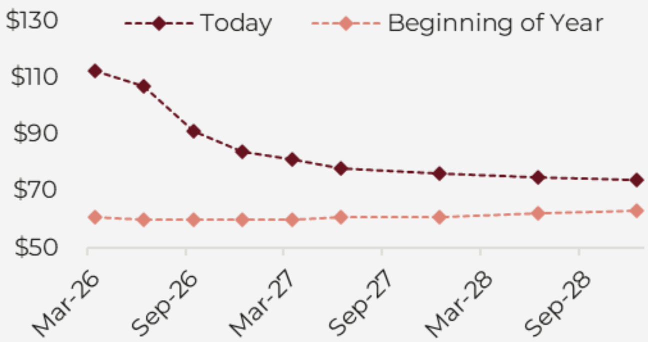
The front of the Brent curve sits around $110, up sharply since late February. Physical markets are more extreme — Oman crude, the benchmark for Asian delivery, has traded materially higher, with refined products like jet fuel seeing even sharper dislocations.



Source: Monas Investments; S&P CapitalIQ

Meanwhile, pre-war, Brent futures were in the low-to-mid $60s across the curve, flirting with contango. Today, you have steep backwardation in the front few months that flattens rapidly. December 2026 Brent is around $85. By 2027, you're back in the mid-$70s.

Brent (Curve; Today vs. Beginning of Year)



Source: Monas Investments; S&P CapitalIQ

The market is pricing in a resolution: the Strait reopens, flows normalize, and we move on with perhaps a modest structural premium for the disruption.

This is, broadly, consensus. Torsten Slok, Apollo's Chief Economist, put it most directly: "Markets are overreacting to what will likely be a 4- to 6-week period of volatility, which will ultimately result in 50 years of stability in oil markets, supply chains and geopolitics."

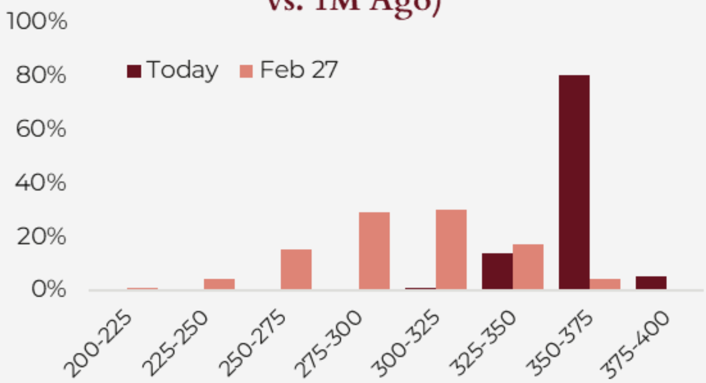
Consensus is probably right. But it's worth thinking through what happens if it isn't, or even if it's only partially right, because the downstream effects compound in ways the market hasn't fully considered.

Immediate problems: inflation and rates.

CPI was already running at 2.4% in February, above the Fed's target before any of the energy shock showed up in the data, and the Fed held on March 18, signaling a slower path to easing.

Now over the last month, traders have all but erased the chance of cuts, from a projected 2-3, down to 0-1 since the end of February.

Projected Rate Probabilities (Today vs. 1M Ago)



Source: CME Group

2Y Treasury Rate (YTD)

Source: S&P CapitalIQ

But even with this, equity markets are only off slightly. We had significantly worse market outcomes in 2022 when rates rose and it was clear inflation was here to stay.

The consensus is this is a blip, rates settle, cuts get repriced back in, and we move on.

What happens if it isn't a blip?

The market is almost entirely focused on oil price. But there are countless second order effects the broader market has not yet considered if things aren't resolved quickly.

A simple example: Hydrocarbon processing in the region is a key source of elemental sulfur, a byproduct used to produce sulfuric acid, an essential input in copper extraction. The Middle East represents a meaningful share of global sulfur production and an even larger share of seaborne trade.

In the DRC, where copper production is heavily dependent on sulfuric acid leaching, Ivanhoe Mines' CEO Robert Friedland has publicly warned that supply disruptions could force production curtailments if sustained.

Copper is already a binding constraint for large power transformers and high-voltage switchgear, equipment that had multi-year lead times prior to this shock. It will be hard to sustain the infrastructure that supports the AI explosion.

COPX (Copper Miner ETF) Returns YTD

Source: Monas Investments; S&P CapitalIQ

An even more worrisome example: the Middle East accounts for a significant share of global urea exports and nitrogen fertilizer production is directly tied to natural gas availability. Urea prices at the U.S. Gulf have risen sharply since the conflict began. If disruption persists through a planting cycle, that flows directly into food prices within a single harvest.

CF Industries, a major domestic nitrogen producer, has rallied significantly since February 28. This size move is the market pricing a supply shock that most macro commentary isn't discussing.

CF Industries Stock Returns YTD

Source: Monas Investments; S&P CapitalIQ

Food prices, electricity prices, building prices, even clothing prices are all tied to oil and petrochemicals, which are at risk of disruption today. Investors better versed in this than me have written more than I'll be able to learn on the topic, yet today we sit with the 60/40 portfolio within striking distance of all-time highs.

Meanwhile, unlike the SVB crisis we spoke about in Austin, the Fed can't jawbone rates lower and inject liquidity to fix this problem quickly.

Remember the two crisis paths: the pessimists are wrong, and we move on, or they aren't, and it is impossible to predict the "depth" of the problem.

Hopefully, they are wrong.

Market Financial Solutions, and private credit cracks

In February, Market Financial Solutions, a London-based mortgage lender with a loan book north of £2.7 billion, entered administration in the UK, which alone wouldn't be much of a story.

However, creditors alleged that the same assets had been pledged as collateral for multiple loans simultaneously, a practice known as double-pledging, leaving what could be £1.2 billion in debts collateralized by only £230 million of assets.

Barclays, Jefferies, Apollo, Santander, and Wells Fargo were all among those exposed, each having extended financing under the belief they held secured positions against real assets.

Even though this is starting to look like a pattern (remember First Brands and Tricolor?), we're willing to extend the benefit of the doubt. Maybe this isn't systematic. Though given the underwriting of the aforementioned, MFS probably isn't the last.

The private credit market is estimated over $3 trillion; three fraud cases do not a systemic crisis make. This isn't Bear, it isn't Lehman.

The bigger issue is it is easy to see how the math stops working.

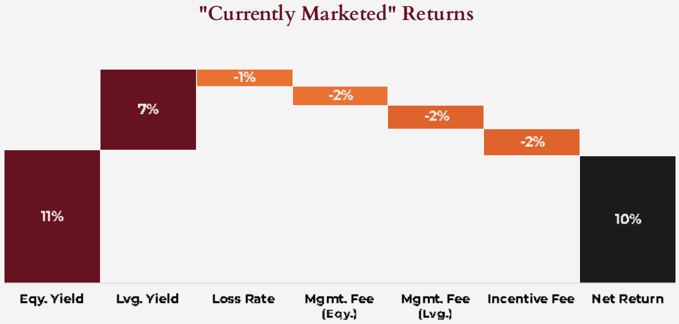
What was an obvious trade may no longer be.

Private credit made obvious sense in the years following the GFC. Banks retreated from middle-market lending under the weight of new capital requirements, leaving a genuine gap. The investors who stepped in were compensated accordingly: wide spreads, tight covenants, real illiquidity premium. The asset class earned its reputation.

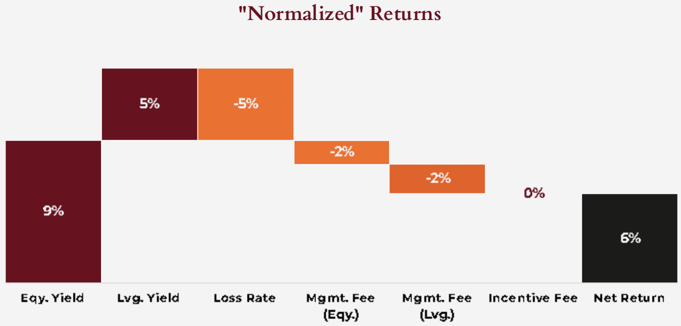
Then it got "democratized" and sold as "liquid" funds with high yield returns and investment grade risks. A decade of inflows brought more and more capital chasing the same pool of borrowers — if slightly more levered ones.

Spreads compressed. Underwriting and covenants loosened (clearly). The structural edge that made post-GFC direct lending attractive may be in the process of being gradually arbitraged away by the very success of the trade. Meanwhile, recent returns have been largely a function of financial engineering and potentially some good luck, which may not sustain through an entire cycle.

To illustrate this, we decomposed the returns of one of the public BDCs below. We aren't naming the fund, because it really isn't about this specific fund, it's about the environment.



Source: Monas Investments; BDC Filings



Source: Monas Investments; BDC Filings

In the “Currently Marketed” returns, we backed into what headline expected returns are for this popular product.

We estimate the fund generates roughly 11% returns on its underlying investment portfolio (a mix of loans and equity positions) (“Eqy. Yield”) and after paying its cost of debt which is around 5-6% today, it generates an additional 7% on the leverage it has taken on the portfolio (“Lvg. Yield”).

We used a conservative estimate for expected loss rate (which isn’t disclosed) and apply their management fee to both AUM *and* the leverage they are taking (surprise!) as well as their incentive fee, to get to a reasonable marketed net return of 10%.

Now, we would argue for taxable investors, that number really isn’t that great due to the fact that it is primarily ordinary income, but we’re willing to assume anyone putting capital into this product has thought about that critically.

The problem isn’t this return. The problem is what happens if we make only slight tweaks to the assumptions.

Instead of assuming ~10% returns on loans, and ~13-14% returns on equity positions, we assume 9% on loans (slightly higher than the rate at which they are currently lending), and 10% on equity (which is still generous).

Meanwhile, instead of 2.5% default rates and 70% recovery rates, we assume 5% default rates (which is lower than the ~9% recently released by Fitch) and 50% recovery rates, which is around where recent par-weighted recoveries have been.

As an aside - some estimate payment-in-kind loans have risen from roughly 5% of private credit exposure in 2022 to over 11% by end of 2025, with "bad PIK" (borrowers switching from cash interest to PIK) reaching 6.4% of exposure.

No other changes. Just modest, common-sense adjustments to expectations.

The net result: returns that looked like 11-12% in recent years could easily look like 5-6% on a forward basis.

This doesn’t include the fact that the cost to borrow for a lot of these vehicles has gone up meaningfully in the last 3-6 months. They do not need to refinance soon, so it’s possible they keep borrow costs low, but even an extra 1% in their cost of leverage directly reduces investor returns.

The problem is, now you can't leave.

The liquidity math is a more immediate problem for some than the returns math.

The sequence started with Blue Owl. In February, Blue Owl announced it would restrict withdrawals from OBDC II (one of its retail-focused private credit funds) permanently halting quarterly redemptions and converting the vehicle to periodic return-of-capital distributions instead.

Then came BlackRock. Its $26 billion HPS Corporate Lending Fund (HLEND) received redemption requests of roughly 9.3% of NAV, or $1.2 billion, in Q1 2026, and capped repurchases at its standard 5% limit, returning approximately $620 million and leaving the rest in queue. To be clear, this is not even unexpected behavior, this is exactly what we would expect in this environment.

That said, Blackstone took a different approach. BCRED faced roughly $3.7 billion in Q1 redemption requests (a record 7.9% of the fund) and rather than gate investors, Blackstone raised its quarterly cap to 7% and injected $400 million of firm and employee capital to honor all requests.

Good for investors, but it was also a one-time fix, not a structural solution.

Apollo's $25 billion Debt Solutions fund capped redemptions at 5% after investors sought to withdraw roughly 11.2% of outstanding shares, returning about 45 cents on the dollar to each redeeming investor.

Cliffwater, Ares, Morgan Stanley's North Haven fund — the list goes on.

The frustrating problem is that we've seen this before, less than 4 years ago, and yet most investors in these products appear to be surprised by the outcome.

In November 2022, BREIT gated redemptions after withdrawal requests exceeded its monthly 2% and quarterly 5% caps. It took until March 2024, well over a year, before BREIT could fulfill 100% of redemption requests, returning more than $15 billion to shareholders in the process. The lesson, apparently, was not learned.

None of this is an acute crisis. Private credit will survive MFS, and it will survive this redemption cycle. But the combination of tighter math, rising defaults, PIK creep, and a retail investor base that is only now learning what "semiliquid" actually means in practice suggests the asset class will generate returns far closer to what you'd expect from the underlying credit risk, not the premium that justified a decade of inflows.

The rolling SaaSpocalypse

Through the first quarter of 2026, a rolling sell-off has moved sector to sector, driven largely by whatever press release Anthropic or their competitors have dropped.

The SPDR Software ETF (XSW) is down over 30% from highs. Salesforce and Adobe down 30% YTD, double that from all time highs.

This was the obvious risk associated with increasing success of LLMs.

Then IBM. Anthropic published a blog post on Claude Code's ability to automate COBOL modernization, the 60-year-old programming language running 95% of US ATM transactions and IBM's highest-margin consulting work. Shares fell 13%, and again, maybe some novel risks being priced in.

An AI-based tax planning tool led to the RIA brokers like LPL and Schwab falling over 5% in a day.

And then trucking?

Algorhythm Holdings, formerly a karaoke machine company, announced an AI freight tool called SemiCab. C.H. Robinson, RXO, Expeditors, all down double digits in a day.

In a note to clients, Jefferies described the market as being in: "shoot first, ask questions later mode."

We're not arguing this is all noise.

We would agree there is a real valuation question underneath. The distinction that matters is switching-cost businesses versus knowledge businesses.

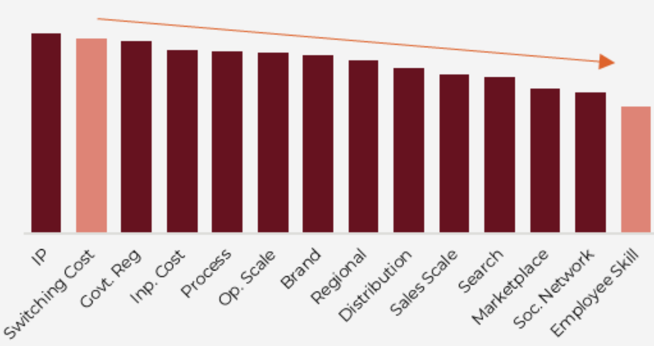
When I was working at Valens Research, we were mapping a taxonomy of 14 competitive advantages across the public company landscape to identify trends in valuations, profitability, and growth based on *how* companies earned their returns.

As it relates to today, it should come as no surprise that switching-cost businesses (in this case software so deeply embedded that leaving costs more than staying) trade at a premium because customers are captive, not because the product is best. These companies can sell ancillary products easier, which embeds them even more deeply, and net revenue retention rates regularly exceed 100%.

On the other end of the spectrum were what we called "employee skill" and "process knowhow" businesses – companies that generated their returns because their employees knew more or the institutional knowledge was such that paying a premium was worth it.

Consulting companies fall into this category. And any executive who has used consultants before knows that some of the value is the explicit "they help you improve your business", and some of that value is the implicit "there is someone to yell at when things break, that aren't your employees."

Good business, but not worth the same economic premium.



Source: Monas Investments; Valens Research

The question AI is forcing today is whether a cohort of software companies is slowly migrating from the first category to the second. If Claude Code can replicate a mid-market SaaS product's core functionality in weeks, then at some point you're truly just paying for an accountability layer.

Meanwhile, the cross-sell flywheel is slowing. Much of enterprise software's valuation premium reflected expansion economics. Every renewal was also an upsell. As AI makes alternatives easier to evaluate, incremental spend gets incremental scrutiny.

All of this is now largely consensus. It is why we have seen the sell offs, and we would argue we aren't arbitrarily buying this dip.

Then came Citrini, and trading on vibes

On Sunday, February 22nd, Citrini Research published *The 2028 Global Intelligence Crisis*

They highlight a world in which AI has disrupted the global economy. An entertaining read. Dystopian. But fictional.

And yet, Monday the 23rd, the market was down over 1%.

We would argue nothing in the hypothetical laid out in the article was "new" information, much like the idea that AI could build better tax planning tools was something that should have been obvious since ChatGPT first launched.

Yet the market reacted like this was a harbinger of greater doom.

Maybe the market just needed someone with decent writing skills to tell a story, but more likely we're in a world where "vibes trading" is a real phenomenon.

Today's marginal trader is not a fundamental analyst.

10 years ago, JPMorgan estimated that just 10% of all trading was being done by fundamental "stock pickers". That number is probably closer to zero today.

Everyone in this industry has seen the work on passive flows, and how there are now more funds allocated to passive solutions than active, and with the size of 401(k)s and other similar products, allocation is even done passively. Although probably fairly distortionary to markets, that is a topic for another day.

The more meaningful marginal trader to this story is the algorithmic trader. Brilliant PhDs are working at some of the best firms in the world to build models predicting where stocks go next.

Most of these funds don't truly care about fundamentals or valuation. These models watch price levels, momentum, qualitative signals, anything that could inform the next trend, and when a trade signal occurs, they execute.

This happens regardless of human input, whether the signal is durable or even rational. And they are all competing to be a little bit faster on signal than their peers. Buy before others buy, sell before they sell.

And they are all making similar bets. In a research note from one of the large investment banks earlier this quarter, they highlighted their overall prime book factor exposure to momentum had risen from ~0-20% over much of the last 5 years, to north of 50%. That is, implicitly or explicitly, most of their clients were taking the same momentum bet, at the same time.

And that brings us to headline trading. When these algorithms see a negative headline, they sell. When they see a positive headline, they buy.

They are pattern recognizing on recent history, to get to the trade before anyone else. When history shows Trump is likely to chicken out, they buy, because it has usually worked.

The problem is they are pretty bad at predicting when the world has changed.

A brief review of our "opportunities"

In our year-end letter, we highlighted nine places we were watching this year as opportunities for investors.

It is *far* too early to evaluate the "correctness" of these ideas (except one), and our evaluation instead is "has anything changed."

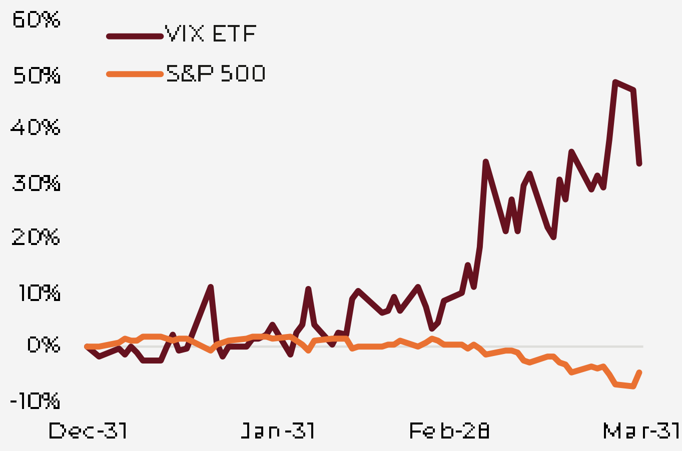
Before focusing on the underlying themes, we highlighted in our letter that for 2026 to look like 2025, we needed four different legs of the market bet to work:

- Growth had to stay high
- Inflation had to remain muted
- Rates needed to fall
- Geopolitical risk needed to cool

All four went the wrong way, so it is no surprise to date we have been right on the 60/40. Unfortunately (or fortunately), at present there is still hope these trends reverse back to a more favorable direction, but it is worth watching closely.

First, we're willing to claim victory on buying volatility.

When volatility is priced in first decile tights, while actual volatility is high (and generally exogenous), it is usually a good opportunity to introduce hedges into a portfolio.



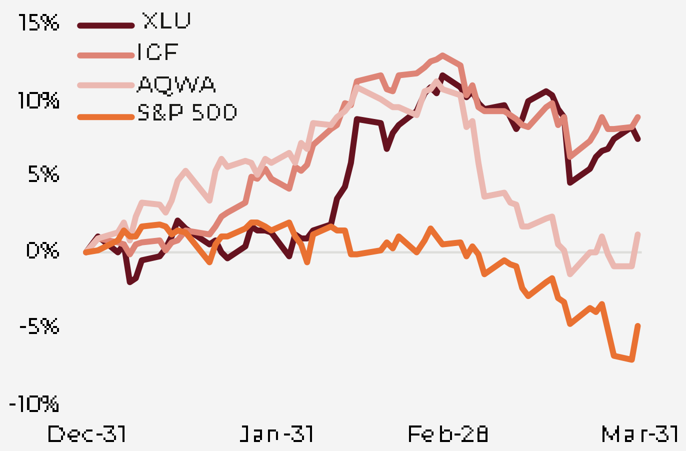
Source: S&P CapitalIQ

At close of the quarter, the VIX index sits at 25, almost double where it was at the beginning of the year, but off from highs earlier this week. Not nearly as obvious a trade as it was, and likely more appropriately pricing issues we're facing on the four legs. For context, a VIX level of 25-30 implies expected daily moves of 1.5-2.0% over the coming month. Meaningfully higher than VIX under 15.

Meanwhile, credit spreads remain near decade tights, wider than post-COVID lows, but still failing to price any potential economic stress broadly, suggesting there might be opportunities elsewhere in the capital structure.

The infrastructure and utilities themes remain compelling, with one caveat.

XLU (The SPDR Utilities ETF) is up 8% YTD, AQWA (Global X Water ETF, a proxy for the water theme) is up 1% and IGF (iShares Global Infrastructure ETF) is up 9%.



Source: S&P CapitalIQ

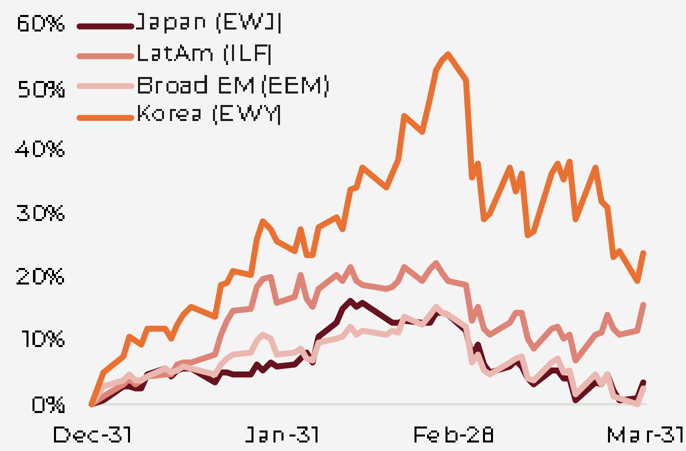
The thesis hasn't changed: you can't build the AI future without physical infrastructure, and the physical infrastructure has been underinvested for years.

The caveat is the hyperscaler CapEx cycle that underpins a large part of this theme could come under pressure if energy prices remain elevated. If the marginal data center becomes harder to justify, sentiment could shift on this theme, regardless of justification.

However, we view this as a longer-term risk, not an imminent one. The demand side continues to accelerate faster than supply can respond, and given the years of underinvestment, this is unlikely to change quickly.

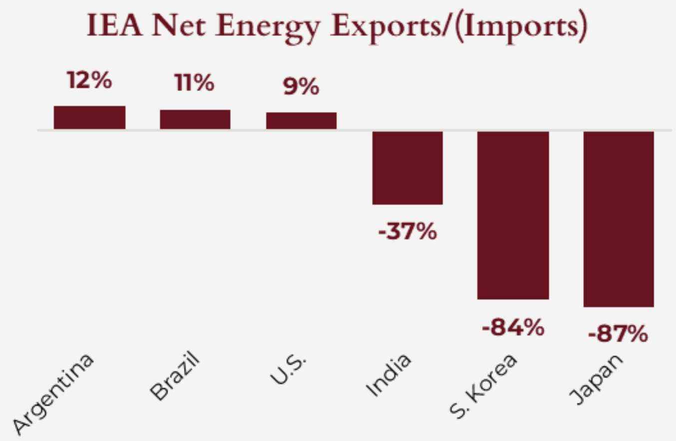
The emerging markets and governance stories are getting more complex.

The Japanese and Korean governance stories remain idiosyncratic tailwinds to those geographies, and commodity returns and dollar weakness have been tailwinds to emerging markets broadly.



Source: S&P CapitalIQ

However, since the beginning of March, it is clear the biggest headwind to the continued success of this theme is energy prices.



Source: IEA

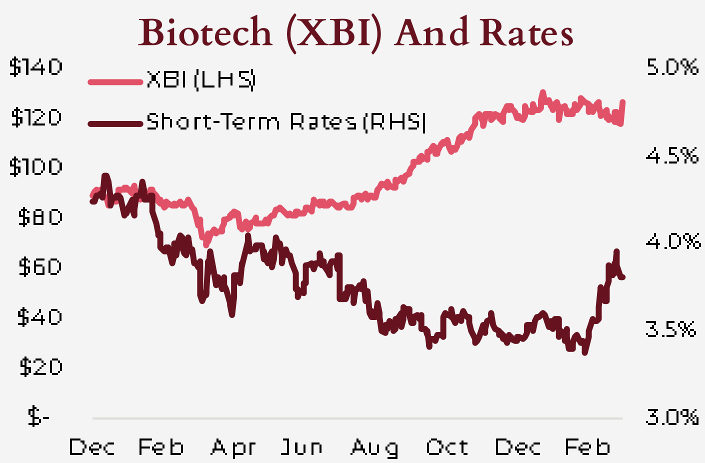
The chart above highlights the IEA's estimates of what percentage of total energy production/supply is exported/imported. It should not be a surprise that the equity markets of energy exporters (LatAm, United States) have held up better over the last month than net importers (India, South Korea, Japan).

Should energy constraints persist, we would expect that to outweigh the benefits of improving governance and dollar weakness for these markets. For the same reason, we are beginning to evaluate the value-add of certain LatAm markets going forward.

The idiosyncrasy of biotech remains, but the current environment does offer a key headwind.

We highlighted that while other long-duration assets exploded post rate-hike cycle, biotech had been left behind. This was due to a number of factors, including an icy M&A environment, and general investor fatigue with the sector.

Following a relatively strong 2025, where it seemed the headwinds were easing, XBI (SPDR Biotech ETF) is off nearly 10% from highs, as the risk of unexpected inflation and rising rates again pressures the longest duration industry.



Source: S&P CapitalIQ

That said, biotech has already spent four years getting repriced while other long-duration assets like tech and growth software rode the wave higher. The sector entered 2026 having already absorbed most of the pain that rising rates typically inflict. We think there's less incremental downside from a rising rate environment here than in comparable asset classes, precisely because biotech never participated in the recovery.

Private markets face headwinds for all the reasons we mention in this paper, but we remain positive on liquidity solutions and micro caps.

We've already covered the private credit story at length in this letter, so won't rehash the problems. The question for these two sub-themes is simpler: has anything changed?

For late-stage liquidity solutions, the answer is no, and that's the point. There have been 34 IPOs priced so far in 2026, a slow start (though with SpaceX, OpenAI, and Anthropic potentially coming later). The SEC backlog from the late-2025 government shutdown is still clearing, and the Iran conflict has the potential to freeze the window further.

More than 800 unicorns are sitting in what amounts to an IPO waiting room, with insiders growing more impatient for liquidity with each quarter that passes. Secondary transaction volume surpassed $60 billion in 2025, and the structural demand for liquidity solutions continues to grow.

For the lower middle market, the valuation spread between large and small deals remains wide, and the succession dynamics we highlighted haven't changed either. Nothing has emerged to make these trades less attractive. If anything, the current environment of uncertainty and tighter credit makes the patient buyer with operational capability more valuable, not less.

We're not good at probabilities and should invest as such.

There is consistent evidence that humans are generally incapable of distinguishing between the actual likelihood of low (and high) probability events.

1% feels like 5%, which doesn't feel too dissimilar from 15%. On the other side 80% feels pretty similar to 90%, which is pretty similar to 95%.

The challenge is when probabilities compound.

The odds of 4 unrelated 95% probability events all hitting is about 81%. The odds of 4 different 80% probability events all hitting is less than a coin flip (41%).

We can't put an exact number to the odds growth stays high, the odds inflation stays low, or rates fall, or geopolitical risk is tame. (And these are not uncorrelated, which does complicate the math.)

What we are pretty sure of though, is that these are not 95% probabilities, and yet the market has been conditioned that every risk is effectively zero, and that there are no compounding effects.

Fifteen years of central bank backstops have trained an entire generation of allocators to buy every dip, sell every vol spike, and lever the bet that things mean-revert to "good." The conditioning was rational when the Fed was buying corporate bonds and rates were zero. The problem is that Pavlovian responses don't distinguish between the environment that created them and the one they're deployed in.

Fortunately, there are ways to position for uncertainty without forgoing opportunity. That's the entire point of looking for asymmetries.

We don't need to predict all of the outcomes. We just need to create portfolios that are successful across many.

Disclosures & Important Information