THE BOSTON FAMILY OFFICE
INVESTMENT SERVICES

Market Update

First Quarter 2026

Equity Markets: A Tug-of-War Between Innovation and Geopolitics

Equity Markets (Total Return)	1Q’26	1-Year
Dow Jones Industrial Average	-3.2%	12.2%
S&P 500	-4.4%	17.8%
S&P 400 Mid-Cap	2.5%	17.3%
S&P 600 Small-Cap	3.6%	20.6%
MSCI All-Country World	-3.1%	20.5%
MSCI Foreign Developed Markets	-1.1%	22.0%
MSCI Foreign Emerging Markets	-0.1%	30.3%

US Bond Markets (Total Return)	1Q’26	1-Year
Bloomberg US Treasury	0.0%	3.3%
Bloomberg US Municipal	-0.2%	4.3%
Bloomberg US Corporate Investment Grade	-0.5%	4.8%

Source: Bloomberg

Most global equity indices retreated in the first quarter, with the S&P 500 declining 8.9% from its January 27th all-time high through March 30th. While such dips are not comfortable, the pullback follows a period of strength, with all indices we report on below still up significantly over the last twelve months.

In mid-January many software stocks sold off as investors began to fear that even the large, publicly traded incumbents’ offerings may be at risk of being disrupted by the proliferation of a slew of new AI applications. The increased spending outlook from large cloud providers added further to the early-year weakness in the Technology sector as investors questioned whether these companies will generate adequate returns to justify the hit to their free cash flow.

By late-February these concerns seemed to be dissipating, but then war broke out in Iran focusing investors on the risks to global economic growth and weighing on markets more broadly through the end of the quarter.

SaaSpocalypse

To provide context for the current volatility in the software industry, we can look back to the turn of the millennium and the revolution of the Software as a Service (SaaS) business model. This shift fundamentally re-engineered the industry, moving away from physical media and "lumpy" license-based sales toward the highly predictable, recurring revenue "gold mine" that became the industry standard.

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For over two decades, investors prized this model for its low capital intensity, high margins, and financial visibility—until the 2022 debut of ChatGPT redirected market enthusiasm. Since then, investor interest has pivoted toward the hardware and infrastructure providers that benefit most directly from the immediate buildout of the AI ecosystem.

The evolution of generative AI has since ushered in a new era in which the threat of disruption for software incumbents has climbed. By effectively lowering the barriers to entry for coding and application development, AI has begun to diminish the competitive moats that once shielded legacy software companies. Despite these shifts, our view remains that software companies providing core, mission-critical applications will continue to maintain durable competitive advantages. These platforms are often so deeply integrated into their customers' daily operations that they remain insulated from the disruption facing more discretionary or superficial software tools.

The $650 Billion Bet

The four largest cloud service providers (Meta, Amazon, Alphabet and Microsoft), anticipate spending ~$650 billion on AI infrastructure this year – a figure that rivals the inflation-adjusted cost of the entire U.S. Interstate Highway System over the course of four decades.

In 1Q26, we saw another wave of pushback from investors on the level of spending as it took another leg higher from already astonishing levels. While the long-term potential of AI is undeniable, the market is transitioning from blind enthusiasm to more disciplined verification.

Investors now want a clearer timeline for when these investments will pay off and are closely watching how elevated spending affects the actual cash these businesses have left over after paying their operating expenses.

As for companies (and individuals) throughout the rest of the economy which may eventually pay to use this new AI infrastructure, most all are only in the early stages of learning to leverage the technology to implement productivity enhancing measures. We suspect over time demand for AI capabilities will generate sufficient returns to justify the cloud providers' current investments.

Watching for the "Cockroach"

Private credit refers to lending by non-bank entities or funds to other companies. With the increase in regulations since the financial crisis, less and less of the normal lending in the economy is done by banks or traditional lenders. Concerns surrounding the asset class began percolating in 4Q25 with the discovery of two large-scale frauds (Tri Color and First Brands). In his discussion on the topic during a recent earnings call, JPMorgan CEO Jamie Dimon—never one to mince words—opined that "when you see one cockroach, there are probably more." Unsurprisingly, this view failed to quell investors' nerves.

The 'SaaSpocalypse' narrative compounded these fears in Q1, as a significant portion of private credit portfolios typically consists of loans to software companies leading many investors to request withdrawals. This created a cash shortage within many funds, forcing them to restrict how much cash investors could take out, which was within their rights but in turn raised additional concerns among investors.

While our view is that fears about private credit may be elevated relative to actual risk, the resulting market sentiment will likely pressure borrowing costs and refinancing activity. Because BFO prioritizes transparency, we have maintained very little direct exposure to the private credit asset class—a position that, when coupled with the sector's current uncertainty, justifies a cautious stance.

Geopolitical Tensions Creating New Challenges

The escalating tensions involving Iran and the disruption of transit through the Strait of Hormuz have cast a long shadow over the macroeconomic outlook. While there is sporadic hope for a resolution, investors must realize that global energy markets do not function like a spigot. Even if the Strait were to open tomorrow there are several dynamics that are likely to keep upward pressure on energy costs. Damage to energy production infrastructure in the region may take years to fix, there is a logistical backlog of oil already in transit and wells that have been shut down that will take time to sort through, and we believe there is a risk premium baked into energy prices that we expect to subside gradually.

The added layer of rising energy and fertilizer prices has brought about renewed concerns of stagflation– stagnant growth alongside heightened inflation. With higher energy costs acting as an inflationary tax on the consumer and driving up raw material and production expenses for manufacturers, the prospect for interest rate cuts has become more clouded. On one hand, the risk that the economy slows would call for the Federal Reserve to reduce interest rates to stimulate the economy, while on the other, the Fed may be inclined to increase rates to quell the renewed inflationary threat. These competing forces will be a widely debated dynamic that the Federal Reserve will grapple with as the full effects and duration of the war become clearer.

Incidentally, the prospect for either fewer rate cuts – or even rate hikes – also weighs on growth stocks, which created another downward force on the Technology sector throughout the quarter.

Tricky Backdrop for Bonds

The macro environment has created a difficult backdrop for bonds. While bonds are typically a reliable hedge during geopolitical turmoil, they struggled this quarter as the particulars of this crisis- namely, its inflationary nature- have pressured yields. However, they continue to serve their primary purpose as a stabilizer against equity volatility.

Looking Ahead

Despite the downward drift in the indices and the Middle East conflict, history offers a consistent lesson: geopolitical events, while jarring, tend to be long-term buying opportunities rather than reasons to exit the market.

To achieve long-term returns, investors must be willing to endure short-term market swings. The current environment—characterized by a massive technological shift funded by historic levels of capital—requires patience. While this transformation will not happen overnight, the foundational strengths of the economy remain intact. Because our strategy focuses on investing in high-quality, resilient businesses, we are confidently maintaining our approach.

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