

# Q2 2026 Market Outlook

Q1 2026 Review & Second-Half Implications

## THE HEADLINES VS. THE DATA

For much of the Q1 2026, attention was consumed by the U.S.-Israeli military campaign against Iran, which began on February 28 and sent shockwaves through energy markets, closed shipping lanes through the Strait of Hormuz, and dominated financial headlines from March onward. However, behind the scenes of that dramatic backdrop, the U.S. economy had quietly been putting together a solid stretch of broad-based expansion.

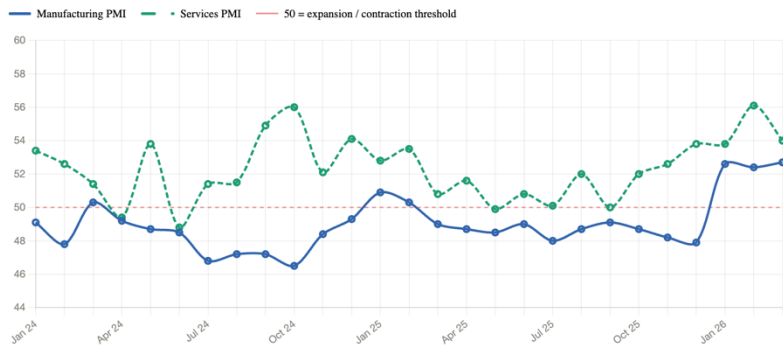
More recent developments, including cease-fire agreement and a potential reopening of the Strait of Hormuz, have reintroduced optimism to financial markets, which have rebounded nicely from their March lows. While we're encouraged by this progress, positive economic data throughout the past quarter could potentially setup the markets for further upside as the year progresses. However, we must also consider the secondary effects to recent energy shocks and ask whether inflation may inflect higher this year and how that could impact Fed policy and market expectations.

## WHAT THE ECONOMIC DATA WAS ACTUALLY TELLING US

### *Manufacturing: A Genuine Comeback*

One of the most underappreciated developments of early 2026 was a durable recovery in U.S. manufacturing activity. After spending most of 2024 and early 2025 in contraction, the ISM Manufacturing PMI climbed back above expansionary territory of 50 in January and continued rising through March, reaching 52.7% — the highest reading since August 2022 and the third consecutive month of expansion. New orders, production, and supplier deliveries all held in positive territory. Of the six largest manufacturing industries, four were expanding in March.

The shadow over that recovery, however, was the ISM Manufacturing Prices Paid Index, which surged to 78.3% in March — up nearly 20 percentage points in just two months and the highest reading since June 2022. Panelists were explicit: Iran war disruptions to energy and global shipping were feeding directly into input costs. Manufacturing employment also stayed in contraction at 48.7%, with companies reluctant to add headcount amid ongoing uncertainty over tariff policy and trade.



Source: Institute for Supply Management (ISM). Above 50 = expansion, below 50 = contraction.

### *Services: The Steadier Engine*

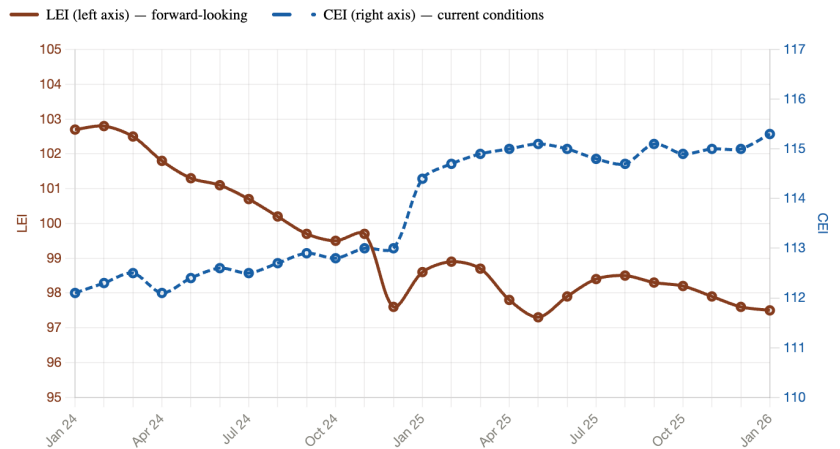
The services sector has been the more consistent driver of U.S. growth throughout this cycle, and Q1 2026 was no exception. The ISM Services PMI registered 54.0% in March — its 21st consecutive month in expansion territory and among the strongest readings since late 2024. New orders hit 60.6%, the highest since February 2023, and backlogs expanded for the second straight month. The 12-month moving average for the Services PMI has been rising for three consecutive months, reinforcing the durability of services-sector demand.

As with manufacturing, the price story complicated the otherwise solid picture. The Services Prices Paid Index surged to 70.7% in March — the largest single-month jump in nearly 14 years. Every one of the 17 reporting industries noted higher prices. No commodity was reported lower in price. Rising fuel, shipping, and energy costs were the primary cited factors — a direct transmission of the oil shock into the broad economy.

### The Leading vs. Coincident Divide

While still working through delays related to the government shutdown, The Conference Board's index suite captures the tension well. The Coincident Economic Index — which measures the economy as it is right now — rose for the fourth straight month in January, with all four components improving. The economy, in real time, was still expanding. The Leading Economic Index, by contrast, fell for the fifth consecutive month in January, declining to 97.5. The six-month rate of decline has moderated compared to 2025, and 7 of 10 components were positive on a six-month basis, suggesting the deceleration is losing momentum. But the direction remains negative, and that data predates the Iran conflict entirely.

Consumer confidence tells a similar story of a present holding up even as the future looks uncertain. The Conference Board's Present Situation Index rose a healthy 4.6 points in March to 123.3. The Expectations Index, however, fell to 70.9 — readings below 80 have historically been a reliable early warning of recession. Consumers are spending for today but growing more anxious about tomorrow.

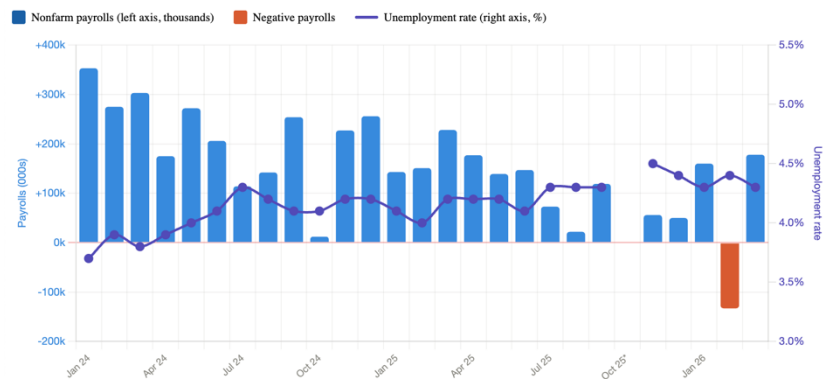


Source: The Conference Board (2016=100). LEI leads the business cycle by ~7 months; CEI reflects current economic conditions.

### The Labor Market: Resilient and Recalibrating

March's jobs report was the quarter's most upside surprise: 178,000 nonfarm payrolls added against a consensus of roughly 60,000, reversing February's weather- and strike-distorted loss of 133,000. Healthcare, construction, and transportation led the gains. Manufacturing added 15,000 against an expected loss of 5,000. The unemployment rate edged down to 4.3%.

Wage growth moderated to 3.5% year-over-year — helpful for inflation but a sign of cooling labor demand. More structurally, the Dallas and San Francisco Feds have both highlighted that sharply reduced net immigration has pushed the labor market's 'break-even' pace — the monthly job creation needed to hold unemployment steady — close to zero. The economy no longer needs 150,000 or 200,000 new jobs per month to maintain labor market stability. That recalibration matters: it gives the Fed more patience before interpreting soft payroll months as distress signals.



Source: Bureau of Labor Statistics. Seasonally adjusted. Note: October 2025 data not collected due to federal government shutdown. Payroll figures reflect latest available revisions.

## OIL, INFLATION, AND THE FED: WHAT LIES AHEAD

We expect the economic story for the second half of 2026 to be written largely by two variables: the trajectory of oil prices and the Federal Reserve's response to the inflation they generate. In addition to the Iran conflict, this could become the primary focus of potential market uncertainty as we head toward 2H 2026.

Oil markets are pricing in a world where the Strait of Hormuz remains at least partially impaired. *Brent crude surged more than 25% in the weeks following the opening strikes on Iran, briefly exceeding \$100 per barrel.* Saudi Arabia and the UAE have moved to reroute crude through alternative pipelines, and the IEA has coordinated a strategic reserve release, but these measures provide only partial offset. Bloomberg Economics estimates that at \$110 per barrel, the inflation impact on the U.S. is roughly 1 percentage point of additional annual CPI.

One of our bullish cases for 2026 had been the replacement of Fed Chair Powell in May with a potentially more dovish FOMC Chairman who may push for lowering the Fed Funds benchmark rate. However, since the oil price surge, the FOMC is now widely expected to remain on hold through at least the summer. The Fed raised its median 2026 PCE inflation forecast to 2.7% — already above the 2% target before the full oil pass-through has been measured. With CPI tracking near 3.4% in March according to real-time estimates, the central bank finds itself in an energy-shock bind, and markets have largely priced out any 2026 rate cuts, with CME FedWatch showing roughly a 79% probability of no change through December.

While the markets will continue to evaluate Middle East tensions and energy price swings, we will be equally focused on economic data and this upcoming earnings season. Thus far, we remain encouraged and optimistic by the continued theme of a resilient US economy and consistent earnings growth.

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