



Topsy-Turvy

Q1 2026

The quarterly must be written and in a timely fashion, so my editors keep reminding me. For my part, I had been scribbling in pencil, and stalling, hoping some bit of news might save me from wandering off in the wrong direction. Finally, my fondness for procrastination has paid off.

Thank goodness, it appears that we and the Iranians have finally agreed that the bombing should stop and the Strait of Hormuz should open. But this was always the end game. Too much indispensable oil and fertilizer feedstocks transit the strait for the situation to continue indefinitely. This cease-fire is guaranteed to be a messy affair with fits and starts given their longing for revenge and typical regime double-talk, but they will yield. We assume the price of oil will eventually normalize lower. How much lower? Nobody knows.

The Iran affair has interrupted the bull market in stocks, but that's just one headline in a topsy-turvy first quarter. The S&P 500 leaked a little more than 4%, while the average large cap stock actually rose fractionally. Small caps were up about 1%. Small caps beating large? That's an interesting reversal from recent years. In fact, the Magnificent 7 and software stocks suffered significant declines as investors began to genuinely worry about runaway AI spending and the potential for disruptions in existing software businesses as AI tools proliferate. More on that later. The big winner-- no surprise--was energy. The sector rose nearly 40% during the quarter. Materials did well too. Other recent laggards perked up with utilities and staples rising 8% and 6%, respectively. So, there was steep correction in parts of tech, a rotation from winners to losers and a partial flight to safety, but the averages remained remarkably calm at the surface, probably owing to the view that eventually this war business will be settled with manageable losses of treasure. However, the oil price spike has scrambled inflation and rate cut views. Maybe we'll have a rate cut or two. Maybe not. The ten-year Treasury yield spiked in March to its highest level since last summer on the uncertainty. In any case, the consensus remains that the economy is resilient enough to cope.

"Open the pod bay doors, HAL." That's the most quoted line from the 1968 classic *2001: A Space Odyssey*. I recently rewatched the clip where HAL (HAL 9000 AI mission software) refuses to let the mission commander (Dave Bowman) back into the ship after deducing that the humans plan

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on disconnecting it. 58 years on, it's still great cinema to watch it dawn on Dave that the computer means to kill him. I'm not going down that rabbit hole, but we're on target to spend a couple trillion dollars attempting to create super intelligence, whatever that might be. With stories piling up every week of AI inventing and endlessly improving software, without human direction, it's dawning on the market that some existing software businesses must be at risk of being 'locked out' by better software. But which exactly? Pundits are hypothesizing an endless number of AI agents performing all manner of tasks. It's head-spinning stuff with no answers likely in the short term. Broadly, software stocks crashed roughly 25% in the first quarter, with almost no actual business disruptions noted...yet. The angst also infected some private credit (a big lender in the software space) forcing a few funds to restrict withdrawals. Never a good sign. The markets' shoot-them-all reaction seems too indiscriminate in our view. Won't AI help incumbents improve their offering? Won't it help lower costs (employees)? We're obviously paying close attention. One thing is sure: there will be more software in the future, not less.

I'd characterize my current investment mind-state as idling. It seems likely we're moving into a new normal, but what that might be isn't clear. It's an understatement to say there's much to consider. Valuation differentials between traditional value and growth stocks aren't provocative. Often this will lead us in one direction or another, but not today. We continue to favor a mix of growth and value with a fair helping of our favorite of the Magnificent 7 thrown in. They're still, inarguably, the best businesses ever created and they aren't expensive. The coming earnings season will provide some clarity and it's likely to be pretty good, even with the oil shock. Our country is richer than ever. The wildcard: the AI spending boom probably continues unabated. We'll just have to wait and see what HAL does next.



Richard H. Skeppstrom II serves Brockenbrough as Managing Director and Chief Equity Strategist. He manages two of our investment products and writes most of our investment commentary. Richard joined the firm in 2016 and has 30 years of experience in the investment management industry.

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