

## Key Insights

- **Earnings Deliver Strongest Q1 in Over a Decade:** The blended Q1 2026 earnings growth rate jumped to 15.1% from 13.1% at quarter-end, with revenue growth of 10.3% (highest since Q3 2022) and a record 13.4% net profit margin %.
- **The Mag 7 Resurrection and Collapse of the AI Scare Trade:** February's narrative of AI-driven human displacement collapsed as Q1 results showed AI deployment was driving margin expansion rather than displacing enterprise revenue, sending the Magnificent 7 up 14.88% in April after falling nearly 6% in February.
- **Iran Peace Talks Collapse, Sending Brent Above \$119:** A temporary US-Iran ceasefire announced earlier in April had unwound much of February's safe-haven trade, sending Energy down 2.63% for the month and stalling gold's run at -12.53% from its late-February peak, but peace talks broke down in late April after President Trump rejected Iran's proposal to reopen the Strait of Hormuz. Per Bloomberg, Brent surged 9.66% in April to above \$114 a barrel (highest since June 2022), the UAE announced its exit from OPEC, and the renewed energy shock now lands on a Fed already constrained by sticky inflation and a leadership transition, materially complicating the May setup.
- **Complete Inversion of February's Sector Leadership:** Sector leadership flipped to Technology (+20.02%), Real Estate (+8.74%), and Consumer Discretionary (+8.60%), while Energy (-2.63%) and Health Care (-0.42%) lagged and defensive sectors that led February became laggards.
- **The Fed's Narrowing Path and Credibility Question:** April's oil pullback eased immediate inflation pressure but did not resolve the underlying policy bind, with

sticky core services and shelter components leaving the FOMC's median 2026 PCE forecast of 2.7% unlikely to be revised meaningfully lower.

- **Stretched Valuations Narrow the Margin for Error:** The forward 12-month P/E expanded to 20.9 from 19.7 at quarter-end, with analyst targets implying 17.6% upside from the April 24 close. However, trade policy remains in flux following the Supreme Court's reciprocal-tariff ruling and midterm-election years have historically delivered an average drawdown of 17.5%, leaving the market leaning hard on a fundamental backdrop it has largely priced in.

## Monthly Recap

April 2026 marked a sharp reversal of February's market dynamics, as the S&P 500 surged 10.49% to recover its earlier losses for the year and a powerful tech-led rally restored Magnificent 7 leadership. The seven mega-caps gained 14.88%, the Nasdaq added 15.32%, and the Russell 2000 Index rose 12.29%. The growth-over-value rotation that briefly inverted in early 2026 came roaring back, with the Russell 3000 Growth gaining 12.22% versus Value's 8.23%. Sector leadership is now dominated by Technology (+20.02%), Real Estate (+8.74%), Consumer Discretionary (+8.60%), Industrials (+7.95%), and Financials (+5.59%), while Health Care (-0.42%) lagged, a near-complete inversion of February's sector ranking. Energy (-2.63%) was on track to be April's worst-performing sector before the late-April collapse of US-Iran peace talks sent Brent vaulting back up, erasing the month's energy retracement and reframing the entire macro setup heading into May. Internationally, MSCI Emerging Markets surged 16.04% and MSCI World ex-US gained 5.88%, with emerging markets now up 15.90% year-to-date (YTD).

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## Earnings Save the Day: Strongest Q1 in More Than a Decade

The defining macro story of April was the strength of Q1 2026 earnings, which arrived in dramatic fashion and reframed the artificial intelligence (AI) narrative from displacement risk to productivity acceleration. Per FactSet (28% reported as of April 24), the blended Q1 earnings growth rate, which combines results from companies that have already reported with estimates for those that have not, jumped to 15.1%, up from 13.1% at quarter-end, on pace for the sixth consecutive quarter of double-digit growth. Revenue growth reached 10.3%, the highest since Q3 2022, and the blended net profit margin of 13.4% set an all-time record going back to FactSet's tracking inception in 2009. 84% of companies beat earnings per share (EPS) estimates versus a 5-year average of 78%, and the magnitude of beats hit 12.3% versus the 7.3% historical average. Information Technology led with earnings growth of 46.3%, driven by NVIDIA (EPS of \$1.74 vs. \$0.81 a year prior) and Micron Technology (\$12.20 vs. \$1.56). Materials posted earnings growth of 33.1%, anchored by the Metals & Mining industry at +133%. Financials reached 19.8% on substantial beats from JPMorgan Chase, Citigroup, Bank of America, and Morgan Stanley. Industrials rose 16.7%, lifted by GE Vernova's \$17.44 vs. \$1.95 surprise, which included \$4.5 billion in pre-tax mergers and acquisitions gains.

## The Iran Head-Fake: From Ceasefire to Renewed Crisis

For most of April, the geopolitical risk premium that drove February's flight to safety appeared to be unwinding. A temporary US-Iran ceasefire announced earlier in the month gave markets reason to price in at least a partial path to de-escalation, sending Energy down with its first negative month since the conflict began, and stalling gold's run, which declined 1.08% in April and slipped to -6.46% YTD, now down over 12% from its late-February peak. The Bloomberg US Dollar Index fell 1.93% as risk appetite returned, and the Bloomberg Galaxy Crypto Index rebounded 7.58%, though it remains down 20.98% YTD. The earnings impact was visible in FactSet's data: the Energy sector flipped from an expected +8.3% Q1 growth at March 31 to a -14.4% blended decline today, with Exxon Mobil (\$0.97 vs. \$1.76 prior year) the single largest drag, and downward EPS revisions for Chevron and Phillips 66 compounding the deterioration.

That fragile improvement collapsed in the final days of April. According to Bloomberg, peace negotiations broke down in late April, with President Trump rejecting an Iranian proposal to reopen the Strait of Hormuz and instead discussing steps to prolong the US naval

blockade. Brent surged more than 9% to trade above \$114 a barrel, the highest since June 2022, while West Texas Intermediate (WTI) crossed \$105. Prices have now fully erased all losses since the temporary ceasefire was announced. The two-month-old conflict has produced what Bloomberg describes as a record supply shock and a global energy crisis, with crude, natural gas, and oil product flows from the Persian Gulf effectively cut off and gasoline, diesel, and jet fuel prices surging worldwide.

The picture has been further complicated by the United Arab Emirates' announcement that it will leave the Organization of the Petroleum Exporting Countries (OPEC), citing the need for agility to respond to wartime market conditions without being constrained by the cartel's collective decision-making process. Iran, meanwhile, is rapidly running out of crude storage capacity, which may force production cuts and tighten the physical market further. The base case heading into May is no longer de-escalation; it is whether the global market or Iran capitulates first to end the stalemate.

## The Fed's Narrowing Path

The April oil retracement that briefly eased inflation pressure has now reversed into something materially more dangerous for the Federal Open Market Committee (FOMC). With Brent back at high levels and refined product prices surging globally, the headline inflation relief that markets had begun to price out is gone, and the FOMC's January-meeting median 2026 Personal Consumption Expenditures (PCE) forecast of 2.7%, up from 2.4% in December, now looks if anything too low. Strong Q1 earnings growth had already weakened the recession case and removed the Federal Reserve's growth-related justification to cut; the renewed energy shock now adds a textbook supply-side inflation channel on top of sticky core services and shelter components. The combination is the closest thing to a stagflationary impulse the central bank has faced this cycle.

The leadership transition sharpens the credibility question at precisely this moment. With Kevin Warsh, the presumptive successor at the Fed, viewed by parts of the market as more politically responsive than Powell, every dovish signal is now being scrutinized for whether it reflects evolving data or evolving political pressure. The dollar's decline in April and the surge in MSCI Emerging Markets suggest foreign exchange markets have already begun discounting some erosion of the inflation-fighting anchor, and a renewed oil shock during a leadership handoff is exactly the kind of test that asks whether the next Federal Reserve (Fed) chair will lean against inflation

or accommodate it. The risk is asymmetric: the Fed gets little credit for staying ahead of inflation, but losing that credibility would steepen the yield curve, weaken the dollar further, and unwind the easy-financial-conditions tailwind that drove April's risk-on rally. Equities have priced the upside of a more accommodative Fed; they have not priced the cost of a less credible one facing a fresh energy shock.

### **The Mag 7 Resurrection and the End of the Scare Trade:**

Even with the Fed bind unresolved, the equity narrative shifted decisively in April. February's narrative of AI-driven human displacement collapsed as Q1 results showed that AI deployment was driving margin expansion rather than displacing enterprise revenue. The Magnificent 7 surged 14.88% in April after falling nearly 6% in February, while the Russell Top 50 Index added 10.44%. NVIDIA's print was the largest single contributor to S&P 500 earnings growth and emblematic of the trend: semiconductor industry earnings grew 98% year-over-year, software earnings grew 18%, and all six Information Technology industries posted double-digit revenue gains.

### **Fixed Income, Currency, and the Reversal of Defensive Trades**

The mirror image of February played out across asset classes for most of the month, though the late-April oil surge has begun to put parts of that trade back in question. The U.S. Aggregate was flat, and 20+ Year Treasuries fell 0.84%, with bonds unable to compete with the equity rally. The dollar weakened as international assets attracted flows, and emerging markets were the standout, with MSCI Emerging Markets gaining 16.04% in April alone. Defensive sectors that led in February turned into laggards as Utilities, Consumer Staples, and Health Care lagged the broader S&P 500. The cumulative effect of February's safe-haven trades unwinding through most of April has been substantial: from February 28 to today, gold has dropped 12.53% and 20+ Year Treasuries have lost 5.03%, while the Magnificent 7 has rallied 8.39% and the Nasdaq 9.92%. With Brent now back to triple digits and the war premium re-priced into crude, some of those defensive unwinds may prove premature.

### **Forward Estimates, Valuation & Outlook**

Analysts now project S&P 500 earnings growth of 20.6%, 22.7%, and 20.4% for Q2, Q3, and Q4 2026, with full-year 2026 growth at 18.6%. The bottom-up 2027 EPS estimate, which aggregates individual analyst forecasts across the index, sits at \$376.12, implying continued mid-teens growth. The forward 12-month P/E of 20.9x is elevated and above the 5-year (19.9) and 10-year (18.9) averages. The

bottom-up target price of 8,362.16, derived by aggregating individual analyst price targets across the index, implies 17.6% upside from the April 24 close of 7,108.40, with Health Care (+23.0%) and Information Technology (+21.4%) seeing the largest projected price gains. Analysts expect net profit margins to climb further, with estimates of 14.1%, 14.6%, and 14.6% for Q2, Q3, and Q4, each setting new records. Q2 negative guidance has been muted, with only 55% of preannouncing companies issuing negative EPS guidance versus the 5-year average of 58%. These estimates, however, were largely set before the late-April collapse of US-Iran talks and Brent's return to high levels, and they will need to be tested against renewed input-cost pressure for energy-sensitive sectors and the prospect of stickier headline inflation.

## **Topic of the Month: The Private Credit Market**

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Private credit refers to non-bank lending extended primarily to small and midsize businesses, most of which carry sub-investment-grade ratings. Unlike publicly traded corporate bonds or broadly syndicated loans, which are large corporate loans originated by a bank and then sold in slices to a group of institutional investors, private credit involves direct loans negotiated bilaterally between investment funds and borrowers. The funds, typically managed by large institutional asset managers, pool capital from pensions, insurers, sovereign wealth funds, and increasingly from retail investors, and they generally hold the loans to maturity. The asset class accelerated after the 2008 Global Financial Crisis (GFC), when stricter post-crisis regulations forced banks to retreat from riskier middle-market corporate lending. Those rules pressured banks to build up capital cushions, which made risky lending more costly for them and effectively redirected the flow of below-investment-grade credit toward investment funds.

### **The Size of the Market**

Private credit has grown rapidly, driven by a decade of low interest rates and an institutional hunt for higher yields. The market today sits at roughly \$1.7 trillion to \$3 trillion globally and is projected to reach \$5 trillion by 2029. In the US alone, private credit is estimated at between \$1.3 trillion and \$1.6 trillion, larger than the domestic markets for high-yield corporate bonds and broadly syndicated loans. Bloomberg reports that the broader leveraged finance market, which spans high-yield bonds, syndicated loans, and private credit, reached approximately \$4.2 trillion in

2025 and now provides more than 40% of the financing available to US companies. Drawing on Federal Reserve Bank of New York data, Bloomberg notes that US private credit more than doubled from about \$500 billion in 2020 to roughly \$1.3 trillion as of December 2024, and that private credit now represents about 30% of debt issued by below-investment-grade-rated US borrowers, up from 13% immediately following the 2008 crisis.

## Core Risks in the Current Environment

While private credit has historically delivered premium yields and lower reported volatility, the asset class is now navigating a series of converging pressures.

### Opacity and the “Cockroach” Problem

Private credit operates with materially less transparency than public markets. Loans are not actively traded, and valuations are reported quarterly using mark-to-model appraisals rather than real-time mark-to-market pricing, which means the lender holding the debt ultimately determines its carrying value. This lack of price discovery can mask underlying stress for extended periods.

According to Bloomberg, Renovo Home Partners filed for bankruptcy in November of last year, only one month after BlackRock had marked the home improvement company's debt at 100 cents on the dollar in its portfolio, even though Renovo was already failing to make interest payments. BlackRock subsequently moved to write the \$150 million position down to zero.

The high-profile bankruptcies of First Brands Group, an auto-parts supplier, and Tricolor Holdings, a subprime auto lender, both involving allegations of fraud and billions in hidden off-balance-sheet debt, have rattled the broader credit market. Bloomberg recounts that First Brands filed for Chapter 11 on September 28 after a decade-long, debt-fueled acquisition spree had built a small Ohio manufacturer into one of the world's largest makers of replacement auto parts, eventually owing creditors roughly \$10 billion, with investment funds managed by Jefferies and UBS among the lenders that absorbed losses. JPMorgan CEO Jamie Dimon, reflecting on his bank's losses from Tricolor, warned that further “cockroaches” were likely lurking in opaque lending books, on the premise that one visible problem typically signals more hidden ones.

### Sector Concentration and AI Disruption

Private credit portfolios are heavily concentrated in software and asset-light technology companies. Software comprises roughly 20% of all loans held by Business Development Companies (BDCs), publicly traded or

non-traded vehicles that lend directly to middle-market borrowers, and broader exposure to asset-light businesses approaches 60% of private credit overall. The rapid advance of artificial intelligence poses a real disruption risk to the recurring-revenue models that underpin many legacy software borrowers, and concerns that AI could erode these business models have driven sharp selloffs in the equities of alternative asset managers and publicly traded BDCs.

A separate but related risk is the AI build-out itself. Bloomberg, citing McKinsey, notes that total spending on data centers and other AI infrastructure could reach \$7 trillion by 2030, with lenders lining up to fund construction, including transactions in which borrowers seek to raise more than the total cost of construction on the assumption that future rents will more than cover the gap. Much of this lending flows to blue-chip hyperscalers, but a meaningful share is reaching junk-bond and private credit borrowers whose business models remain unproven.

### Rising “Bad PIK” and Shadow Defaults

To win competitive deals, private lenders sometimes permit borrowers to use Payment-in-Kind (PIK) interest, which lets the borrower defer cash interest payments by adding the amount owed to principal. While some PIK is structured at origination, there is a rising trend of unplanned, mid-stream PIK, often described as “bad PIK,” which is widely viewed as an early warning sign of severe cash-flow strain and a form of shadow default. Adjusting for PIK and liability management exercises, some analysts estimate that the real distress rate in private credit is closer to 5.4%, materially higher than officially reported default metrics.

### Liquidity Mismatches and Fund Gating

To attract retail capital, the industry has built semi-liquid vehicles such as non-traded BDCs that allow periodic redemptions, typically capped at 5% of net asset value per quarter. Liquidity, however, cannot be conjured from illiquid loans. Amid recent market anxiety, retail investors have rushed for the exit, forcing major firms including BlackRock, Ares, and Morgan Stanley to hit redemption caps and effectively gate their funds, denying investors full access to their cash and preventing forced sales of underlying assets.

### Interconnectedness and Back Leverage

Although private credit shifted risk away from bank depositors, banks remain heavily intertwined with the sector. Bloomberg, citing a Moody's report, places US banks' exposure to private debt vehicles at nearly \$300

billion as of October. Insurance and annuity providers, many now owned by private equity firms, have likewise built substantial private credit positions in pursuit of yield, with Moody's estimating that US life insurers held as much as \$2 trillion of exposure to illiquid forms of credit last year. Critics note that some of the structures used to package and rate this exposure echo techniques that proved damaging during the 2008 crisis. Severe losses or downgrades inside private credit could therefore trigger margin calls and transmit stress directly back into the regulated banking and insurance systems.

## Structural Pressures: The Duration Trap and Macro Headwinds

Private credit loans typically carry floating interest rates. While that feature generated outsized returns for lenders during the rate-hiking cycle, it sharply increased the debt-service burden on borrowers, weakening interest coverage and profitability. The market is also navigating what practitioners call a duration trap. Because private equity sponsors have struggled to sell portfolio companies at acceptable valuations in the prevailing rate environment, exit activity has effectively stalled. Capital is trapped in aging funds, distributions to limited partners have fallen to post-GFC lows, and lenders are unable to recycle capital at historical rates.

Weakened lender protections compound the problem. As capital flooded into credit markets, borrowers and their private equity sponsors negotiated away covenants that previously allowed lenders to monitor performance closely and restrict additional debt issuance. Bloomberg reports that in 2025, lenders opted to take over more than 13 large US companies that breached their loan terms, including a dining chain, a food supplier, and a private-equity-owned portable-toilet business. A growing number of restructurings now cut creditor recoveries while leaving equity ownership intact: Bloomberg counts 33 US companies with \$500 million or more of debt that restructured on those terms in 2024 and 23 in 2025, with cases ranging from Tropicana Brands and Wellness Pet to GoTo Group, Rackspace Technology, and Del Monte Foods.

## Mitigating Factors: Is This the Next GFC?

Despite the mounting fault lines, many practitioners argue that private credit does not pose systemic risk on the scale of the 2008 housing crisis. Unlike banks, which fund long-term illiquid assets with short-term, runnable deposits, private credit funds exhibit very little maturity mismatch.

They are also extremely well capitalized, with equity typically funding 65% to 80% of total assets, compared with roughly 10% at commercial banks. The implication is that the bulk of any losses would be absorbed by long-term institutional equity investors rather than cascading through the deposit base.

## Recent Stress

According to Bloomberg, the roughly \$3 trillion private credit sector is now experiencing what many describe as its first serious liquidity test. Publicly traded investment companies focused on private credit have seen their shares fall between 25% and 40% year-to-date, several major managers have restricted investor redemptions, and default rates among direct lending funds are now expected to climb from 5.6% toward 8%, driven largely by AI-related disruption concentrated in software and technology.

The structural problem remains opacity. With valuations reported quarterly and ultimately determined by the lender holding the debt rather than by market prices, stress can accumulate quietly before it surfaces. Payment-in-kind activity continues to climb, a classic early signal of borrowers running short of liquidity. BDCs are increasingly trading at discounts to their stated net asset values, suggesting that public markets do not fully trust the carrying values on private credit books. Jeffrey Gundlach of DoubleLine has warned that private credit may be the leading candidate to start the next financial crisis.

In a higher-rate environment with tightening financial conditions, the slow burn has less time to stay slow.

## Conclusion

April closed with the S&P 500 index up 5.68% year-to-date, the Magnificent 7 back in front (+49.35% on a trailing twelve-month basis), and emerging markets quietly leading the global tape (+49.16% trailing twelve months). The proximate driver was the strongest earnings season in over a decade, with a blended Q1 growth rate of 15.1%, revenue growth of 10.3%, and a record 13.4% net profit margin per FactSet. For most of the month, that earnings strength was joined by what looked like a path toward Iran de-escalation, with a temporary ceasefire pulling the war premium out of energy and gold. The closing days of April have made that second pillar look like a head-fake: peace talks have collapsed, Brent has surged back above \$114, and the United Arab Emirates' exit from OPEC has removed one of the few stabilizing forces in global oil supply.

The bull case from here is straightforward and well advertised: 18.6% projected 2026 earnings growth, record forward margins of 14.1% to 14.6% across the next three quarters, and analyst price targets implying a further 17.6% of upside from the April 24 close. The risks are equally clear and now more acute. Forward multiples at 20.9x sit above both the five-year and ten-year averages, leaving little room for earnings to disappoint, and they were set before crude returned to its highest level since June 2022. Trade policy remains in flux following the Supreme Court's reciprocal-tariff ruling. Midterm-election years have historically delivered an average drawdown of 17.5% in the S&P 500. And the Fed's credibility, more than its policy path, is the variable the market has not yet priced; the dollar's 1.93% April decline and the 16.04% surge in MSCI Emerging Markets suggest currency markets are already testing that anchor, and a renewed energy shock during a leadership transition is precisely the kind of test that exposes whether the credibility is intact.

Beneath the surface of the equity rally, the private credit market remains the area of the financial system most worth watching. Stress signals continue to accumulate quietly: BDCs trade at widening discounts to net asset value, payment-in-kind activity is climbing, default rates among direct lending funds are projected to move from 5.6% toward 8%, and major managers including BlackRock, Ares, and Morgan Stanley have already gated retail vehicles to slow redemptions. In a higher-rate environment with tightening financial conditions, that slow burn has less time to stay slow, and any acceleration would land on an equity market already priced for a benign outcome.

The setup entering May is therefore a market that has correctly identified a strong fundamental backdrop and is now leaning hard on it, just as the most important macro tailwind of the past month has reversed. Earnings may carry the index higher from here, but the margin for error has narrowed alongside the rally, the Iran de-escalation that anchored April's risk-on tone has given way to a renewed energy crisis, and the quieter risks building in private credit are precisely the kind that tend to matter only after they already have.

Sincerely,

The James Research Team



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