

COLONIAL TRUST *Quarterly*

Review of Q1 2026

Welcome Brittany Bynum

Current Market Focus



QUARTERLY REVIEW

JANUARY WAS A CONTINUATION OF 2025'S EQUITY MARKET STRENGTH, WITH THE S&P 500 HITTING AN ALL-TIME HIGH ON JANUARY 29.

It traded in a range in February, but obviously everything changed with the US/Israeli offensive on February 28. During the final week of March, both the DJIA and the Nasdaq fell into correction, a fall of 10%, and the S&P approached that level. Even with a strong rally on March 31, this was the worst quarter for the S&P and DJIA since the third quarter of 2022. While US markets were negative, international markets fell more sharply from their pre-war highs by comparison. The bond market, as measured by the Bloomberg Aggregate Bond Index, was slightly negative as the 10-year Treasury yield rose 0.19% during the quarter.

Asset prices fell as the war caused oil prices to spike. During the quarter, WTI Crude (which is largely used by the US) increased 77%, while Brent (which reflects global pricing) rose 95%. The transmission mechanism of this war to the economy and markets seems to be higher oil prices. Iran controls the Strait of Hormuz, the critical passage for 20% of the world's crude and global LNG as well as fertilizer and other commodities.

Index	1Q26 ¹	Off 52wk High ²	Date of 52wk High
S&P 500	-4.35%	-5.95%	1/27/26
DJIA	-3.19%	-7.66%	2/10/26
Nasdaq	-6.96%	-9.88%	10/29/25
Russell 2000	0.92%	-8.18%	1/22/26
MSCI EAFE	-1.09%	-10.73%	2/27/26
MSCI Emerging Markets	-0.13%	-13.26%	2/26/26
Bloomberg Agg Bond Index	-0.05%	-2.13%	2/27/26

Source: Bloomberg, LP

1. Total Return
2. Price Change

WHAT CHANGED: WAR, OIL, AND MARKET VOLATILITY

OUR ECONOMIC AND MARKET EXPECTATIONS FOR 2026 DID NOT INCLUDE A KINETIC WAR WITH IRAN.

How the economy and markets perform for the remainder of the year will likely be a function of the resolution of the war. For that reason, we are going to depart from our normal newsletter format and try to highlight how this action could impact the economy, possible outcomes, and their impact on the economy and markets. With bombs landing in the Middle East, current reports about manufacturing, initial claims, and last quarter's earnings offer less insight into the near-term direction of our economy.

Oil shocks could impact our economy on several connected fronts, which we will lay out in sequence. First, this could increase inflation expectations as market participants and consumers anticipate paying higher energy prices. This can be measured in inflation breakevens, which is the implied inflation rate as measured by the difference between nominal Treasury yields and TIPS yields. The 2-year inflation breakeven rate rose by 0.94% during that time; implying markets believe inflation will be nearly 1% higher for the next two years than in January.

ECONOMIC TRANSMISSION: INFLATION, RATES, AND CONSUMER IMPACT

HIGH INFLATION EXPECTATIONS CHANGE BOND INVESTORS' RETURNS AND FED POLICY.

Investors could reasonably demand higher yields to compensate for higher inflation expectations, and the Fed could become more hawkish about inflation and prefer higher interest rates. Since the conflict began, the 10-year treasury yield rose 0.38% to 4.32% and the market no longer expects any Fed rate cuts this year. This could impact all borrowers and the present value of future income streams, thereby reducing asset prices.

Oil shocks would also have an impact on businesses and consumers. The impact would likely be unequal among businesses, with energy-intensive businesses impacted to a greater degree. For truckers, airlines, and cruise lines, fuel is large input. Companies rely on energy for the manufacturing process and the production of plastic packaging used on many of our products require petrochemicals as an input. Farmers are beginning their spring planting season and are facing fertilizer price increases between 20% and 65%. Each of these businesses must decide to either reduce their profit margin while maintaining their prices, or to increase prices to offset higher input costs. If they elect the latter, inflation from the energy shock feeds into other parts of consumer price inflation.

Consumers are also hurt by higher energy prices, as we have all experienced. Higher gas prices act as a tax on the consumer. If a consumer's gasoline spending increases by \$25 per week, this is \$25 that is not spent on other goods and services. This leads the consumer to curtail other spending or trade down to lower priced goods and services, thereby reducing aggregate demand in the economy.

THE NET RESULT OF AN OIL SHOCK COULD BE HIGHER INFLATION, HIGHER INTEREST RATES, LOWER ASSET PRICES, LOWER CORPORATE PROFIT MARGINS, AND REDUCED CONSUMER SPENDING.

The economic and market impacts are determined by the magnitude and duration of the oil shock. We are a month into this current situation and have limited releases of March economic data. Purchasing managers' indices, initial claims for unemployment, and consumer confidence continue to point to growth; however, an extended period of high oil prices could cause economic data to weaken and asset prices to fall.

It appears Trump and Netanyahu may have underestimated Iran's resolve and the ferocity of their response. The escalation is having a global economic impact due to the near closure of the Strait of Hormuz and significant damage to energy infrastructure in the Gulf States. No other country has offered direct military support, but there is global pressure to reopen the Strait. Hard pressure is being applied to the Iranian regime by many Gulf States and some Western allies. Diplomatic pressure to reopen the Strait and end the war is being applied by Europe and a UN coalition, with twenty-two signatories to a non-binding agreement to reopen the Strait. Soft pressure is being applied by China and Pakistan who have offered a joint five-point peace initiative to restore peace and stability to the region.

THREE POSSIBLE PATHS FORWARD

WITH PRESSURE INCREASING ON IRAN, THERE ARE SEVERAL POSSIBLE OUTCOMES. THE WORST-CASE SCENARIO COULD INCLUDE THE INTRODUCTION OF US TROOPS.

Marines and part of the 82nd Airborne Division are in the region. The introduction of troops could serve to escalate the situation, as we learned in Iraq and Vietnam. Even a limited mission to secure Iran's uranium or reopen the Strait might require thousands of soldiers in support roles to fulfill the mission. This could also generate a response from a weakened Iran. History shows that once this type of escalation begins, it may lead to further escalation and mission expansion, rather than quick resolution. The Pentagon is preparing for possible ground operations, but Trump has been ambiguous about his willingness to deploy troops. The mid-terms are a few months away and the Washington Post has reported that 60% of Americans oppose sending troops. Trump ran on "no forever wars" and polls favor ending the war quickly. A prolonged war could cause the GOP to lose the House and perhaps the Senate, potentially making the last two years of Trump's term deadlocked with constant impeachment hearings.

The economic impacts of this scenario are dire, and the Strait of Hormuz could be closed for an extended period. Oil prices could spike from current levels and cause inflation to rise. Price pressures could bleed from energy to the broader economy, and companies could pass on higher input costs to consumers. The economy could slow and likely enter a recession. The Fed could have to choose to fight inflation by raising short-term rates or the weakening labor market by lowering short-term rates. The equity market could enter a bear market as earnings fall.

THE MIDDLE-OF-THE-ROAD SCENARIO MIGHT ENTAIL A FEW MORE WEEKS OF THE AIR CAMPAIGN.

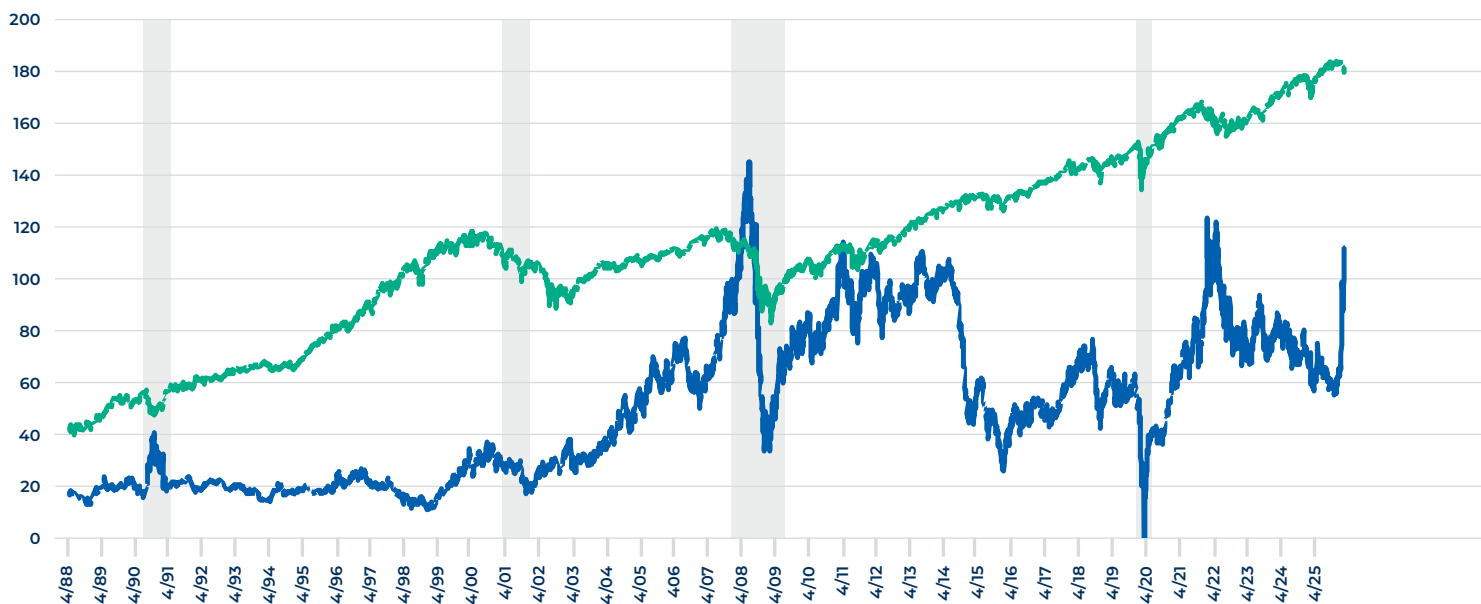
Trump's press conference on April 1 outlined this strategy. When the Iranian regime's infrastructure and capabilities are destroyed, the marginal benefit of the continued air campaign could fall to zero. The Iranian regime could remain in power and defiant. Both the US and Iran could claim victory as a political message rather than a decisive outcome. The US and Israel could point to a degraded Iran, unable to restart its nuclear program or wreak havoc in the region. Iran could claim they survived a regime-change assault and impose costs on the West. The Strait of Hormuz could partially reopen as Iran needs oil revenue and the global pressure is too much to bear. Iran and its proxies may continue to disrupt some traffic. There could be continued talks

between the US and Iran, but a formal agreement is unlikely. The tensions between the countries could remain, but Iran's ability to project power could be curtailed. This stalemate may exist for years, while Iran tries to rebuild its country and its military. This could cause a repeat of this exercise in the future if Iran is able to reconstitute its military and nuclear program.

Under this scenario oil prices could remain elevated – likely in the \$80-\$115 range. The oil risk premium would be unlikely to spike from here, but we may not return to the mid-\$60/bl range of February. The moderation of inflation over the last six months could reverse but would likely not spike. Interest rates remain elevated, but the increase in rates in the last few weeks has priced in oil prices at these levels. The Fed would likely be “high for longer” with no rate cuts or hikes. The consumer could be squeezed due to higher gas prices and businesses could see a mix of price increases and margin contraction. Economic growth could slow, but not contract. Corporate earnings growth expectations could be reduced, and asset prices could rerate to reflect slower growth. The analogs to this scenario are the 1990 Gulf War, the 2011 Arab Spring, and 2022 Russian invasion of Ukraine. In the Gulf War the US was in a mild recession before the war and in the other two examples, growth slowed due to the spike in oil prices but the economy did not enter recession as shown in this chart.

MARKET AND ECONOMIC IMPACTS OF OIL PRICE SPIKES

● S&P 500 (Log Scale) ● WTI Crude ● US Recession



Source: Bloomberg, LP

THE UPSIDE SCENARIO COULD BE A NEGOTIATED SETTLEMENT AND A STRATEGIC RESET OF THE US-IRANIAN RELATIONSHIP.

This could play out similar to the middle-of-the-road scenario initially. However, after an air campaign was exhausted, the damage to the country and the global pressure for resolution could bring Iran to the negotiating table. Some semblance of the regime might remain in control but may be more amenable to peace. Iran could agree to concessions on its nuclear program, proxy attacks, and the Strait of Hormuz. The leadership could agree to monitoring and verification of its nuclear and ballistic missile programs. Iran could become a better neighbor in the region. This upside case is not nirvana or a secular leader like Reza Pahlavi turning Iran from a religious state to a secular state; but rather could be a defeated clerical state accepting reality and choosing survival.

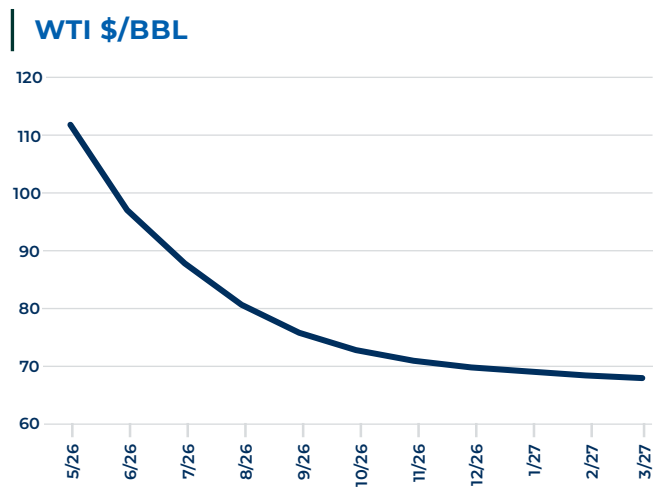
If this plays out, we suspect it could take time for the “new” Iran to gain the trust of the West and its neighbors.

This scenario could be positive for the economy and markets. Oil prices could drop sharply, likely to the \$70-\$85/bl level. Inflation prints for March and April could be elevated, before returning to the level of February. Asset prices could rise in a “risk-on” rally as forecasts for growth and earnings are increased. Interest rates could fall across the yield curve and the Fed would look through the transitory uptick in inflation and reconsider rates cuts in 2026.

IT IS DIFFICULT TO SIFT THROUGH THE NEWS FLOW AND TRY TO PROGNOSTICATE HOW THIS CONFLICT COULD BE RESOLVED.

There is a steady stream of news from the US and the region. It is hard to ascertain if leadership is speaking to each other or even through intermediaries. Statements from Trump about progress are denied by the Iranian side.

When we can't make sense of the news from politicians, we turn to the “Wisdom of Crowds” or the markets to tease out the anticipated end of the conflict. The prediction markets are anticipating resolution this year. Polymarket contracts speculating on the timing of the end of the conflict predict a 66% chance it is over by June 30 and 85% by year-end. The futures market is much larger and deeper than the predictions market and futures for WTI crude are in backwardation. This means the price for a barrel of oil to be delivered in the future is lower than price of the same barrel of oil today. Traders at the Chicago Mercantile Exchange believe that oil prices will be back in the \$70s by September.



Source: Bloomberg, LP

The Fed funds futures market currently shows no rate cuts in 2026 and prices in two 0.25% cuts for early 2027. However, if markets begin to anticipate a ground war and a renewed spike in crude prices, the Fed may respond with rate hikes to counter the resulting inflation. In that case, cuts currently expected in early 2027 would likely be pushed to later in the year.

The capital markets are currently forecasting an end to the conflict in the next several months. Prussian military theorist Carl von Clausewitz is credited with the phrase “the fog of war” and Donald Rumsfeld coined the phrase “unknown unknowns.” The actions in the theater and the political responses will determine the length of this engagement. Going back to Rumsfeld, we do have several known knowns. We know today that Trump ran on no forever wars, and the American people do not support troops entering the conflict. We know Trump approval ratings are underwater and this is an election year. Additionally, we can see the markets are discounting falling oil prices later this year. With the information we have now, we believe either the middle of the road scenario or upside scenario will begin to play out in the next few weeks.

In either scenario, the economy could avoid recession and the threat from Iran could be reduced. That would allow the markets to again focus on corporate earnings. We look forward to the markets refocusing on artificial intelligence, onshoring of manufacturing, employment, and other economic factors.



BRITTANY BYNUM
Client Services &
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WELCOME BRITTANY BYNUM

Brittany Bynum joined Colonial Trust in April 2025 as the Client Services and Operations Coordinator. She brings over eight years of experience as Vice President of Operations at FinTrust Capital Advisors, LLC, where she oversaw operations, compliance, and client service. Prior to that, she spent three years in Charlotte, NC, working as a Registered Client Associate at Wells Fargo Advisors. Throughout her career, Brittany has earned her Series 7, 66, and 24 licenses, along with South Carolina Life, Accident & Health or Sickness, Variable Life, and Variable Annuity insurance licenses.

Brittany holds a Bachelor of Science in Business Administration with a concentration in Finance from the University of North Carolina Wilmington, earned in 2013. Originally from Sanford, NC, Brittany now lives in Gray Court, SC, with her husband, Rick, and their two sons, Cooper and Beckett. Brittany enjoys spending time with her boys on their farm and watching them grow. Her family is active in their local church, Rabun Creek Baptist. She likes vacations at the beach and often travels back to North Carolina to visit family.

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