



Quarterly Investment Bulletin

Apr 2026

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Headlines

- ❖ Global equity markets started the year well, reaching new highs in February, but momentum stalled in March as sentiment turned negative due to the Iran conflict.
- ❖ Developed markets were resilient initially, but asset prices fell when it became clear the conflict was going to extend further than anticipated. An extended conflict will challenge global growth assumptions and lead to higher levels of inflation, but an earlier resolution would improve the chances of central banks keeping control of inflation.
- ❖ Bond markets have also been affected with yields rising significantly as it became clear the conflict might impact inflation and future interest rate cuts.
- ❖ AI has remained a major theme and software companies have suffered more than most as investors assess the effect AI could have on specific sectors and industries.
- ❖ The UK economy has had tepid growth in the last few months, constrained by fiscal pressures, political uncertainty, and lingering inflation as the rising cost of living hits more and more families.
- ❖ The Bank of England maintained interest rates at 3.75% in March. The likelihood of rates being cut further this year is limited.
- ❖ UK inflation held steady at 3.0% in February.
- ❖ The US economy continues to be more insulated than the rest of the world although petrol prices are rising, causing potential issues for the President in the forthcoming mid-term elections should they stay elevated.
- ❖ The Federal Reserve held interest rates in March and is unlikely to reduce them again this year if the Iran war continues.
- ❖ Equity markets fell during March, but not all regions had negative returns over the full quarter – the UK and Japan maintained positive returns.
- ❖ Emerging markets continue to offer good valuation opportunities.



General Economic Overview – Quarter 1 2026

At the beginning of March there was a change of strategy in the Middle East as the US and Israel decided to launch attacks on Iran. This news and its possible implications drowned out nearly everything else that happened in the quarter and much of the stock market momentum was lost, despite an encouraging start to the year. Initially it was hoped that the conflict would be short lived, but this proved optimistic – the four-year anniversary of the war in Ukraine in February highlights that the best laid plans don't always deliver the expected results. The change in regime in Iran that was anticipated by the US President early in the conflict, has not materialised even though the Iranian leader and his close team were removed early on. Iran has continued to defy the might of the US and Israel and has involved other Middle East states and closed off the Strait of Hormuz, one of the key routes for global trade. The situation is difficult to predict, given that both sides are claiming victory without having achieved a meaningful peace. The White House is reluctant to back down without being able to declare some sort of victory, however pyrrhic, and Iran is prepared to fight on, ignoring the US rhetoric.

The Iran conflict is dominating macro discussions as it has both short- and long-term implications. The short-term effects are more obvious – the price of oil has surged alongside other real assets, with the exception of gold which has fallen in value, for reasons that are difficult to interpret. Volatility in equity and bond markets abounds, and sentiment is on a knife edge due to the regular statements from the White House and counter statements from Iran which cause markets to rise and fall on a regular basis. Longer term we should focus more on how the global economy resumes after the conflict is resolved. Inflation will be affected as oil price rises affect nearly all industries and consumers, and global trade and supply routes will take time to re-establish themselves which will hit growth estimates. It is likely that those regions which depend on external energy supplies, such as the UK and Europe, will be hit to a greater extent than those with more independence, such as the US. There may also be indirect influences, such as driving more interest in renewables to speed up the process of achieving energy independence. Diversification, a stalwart of investment advice over the years, has also been challenged as many offsetting risk strategies are correlating with traditional risk assets, leaving very few safe havens outside of cash. Longer term diversification still makes sense for investors who are unlikely to time market entry and exits with any accuracy.

The current message is one of ongoing uncertainty and the length of the conflict will determine which issues are the most significant longer term. Planning is difficult as markets are very volatile and susceptible to sentiment changing rapidly on the release of any information related to the conflict. We can only hope that the conflict is resolved sooner rather than later and confidence in the global economy is restored, thereby minimising the damage caused and avoiding a recession.

Equity Markets

Risk assets came under pressure and markets fell significantly in the final month of the quarter but surprisingly several regions posted positive returns over the full quarter. In the developed markets, stock markets in the US and Europe have been hit most, but the UK and most emerging markets remained positive. The issues in the US had started to appear prior to the war with Iran as challenges to valuations in the tech sector meant investors derisked portfolios. Notably, the impact of AI on certain sectors such as software meant the prices of many of these companies fell significantly. Over the longer term it will



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be very interesting to see which sectors are enhanced by AI and which suffer as the technology advances.

UK

The UK economy currently faces a challenging environment shaped largely by the energy price shock triggered by the Middle East conflict. Higher oil and gas prices are expected to push inflation above earlier forecasts, with CPI projected to peak around 3.5% in the third quarter. The British Chamber of Commerce (BCC) similarly predicts inflation rising to 2.7% by the end of 2026, driven by global uncertainty and elevated commodity prices.

Growth remains weak with UK GDP forecast to expand by only 0.7% in 2026 according to KPMG, reflecting falling real incomes and subdued investment. The BCC offers a slightly higher but still modest estimate of 1%, with services doing most of the lifting while construction and manufacturing are set to contract. Household spending is expected to remain constrained as purchasing power declines and energy bills rise, prompting cutbacks in discretionary consumption.

Until very recently the UK stock market outlook was more optimistic. In 2025 UK equities benefited from record-breaking FTSE 100 levels and many analysts expected gains to continue in 2026. More recently all risk assets were hit by the war in Iran, and the UK market was no exception. This level of uncertainty around the globe and the reaction of developed markets to statements and tweets from the US means that volatility in stock prices will continue. We have noted for some time that the UK stock market is not aligned with the economy as the major weightings are concentrated in global companies and this creates some degree of independence from what is happening in the domestic economy. This is part of the reason why large cap stocks have outperformed smaller and mid cap stocks and why the market as a whole remained positive this quarter despite the obvious geopolitical issues.

US

The US has remained comparatively resilient in the face of the situation in Iran, especially relative to other economies and equity markets, for several key reasons. Energy independence means that although petrol is up significantly in the US, it has risen further elsewhere. Similarly, US natural gas prices have barely moved as this commodity has been in abundance with oversupply in the States for many years. In addition, retail investors have kept buying the US stock market on bad days, and historically US institutional investors often repatriate money held abroad by selling international assets at times of uncertainty. The dollar has now appreciated against every major currency since the war began, reversing earlier weakness. Energy and other commodities are priced in dollars, so the currency shocks are greater elsewhere than for US consumers or businesses. The US AI dominance and the dollar's reserve currency status has meant the US continues to attract global capital regardless of the war.

This resilience is being tested with the status of the war at the end the quarter uncertain – the US is caught up in a conflict which they thought would last a matter of weeks, if not days. Iran has proven to be a more stubborn opponent than anticipated and it is beginning to hit the pocket of middle America as gas and fertiliser prices have risen. The broad economy still seems to be in robust health, but a long war in the Middle East will test this and a longer lasting oil shock could lead to a global recession which would also affect the US. Even a rapid end to hostilities will leave questions over how the global economy recovers, especially if this doesn't include the re-opening of the Strait of Hormuz.



Europe

Prior to the Iranian conflict, data this year supported moderate European growth projections from the ECB of around 1-1.5% for 2026 after an improving 2025. This reflected a reasonably robust consumer and was held up by government spending on infrastructure and defence, especially in the two largest European economies. The Middle East conflict and the disruption to energy supplies is more problematic for Europe than other regions as it imports a lot of its oil and gas, and this has highlighted the same supply issues as the Ukraine conflict. This is likely to have a direct effect on inflation which will create problems for the ECB in its battle to keep to the target level of 2%. Monetary policy is therefore in a wait and see mode with several banks suggesting that there may be interest rate rises this year. Higher inflation would be a blow for the overall economy which is still recovering from the issues created by Covid and the Russian invasion of Ukraine. A low growth and high inflation scenario would be the worst-case outcome for Europe and may push the fragile growth levels into recession. At the moment there is still the belief that the conflict will be resolved sooner rather than later and that this scenario won't come into play. Even if the conflict ends in the near term, the outlook for growth is weak with projected levels well below the US at around 1% but improving as we move towards the end of 2026.

Asia & Emerging Markets

Emerging market economies had seen increased capital flows from foreign investors in the period up to the beginning of the Iran conflict and continue to offer opportunities for diversified portfolios despite slower global growth, geopolitical tensions and tariff issues. They are however not immune to the disruption in global trade that the conflict in Iran has created. Many countries in the region benefitted from the fall in the US dollar and the increased trading opportunities with China and other countries seeking to reduce the impact of the US tariffs.

China entered the year with stronger market momentum, supported by government efforts to shift savings away from property and toward equities. The Shanghai Composite rose 18% in 2025 and reached a 10-year high in February, helped by increased IPO activity in both China and Hong Kong. Policy remains supportive, with authorities intervening at times to stabilise markets. Investors have focused on technology, brokers, and other beneficiaries of capital market activity, and foreign investors have shown tentative renewed interest.

Industrial profits grew over 15% year-on-year to February, led by electronics, non-ferrous materials, and financial firms tied to capital markets. Exporters in green technology and AI-related supply chains remain strong, though property weakness continues to weigh on broader earnings and some banks. Inflation remains very low, supported by falling pork prices, though cost-push pressures may emerge as wage growth stays muted. China's new growth target of 4.5–5% still relies heavily on exports.

China's large trade surplus, US\$1.2tn in 2025, reflects chronic overcapacity and rising global concerns about dumping, particularly across Asia and Europe. Long-term growth faces headwinds from demographic decline and high debt – consumer spending has grown around 5% annually but confidence remains constrained by property market losses. Despite these challenges, equities retain potential, supported by strong industrial profits and global leadership in green manufacturing.



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India had a weak start to the year after a difficult 2025, with key sectors such as IT services and banking facing sharp declines. Foreign investor selling intensified, driving the rupee to record lows and increasing concerns about imported inflation, especially as oil, food, and fertiliser prices rose. Despite high valuations and sustained local investor participation, earnings have repeatedly disappointed, with Nifty 50 Index growth stuck in single digits. Inflation briefly fell to 2.75% but is expected to rise above the RBI's 4% target due to the oil shock, limiting the scope for rate cuts.

Although long-term potential remains, India currently faces a challenging mix of energy, labour, and structural headwinds. Its heavy dependence on imported crude oil, much of which is routed through the Middle East, makes it vulnerable to geopolitical tensions, manufacturing has failed to expand its share of GDP, and graduate unemployment remains persistently high as AI disruption is pressuring the IT sector, historically a major employer.

The Brazilian stock market has been one of the strongest emerging markets year-to-date, and in February had delivered over 30% year-on-year, driven by banks, oil and commodities and expectations of rate cuts. Unsurprisingly the market has pulled back since the onset of the conflict in Iran, but both the market and currency have been insulated to a degree compared to other emerging markets as Brazil exports energy, along with soft commodities and food stuffs. The attractive level of real (after inflation) yields had attracted capital, and the fundamental economic backdrop of stronger commodity prices was also positive. The Mexican stock market started 2026 well, hitting an all-time high in February. The impact of the uncertainty from the Iran conflict on inflation, growth and corporate earnings has caused the market to pull back over 10% from its peak. The US currency has also been strong which limits rate cut expectations even though there are signs that inflation is ticking back up above 4%. Mexico continues to have strong long-term potential as long as there is not a major dislocation in its trading relationships with the US, but like any emerging market, there are heightened levels of economic uncertainty due to the Iran conflict.

Emerging market economies outside China and India entered 2026 with mixed but generally resilient momentum. Overall EM growth is projected at about 4%, outpacing advanced economies, though slightly slower than 2025. Southeast Asia continues to strengthen its position in global manufacturing, benefiting from supply chain diversification and rising exports, particularly in electronics and AI-related components.

Japan

Japan's stock market began the year strongly – the Nikkei 225 surpassed 56,000 in February on the back of post-election optimism, a weak yen, robust earnings, and expectations of fiscal support. By that point, the index had gained over 13% in local currency terms. The outbreak of the Iran conflict triggered a sharp market pullback and further currency weakness, which was particularly challenging for a nation heavily reliant on imported energy.

Despite recent volatility, the yen's weakness over the past year has supported Japan's powerful export sector, especially manufacturers contributing to global AI-driven growth. Earnings expectations remain generally positive in a post-deflation environment, though higher inflation has weighed on consumers as wages have not kept pace with rising costs, particularly for essentials like food and energy. A key market driver has been optimism around continued corporate governance reform, including improved capital allocation, reduced cross-shareholdings, higher dividends, and increased share buybacks. M&A activity has also accelerated, with several major parent companies acquiring listed subsidiaries.



Looking ahead, Japanese companies are broadly confident about profit growth for the fiscal year beginning March 2026, supported by improved bank profitability and a stronger labour market driving wage gains, but exporters tied to the US market and traditional auto manufacturers remain under pressure. The government faces the challenge of balancing inflation management with consumer support as energy dependence, particularly on Middle Eastern oil and LNG, exposes Japan to geopolitical shocks. Nevertheless, with improved competitiveness from the weaker yen and ongoing reforms, Japan's market retains significant rebound potential once geopolitical tensions ease.

Fixed Interest

Yields have increased in recent weeks, reversing the previous trend, as markets have reacted to the uncertainty in the Middle East. The expected pattern of falling interest rates has been put in doubt as the war in Iran takes its toll.

UK government bond yields have surged to their highest levels since the 2008 financial crisis. The 10-year gilt yield recently crossed 5%, reflecting a major repricing as markets adjusted to higher inflation expectations driven by the Iran conflict and resulting spike in energy prices. Short-dated gilts rose even more, with 2-year yields climbing to around 4.6%. Britain's bond market has been particularly susceptible to fears of resurgent inflation, partly because of its reliance on imported energy. Markets had expected the Bank of England to cut rates through 2026, which would normally bolster gilt prices, but volatility remains likely due to inflation risks and political uncertainty. Analysts note that delays to rate cuts could keep yields elevated, but if the BoE turns more dovish due to weakening economic conditions, the rate cutting cycle may be restarted.

The uncertainty due to the conflict in the Middle East has also caused government bond yields to rise and global government bond markets have recently reversed their early-2026 gains. The Bloomberg Global Aggregate Index has fallen back to flat for the year, as oil prices rising above \$100/barrel revived inflation concerns which triggered a broad selloff as investors anticipated delayed rate cuts and higher term premiums. Monetary policy across the major economies is no longer synchronised as Japan is tightening, the ECB is in an extended hold, and the Fed and Bank of England have been (until recently) on an easing path.

Corporate credit is not immune to the pressure on yields created by political uncertainty. A weakening UK economy, soft labour markets, slower wage growth, and declining business investment suggests a rising risk environment for corporate debt. Although insolvencies are elevated, NatWest notes it is a case of gradual economic decay, not an acute credit shock. Still, weaker profitability means reinvestment capacity is constrained, posing risks for future creditworthiness. One area of concern raised in recent months is that of private credit or non-bank lending. Areas of the market which include leveraged lending have come under scrutiny as the war in Iran creates the possibility of a credit recession.

Across the UK and Europe, credit spreads have compressed to near-historic lows, offering limited compensation for rising credit risk. Vanguard notes spreads are now approaching levels last seen during the 1990s tech boom, leaving valuations 'one-sided' and vulnerable to widening should risks materialise. Yields in global credit markets have increased as the same concerns have resulted in selloffs in bond markets. Interestingly spreads have not moved out much, suggesting company level concerns are not



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as significant and that investors are demanding more compensation for duration/inflation risk, not credit risk. A surge in corporate borrowing to fund AI and data-centre infrastructure is putting upward pressure on issuance volumes and therefore poses a risk of further spread widening. Global high yield markets have delivered small positive returns so far this year, supported by solid fundamentals and investor demand for income, but sector dispersion is rising.

Corporate bond markets remain stable but stretched, with tight spreads, strong fundamentals in high quality credit, and rising issuance creating pressures. High yield looks supported but increasingly selective, while global macro uncertainty and AI-driven investment cycles introduce new risks.

Alternatives

Infrastructure assets have delivered a mixed but generally resilient performance so far this year, reflecting their defensive characteristics amid economic uncertainty and heightened geopolitical risk. Core sectors such as utilities, transport, and energy infrastructure have benefited from stable, often inflation-linked revenue streams, helping to cushion investors against volatility in broader markets. That said, the ongoing conflict in the Middle East has added a new layer of complexity, driving energy price volatility and raising concerns over the security of critical trade routes.

Commodity markets reflected slowing global growth, geopolitical tensions, and divergent demand trends. Energy prices are volatile; the oil price has clearly surged and whilst it has fluctuated widely it is unlikely to go back to its pre-Iran levels for some time, even if there is a cessation of hostilities. Precious metals were the standout performers prior to the war in the Middle East, and gold reached new highs amid central bank buying, geopolitical uncertainty, and expectations of lower global interest rates. The ongoing conflict affected the price of gold, but negatively rather than positively as it appeared to react like other risk assets rather than as a hedge to uncertainty. There has been much speculation as why this has been the case with possible reasons being the increase in retail investor participation and the reduction of some central bank purchases, and in some cases sales, to fund wars and to pay back large debt overhangs. Agricultural commodities were relatively subdued, helped by generally favourable weather conditions and improved supply, though pockets of volatility emerged from climate-related disruptions. The war in Iran has threatened this careful balance as the supply of fertiliser has been disrupted which has affected the global food production framework.

The commercial property market has entered a phase of stabilisation and early recovery, following two years of repricing. Liquidity has improved as transaction activity has risen and bid-ask spreads narrowed, supported by falling debt costs and greater investor confidence. Investment volumes are expected to increase by around 10%, driven by renewed capital flows and clearer pricing conditions. Market performance remains income-led, and yields are broadly stable due to high benchmark gilt rates, meaning capital value growth is limited and returns depend on rental increases and active asset management. Rental growth is strong across prime assets, especially industrial, logistics, and high-quality offices supported by low development pipelines and resilient tenant demand. Overall, there is a steady but selective recovery driven by improving debt conditions, structural undersupply, and a focus on quality.

As with all our analysis this quarter, none of the alternative options are insulated from global events and the production and supply of oil is clearly vital to the running of a balanced global economy.



Summary

A strong start to the year by markets and company earnings has been overshadowed by the events in the Middle East. The global economy relies on the balance of trade between nations as resources are exchanged, and for many decades a key component of this has been the supply of oil. When this balance is threatened it causes high levels of uncertainty. The war in Iran is potentially one of those moments which could develop into a global recession, as has occurred in previous oil crises. That said, this is not the 1970s when oil had a greater share of energy production, there are many other sources of energy today (as well as strategic reserves) but not enough to last for significant periods of time. The US is now in a very difficult position – it needs to end the war but somehow manufacture a victory and Iran is not playing ball. Global stock markets have remained optimistic, but it will not take much to send sentiment spiralling downwards if the war continues for an extended period and the Strait of Hormuz remains closed.

With the only options for the US appearing to be binary, this is a difficult time for investors to make clear decisions. For most investors holding steady seems the most prudent option as it has always proved difficult for private investors to exit the market ahead of a downturn and then re-enter in time to capture a subsequent rally. Any hint of progress towards peace would lead to a sharp jump in equities, even before certainty emerged. As long as oil futures remain in deep backwardation investors should follow the oil markets logic and remain invested but be prepared to sit out short-term volatility. Trump's political interests, namely the US mid-terms, and the longer lasting impact of high oil prices on voters, point towards a strong desire for an early unilateral declaration of victory. The longer the conflict goes on, the greater the chances of a negative supply shock impacting severely on company profits.

Central banks face difficult trade-offs between higher inflation and lower growth, and therefore the potential for policy mistakes increases. Investors probably have more confidence in the Federal Reserve's ability to navigate this than the ECB, looking at more recent history. Once the conflict is resolved investors will need to reassess the environment to understand whether the global economy will return to its early-2026 state. The arguments in favour of Asia and emerging markets making a sustained recovery look more promising than the 12-month outlook for Europe. The US currency could easily unwind its gains rapidly and this would benefit Latin America and parts of Asia, allowing rate cuts. In Europe, the energy shock is likely to mean the ECB will remain concerned about the outlook for inflation, and so there is the possibility of interest rate increases. The relative position of the US domestic economy has improved versus others, and AI corporate capex is likely to remain resilient, which would likely allow for a rapid bounce back in equity prices, although non-US investors would probably see returns hit by an end to US currency strength.

In the short-term uncertainty remains, and the longer-term effects of the war in the Middle East will be determined by how long it lasts. With no obvious pathway to avoid the current issues we conclude that staying invested is the pragmatic approach, avoiding trying to time market rises and falls.

Ken Rayner, CEO
RSMR
April 2026



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