

Equity Market Update



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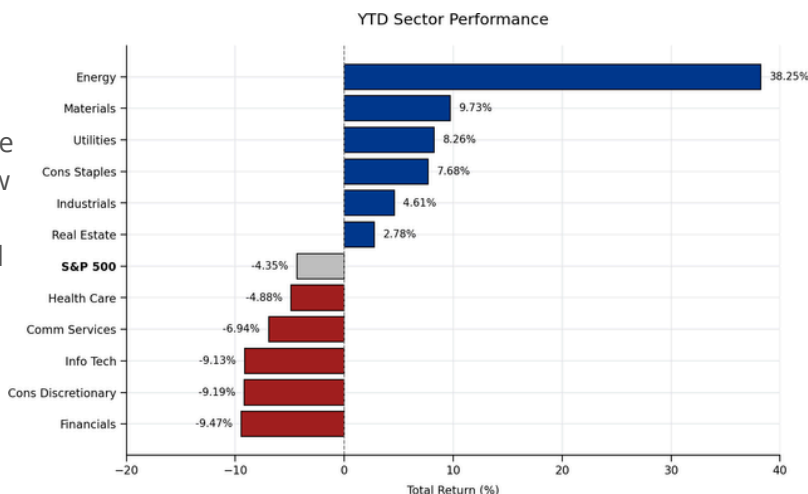


As of March 31, 2026 | Volume 15, Issue 3

Stocks experienced their first back-to-back negative months since the Liberation Day sell-off last April. The dominant catalyst was the significant escalation of the U.S.-Iran conflict, which triggered a surge in energy prices—highlighted by Brent crude topping \$100 per barrel for the first time since 2022—and forced a global repricing of risk. While the energy sector stood out as a lone pillar of strength, broader equity markets fell as investors shifted into a "de-risking" posture. By month-end, the combination of rising bond yields, mixed inflation data, and heightened uncertainty over the Straits of Hormuz left market participants braced for a more complex, potentially more restrictive macroeconomic environment in the second quarter.

Performance

In March, the equity markets experienced downward pressure, with all major indices posting negative returns for the month. The S&P 500 Index fell by -4.98%, while the Dow Jones Industrial Average saw a sharper decline of -5.20%. Small-cap stocks showed relative resilience compared to their large-cap counterparts, with a total return of -4.07%. Market breadth during this period was notably weak; within the S&P 500, 425 constituents declined while only 82 advanced.



Energy was the outlier in an otherwise bearish month, surging by 10.40% as oil majors Exxon Mobil and Chevron led the market. Conversely, industrials and healthcare were the worst-performing sectors, falling -8.44% and -8.11%, respectively. Mega-cap technology weighed heavily on index performance, with Microsoft, Meta, and Apple serving as the primary laggards that dragged down the S&P 500. In the Dow, Home Depot and Sherwin-Williams were significant detractors, each with a double-digit negative impact on the index.

On a year-to-date basis, performance remains bifurcated. While the S&P 500 and Dow are down -4.35% and -3.19%, respectively, mid- and small-cap indices are up 2.50% and 3.58%, respectively. The Energy sector continues to dominate the 2026 leaderboard with a massive 38.25% return, followed by Materials at 9.73%. Meanwhile, the Information Technology and Consumer Discretionary sectors have struggled significantly, with both posting losses of more than 9%.

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Economic Data Summary

Overall, the first quarter of 2026 depicts an economy characterized by steady growth and robust service demand, yet one that must navigate a volatile job market and renewed upward pressure on business costs. The U.S. labor market displayed significant volatility but remained fundamentally resilient. Non-farm payrolls saw a turbulent start to the year, beginning with a gain of 130,000 jobs in January, followed by a surprising contraction of 133,000 in February, before rebounding strongly with 178,000 new jobs in March. Despite these fluctuations, the unemployment rate stayed relatively stable, hovering between 4.3% and 4.4%. Wage growth showed signs of a gradual cooling trend, with average hourly earnings slowing from a 3.8% year-over-year increase in February to 3.5% in March, though real earnings growth remained positive, providing some support for household purchasing power.

Consumer activity and inflation indicators suggest a stabilizing economic environment with easing price pressures. Retail sales grew by 0.5%, indicating that consumer spending remained positive despite broader economic uncertainty; however, many CEOs have described a “K-shaped economy” where wealthier households continue to spend freely due to rising equity prices and large sums of home equity, while lower-income citizens are cutting back on spending given the high prices on everyday essentials. Inflation, as measured by the Consumer Price Index (CPI), held steady at 2.4% year-over-year, while Core PCE stood at 3.1%. These figures suggest that while headline inflation is approaching the Federal Reserve's long-term targets, underlying core inflation remains slightly more persistent.

The manufacturing sector maintained a steady pace of expansion throughout the quarter, with the ISM Manufacturing Index consistently remaining above the 50-point threshold, reaching 52.7 in March. While new orders in manufacturing began the quarter strong at 57.1, they tapered off to 53.5 by quarter-end. A primary concern for the sector, however, is the rapid escalation in costs. The ISM Manufacturing Prices Paid index surged from 59.0 in January to a high of 78.3 in March. This sharp increase in input costs suggests that supply-side inflationary pressures may be intensifying, potentially impacting producer margins in the coming months.

The service sector also remained in expansion territory, providing a solid foundation for the overall economy. The ISM Services Index rose to 56.1 in February before settling at 54.0 in March, supported by a significant acceleration in new orders, which climbed to 60.6 by the end of the quarter. However, the sector faced its own set of challenges, including a contraction in services employment (45.2) and persistently high prices paid (70.7).

The Federal Reserve held policy rates steady at 3.50%–3.75% in a decision that aligned with market expectations, marking its second consecutive pause after three cuts in 2025. While the dot plot still reflects a median expectation of two cuts over the next two years, the distribution turned more hawkish, with a growing number of officials projecting no cuts in 2026 and one member proposing a potential hike in 2027. The Summary of Economic Projections (SEP) showed modest upward revisions to both inflation and GDP growth, while the unemployment outlook remained broadly unchanged. Inflation dominated the press conference discussion. Chair Powell emphasized that any rate cuts would require clear and sustained progress on underlying inflation, particularly core goods, acknowledging uncertainty around tariff passthrough and energy prices. Although Powell pushed back on the likelihood of rate hikes or stagflation, the overall tone was viewed as slightly more hawkish, a view reinforced by Fed funds futures, which assigned a lower probability of rate cuts in 2026.

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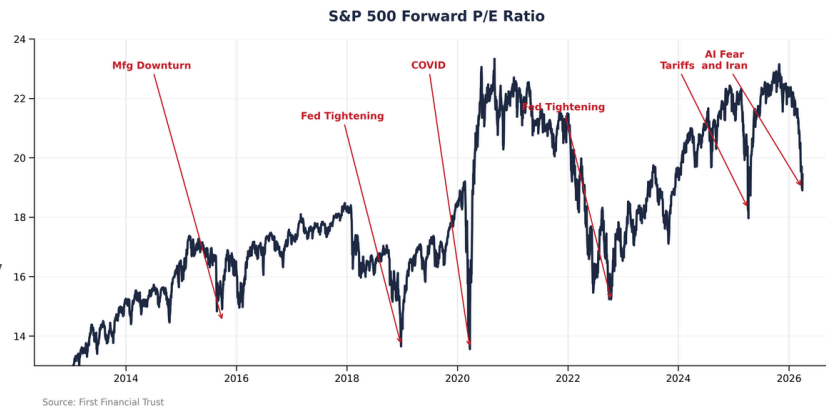
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Valuation & Earnings

The valuation of the S&P 500 currently stands at 19.6x forward earnings estimates. This is slightly less than one year ago (20.4x), and it is also lower than the 5-year (19.9x) average. Valuation has also neared the 10-year (18.9x) average as well. The pullback in stocks the past two months, along with increased earnings growth expectations, has placed equities in a more favorable position for long-term performance. However, the equity risk premium that compensates investors for the excess risks associated with stocks compared to bonds remains thin due to the higher interest rate environment.

We are on the brink of another earnings season. Analysts believe first-quarter profits will grow 13.2% from one year ago. If this comes to fruition, it will mark the sixth-straight quarter of double-digit (year-over-year) earnings growth. Nine of the eleven sectors are projected to report profit growth, led by technology, materials, and financials. Analysts believe earnings are strengthening across much of the economy, along with better-than-expected revenues. Therefore,

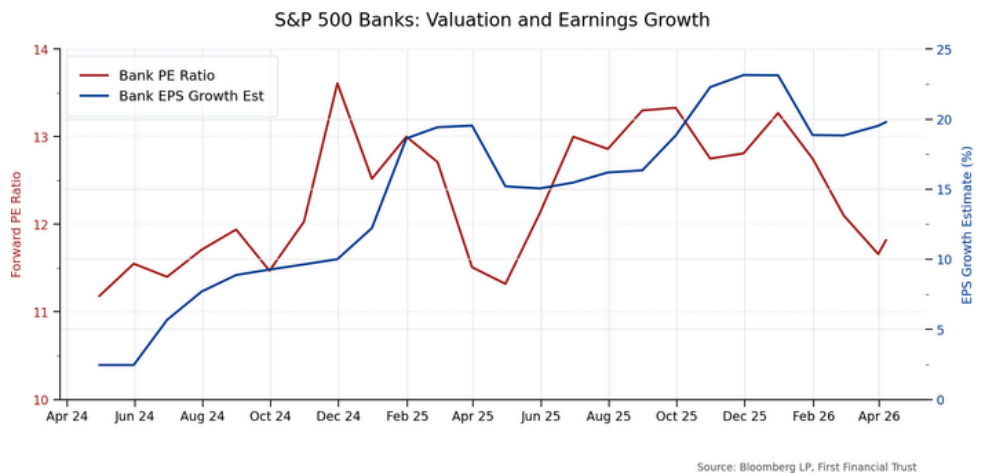
they have upgraded their full-year 2026 earnings growth rate to 17.4% from 14.7%. Technology is still expected to be the best grower of earnings, but the spread between tech and other sectors (primarily materials and financials) is thought to narrow. The largest upward revision to earnings growth has been in the energy sector. Analysts believe higher oil prices from the Iran conflict will now lift full-year energy profits by 26%, up from their previous forecast of 6.4%.



Conclusion

Stocks remain vulnerable to headline risk from major economic reports, the Fed, and geopolitical events; however, with the market trading in line with valuations from the past decade, we believe many pockets of opportunity have opened during the recent sell-off. For several months, we have written about the large valuation gap between the big tech companies at the top of the index and the rest of the market.

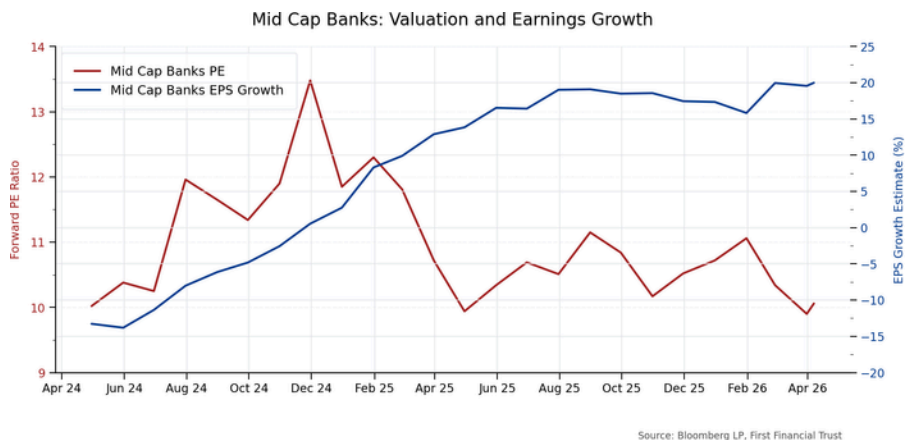
Currently, if you equal-weight the names inside the S&P 500, the forward PE ratio drops from 19.6x to 16.0x. That spread of 3.6 turns has been cut in half in just four months. During that time, there was a major rotation away from higher-valued tech names at the top of the index toward areas with improving profit growth and lower valuations, primarily industrials, healthcare, energy, and materials.



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Currently, the Mag 7 (ex-Tesla) trades at a forward PE ratio in line with the index and a discount to consumer staples (a popular defensive hedge). That seems strange given that big tech is forecast to grow earnings by 37.3% in 2026, compared to +17.4% for the market and +5.9% for staples. In our opinion, this illustrates the level of fear and caution that is already priced into the market. With big tech



trading in the 2nd percentile of observations over the last five years, we believe the group offers a compelling relative risk-to-reward profile. Therefore, we would be buyers of big tech at these levels.

Finally, we remain bullish on financials. The higher interest rate environment is good for asset repricing, and the underlying economy is still growing. Credit quality, especially among banks, is strong. For larger banks with capital markets divisions, market volatility has likely boosted trading activity. These factors, along with the Fed's lower capital requirements, should lead to strong profit growth. Concerns about private credit appear to be limited to a small segment of loans and product structures, while banks' exposure to non-bank financial institutions (NBFIs) is low. Relative valuation of banks versus the market has collapsed during the sell-off; therefore, we would also be buyers of these stocks, especially given the likelihood that the Fed will become more dovish once the Iran conflict concludes.

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