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Investment Newsletter – March 2026

Executive Summary

Negative sentiment regarding private credit holdings caused the Short-Term Income portfolio to decline 2.3% over the last year; this has also presented an opportunity. The war in Iran will boost inflation worldwide in 2026; the Federal Reserve's preferred inflation measure expected to hit 4.2%. Interest rates have risen sharply since the start of the war, perhaps too much given the likeliest outcome. National stock markets have reacted according to their exposures to the energy price shock. As an energy exporter, the U.S. economy has lower risk relative to other large economies.

Short Term Income Portfolio Strategy and Performance

Berkeley Investment Advisors uses several strategy portfolios to manage client assets. The Short Term Income portfolio, which we focus on in this, its anniversary quarter, is a fixed income portfolio holding short to intermediate rate maturity loans and bonds. Shorter maturity bonds usually offer lower interest rates (yields) than longer maturity bonds and are less sensitive to changes in interest rates. This category includes securities and private market loans with floating interest rates that can reset periodically depending on market conditions. For example the rate paid could be set based on banks' "prime rate" or the 3-month term Secured Overnight Financing Rate. These rates, in turn, change as the Federal Reserve Bank raises (or lowers) its "Fed Funds Rate".

The interest rate risk sensitivity of the portfolio is measured by its duration. Usually a short term bond fund strategy owns bonds with durations below 3. If we held a bond with duration of 3 when rates went up 1 percent, we would expect the bond's price to decline by 3 percent. The current duration of the portfolio is 0.9; one year ago, it was 1.3.

There is also credit risk in our portfolio –borrowers may default and not pay all that is due. High yield bonds and loans have a higher probability of default than investment grade rated bonds, but they compensate by paying higher interest rates. It is this spread compensation that fluctuates

depending on the market's current risk pricing attitude (mood). This pricing risk is related to equity market risk (meaning swings in investor sentiment towards risk), and, fluctuations in the economy. We manage individual credit risk by diversifying across a large number of issuers. This ensures that the extra premiums earned will not get wiped out by a few companies defaulting. Our strategy is to accept credit risks to earn the extra returns associated with those risks.

The portfolio also earns incremental yield by holding closed-end funds. For a detailed explanation of the advantages of closed-end funds see the March 2017 newsletter. To hold these securities, we must endure more price volatility in down markets: retail investors want to sell more at lows. In contrast, our strategy is to buy at these lows and then reduce positions as prices recover. In other words, we trade with anxious sellers and buyers who are willing to transact at prices that provide us good returns.

Private Credit Negative Sentiment Impact

Our largest position in the account, ticker FSCO illustrates this strategy in action over the last few years. This is a fund that invests mostly in private loans (not securities). In the June 2025 newsletter we did a case study of this formerly private fund and how it's conversion to a closed-end fund enabled us to earn 97% on this over 27 months. This case study explained that the fundamental reason was that we provided liquidity to desperate sells by buying a huge discount to Net Asset Value (NAV).

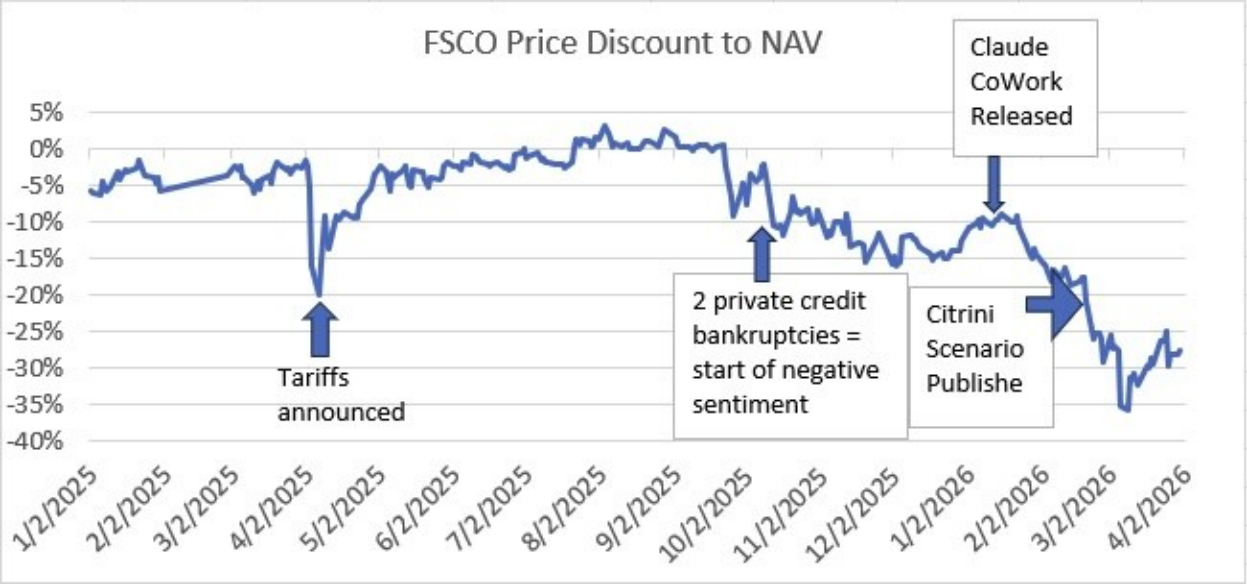
We initially bought at discounts between 21% and 29%. Subsequently the discount went down below 5% and we sold in January 2025 to reduce the size of the position. Subsequently the fund kept rising till it traded at premium to NAV because the yield was very high. This situation persisted from late July 2025 to late September 2025. At that point sentiment towards the private loan sector began a reversal.

It started with two bankruptcies: Tricolor (auto lender) and First Brands Group (auto-parts manufacturer). For the rest of 2025 there were many negative private credit headlines. Much of this was unrelated to underlying credit conditions. Instead, retail investors who were the new targets for investing in private funds learned that you cannot get your money out just because you're nervous. Thus, restrictions by funds on withdrawals produced poor sentiment which in turn drove further redemption requests that were not paid. Funds did sell some loans to do payouts, which put pressure on private loan pricing. But these private funds were not designed to handle the high volume of requests and so investors were stuck holding their shares.

Meanwhile, retail investors in the closed-end fund market reading those headlines withdrew their funds by selling their shares. This reduced

closed-end fund prices - driving discounts higher on funds like FSCO that hold similar assets to the illiquid private funds.

In 2026 there were two more news items that soured sentiment for the loan sector. In January Anthropic released the Claude CoWork app which considerably simplified the use of Claude Code so that virtually anyone could safely do coding using Claude artificial intelligence (AI). This was a negative for loan investors' thinking because a significant portion of private credit loans were made to software companies. The new AI tool called into question these companies' subscription revenues. Then February 22nd, Citrini Research published a hypothetical future scenario titled "**THE 2028 GLOBAL INTELLIGENCE CRISIS -** A Thought Exercise in Financial History, from the Future". This piece, about the potential negative effects of AI on the economy and certain sectors and companies, went viral and further spooked the market. (I'll have more to say about Claude Cowork in a later newsletter). Here's a graph of the FSCO discount since the start of 2025:



The change in the discount was large enough to reduce our return on this strategy by 5.3% for the year ended 2/28/26. Thus, this sentiment driven discount was enough to change a positive return to a slightly negative return for our portfolio for the year.

In early March the price and yield of FSCO reached a discount of 35%. Given that I expected returns on FSCO to exceed 13% over the next year, I rebalanced the portfolio from safer positions to boost our weighting back up for FSCO. Since the purchases FSCO has already returned more than 13% so my estimate may have been too conservative.

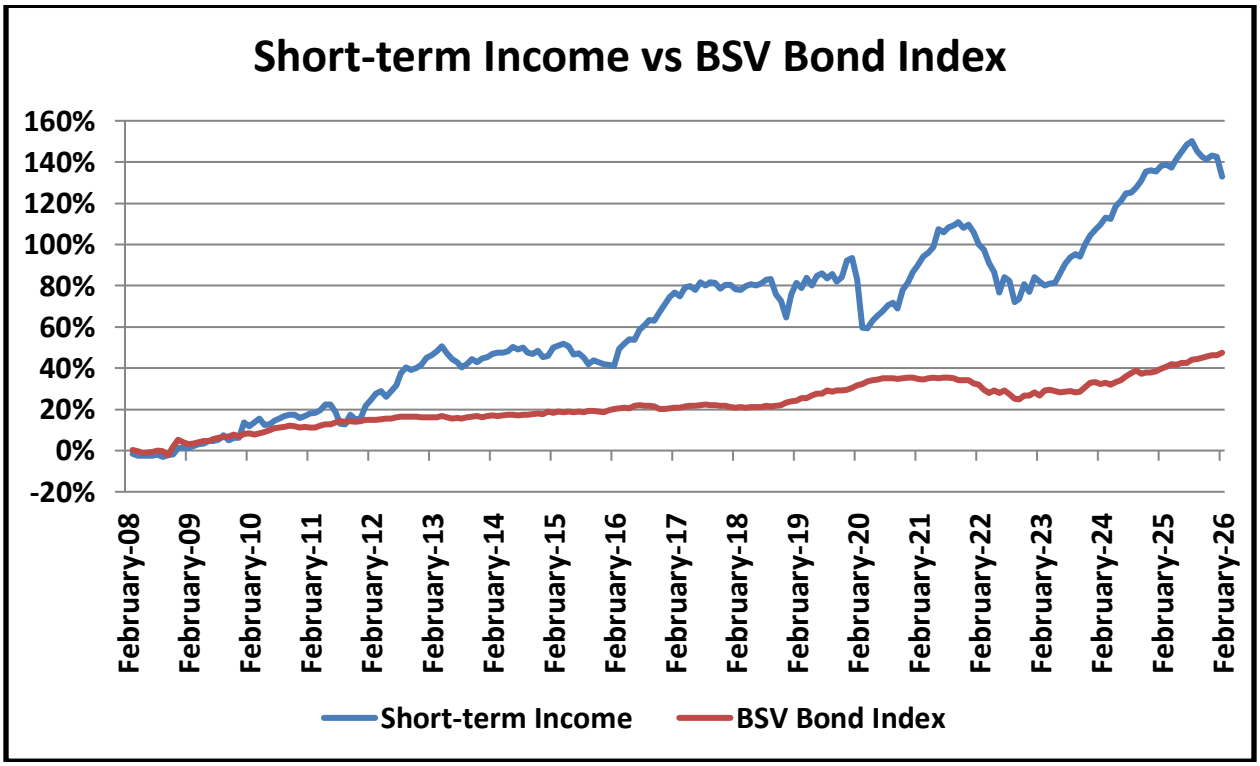
Portfolio Performance

While FSCO is a major holding of this portfolio, it is diversified across

various types of short rate maturity income funds. The best comparison index is the "Barclays U.S. 1-5 year Government /Credit Float Adjusted Bond Index" as represented by the Vanguard Short-Term Bond exchange traded fund (ticker BSV). This is meant to represent the total short maturity U.S. bond market. It is not a perfect comparison to our strategy but there is nothing closer that has been in existence for the life of our portfolio.

Some clients have had money invested in this portfolio since it was created in February 2008. The graph below and the table on the next page show total returns including price and interest payments in comparison to the bond index mentioned above as implemented in the exchange traded fund (ticker BSV). Our portfolio returns calculated here are based on a particular client's account and have been reduced by annual fees of 1.25 percent which would apply to new accounts above $500,000 but below $1 million.

The graph below shows that this strategy incurs small drawdowns but subsequently has "catchup" years to return to its long term trend. This strategy has had losses in 3 out of 18 years, including this past year and has underperformed its benchmark in 7 years out of 18 years. Generally, however, there is lower risk of principal loss over a year's time than in other strategies - such as stocks or long term bonds.



The Federal Reserve has been reducing interest rates the last two years and this reduces some of the income on this portfolio. Given the

expected path of inflation, further rate cuts are unlikely unless the U.S. goes into recession.

The table below shows the portfolio returns by year since inception.

		Returns by Year		
Year	Year Ended	Short term Income	BSV Bond Index	Difference
1	2/28/2009	1.4%	3.1%	-1.7%
2	2/28/2010	10.3%	5.0%	5.4%
3	2/28/2011	5.5%	2.7%	2.8%
4	2/29/2012	5.5%	3.4%	2.1%
5	2/28/2013	17.5%	1.1%	16.3%
6	2/28/2014	0.5%	0.6%	-0.2%
7	2/28/2015	2.0%	1.2%	0.8%
8	2/29/2016	-6.0%	1.5%	-7.4%
9	2/28/2017	25.5%	0.6%	24.9%
10	2/28/2018	0.9%	-0.1%	1.0%
11	2/28/2019	1.7%	2.9%	-1.1%
12	2/29/2020	0.9%	6.2%	-5.3%
13	2/28/2021	3.9%	2.3%	1.6%
14	2/28/2022	5.1%	-2.2%	7.3%
15	2/28/2023	-8.9%	-4.0%	-4.9%
16	2/28/2024	15.1%	4.5%	10.6%
17	2/28/2025	13.8%	5.6%	8.1%
18	2/28/2026	-2.3%	5.5%	-7.8%
	Compounded Total	132.8%	47.5%	85.3%

Over the last year, the strategy return was -2.3 percent, while the Vanguard Bond Index Fund earned 5.5 percent. The cumulative return for the strategy from 2/29/2008 to 2/28/2026 is 132.8 percent. Thus, the annualized compounded rate of return since inception (18 years ago) has been 4.81 percent.

Over the year ended 2/28/26 credit spreads have increased by .25 percent, which is very minor. As discussed earlier, private credit market headlines caused a large increase in discounts in the Short-Term Income portfolio; the discount on the largest closed-end fund went from 3.72% down to 29.26%. This explains the mark to market loss on the fund. This portfolio continued to generate income of about 8% over the year. Currently the average closed-end fund discount in the portfolio is 21.3% percent which is very high. I expect these discounts to decline over the coming year and thereby boost our returns. The portfolio currently generates income of 8.7% so it's reasonable to expect returns above this level in the year ahead.

The War's Potential Economic and Market Impact

According to the March 12th report from the International Energy Agency (IEA), the closure of shipping from the Persian Gulf due to the war "is creating the largest supply disruption in the history of the global oil market". It is also the largest disruption of the liquefied natural gas (LNG) market, which is critical for electricity, heating, and industrial production across Europe and Aisa.

Before the conflict, countries in the Persian Gulf exported nearly 20 million barrels of petroleum products per day through the Strait of Hormuz—roughly a fifth of global consumption. Because producers outside the Persian Gulf increased their output, the IEA estimates net worldwide production is now 8 million barrels per day lower. Approximately 20% of the world supply of LNG is blocked from export.

The table below summarizes the key numbers we use to estimate the economic impact of the disruption once strategic reserves are depleted:

	Oil	LNG
A. 2025 Resource cost as % of Global GDP	3.0%	0.20%
B. Reduction in world supply	7.6%	20%
C. Estimated Price Elasticity of Demand	-10.5%	-18.6%
D. Estimated Price change (after reserves depleted)	72%	108%
A×D World energy bill increase as % of income	**2.2%**	**0.2%**

Worldwide, the combined effect is to increase costs by2.4% of total output.

Understanding Price Elasticity

The estimates for the price elasticity of demand in row C of the table above measure how much consumers reduce their consumption of a commodity when its price rises. An elasticity of -10.5% for oil means that for every 1% increase in the price of oil, global consumption falls by only about 0.105%. In other words, oil demand is highly inelastic in the short run: people and businesses cannot easily or quickly switch away from oil for transportation, heating, and industrial processes.

This inelasticity is what makes supply shocks so painful. When oil supply drops by 7.6% and consumers can only reduce their usage modestly, the price must rise dramatically—in this case an estimated 72%—to bring the market back into balance. The same logic applies to LNG, where elasticity is somewhat higher (-18.6%) because some electricity generators can switch to coal or other fuels. However, because a larger portion of LNG production is offline, the estimated price increase is still a punishing 108%.

The above estimates apply after all reserves have been used. At that point the European oil benchmark price will be $124 per barrel of oil.

It is important to note that these elasticities are short-run estimates. Over longer time frames (quarters and years) consumers and businesses find more ways to conserve, substitute, and adapt. Long-run elasticities for oil are typically two to four times higher than short-run figures, which is why prolonged price shocks, while painful, eventually generate their own cure through demand destruction and the development of alternatives.

Government Subsidies and Price Controls

Many governments—particularly in Asia—subsidize fuel and electricity prices for their populations. During a supply shock, such as this one, these policies make the global price impact worse. Here is why: if a government caps the retail price of gasoline, its citizens have less incentive to conserve fuel. This means the demand reduction that should come from higher prices does not materialize in subsidized markets. The burden of adjustment then falls more heavily on unsubsidized markets, where prices must rise even further to balance global supply and demand. Thus, these government policies effectively lower the global price elasticity of demand, meaning prices must rise more than they otherwise would to clear the market.

Widely Varying Impacts

The disruption will be far larger in certain geographies and certain industries depending on their reliance on Middle Eastern energy imports.

The projected 108% increase in LNG cost will severely impact Japan, Korea, and Taiwan, as well as European industry. The European natural gas benchmark price has already increased 72% since the start of the war. China is less affected as they have greater capacity to switch over to coal.

The countries with the largest costs of imported energy as a percent of the economy are in Asia. Europe and California will be impacted, but these costs are a smaller share of their higher incomes. Here are estimated statistics for selected locations that show the wide range of exposures:

	Pre-War Costs as a % of GDP		
Geography	**Oil & Refined Products**	**Liquefied Natural Gas**	**Combined Exposure**
Japan	2.1%	1.0%	3.1%
Korea	5.0%	1.5%	6.5%
Taiwan	3.6%	1.5%	5.1%
China	1.9%	0.2%	2.1%
European Union	1.4%	0.2%	1.6%
California	1.2%	0.0%	1.2%
World Average	3.0%	0.20%	3.2%

Major energy exporters outside the Middle East include: the United States, Canada, Brazil, Russia, Norway, and Australia (LNG).

In the U.S. the largest impact will be in California and Hawaii because these states normally source oil and refined products from international markets. Normally the Jones act prevents shipping from U.S. export terminals to California but the president has suspended the law which may provide temporary domestic supplies to reduce the severity of shortages. In any case transportation costs for everything are already up more than 20%. Sudden price changes of this magnitude will result in losses to businesses that cannot adjust prices fast enough to compensate.

Industries Facing the Biggest Impact

Oil and gas producers outside the Middle East are the most obvious beneficiaries. Profit margins will likely be up by multiples in 2026. The S&P 500 energy sector has surged 12% in March.

Shipping companies are seeing freight rates for very large crude carriers rise to at least three times their normal rate, as tankers reroute around the conflict zone and demand for available vessels intensifies. Shipping container rates from Shanghai to Los Angeles are up 12%.

Agriculture and fertilizer: The war has stranded large volumes of ammonia, urea, sulfur, and phosphates that normally ship through the Gulf. Urea prices in the Mideast have jumped over 50% since the bombing began. U.S. domestic fertilizer producers which benefit from America's ample natural gas supplies, will see much higher profit margins, and like the oil producers, have already seen outsize gains in share prices. Higher fertilizer costs mean higher food prices are likely to follow—corn requires significant nitrogen fertilizer, and less corn means higher prices for the crop, animal feed, and meat.

Chemicals and plastics: U.S. plastics producers are benefiting from the same dynamic as fertilizer makers. Naphtha, ethane, and propane—the building blocks of plastics—are becoming more expensive for import-reliant producers, while U.S. producers with access to domestic feedstocks can raise prices in tandem.

Semiconductors and helium: Qatar accounts for about 35% of world helium capacity, and helium is an essential coolant in MRI machines and semiconductor manufacturing. If Qatari output remains offline for another four to eight weeks, chip production could face constraints.

Airlines and tourism: Jet fuel is already in shortage across Asian countries (especially Vietnam). Flight cancellations at some Middle Eastern airports are near 100%.

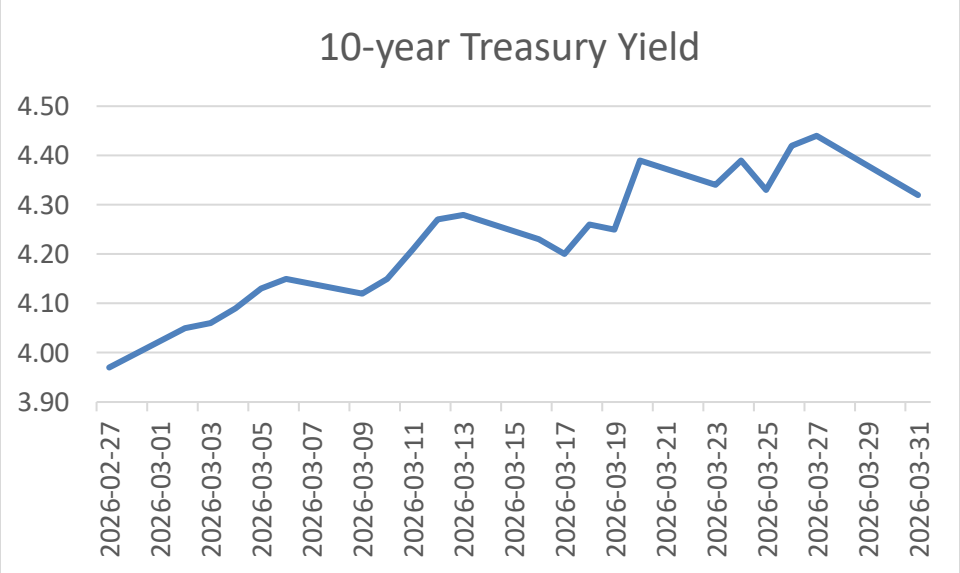
Aluminum: Qatar has shut down aluminum production; the blocked shipping lane has pushed aluminum prices 5% higher. Given the large energy input needed to produce aluminum, prices may go much higher as

producers in LNG importing countries reduce output. Users ranging from auto parts manufacturers to beer and soda companies will feel the squeeze.

Inflation and Interest Rates

Energy prices will push inflation up all over the world in the near term. This effect is likely temporary but it depends on how long it takes for normal shipping to resume in the Persian Gulf. My base case estimate is a rise of 1.45% in inflation for 2026; this implies the Personal Consumption Expenditure measure will end the year at 4.25%. This is the measure used by the Federal Reserve as their target. In contrast, market pricing for inflation protected bonds implies an inflation rise of just .85% (assuming all impact is in 2026).

Long-term interest rates are up significantly . The chart below shows the benchmark 10-year yield rose .35% from the start of the war to March 31st. Given that this higher yield applies for 10 years, this is a much larger move than the near term expected inflation spike.

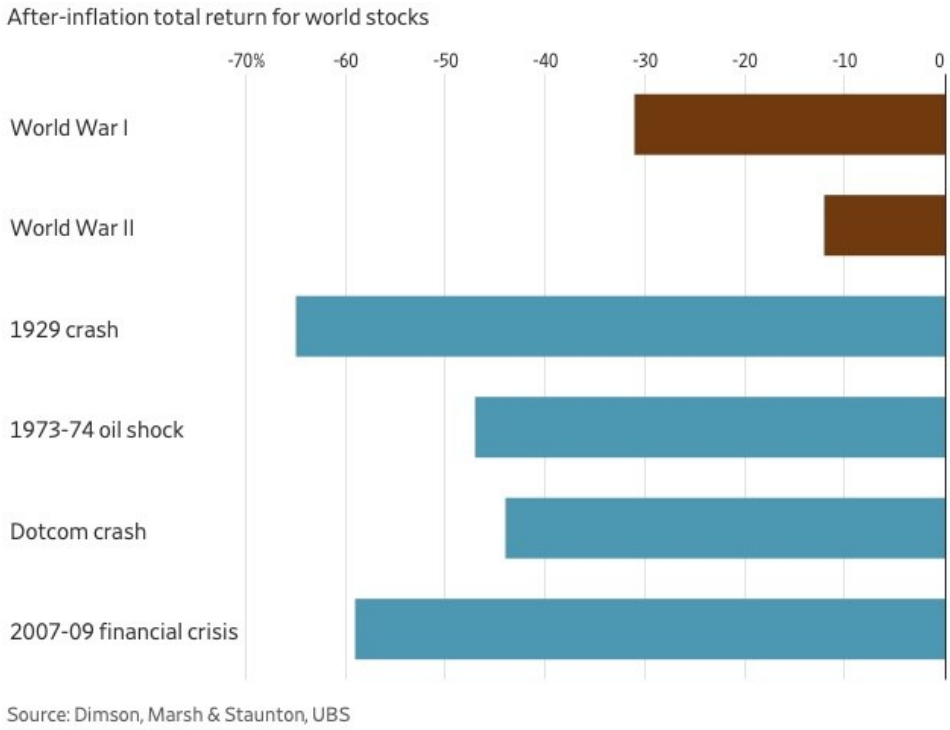


This is a very large move and runs counter to the idea that the war might produce a recession in the U.S. (because that would tend to lower interest rates). I interpret this as an expectation that world-wide government borrowing will increase to cushion the economic hit and thus rates are rising in anticipation of that increased borrowing.

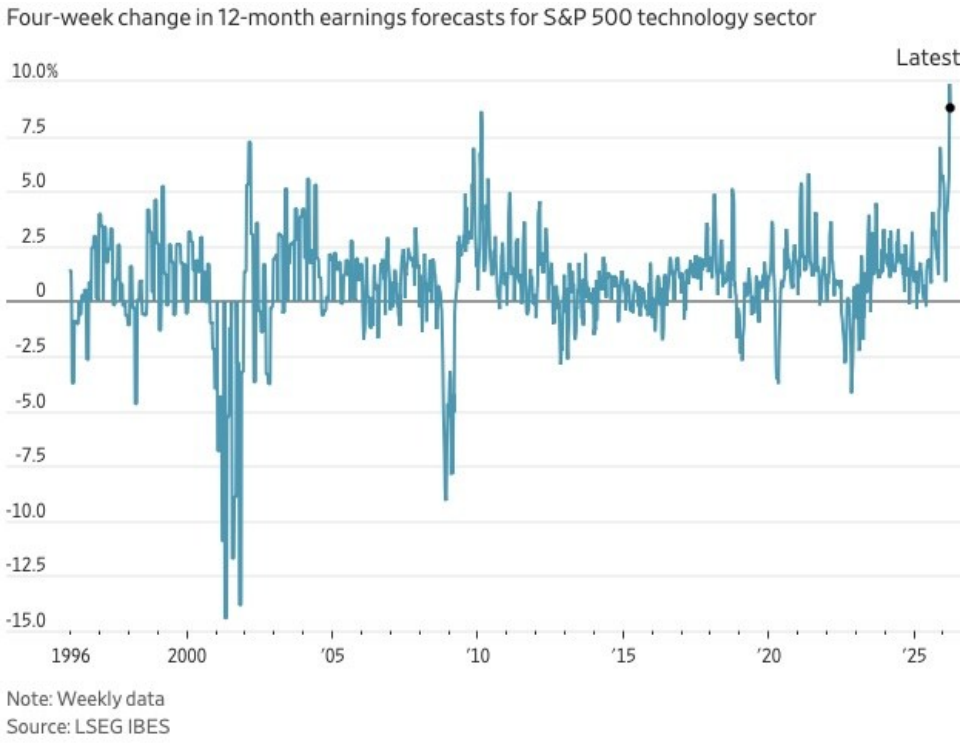
U.S. Stocks' Muted Reaction

So far stocks have declined very modestly. Investors are looking to history as a guide. Deutsche Bank research shows that the average stock market drop across 30 major geopolitical events since 1939 was just 4%, and recoveries were typically quick. The four great bear markets of the past century—the Great Depression, the 1973–74 oil embargo, the dot-com

crash, and the 2007–09 financial crisis—were all significantly worse for stocks than either of the world wars. Here's a comparison:



Although the U.S. market is declining, U.S. equity analysts have actually been increasing earnings forecasts at a record rate:



For now, investors are looking past the war and focusing on the strength of the U.S. economy. Before we relax, let's consider the range of uncertainty we are facing.

Scenarios: The Range of Uncertainty

As the chart on wars and recessions in the accompanying materials illustrates, recessions have historically been far worse for financial markets than wars—unless your country's physical infrastructure is destroyed. Here are three scenarios to frame the range of possible outcomes.

1. **Base (best) case: 2-month war and the Strait of Hormuz re-opens by end of May.** In this scenario, the war is over and oil tankers resume sailing from the Persian Gulf in May. In this case the 400-million barrel release of strategic reserves (announced by the IEA on March 11) is sufficient to cover the decline in global production that would normally go to U.S. allies. China, which is the largest buyer of Mideast oil, has its own (undisclosed) reserves that it will use to cover its shortfall. Oil prices would never need to reach the $124/barrel equilibrium level. Damage to production assets will keep energy costs elevated for at least the next year, and certain industries will face disruption, but a U.S. recession is unlikely. Inflation will likely rise above 4% this year.
2. **Bad case: war continues 6 months, but ships are escorted through the Strait starting at month 3.** In this scenario the release of strategic reserves won't quite make up the lost output of oil so the price will rise high enough to reduce demand (estimated at $124/barrel for Brent crude). The LNG shortage will severely impact Asia and European industries. In this case the price shock will be enough to throw some countries into recession. The U.S., as an oil exporter, will probably not be one of them.
3. **Worst case: the war goes on for years at a lower level of intensity** (as it was before the U.S. decided to try to end Iran's capabilities). The world funds the costs of protecting energy shipments from Iran indefinitely. In this case costs for oil and liquefied natural gas will be permanently higher than before the war. The adjustment process for the world will take years and worldwide economic growth will be much lower than it would have been. On the other hand, this scenario would likely accelerate adoption of alternative energy sources for transportation and power production. So, there will be some long run economic (and financial) positives that follow from a prolonged energy price shock.

My guess is that the probability of the best case is 60% and I put the other two cases at 20% each.

Implications for Investing

In thinking about investment implications, we should consider the context of how prices have already moved and decide if we have a strong reason to believe what the next move from there will be. So far, the U.S. equity market is down 5.2%. Our international stock portfolio is down 8.2%. Within those international stocks, Korea has done worst, losing 18.7%. At the other end of the spectrum, Norway (an energy exporter) is best - up 6.8%.

In scenario 1 there is little reason to expect the war to have other than a temporary effect on stock prices. Long term bond yields may have already moved more than they should, which would mean bonds will do well going forward as uncertainty is resolved. In this case equity prices may have already declined more than they should.

The existing equity price declines may have further to go in scenario 2 but it's not obvious that they are far off from where they should be.

Only if scenario 3 turns out to be the case would I estimate that international equity prices are likely to decline much further.

For the time being, there is no urgent reason to make changes to equity allocations in the absence of strong views about which scenario will play out. Given the high probability which I assign to case 1, bond prices may have over-reacted. I believe bonds will provide a cushion for overall portfolio returns going forward.

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