

# SPEAK SOFTLY AND CARRY A BIG STICK

**COMMENTARY**

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Any ideas that 2026 would be a nice relaxing year ended on January 3, when the US launched an incursion into the capital of Venezuela – capturing its President, Nicolas Maduro. Even though the markets moved up in the days following the removal of Venezuela’s President, it seemed a warning shot over the bow that this year would be anything but normal. Indeed, SIM had warned in its year-end review and outlook for 2026, “unexpected events do happen,” and that “investors should remain vigilant”. We just didn’t believe that the unexpected events would begin right away!

President Theodore Roosevelt, then Vice President Roosevelt, said “Speak softly and carry a big stick – you will go far” at the Minnesota State Fair on September 2, 1901, two weeks before the assassination of William McKinley would elevate him to the Presidency. It was one of his favorite sayings.

Big stick ideology<sup>1</sup>, according to Roosevelt, had five parts:

1. Possess serious military capability that would force the adversary to pay close attention.
2. Act justly toward other nations.
3. Never bluff.
4. Strike only when prepared to strike hard.
5. Be willing to allow the adversary to save face in defeat.

We turn to Roosevelt's Big Stick ideology because it seems to SIM that, given his seeming fondness for what we would term "aggressive" presidents, President Trump has apparently adopted at least parts of it as he asserts US dominance in the western hemisphere and (apparently) around the world. Referred to as the Donroe Doctrine or Trump Corollary<sup>2</sup> to the Monroe Doctrine (Big Stick Ideology was also referred to as the Roosevelt Corollary to the Monroe Doctrine), it emphasizes the restoration of American preeminence in the western hemisphere. Specifically, it has four principles:

- Hemisphere Primacy: The US claims a standing right to prevent non-hemispheric powers from gaining strategic strength in the Americas.
- Active Intervention: Supports proactive measures, including military, economic and political actions, to enforce US security and economic interests.
- Countering Rival Powers: Targets Chinese and Russian influence, as well as others perceived as threats to US security and economic interests.
- Strategic Resource Control: Includes efforts to secure key assets such as the Panama Canal, Venezuelan oil, Greenland's minerals and other strategic locations.

What has this meant for markets and the economy so far this year? Put simply, expectations for how the year would play out have, pretty much, gone out the window. Prospects for a couple of rate cuts are largely gone (though the FOMC indicated, in its most recent Summary of Economic Projections, that there was still the potential for lower rates). Energy prices (specifically, gasoline and crude oil), which had trended downward through the first month of this year, have now spiked to levels not seen since the third quarter of 2023. Equity prices have fallen across the market cap spectrum, and the yield curve has flattened.

## **A Review of the First Quarter**

Let's just say that the first quarter was "interesting". Early on in the quarter it seemed that the US was on course for a reasonably good quarter with an expectation that the Fed would likely cut rates at least once (if not twice) by year-end as inflation seemed to be moderating. This would give the FOMC some cover to use the decline in job openings as its rationale for bringing short-term rates down. Unfortunately, the Trump administration set some things in motion (air assault against Iran) that have turned the benign inflation scenario on its head.

While the United States is not as dependent on foreign oil (or any oil for that matter) as it was in the 1970s, the fact that oil prices are now more than 50% higher than they were on January 1st and more than 70% higher than they were on December 1st (see Figure 1 below) should still show up in higher inflation numbers. Gasoline prices have largely followed oil prices higher – which should have been expected

(see Figure 2 below). Instead of acting like a tax cut (as was the case for much of 2025 as prices came down), the more than 40% increase in gasoline prices has turned into a massive “tax increase”. Will this cause a pause in consumer spending? We will cover that in greater detail below (although we should see the first glimmers of the impact of high gasoline prices over the next month or so as we get CPI and early Q1 GDP data).

Is inflation moving higher? Results so far this year have been mixed. While the all-in consumer price (CPI) data moved markedly higher from January to February (0.17% to 0.27%), the Core CPI data actually moderated. This does make some sense as core CPI removes the impact of food and energy prices from the headline number. Given that producer prices (PPI) have moved steadily and significantly higher since the end of October 2025 (from 0.13% in October to 0.68% in February), we should expect that consumer prices should also trend higher as business pass on at least some of their higher costs.

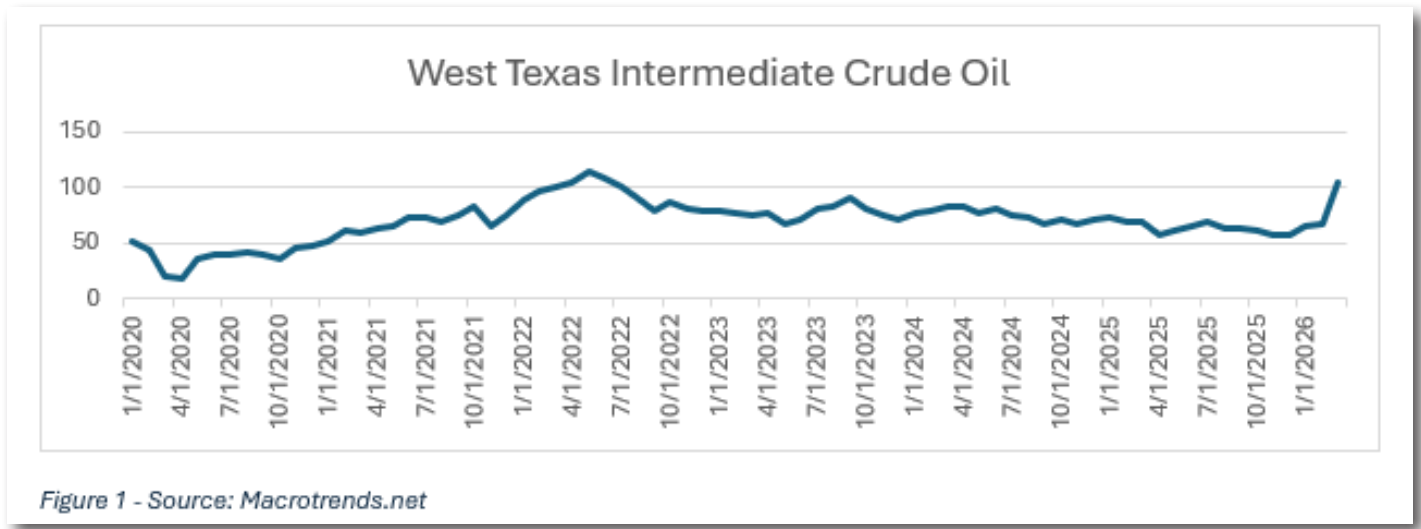


Figure 1 - Source: Macrotrends.net

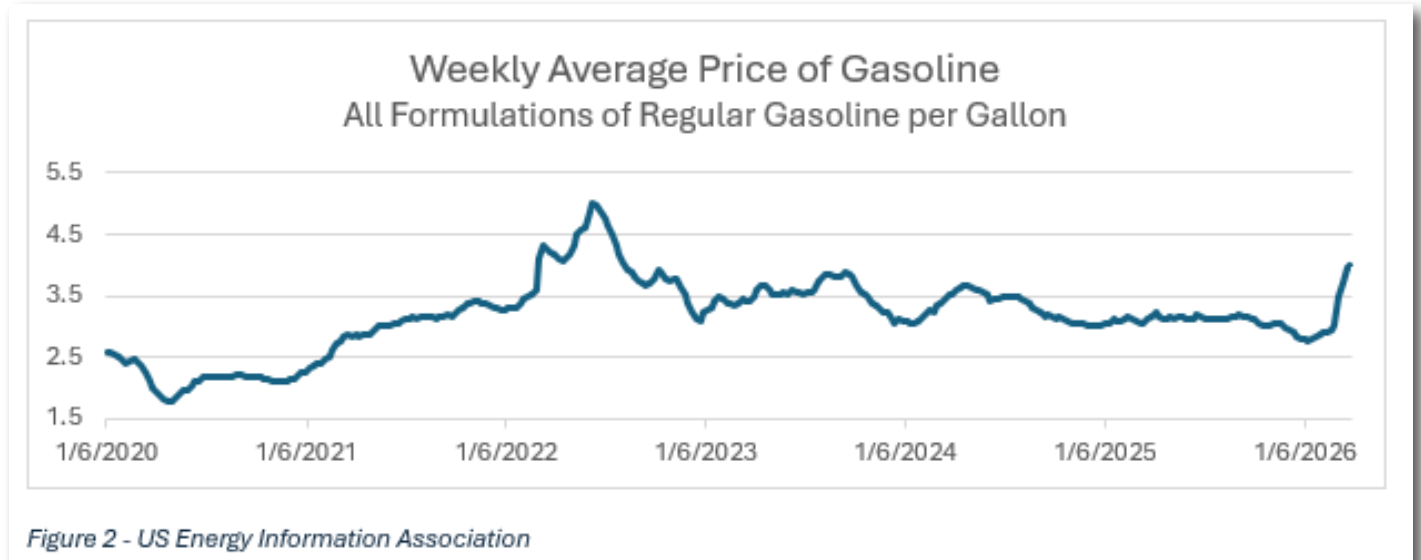


Figure 2 - US Energy Information Association

Equity markets largely shrugged off the US incursion into Venezuela, a short government shutdown, and used January's Supreme Court decision calling the Trump tariffs unconstitutional to recover from another partial government shutdown. However, the attack on Iran and the closure of the Strait of Hormuz put equities in a tailspin (see Figure 3 below).

The S&P 500 ended the quarter, down more than 300 points (more than 4.6%) from its year-end close, a last-day-of-the-quarter rally notwithstanding. Smaller and international stocks also tumbled from their highs but managed to eke out small gains. (The S&P MidCap 400 added 71.21 points or just over 2%, while the small cap S&P 600 Index added 45.47 points or just over 3%, the MSCI EAFE Index added just 1.1 points or a little more than 1% and the emerging international markets, MSCI EAFE- EM, added 143 points or just over a quarter of a percent.)

From a total return standpoint, the S&P 500 fell 3.96% for the quarter, the Russell MidCap Index rose 1.29%, the small cap Russell 2000 added 0.89%, the iShares MSCI EAFE ETF (our proxy for the index) gained 1.01% and the iShares MSCI Emerging Markets ETF (our proxy for the emerging markets index) increased 2.79%.

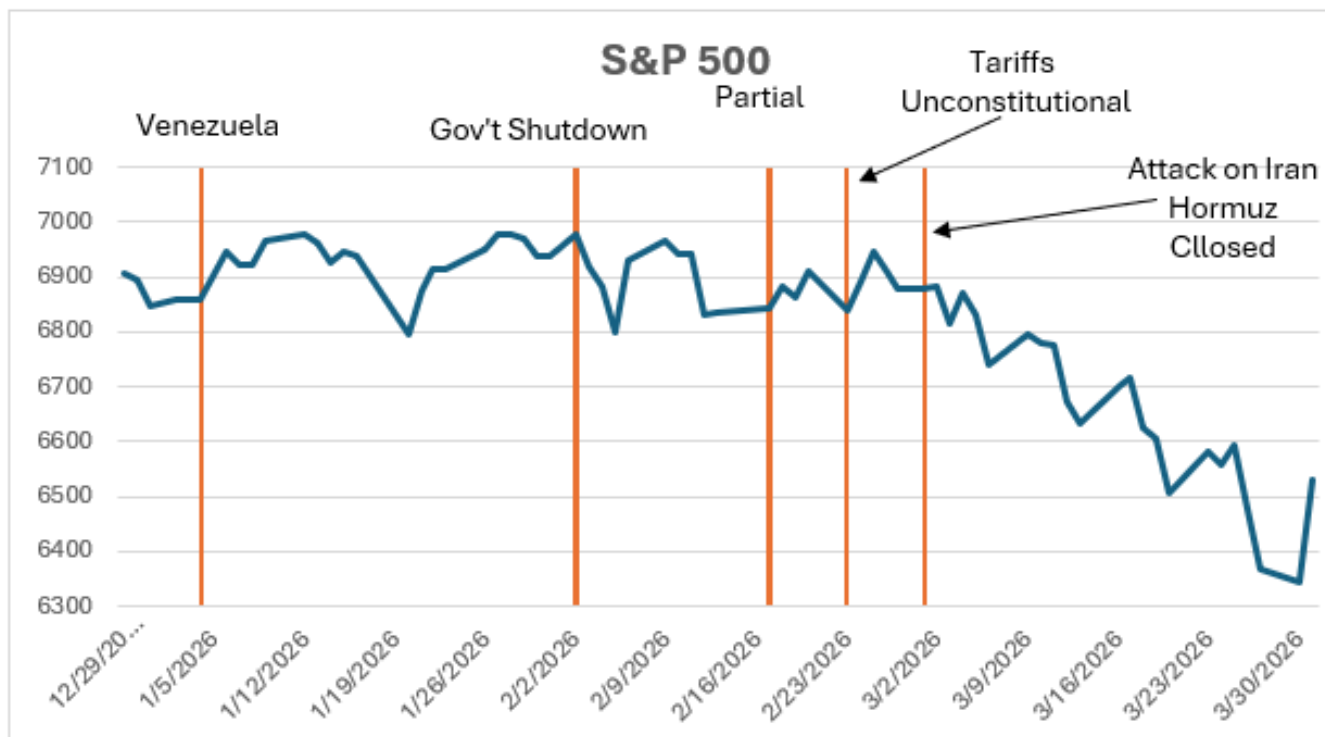
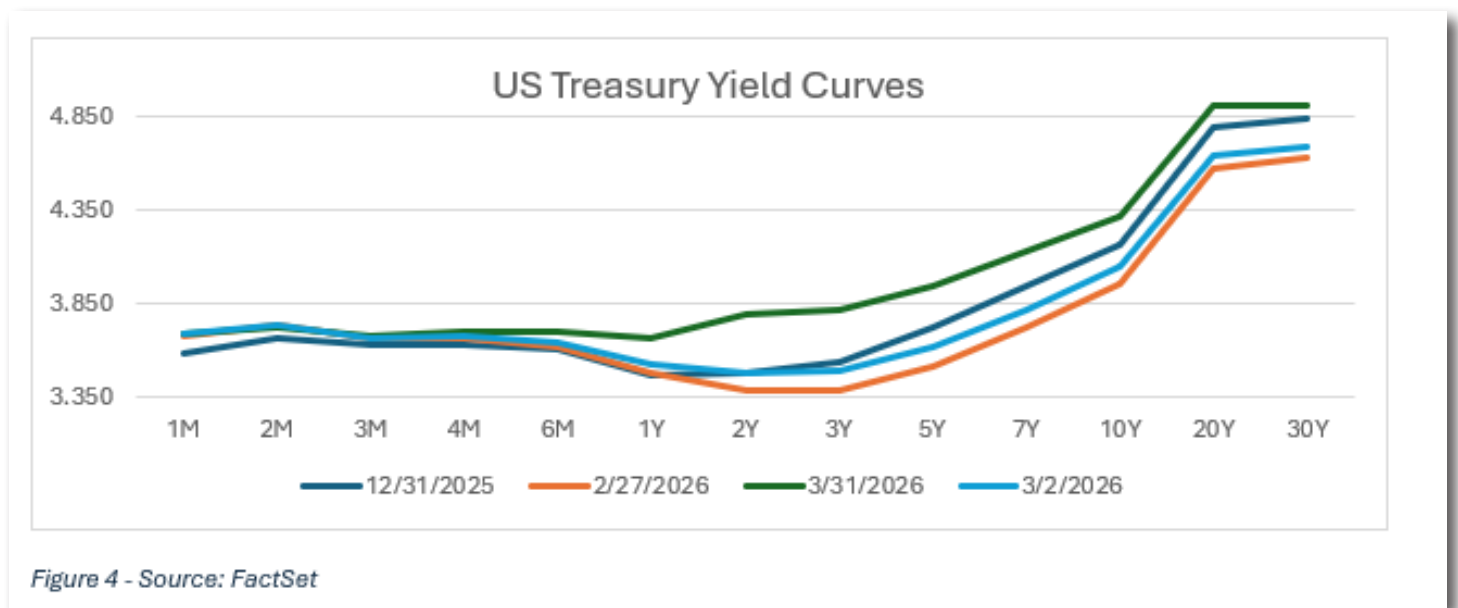


Figure 3 - Source: Gurufocus.com; "Early 2026 Government Shutdowns" Center for Homeland Defense and Security; "Is there a US government shutdown? What to know" by Maria Cortes Gonzolas, El Paso Times, February 2, 2026; "Supreme Court strikes down tariffs" by Amy Howe, SCOTUSblog, February 20, 2026; "What's Happening With the US and Venezuela, Explained" by Miranda Jeyaretnam, TIME, Inc., January 12, 2026; "War US-Israel vs. Iran-Timeline 2026", by Heloise Liebenberg, EISMENA, March 4, 2026

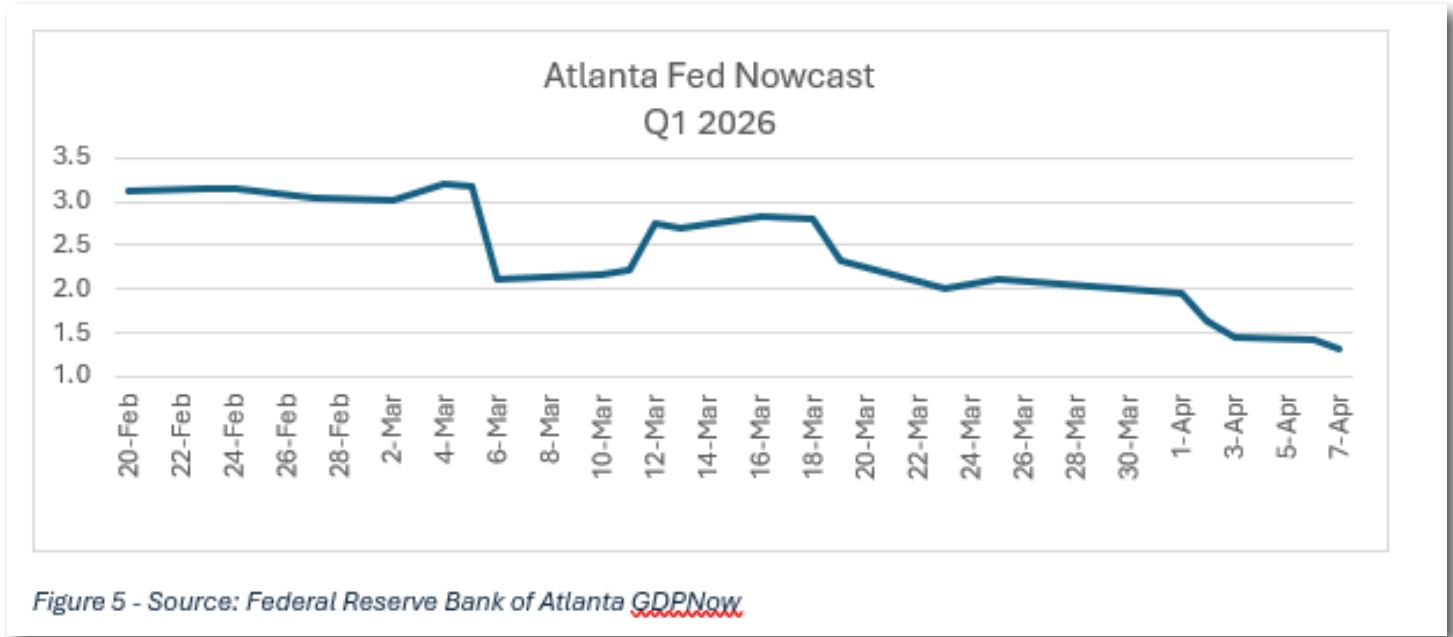
Treasury yields went on a wild roller-coaster ride in the quarter (see Figure 4 below). From the end of the year to February 27, the 2-to-30-Yr Treasury curve dropped (rates lower) between 9 and 22 basis points. Subsequent to the first bombs being dropped on Iran, yields moved higher across the yield curve with the most noticeable moves from 1-Yr T-Bills (up 19bp), 2 to 7-year notes (up 41 – 43bp) and 10 to 30-Yr bonds (up 28-36bp). Yields moved higher across the curve as energy induced inflation fears hit the market. Concerns also grew regarding how easily Treasury would be able to finance the existing national debt as well as new debt needed to fund growing deficits – particularly with needed increases to defense as spent munitions are replaced. Concerns that turned out to be well founded.

Auctions of 2, 5 and 7-year Treasuries all drew weak demand the week of March 23, pushing rates higher. Further exacerbating the issue is a reported demand from the Pentagon that it is seeking \$200 billion to replenish depleted munitions and an ask from President Trump for a defense budget of \$1.5 trillion, a 44% increase over the current fiscal year’s spending, in his budget proposal for the next fiscal year (beginning October 1, 2026).



From an economic standpoint, consumer confidence has improved modestly over the last two months of the first quarter. According to the Conference Board, consumer confidence nudged up by 0.8% in March from February’s reading (91.00) and February was up 1% relative to January’s reading (89.00). While the increase over the last two months is encouraging, it has not been enough to offset the large decline in January, nor has it been enough to offset the general downward trend that has been in place since 2021.

While we believe that the domestic economy will have grown for the first quarter of the year, the expectation of how robust that growth will be has diminished – in large part due to the significant increase in energy prices since February 28 (the initiation of the conflict with Iran). The Atlanta Fed’s GDPNow, nowcast of Q1 economic growth has declined steadily since the initiation of hostilities and has fallen from a peak of 3.2% growth on March 4th to a present reading of just 1.3% (see Figure 5 below).



## Outlook

The Trump administration, in their recent budget proposal, is projecting domestic GDP growth of 3.1% over the next four years and then a decline to 2.9-3% through 2036. These seem to be aggressive expectations given the current economic situation.

In their Summary of Economic Projections (SEP), the Federal Reserve Open Market Committee (FOMC) is expecting 2.4% GDP growth this year, declining to 2.1% in 2028 and then 2% over the long term. Which is right? In SIM’s view, and given current conditions, it is more likely than not that economic growth for the year comes in below both the administration’s expectations as well as the FOMC’s current expectations, and our reasoning is fairly simple...

The longer the conflict with Iran goes, and the longer the Strait of Hormuz remains closed, the higher the likelihood that energy prices will continue to act as a massive tax on consumers. This is likely to curtail discretionary consumer spending, on top of a continuation of the difficult housing market that has largely remained at levels not seen in almost a decade and a half (See Figure 6 below).



Figure 6 - Source: FactSet

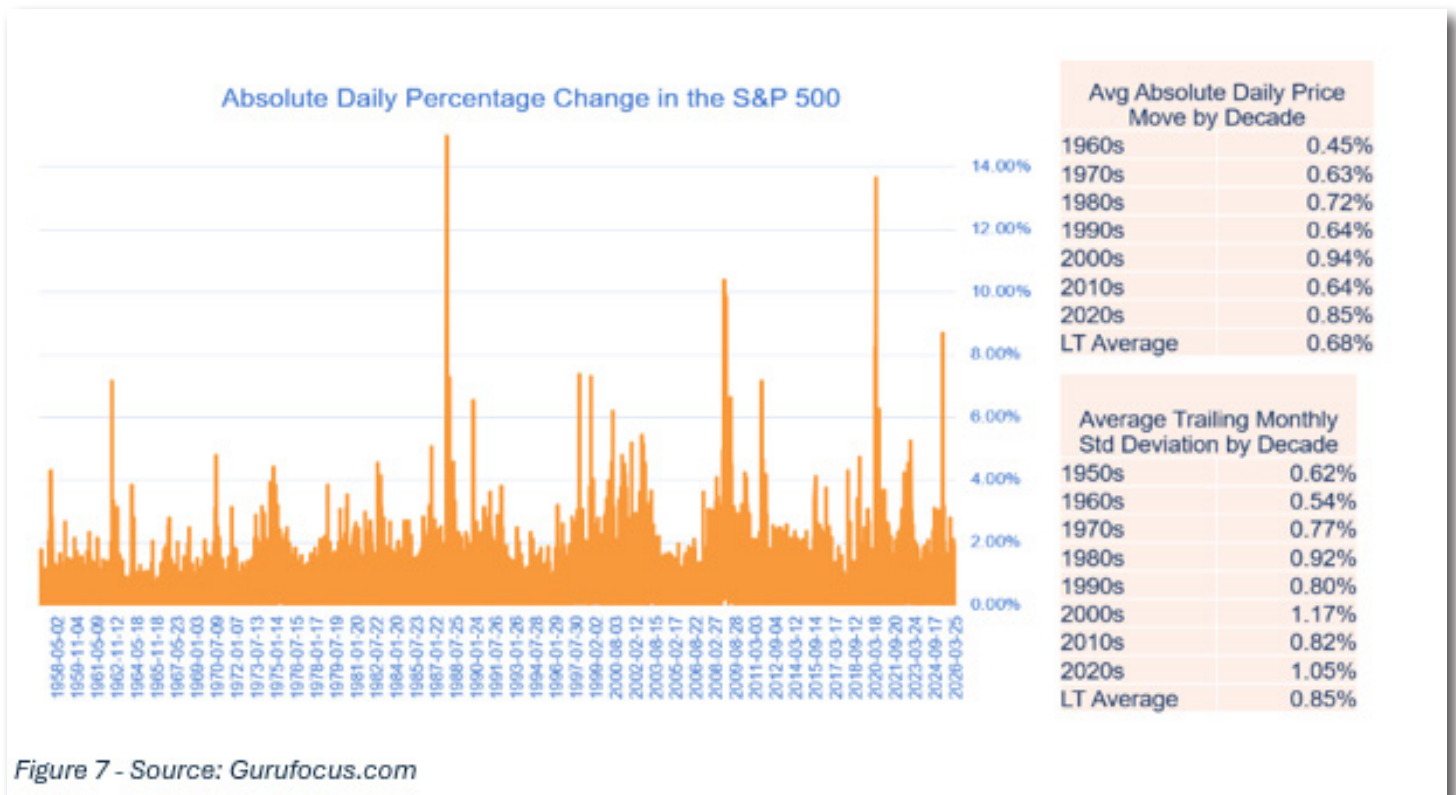
While SIM doesn't currently believe that the Iranian conflict and higher oil prices will cause the US economy to slide into recession, if higher inflation causes the Fed to rethink rate policy and the yield curve continues to adjust higher, that could cause us to rethink our position. This is because the higher yield curve (Figure 4) has already caused some stress in private credit as the industry has seen a rise in defaults among companies funded by private credit. While the stress has been largely constrained to this corner of the lending market, we don't yet see a larger contagion that could give us the credit freeze that would cause greater economic problems.

How could this view change? If banking increases its lending to non-bank financial institutions (JP Morgan disclosed its lending to nonbank financial firms as part of its Q4 earnings presentation) because of looser regulatory standards, then we might become more concerned. We might also become more concerned if we see an increase in non-accruals and 90-day past due balances at banks. An increase in these measures could indicate a higher degree of financial stress in businesses, which could cause an increase in loan losses. These (potentially) higher loan losses would then lead to tighter credit standards which could then provide the credit squeeze that might push the economy into recession... but that (for now) is a discussion for another day.

Given higher energy prices and an expectation that inflation across the board (CPI, PCE and PPI<sup>3</sup>) should trend higher, we don't foresee a scenario where the FOMC – even with cajoling from the White House and a change of the guard at the helm of

the Fed (Fed Chair Powell's term as Chair of the Federal Reserve ends in May) – cuts rates very aggressively if at all. That could keep pressure on the yield curve which is likely to mean that bond returns are likely coupon minus.<sup>4</sup>

Equity markets have been increasingly volatile this century (see Figure 5 below). With continued uncertainty surrounding geopolitical events (Iran, Ukraine, China, etc.), potentially higher interest rates driving up capital costs and the potential for higher interest rates eating into company margins, we believe that the volatility we have seen over the last year is likely to continue. Could this be the reset year we have been waiting for? (From our perspective, a reset year is defined as a year where equity returns come in below to well below average.) Perhaps.



In our year-end commentary, we believed that equity returns could end the year on a positive note. SIM doesn't see a reason to move from that expectation – though we realize that a positive return for equities could well be just above zero. We also believed that equity returns were likely to continue the broadening we saw in the back half of 2025. The biggest change we are making to our outlook is in believing that smaller stocks are likely to continue the outperformance (relative to large caps) we have seen so far this year. Why? We believe that technology stocks are likely to continue their relative underperformance and technology represents more than 30% of the S&P 500, whereas it represents under 15% of both the S&P 400 (Mid Cap) and S&P 600 (Small Cap) indices. (If we included Communications Services, currently over 11% of the S&P 500, that makes the allocation difference even more stark. Total Tech/Communication Services exposure for the S&P 500 would be more than 43% of the index versus less than 14% for the S&P 400 and less than 20% for the S&P 600.)

International stocks should continue to ebb, and flow based on how well the dollar is doing versus international currencies. While both developed and emerging markets outperformed domestic large cap (as defined by the S&P 500) for the quarter just ended, continued outperformance is not assured.

In the end, it makes sense to stay vigilant. Paying attention to risks and making sure you are being paid adequately for risks taken should be a prudent approach. Understand that the Donroe Doctrine does not “speak softly” but intends to carry (and use) the biggest sticks possible. This will likely mean that volatility continues as Wall Street sticks to its “Ready, Shoot, Aim” philosophy. SIM believes that higher volatility should present us with attractive opportunities. We just need to be prepared to take them when they arise.

#### Definitions and End Notes:

1. “Big stick ideology”, Wikipedia
2. “Donroe Doctrine or the Trump Corollary to the Monroe Doctrine”, Wikipedia
3. CPI = Consumer Price Index; PCE = Personal Consumption Expenditures; PPI = Producer Price Index
4. Coupon minus: We define this as the coupon or Bond Interest Rate (BIR) less then change in the bond’s price. The BIR is the stated rate on the bond. Coupon minus would, therefore, be a return that is equivalent to the BIR reduced by the amount the bond price declines due to an increase in interest rates. (In general, the price of a bond moves in the opposite direction from interest rates. If interest rates rise, bond prices fall. If interest rates fall, bond prices rise.)

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