

# ECONOMIC OVERVIEW

## Dwindling Optimism Driven by War, Tariff Strategy

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The S&P 500 fell 4.35% in the first quarter of 2026 and fell 9.78% from its late January high. So far this year we have seen a remarkable shift from A.I. euphoria in 2025 to a risk off environment driven by the war with Iran and the ensuing energy price spike. We began 2026 feeling constructive on the benefits of “The One Big, Beautiful Bill,” but this has given way to a more cynical view of the U.S. economy and an increased risk of a recession. The FOMC, who had cut the Federal Funds rate by 1.75% in 2024 and 2025, is now on the sidelines, and their path forward remains not clear.

### U.S. GDP Estimates

2024 Act.	2025E	1Q 2026E	2Q 2026E	3Q 2026E	4Q 2026E	2026 Est.	2027 Est.
2.8%	1.9%	1.5%	1.7%	2.2%	2.4%	2.0%	2.3%

Source: Pinnacle Financial Partners

In 2025 the Trump administration pushed tariffs as their first major policy initiative, and the result was a significant slowdown capped by a 43-day government shutdown that saw the U.S. economy lose significant momentum. The labor market, which was the Achilles heel of the economy, remains an unknown. The January jobs number misled the markets and the FOMC into believing that their 0.75% in Federal funds rate cut in 2025 had helped stabilize the labor market. This turned out not to be the case as the February data was very negative and challenged the FOMC’s prevailing view. The March jobs data was distorted by one-time revisions that we believe will reveal a weaker picture as we move into the second quarter. Within the labor market, we see several trends happening, including A.I. causing job listings and hiring to slow precipitously as corporations work to raise worker productivity and not hire as

aggressively. We now expect the unemployment rate to peak in the late third quarter and for the rate to climb to the high 4% range by the end of the third quarter.

Currently the risk of a recession remains about 60%. Consumer spending is our biggest concern as it accounts for about 70% of U.S. GDP. Consumers have been buffeted by multiple rounds of inflation starting in 2022 with a complacent Federal Reserve, followed by a 0.6%-0.7% increase in core inflation triggered by tariffs, and now an energy spike caused by the conflict in Iran. The higher oil prices will permeate the entire economy and compress operating margins of businesses.

Lower-end consumers have continued to struggle, and credit card delinquencies for low to medium income borrowers are at the higher than the pandemic peak. The stock market selloff could negatively affect affluent family spending, which has been the only area of consistent growth. Recession risk could rise if the Iranian conflict causes oil prices to rise to \$120+ for a sustainable period.

We are beginning to see some improvement in ISM manufacturing, which is a result of onshoring of manufacturing created by tariffs. We also understand that if the war in Iran creates regime change, that peace in the middle east will mean much lower energy prices as Iran and its proxies like Hezbollah in Lebanon, Houthis in Yemen and Hamas, along with a number of groups in Iraq, will suffer without Iran’s funding. By locking the straight and charging tolls on ships that pass, the Iranian government is restricting the free flow of almost twenty million barrels of oil, chemicals, aluminum and fertilizers.

### Economic Outlook

We were optimistic coming into 2026 and believed that the One Big, Beautiful Bill would provide consumers with some much-needed fiscal stimulus and help the economy recover from the downward GDP growth in 2025, and that the headwinds of tariffs, DOGE and ICE raids would be behind us. We believed that the FOMC would also cut rates by 0.5%-0.75% this year to further help stimulate the economy. We also expected the economy to be helped by a second round of tariff negotiations, and a shift away from tariffs and focus on deregulation and limited fiscal spending of the \$250 billion in tariff money raised.

I guess we were naïve, but the first quarter of 2026 has modified our view of the year substantially. We expect growth to be

negatively affected and the headline inflation number to move solidly above four percent. The war in Iran, the ensuing energy spike and the Supreme Court ruling on tariffs mean that GDP growth will only move up modestly in 2026, and if the war in Iran is still happening into the middle of the second quarter, we believe that our forecast will be too optimistic. No matter how you slice it, the war will reduce GDP growth, hurt the job market and flatten growth projections for 2027.

We also expected the Trump administration to reach second round trade agreements with our largest trading partners that would be accretive to GDP growth and lower the barriers to trade that would be deflationary. The Supreme Court ruled that the Trump tariffs exceeded his authority, and they invalidated the billions of dollars in duties that were collected. The court opened the door for the administration to refund almost \$150 Billion of tariffs paid, and the Trump administration pivoted their tariff legal theory toward Section 122 of the Trade Act of 1974, which allows the president to impose import restrictions to address an urgent macro crisis and is designed as a rapid response tool. The president initially imposed a 10% global tariff, then raised it to 15%, which created consternation among our allies. The silver lining of the Supreme Court ruling is that overall tariffs have been lowered. Chinese tariffs, which were 34%, fell to 12% immediately following the ruling. The new 15% surcharge using section 122, which is now in effect, raised the rate to 27%. So overall the court ruling was positive, but the ruling ceased any additional rounds of trade negotiations that would have helped the economy.

The FOMC is stuck between soaring inflation expectations due to the constriction of the Strait of Hormuz, which is impacting energy, chemicals, fertilizer and 8% of the world's aluminum. We expect the headline inflation number to accelerate from the high three percent area to well over four percent when the March data is released in late April. At quarter end the Federal Fund futures showed that they would lower rates by eight basis points overall the next year. When we look at core inflation numbers, they exclude volatile food and energy, but the rise in oil prices will affect packaging of consumer goods, mass market merchandise and shipping rates, which is why energy spikes typically precede a recession, which has been a pattern in almost every recession post-WWII. We believe that once Kevin Warsh takes over as chairman of the FOMC in early June, he will set the table for what the FOMC's objectives are for the balance of 2026 and 2027. Jerome Powell's term concludes at the end of May.

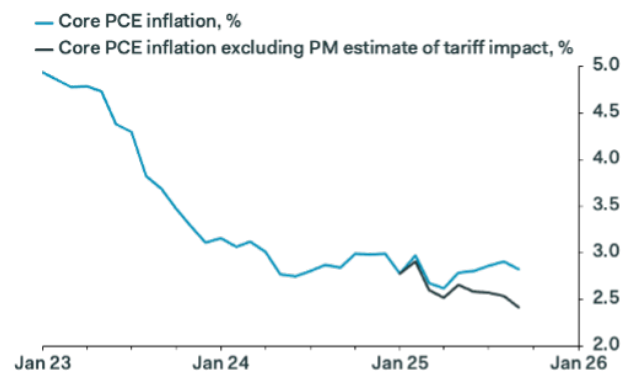
We believe that the war should end by April 30. If the war continues, supply chains across the globe will be negatively impacted and recession risk will rise. When West Texas Intermediate (WTI) oil was \$65 on February 27, the 10-year Treasury yielded 3.97%. At quarter end the rate was 4.33%. The entire yield curve has shifted upward and flattened due to the risk of inflation and risk off atmosphere of the public markets. We believe the FOMC should look through the inflation spikes and be prepared for weaker data as we move into the summer. As part of this, the energy and shipping constraints will make it more difficult to buildout A.I. data centers, which could impact the ability of A.I. companies to spend their capex effectively.

We have seen much news about stagflation, which is a combination of stagnant economic growth, high employment and high inflation. If the U.S. economy experiences stagflation, it would only last a quarter or two. We expect GDP and inflation to moderate and see a slower period of growth but not stagflation. When Kevin Warsh takes over as the Chair of the Federal Reserve he will most likely have to cut rates as the economy has lost significant momentum. The FOMC will need to support the economy to avoid the risk of a recession down the road.

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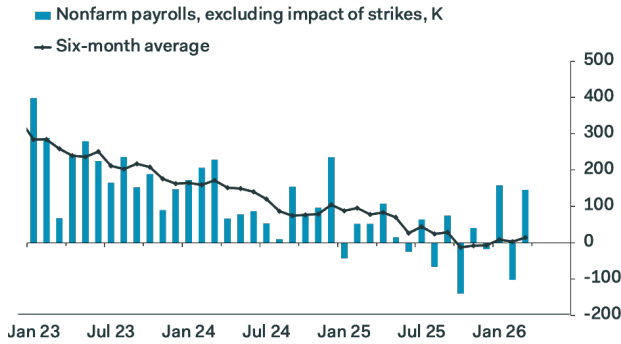
### Core PCE Inflation Excluding Tariffs



Source: Pantheon Economics

WTI oil prices were at \$65 and change on February 27, days before the Iranian war broke out. Prices peaked at \$119 and have spent most of the month of March in the high nineties. At quarter end WTI was \$101.38. The U.S. has not experienced any disruptions in supply. Of the 20 million barrels of oil that transited the straight daily prior to the war, the U.S. only received about 500,000. Early in March President Trump released forty million barrels of oil from the strategic petroleum reserve that has kept supplies sufficient. Most of the oil that transits the straight goes to Asia and Europe. The spread between North Sea Brent and WTI has widened, and Brent has dragged WTI prices higher. Historically the spread has been about \$3.50, but recent volatility has stretched it to up to \$18.

## Nonfarm Payrolls



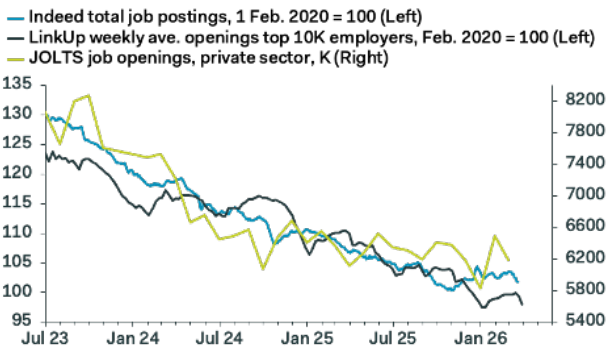
Source: Pantheon Economics

## University of Michigan Confidence Survey



Source: Pantheon Economics

## Jolts and Indeed Job Postings



Source: Pantheon Economics

## Conference Board Expectation Index



Source: Pantheon Economics

Retail sales continue to be held up by wealthier Americans (homeowners), but the overall spending growth has slowed from 5.7% in 2024 to 3.5% in 2025. With the surge in energy prices that will permeate all areas of the economy, we now expect growth to slow further in 2026. Overall consumers are much more cautious as they deal with increased costs for essentials and are delaying major purchases. The one area consumers continue to spend freely on is experiences like travel and entertainment. We have seen negative trends in 4Q in clothing, home furnishings, home exercise equipment and vehicles and parts.

## Unemployment Rates

2025 Est.	1Q 2026E	2Q 2026E	3Q 2026E	4Q 2026E	2026 Est.	2027 Est.
4.4%	4.5%	4.6%	4.9%	4.8%	4.7%	4.5%

Source: Pinnacle Financial Partners

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## U.S. Core PCE YOY

2025 Est.	1Q 2026E	2Q 2026E	3Q 2026E	4Q 2026E	2026 Est.	2027 Est.
2.8%	3.3%	3.1%	2.8%	2.7%	3.1%	2.5%

Source: Pinnacle Financial Partners

## Portfolio Strategy Economic Outlook

At quarter end the S&P 500 traded at 23.8x earnings down from 25.4x in the fourth quarter. The index is currently estimated to be trading at 17.7x 2027 earnings, which is reasonable on a historical basis. We expect strong S&P earnings growth driven by 10%+, which should help the market recover from the sell-off in the first quarter. The spike in energy prices will not impact S&P 500 earnings as much as the broader economy, as energy only represents 3.86% of the S&P 500.

The best performing sectors for the quarter were Energy, up 38.25%, Materials up 9.73%, and Utilities up 8.25%. The worst performing sectors for the quarter were Financials, down 10.15%, Consumer Discretionary, down 9.19%, and Information Technology, down 9.13%.

The S&P 500 sectors currently trading below the S&P 500 at the end of the first quarter were: financials 16.6x, Healthcare 20.4x and Utilities 21.3x.