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1Q26 Investment Letter

Resulting

On February 2, 2015, *USA Today* ran the headline: *What on Earth Was Seattle Thinking with Worst Play Call in NFL History?* It was one of many critiques of coach Pete Carroll's decision in Super Bowl XLIX not to hand the ball off at the one-yard line to star running back Marshawn Lynch. Instead, the Seahawks threw a pass intercepted by the New England Patriots, sealing their loss. The result was not what Seahawks fans wanted – but the decision itself was sound, if not clever. Goal-line interceptions were exceedingly rare, and Carroll had probability and the element of surprise on his side. The backlash was predictable. When outcomes disappoint, we often retroactively condemn the decisions that produced them – a mental shortcut known as **"resulting."** Investment outcomes, including in the current quarter, are no different.

The term "resulting" is most closely associated with Annie Duke and her book, *Thinking in Bets*, but the bias was first observed decades prior by famed behavioral economists Daniel Kahneman and Amos Tversky. It leads individuals to evaluate the effectiveness of a decision solely by the outcome – ignoring the reasoning and context behind it. It remains highly relevant in today's investment landscape, where markets are shaped as much by human instinct as by hard data. We leap to conclusions based on short-term movements: markets are down – something must be broken; markets are up – double down. Seen through this lens, it would be too impulsive to judge first-quarter results – largely positive – without first asking the more important question: **why?**

> **"It was the worst *result* of a call ever...The call would have been a great one if we catch it. It would have been just fine, and nobody would have thought twice about it."**
>
> **-Pete Carroll**
>
> ***Today Show* (four days after Super Bowl XLIX)**

There were moments of trepidation this quarter, but markets have been generally resilient. The bellwether S&P 500 Index started the quarter at 6,846 and finished February at 6,879 - a 0.5% gain. International stocks (MSCI EAFE Index, USD) gained 10.1%, small cap stocks (Russell 2000 Index) rose 6.2%, and taxable bonds (Bloomberg U.S. Aggregate Bond Index) rose 1.8%[i]. These gains were broad-based and part of a longer trend, with the trailing 12-month return for the S&P 500 at +18.9%[ii].

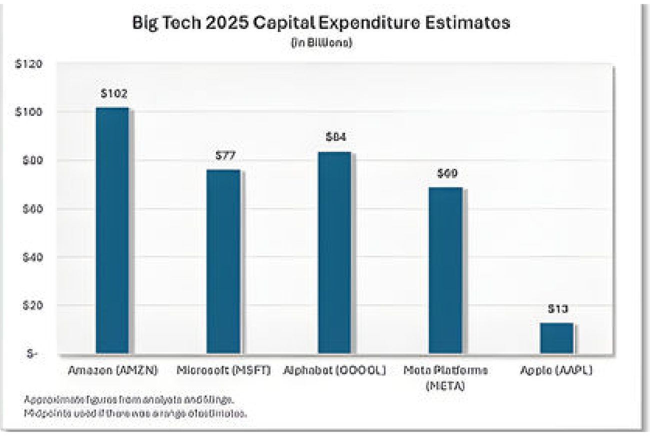
Reflecting on the quarter, there were plenty of concerns. There has been an escalation of conflict in the Middle East, angst over the presumptive Federal Reserve Chairman, and unsettling stock market moves from some brand-name technology companies. These were the headlines - largely negative, and not unlike the reaction to Carroll's play call. Resulting can obscure the more powerful undercurrents shaping markets. One we believe is a corporate version of the Flynn Effect.

The Flynn Effect

In 1984, philosopher and researcher James Flynn published groundbreaking work titled *The Mean IQ of Americans: Massive Gains 1932 to 1978*. The takeaway was straightforward: the world is getting smarter. His research pointed out the following:

"The obvious interpretation of this pattern is that representative samples of Americans did better and better on IQ tests over a period of 46 years, the total gain amounting to a rise in mean IQ of 13.8 points."

His work did not simply document the rise; it sought to explain it. The gains were attributed to structural improvements, from better access to information to evolving educational methods. This phenomenon - now known as the Flynn Effect - has surprising relevance to today's financial markets.



Just as IQ scores rose because environments became more cognitively demanding, corporate IQ may be rising as AI reshapes the environment in which businesses operate – a Flynn Effect in American business. Productivity levels are robust, with the latest reading (2.8%) above this century's average (2.0%)[iii]. AI is increasingly unlocking efficiencies and innovative gains.

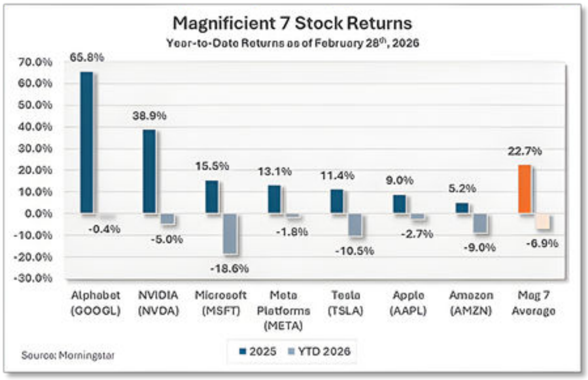
As productivity has surged, operating margins have followed. S&P 500 operating margins are now near historic highs, around 14%[iv]. While productivity gains are encouraging, they are not guaranteed to accrue evenly – and periods of rapid technological change have historically included both excess enthusiasm and capital misallocation. Nevertheless, Magnificent 7 companies are laying the digital foundation, and more companies can run faster because of it.

A key investment theme of ours has been leveraging AI. It is becoming less a question of 'if' and more a question of 'how.' Consider Tim Cook saying last year that *"Apple must do this, Apple will do this."*[v] He would further explain:

"We've rarely been first…There was a PC before the Mac; there was a smartphone before the iPhone; there were many tablets before the iPad; there was an MP3 player before iPod."[vi]

Apple's capital spending last year was roughly $13 billion, modest relative to the AI arms race[vii]. But the company continues to enhance its AI-powered Apple Intelligence with features embedded into products from the iPhone to the Apple Watch. Further upgrades are expected this year as AI functionality expands across the ecosystem. Apple is not a recommendation, but rather a barometer for how markets are pricing the AI transition. Change is underway.

Looking at Magnificent 7 performance across this year and last, a rotation becomes evident. The first phase of the AI cycle rewarded builders of infrastructure. The next phase may reward adopters. Apple underperformed the Magnificent 7 last year with a return of +9.0% compared to a combined, equal-weighted return of +22.7%[viii]. This year, Apple has declined less than the group through February 28 (-2.7% vs. -6.9%), making it a relative outperformer.

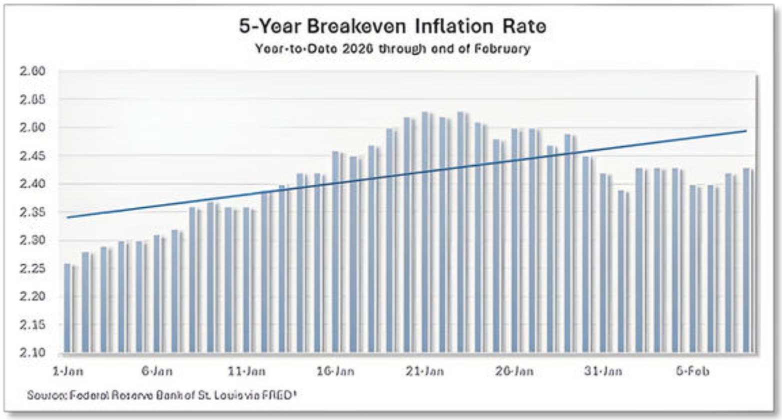


Additional corroboration can be found in more "technology-light" segments of the equity market highlighted by U.S. Value stocks up 7.3% (Russell 1000 Value) and the S&P Equal Weight Index up 7.0%.[ix] This broadening of results is positive for diversified portfolios and is increasingly underpinned by efficiencies gained through AI adoption. It is one key pillar for our take on the financial markets – much like what happens with the Fed.

Dress Rehearsal

When financial market outcomes disappoint, investors frequently look to the Federal Reserve for explanation – or blame. On January 30, Kevin Warsh was named the leading candidate to succeed Jerome Powell, whose term as Chair of the Federal Reserve ends on May 15, 2026. Kevin Warsh is a former Fed governor, academic, and investor who previously worked at Stanley Druckenmiller's firm. For markets, he is viewed as incrementally more hawkish. While his policy path is speculative, he has been a critic of quantitative easing (QE), often described as financial market jet fuel. He said the following in July 2025:

"My simple version of this is: Run the printing press a little bit less. Let the balance sheet come down." [x]



We do not expect Warsh to be a rigid ideologue. But he could be entering his role during a period of increased inflation expectations – a reason to be hawkish. The 5-Year Breakeven Inflation Rate ended February at 2.40%, compared to 2.25% at the start of the year[xi]. Consumers are expecting higher prices. However, businesses, increasingly powered by AI, are working to keep them lower. Productivity gains help contain corporate costs and innovation has historically proven disinflationary – consider the structural effects of Amazon and eBay on commerce. Warsh would need to navigate these crosscurrents carefully.

A recent reminder of the grip the Federal Reserve has on markets was when they aggressively raised short-term rates in 2022 to combat elevated inflation. The S&P 500 finished down 18% that same calendar year – uncoincidentally, the same year we saw the most restrictive Fed in a generation. Also uncoincidentally, the markets stumbled after the Warsh announcement as the S&P 500 fell 2% from the January 30 close through February 5. It was a short-lived pullback, a dress rehearsal for a potentially risk-off environment.

Results alone do not dictate our investment decisions. As noted in our last quarterly investor letter, the combination of accommodative monetary policy, increased fiscal stimulus, and continued investment into the AI ecosystem would create a constructive backdrop for the financial markets. This is what makes the changing guard at the Federal Reserve potentially a fulcrum event. As John Maynard Keynes once reportedly said:

"When the facts change, I change my mind. What do you do, sir?"

DPI Comeback

Our opinions may evolve, but there are anchor points to our approach and process. During volatility, our blueprint typically emphasizes opportunism: tax-loss harvesting, adding to oversold positions, and avoiding hyperbole. A key performance measure we also continuously seek out among managers is DPI.

Distribution to Paid-In Capital (DPI) measures how much cash a private investment has actually returned to investors relative to the amount invested – effectively a cash-on-cash metric. This has been stressed as companies stay private longer. The median age of companies at the time of initial public offering (when they go public) has increased from 6-8 years in the 1980s to 12 years in 2025 [xii]. In this environment, DPI is more than a metric; it is a risk-management tool embedded in our due diligence process. Managers who emphasize DPI create greater optionality by returning capital sooner - and greater peace of mind if the facts change.

There are growing signs of a revitalized IPO market. Highlighting this is the much-discussed initial IPO of SpaceX. OpenAI and Anthropic are other brand-name offerings at significant valuations that could follow, and, more broadly, technology and healthcare firms are set to dominate the IPO pipeline by volume. Dry powder is being amassed in record sums to support these newly minted public companies. Total domestic IPO fundraising is projected to reach $160 billion in 2026, compared with $48 billion last year[xiii] . A revitalized IPO market would benefit some participants more than others.

Those with private stakes in these companies are well situated in this environment. We systematically allocate to private funds to have allocations in companies that could go public, but also at discounted valuations to their IPO price. Managers with DPI discipline are focused on this pathway to liquidity. Yet even with a revitalized IPO market, much can change – which is precisely the point.

An uncertain future is best navigated with a durable process, and a focus on DPI is one of the ways we do so. The market will continue to tempt us to judge decisions by outcomes. We will continue to judge them by process.

In Parting

Quarterly results tell only part of the story. We place greater emphasis on the forces driving them – and on whether those forces are changing. The facts will change. Our discipline will endure.

As always, our priority is helping you navigate these forces with foresight and steadiness. Please reach out to your relationship team to discuss how these themes are incorporated into your portfolio.

If you would like a copy of Annie Duke's *Thinking in Bets* – an insightful exploration of resulting – please let your Relationship or Investment Manager know and we will gladly send one.

We deeply value your trust and partnership, and we are grateful for it.

Editor's Note – At the time of writing, military conflict involving Iran was unfolding. Its implications for the economy and financial markets remain fluid, and we will address developments in future communications.

For more information visit us at:
www.callanfo.com

[i] Morningstar data as of February 28th, 2026 (total return)
[ii] Morningstar data as of February 28th, 2026 (total return)
[iii] U.S. Bureau of Labor Statistics (Q4 2025 reading) - Nonfarm Business Sector: Labor Productivity (Output per Hour) for All Workers
[iv] JPM, Guide to the Markets (4Q 2025 data point)
[v] 'Apple must do this, Apple will do this' – Tim Cook rallies staff in face of AI delays, MSN, Tech Radar (2025)
[vi] Apple CEO Admits the Firm Has "Rarely Been First" with Newer Technologies, Reassures Employees an 'AI Breakthrough' Is Coming Soon in an Hour-Long Pep Talk, WCCFTech (August 1st, 2025)
[vii] Apple Stock Is Big Tech's 'Safe Haven', *Barron's* (February 17th, 2026)
[viii] Morningstar data as of December 31st, 2025 (total return)
[ix] Morningstar data as of February 28th, 2026. State Invesco S&P 500® Equal Weight ETF used as proxy for Equal Weight Index.
[x] July 2025 interview on *Fox Business*
[xi] Federal Reserve Bank of St. Louis via FRED®
[xii] Drivers of IPOs Supportive to Start 2026, NASDAQ (January 22nd, 2026)
[xiii] US IPO proceeds to quadruple to record $160 billion in 2026 as dealmaking rebounds, says Goldman, Reuters (February 9th, 2026)

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