claret Asset Management

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This Too, Shall Pass 2.0

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Navigating War

My oh my! How quickly the narrative can shift. Since the beginning of 2026, the U.S. stock market has navigated a complex tug-of-war between strong economic fundamentals and heightened volatility, heavily influenced by the policy shifts (read: tariffs) and rhetoric of the Trump administration.

Then, the geopolitical landscape took a sharp turn in late February 2026, when the United States and Israel launched a series of coordinated military strikes against Iran. In retaliation, Iran blockaded the Strait of Hormuz—a critical transit route for roughly a fifth of the world's daily oil supply. As of this writing, U.S. President Trump and Iranian officials agreed to a provisional two-week ceasefire brokered by Pakistan, with formal talks scheduled in Islamabad. However, the situation remains highly unstable.

A Rough Blueprint on Markets and Armed Conflict

While the 24/7 financial news cycle will undoubtedly use this to generate fear and heart palpitations, it is important to look back. Historically, the stock market's reaction to the outbreak of war follows a remarkably consistent, often counterintuitive pattern. While armed conflicts represent profound geopolitical and human crises, their long-term impact on broad market indices is usually muted.

The immediate buildup to war—and the actual outbreak of hostilities—almost always triggers a sharp, sentiment-driven sell-off. Markets despise unquantifiable uncertainty, and the threat of disrupted supply chains, energy shocks, and unpredictable fallout causes a rapid contraction in risk appetite. Counterintuitively, the actual start of a war or not too long thereafter often marks a market bottom. Once the ambiguity of whether a conflict will occur is replaced by the reality of the event, the market's "uncertainty premium" begins to evaporate.

Geopolitical shocks rarely derail the structural trajectory of the global economy permanently. Once the initial shock is absorbed and priced in, the market invariably shifts its focus back to its core drivers: corporate earnings, inflation metrics, central bank interest rate policies, and the broader macroeconomic cycle.

Let's look at the historical precedents:

World War II (1941): The attack on Pearl Harbor caused an immediate 4.4% drop in the S&P 500, but the market fully bottomed by April 1942 and subsequently embarked on a massive multi-year bull run fuelled by industrial mobilization and corporate earnings growth.

The Gulf War (1991): Markets drifted lower for months during the uncertain buildup following Iraq's invasion of Kuwait in August 1990. However, the exact day the U.S. launched Operation Desert Storm (January 17, 1991), the S&P 500 surged over 3.7%. It continued to rally, finishing the year up over 26%.

The Iraq War (2003): The market steadily declined during the prolonged, highly publicized buildup. The S&P 500 ultimately bottomed just days before the U.S. invasion in March 2003, and the removal of that uncertainty immediately triggered a rally, marking the beginning of a five-year bull market.

Russia-Ukraine (2022): The S&P 500 dropped over 7% in the weeks surrounding the initial invasion in late February. However, the index rebounded sharply and recovered its pre-invasion levels within a month. The sustained market declines later in 2022 were driven primarily by central bank interest rate hikes and inflation, rather than the war itself.

In essence, while the onset of war triggers immediate fear and rapid capital flight, history dictates that, as long as the system stays fundamentally capitalistic, the resulting panic frequently creates deep, temporary value for disciplined investors who remain anchored to long-term corporate fundamentals.

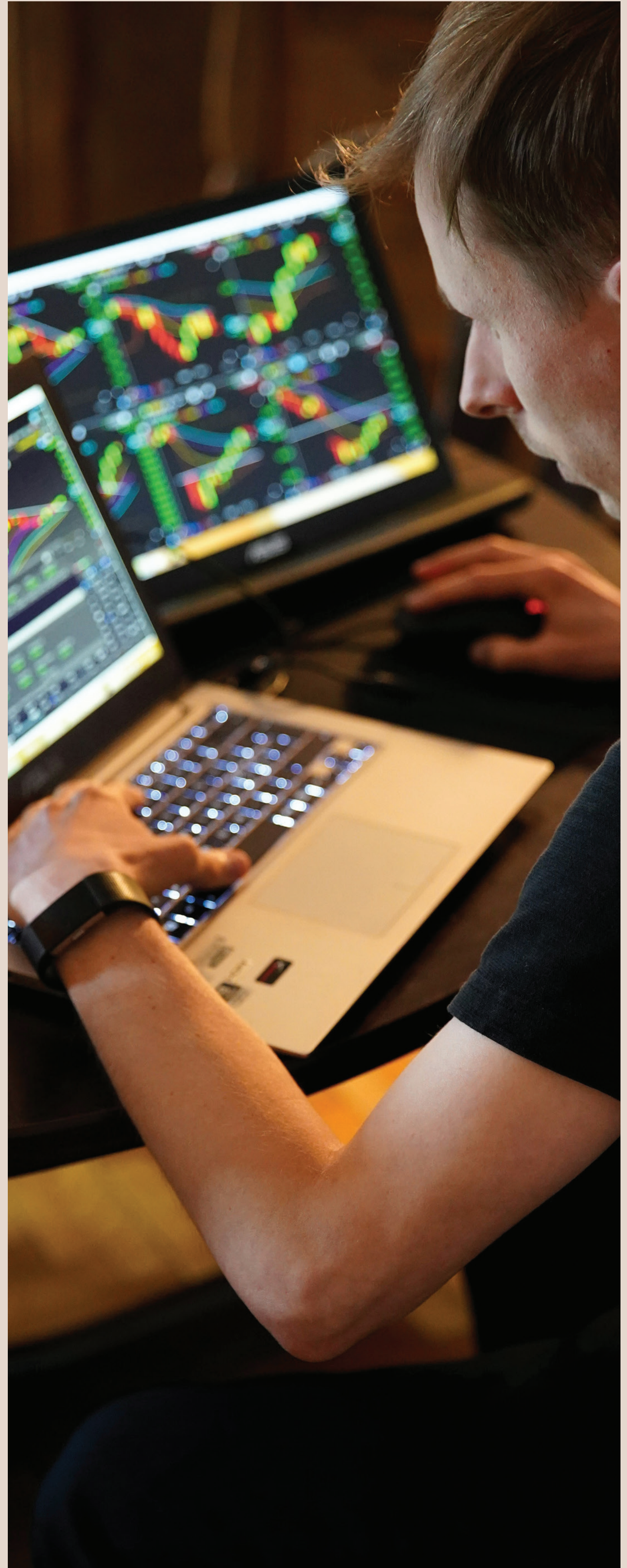
The Madness of Crowds and the Momentum Distortion

Over the last 2 years, equity markets have been quite polarized and overwhelmingly favoured momentum investing. Basically, investors have been rewarded for believing that "What goes up keeps going up." Thus, the most effective—and simplistic—strategy was simply buying stocks that had already gone up.

The unusual momentum of the past few years has created what we see as the tale of 2 markets: the momentum bunch, with PE multiples (if any) north of 30, and the laggards, with PE multiples of 15 or less.

Current market conditions are eerily reminiscent of the dot-com bubble of 1998-1999: aggressive vendor financing mixed with ecosystem building, and AI-related IPOs carrying valuation multiples based on revenues and not on profits. We are seeing Anthropic at 13X revenues, OpenAI at 40x revenues and above all, SpaceX being priced at 100x revenues! Bear in mind, none of these companies are profitable for now and they actually admit they will not be profitable for an extended period of time...

Looking back to 1999... we remember analysts valuing internet stocks on the **"eyeball"** metric. Since none of the companies they were covering were making any money, Wall Street and Bay Street decided to suspend the traditional rules of finance and came up with this "eyeball" metric: An eyeball was simply a unique visitor or a page view on a website. The core thesis was that in the new internet economy, capturing market share and user attention was the only thing that mattered. The logic dictated that if you could aggregate millions of "eyeballs" on your platform, you would eventually figure out how to monetize them later — either through advertising, subscriptions, or e-commerce.



Analysts began calculating a "Value per Eyeball" or "Market Cap per Visitor." If Yahoo was trading at $2,000 per eyeball, an analyst might argue that a new startup trading at only $500 per eyeball was a massive bargain with room to run, regardless of the fact that neither company was generating meaningful cash flow.

"Eyeballs" wasn't the only creative accounting metric born during this mania. Analysts and venture capitalists also popularized:

Mindshare: A vague measurement of brand awareness. The idea was that spending $20 million on a Super Bowl ad (like Pets.com famously did) was a great investment because it bought "mindshare," which would eventually translate into a monopoly.

Burn Rate as a Badge of Honor: How fast a company was spending its cash (its burn rate) was sometimes perversely viewed as a positive metric. A high burn rate meant the company was growing aggressively, spending heavily on marketing and customer acquisition to grab "eyeballs" before competitors could.

Click-Through Rates (CTR): Highly touted as a metric of engagement, even if the clicks didn't result in actual sales.

In short, history may not repeat, but it does rhyme most of the time... Rest assured, we won't be paying 100x revenues for the "next big thing" with your money or ours!

A Sea Change in Interest Rates: The Golden Age of Credit?

Moving away from a four-decade era of steadily declining interest rates and hyper-accommodative monetary policy, the pandemic year 2020 signalled the end of that era and the 2025–2026 landscape is defined by normalized borrowing costs and high macroeconomic uncertainty. The sheer unpredictability of shifting global trade policies, AI-driven market distortions, and the inherent futility of short-term macroeconomic forecasting have raised the cost of capital for all economic participants.

For years, structurally declining interest rates artificially inflated asset prices and bailed out heavily leveraged businesses. Today's higher-rate environment changes the calculus entirely. Capital is no longer free, meaning businesses must rely on genuine operational profitability rather than cheap debt to survive. Furthermore, the massive enthusiasm surrounding artificial intelligence—while fundamentally real and rapidly advancing—has sparked questions about asset bubbles, warning that excessive optimism may be blinding investors to historical valuations and risk.

This macroeconomic shift has created a profound realignment in risk-reward profiles. For the first time in more than a decade, fixed income and alternative credit offer yields that are highly competitive with historical equity returns. Lenders are finally being compensated appropriately for bearing risk, making high-quality credit instruments incredibly attractive relative to fully priced public equities.

At Claret, our strategy in this environment is to adopt a more defensive, more yield-focused approach:

Capitalize on Yield: We are capitalizing on the higher baseline of interest rates by reallocating assets toward credit and fixed income, where strong returns can be achieved without relying on massive equity multiple expansion.

Embrace Fundamental Bargain Hunting: We focus on deep, bottom-up analysis to identify assets trading significantly below intrinsic value, avoiding sectors swept up in momentum euphoria.

Acknowledge Uncertainty: We build portfolios designed to withstand unpredictable shocks by emphasizing risk control and a structural margin of safety over bold macroeconomic bets.

By demanding adequate compensation for risk and shifting focus from aggressive growth to dependable yield, investors can thrive in this newly normalized financial era.

Above all, stay invested, and do not let short-term emotions influence long-term decision making.

Miscellaneous items of interest:

- When times are difficult and we are faced with greater threats, existential or otherwise, it is sometimes an opportune time for “combinations” to create strength, even for competitors.
  A case in point is the proposed tie-up between Pernod Ricard and Brown-Forman (the parent company of Jack Daniel’s), currently the biggest story in the global spirits market. It’s being framed as a massive consolidation play in response to rising costs, shifting consumer habits, and the friction of global tariffs.
  Both companies have carefully used the phrase “merger of equals,” likely to soothe the two iconic founding families (the Browns in Kentucky and the Ricards in France) who still hold significant voting control. The merger would create a “Total Spirits” powerhouse, uniting the world’s second-largest spirits maker (Pernod) with the largest producer of American whisky

(Brown-Forman). In the current 2026 climate of trade wars and "Trump tariffs," a combined entity with significant manufacturing footprints in both the U.S. and Europe could navigate cross-Atlantic trade barriers more efficiently than two separate companies.

If the Pernod/Jack Daniel's deal is a "merger of equals," then the McCormick/Unilever tie-up is a total reimagining of the global pantry. As of April 9, 2026, this $65 billion deal has just officially crossed from "rumour" to "definitive agreement." They are targeting $600 million in annual cost savings by Year 3.

- We came across an article on Kalshi, the prediction market where you can bet on sports and various other events. One very odd bet is called "mentions markets", where a contract pays $1 if the Fed chair Jerome Powell says a certain word at a press conference or whatever, and $0 if he doesn't.

  It reminds me of a story my Dad told me when we were young: people in Viet Nam could bet with a book maker during monsoon season on when it would start to rain on a specific day and time and how long it would last…

  As P.T Barnum said: There is a sucker born every minute…

  And this reminds me of Buffett's quote:

  "Capitalism in the United States has succeeded like nothing you've ever seen… It's a combination of this magnificent cathedral, which has produced an economy like nothing the world has ever seen. And then it's got this massive casino attached to it.

  In the casino, everybody's having a good time, there's lots of money changing hands… it's designed to move money from one pocket to another.

  The balance between the casino and the cathedral is critical… in the next hundred years make sure that the cathedral is not overtaken by the casino."

Full disclosure: This letter has been edited for accuracy by Google's Gemini 3.

– Alain Chung, CFA, Chairman and CIO, on behalf of the Claret team.