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# MARKET MUSINGS

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## Geopolitics Back on Center Stage

Rush Zarrabian, CFA®  
Corbett Road  
*Managing Partner, Portfolio Manager*





## SUMMARY

- Geopolitical tensions flared last week as Israel and Iran exchanged strikes, sparking a swift market response—stocks dipped and oil surged. While the headlines are serious, historical context and energy dynamics suggest a short-term shock, not a lasting shift.
- Markets have rallied sharply off the April lows, with momentum matching past bull market surges. While valuations are extended, history shows the forward price-to-earnings multiple (P/E) offers little predictive power for short-term returns.
- Although the score is still positive, MX strategies shifted to a neutral allocation in late May following a sharp decline in the model's raw score, which triggered a "rate of change" sell signal. Our **microcast™** signal remains at neutral, after briefly moving to a defensive stance in late April.

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*See content within for additional information on the summary items discussed above*



## INSIDE THE **MACROCAST™** DOWNGRADE

**macrocast™** moved to a neutral stance in late May. This means our MX strategies are now roughly 75% invested in risk assets, with the remaining allocation in bonds.

The downgrade to a neutral allocation was due to a “rate of change” sell signal. While the moving average of the **macrocast™** score is typically what guides the positioning in our MX strategies, we also monitor the score’s rate of change. If the model detects a sharp deterioration in market conditions over a short period of time, it can call for reducing exposure to risk assets before the moving average turns negative. Historically, these sell signals have helped the model react more quickly in volatile market environments.

The rate of change sell signal will remain in effect for six weeks. Unless the model’s moving average continues to decline, MX strategies will remain at a neutral allocation until early July.

Several key shifts across the **VITALS** contributed to **macrocast’s™** move to neutral. As a reminder, the **VITALS framework—Valuation, Inflation, Technical Analysis, Aggregate Economy, Liquidity, and Sentiment**—helps capture a wide range of indicators that can influence the market. Together, these factors help us assess the health of the market and the likelihood of a sustained, recessionary bear market.

Reviewing the VITALS at the time of the downgrade:

- **Inflation:** Signals remained neutral. Despite concerns over tariff-driven price pressures, inflation expectations remained anchored with little pressure from commodity prices.
- **Technicals:** Cross-asset momentum and market breadth flashed warning signs.
- **Aggregate Economy:** Consumer-related indicators turned negative amid a softening labor market and weaker consumer expectations.
- **Liquidity:** Higher corporate bond yields reflected rising credit risk; tighter financial conditions.
- Support from **Sentiment and Valuation**—which helped keep the model constructive during the initial tariff-driven volatility—faded to neutral as markets rebounded.

To reiterate, the model has shifted to a neutral stance—not a defensive one. Market conditions have seen a modest improvement over the past couple of weeks since the model downgraded, and that will hopefully continue. As always, we are actively monitoring the signals and will adjust positioning if conditions warrant.

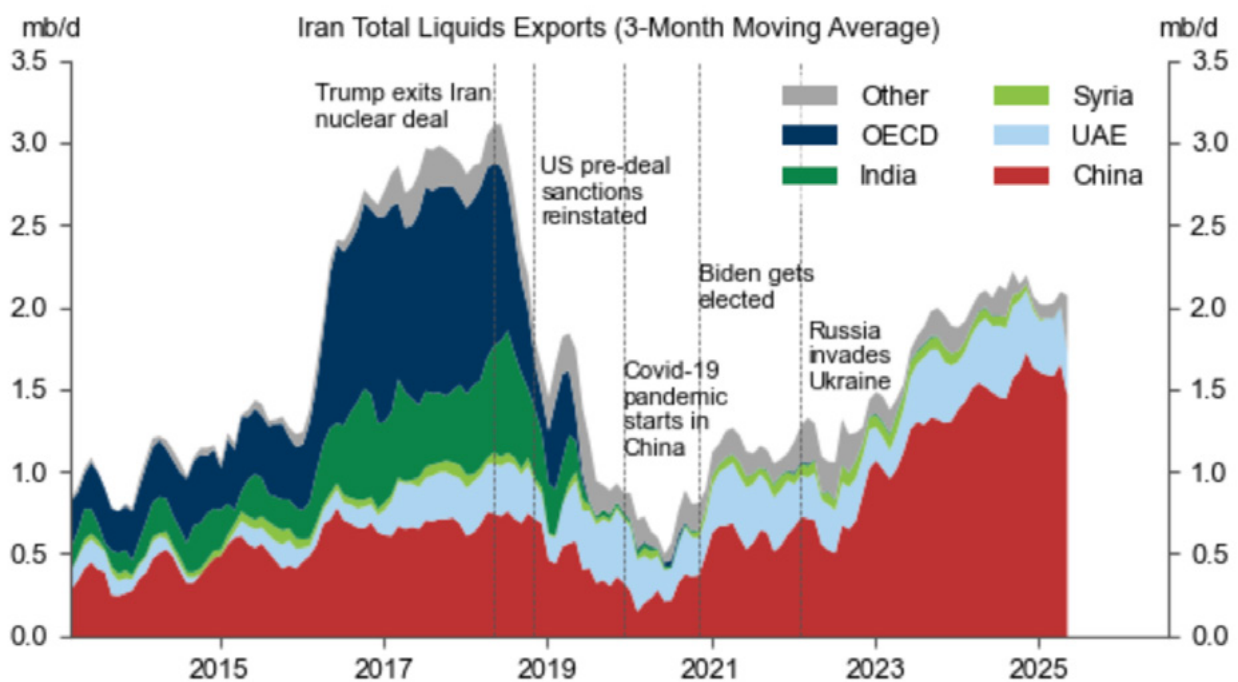
## GEOPOLITICAL **RISK RESURFACES**

Last Friday, tensions in the Middle East came to a head after Israel launched an offensive targeting Iran's nuclear facilities and military personnel. In response, Iran fired ballistic missiles toward Tel Aviv over the weekend.

As is often the case with geopolitical shocks, markets responded swiftly: equities sold off, and oil spiked. On Friday, June 13, the S&P 500 dropped 1.1%, while crude oil surged 5.4%. A major disruption in Iranian oil supplies could certainly drive prices higher. But today's backdrop is very different from past oil shocks.

First, because of sanctions, most Iranian oil now flows to China—and Beijing has every incentive to pressure Iran to keep those barrels flowing (chart from Goldman Sachs):

### **Exhibit 2: Iran's Oil Exports Mostly Go to China**



Source: Kpler, Goldman Sachs Global Investment Research

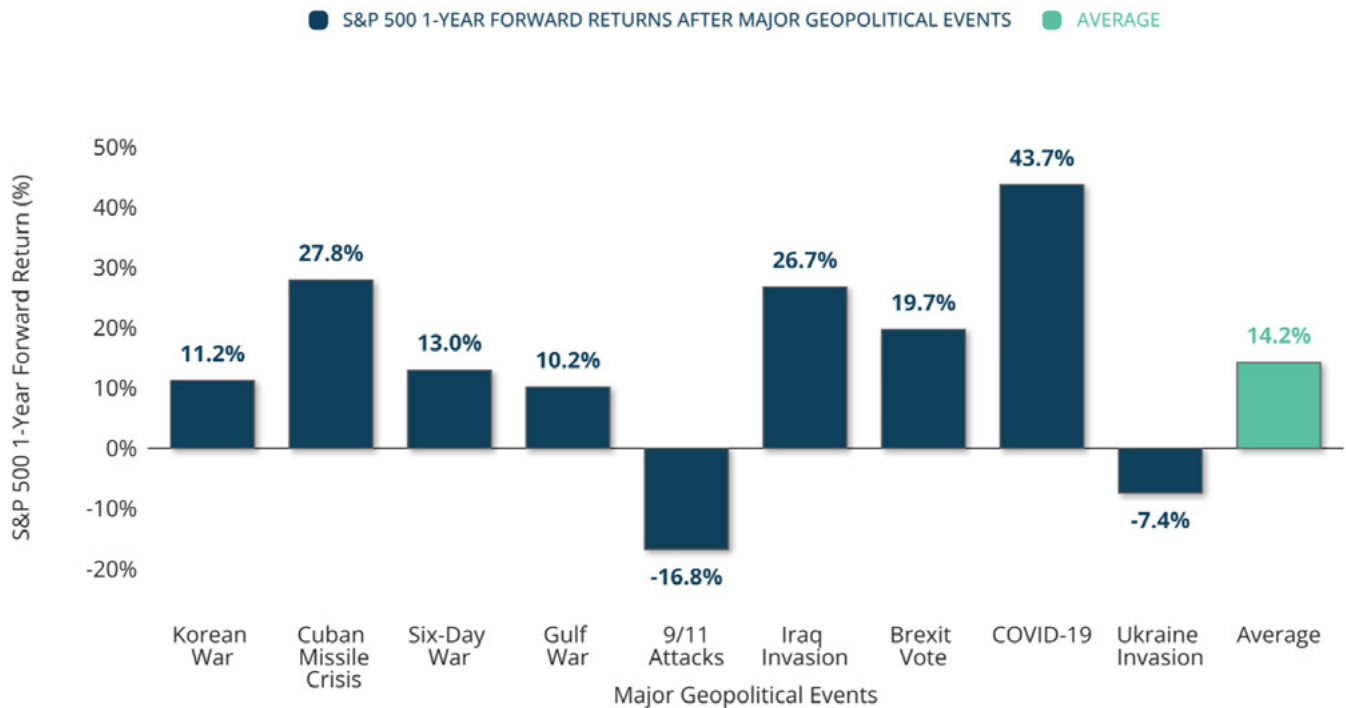
Second, oil still matters, but its grip on the global economy has loosened. In 1973, a single barrel of oil powered \$1,000 of GDP. Today, it's less than half that, according to Columbia University's Center on Global Energy Policy.

What has changed? Efficiency and innovation. Advances in U.S. shale technology mean production can now ramp up in months, not years, and as the world's top producer of oil and gas, the U.S. is far less vulnerable to foreign supply shocks than it has been historically.

Markets have a long track record of reacting quickly to global headlines—and then moving on. The current situation may follow that same pattern (chart from Exhibit A):

#### S&P 500 1-Year Forward Returns (%) After Major Geopolitical Events

Since the Korean War.



For clients, the most important question to ask when headlines hit is simple: Does this impact your plan or goals? In nearly every case, the answer is no—and that answer matters more than anything else.

Geopolitical risks can shake markets in the short term, but they rarely alter long-term outcomes. Staying disciplined—especially in moments like this—is what allows plans to succeed over time.

## MARKET VALUATIONS ARE STARTING TO FEEL STRETCHED

The rebound from the April lows has been powerful—so powerful that the pace matches previous bull market surges. The study below shows that when the Nasdaq 100 rallies from bear market territory to near all-time highs in just 50 trading days, that momentum has historically continued (table from SubuTrade):

| <b>NASDAQ 100 after it rallies from -20% to -2% below a 1 year high within 50 trading days</b> |              |               |               |                |                |                |                |               |
|--|--------------|---------------|---------------|----------------|----------------|----------------|----------------|---------------|
| <i>SubuTrade.com, using daily CLOSE \$</i>   |              |               |               |                |                |                |                |               |
|  | 1 Week Later | 2 Weeks Later | 1 Month Later | 2 Months Later | 3 Months Later | 6 Months Later | 9 Months Later | 1 Year Later  |
| February 5, 1991   | 2.75%        | 2.57%         | 9.52%         | 14.11%         | 10.22%         | 13.74%         | 18.78%         | 43.62%        |
| November 5, 1998   | 1.70%        | 6.62%         | 16.29%        | 36.36%         | 41.06%         | 48.04%         | 51.70%         | 91.10%        |
| May 30, 2003   | 1.27%        | 0.50%         | 0.32%         | 5.50%          | 11.22%         | 18.55%         | 24.34%         | 22.40%        |
| September 16, 2009   | 0.03%        | -0.27%        | 1.72%         | 3.76%          | 4.32%          | 12.78%         | 10.84%         | 13.02%        |
| May 29, 2020   | 2.81%        | 1.13%         | 4.25%         | 11.59%         | 24.81%         | 27.17%         | 39.01%         | 43.23%        |
| May 15, 2023   | 3.25%        | 7.02%         | 11.87%        | 17.15%         | 12.11%         | 15.43%         | 32.76%         | 38.64%        |
| June 6, 2025   |              |               |               |                |                |                |                |               |
| <b>Average:</b>  | <b>1.97%</b> | <b>2.93%</b>  | <b>7.33%</b>  | <b>14.75%</b>  | <b>17.29%</b>  | <b>22.62%</b>  | <b>29.57%</b>  | <b>42.00%</b> |
| <b>% Positive:</b>   | <b>100%</b>  | <b>83%</b>    | <b>100%</b>   | <b>100%</b>    | <b>100%</b>    | <b>100%</b>    | <b>100%</b>    | <b>100%</b>   |
| Average Max Loss   | -0.20%       | -0.46%        | -0.77%        | -0.77%         | -0.77%         | -0.77%         | -0.77%         | -0.77%        |
| Average Max Gain   | 2.56%        | 4.42%         | 8.41%         | 15.84%         | 20.80%         | 25.91%         | 36.85%         | 45.47%        |

Yet this rally has unfolded without a meaningful rise in earnings expectations for S&P 500 companies. Stock prices have outpaced profit forecasts, pushing the forward price-to-earnings ratio (P/E)—price divided by projected earnings over the next 12 months—to just below the highs seen earlier this year. At a forward P/E of 21.6x, the market's earnings multiple now sits above both the 5-year and 10-year averages (chart from Factset):

**S&P 500 Forward 12-Month P/E Ratio: 10 Years**  
(Source: FactSet)



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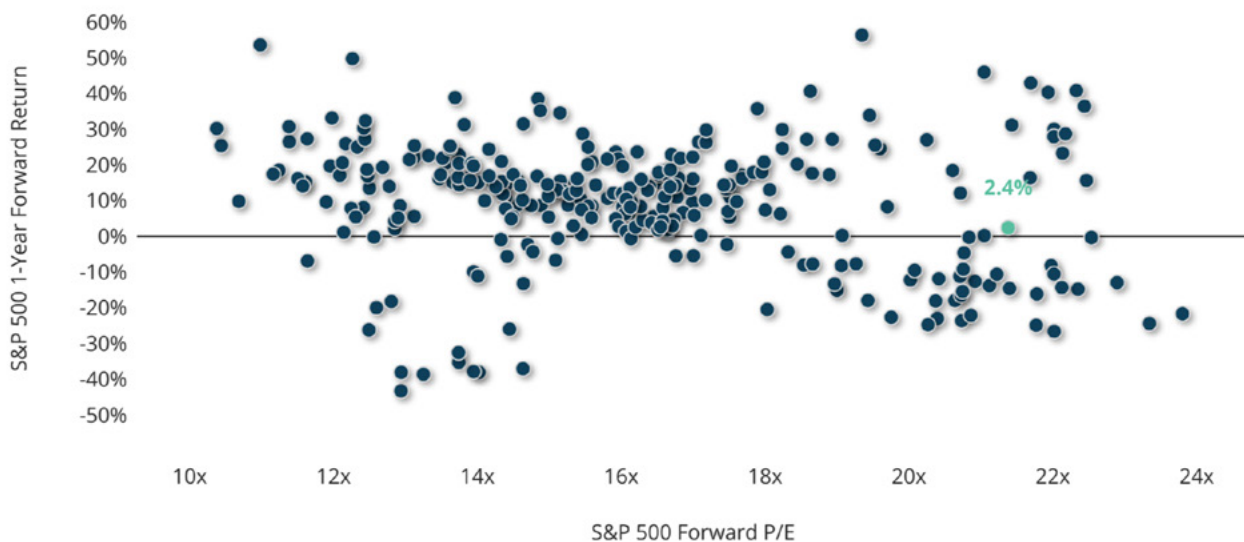


But does the market's P/E ratio actually tell us anything useful about future stock performance? The next chart sheds light on that question by showing how the S&P 500 has performed across different forward P/E levels on a one-year time frame (from Exhibit A):

S&P 500 Forward P/E (X) vs S&P 500 1-Year Forward Return (Y)

Since 2000

■ S&P 500 FORWARD P/E (X) VS S&P 500 1-YEAR FORWARD RETURN (Y) ■ IMPLIED 1-YEAR FORWARD ANNUALIZED RETURN USING CURRENT FORWARD P/E



Across time, high or low P/E levels haven't reliably led to strong or weak returns. One year out, results vary—mostly higher, sometimes down—regardless of where valuations started. In short, the chart reflects a weak relationship between the S&P 500's P/E ratio and its 1-year forward returns. History suggests this indicator is a poor predictor of short-term performance.

Relying on the forward P/E ratio alone to forecast short-term returns is risky. While it can signal how expensive the market looks, the ratio itself tells us little about the direction of the market over the next year.

In summary, markets are navigating a complex landscape marked by geopolitical tension, uncertain trade policy, and stretched valuations. **macrocast's™** move to neutral reflects some signs of pressure across several indicators, prompting a pullback in risk exposure. Meanwhile, Middle East volatility led to a sharp spike in oil prices last week, but today's global energy system is more resilient than in the past. Lastly, although valuations look rich, history shows that high P/E ratios alone aren't reliable indicators of short-term market direction.

In times of noise and uncertainty, the most effective move is to stay disciplined and stay the course with your financial plan.

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**CORBETT ROAD**  
CAPITAL MANAGEMENT



**BARNES DENNIG**  
Private Wealth Management

THANK YOU

**Cincinnati**

150 East Fourth Street  
Cincinnati, OH  
Tel: 513.241.8313

**Dayton**

40 N Main Street, Ste 2000  
Dayton, OH 45423  
Tel: 937.223.7272

**Kentucky**

2617 Legends Way  
Crestview Hills, KY 41017  
Tel: 859.344.6400

**Indianapolis East**

8470 Allison Pointe Blvd, Suite 200  
Indianapolis, IN 46250  
Tel: 317.572.1130

**Indianapolis West**

5342 W. Vermont Street  
Indianapolis, IN 46224  
Tel: 317.241.2999

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