Record Highs Meeting Rising Risks: Stay Opportunistic Amid Potential Volatility

- Record high stock prices, but rising inflation and geopolitics increases volatility risks.
- Fed flexibility is limited as inflation reaccelerates, reducing rate cut expectations.
- Pullbacks of 5–10% are opportunities, supported by solid growth, earnings, and cash on the sidelines.

Equity markets are sitting at or near all-time highs, but the backdrop is becoming more complicated. Elevated oil prices, renewed inflation pressures, and ongoing geopolitical tensions are combining in a way that typically leads to more volatile and choppier markets in the near-term.

Recent events in the Middle East have also changed how investors are interpreting risk. It is not just the presence of geopolitical tension; it is the growing belief that it could last longer and have broader implications for energy markets, inflation, and global growth. This change in expectations has meaningfully increased uncertainty.

In short, the setup has shifted from a smooth climb higher to a potentially more uneven path forward.

Why Volatility is Likely to Increase

Several forces are converging at once, and importantly, they are reinforcing one another.

Geopolitical risks remain elevated. A fractured ceasefire with Iran and continued instability increase the risk of a prolonged conflict, particularly in energy-sensitive regions. Historically, markets can digest short, contained events relatively quickly. But when investors begin to price in long-lasting disruption, the range of outcomes widens significantly, and volatility tends to rise.

Energy driven inflation pressures. Markets are at the center of the current narrative as the energy shock is becoming more impactful. Higher oil prices and damage to energy infrastructure are pushing input costs higher across the global economy. This is now feeding into inflation more broadly, reinforcing the risk that price pressures remain sticky or even reaccelerate from here.

A more constrained Federal Reserve. Earlier in the year, markets expected the Fed to respond to any slowdown with rate cuts; today, that confidence has diminished. Higher inflation driven by energy and supply disruptions effectively handcuffs policymakers, reducing their ability to cushion markets. The so-called Fed put is far less certain than in prior cycles.

Higher valuations. There are also additional crosscurrents that can amplify volatility. Equity valuations remain elevated, leaving less margin for error. When markets are priced for strong outcomes, negative surprises tend to have a larger impact on prices.

Taken together, this is not the type of environment where markets move steadily higher. It is one where volatility increases, sentiment shifts quickly, and pullbacks become more frequent.

A Familiar Pattern Without Systemic Stress

While the current environment feels uncertain, it is important to keep historical context in mind.

Markets often follow a familiar pattern during geopolitical events. Initially, equities sell off as investors reprice uncertainty and reduce risk. Over time, as more information becomes available and worst-case scenarios are better understood, markets tend to stabilize and refocus on fundamentals.

Just as important, the most severe and prolonged market drawdowns have historically been tied to systemic stress, such as credit dislocations, liquidity shocks, or deep economic contractions.

We do not see those conditions today. Financial markets are functioning normally. Credit conditions remain orderly. There are no clear signs of forced deleveraging or systemic strain. Corporate fundamentals also remain supportive, with earnings and margins providing a cushion even as sentiment shifts.

That distinction matters. Volatility driven by uncertainty is very different from a bear market driven by underlying economic weakness.

What to Do if Markets Pull back

Despite the likelihood of near-term turbulence, any meaningful pullback, particularly in the five to ten percent range, should be viewed as an opportunity rather than a warning sign.

The fundamental backdrop remains intact. Economic conditions are improving, providing a strong foundation for corporate earnings, which accelerated far more than expected in the first quarter. This backdrop helps justify elevated valuations, particularly as earnings momentum continues to improve.

In addition, there is significant liquidity on the sidelines. With roughly $26 trillion combined in money market assets and bank accounts, there is dry powder that can be redeployed during periods of market weakness, helping to stabilize markets and support recoveries.

This combination suggests that pullbacks are more likely to be driven by sentiment and uncertainty rather than a breakdown in the underlying economy.

Investment Perspective: Discipline Over Reaction

Periods of heightened uncertainty can test investor resolve. When volatility rises and headlines dominate, the temptation is to react, reducing risk after markets fall or waiting for clarity before reentering. History suggests that approach often leads to poor outcomes. Markets tend to recover before uncertainty is fully resolved, and missing those inflection points can be costly.

A more effective approach is to remain disciplined. That means maintaining diversification, staying aligned with long-term objectives, and focusing on fundamentals rather than short-term noise. It also means recognizing that volatility, while uncomfortable, is a normal part of investing, especially in an environment with elevated valuations and greater policy uncertainty.

Importantly, volatility often creates opportunity for those prepared to act on it, not react to it.

Bottom Line

Markets are entering a phase where inflation uncertainty, geopolitical risk, and policy constraints are likely to drive more frequent and sharper swings. That can feel uncomfortable, especially with markets near all-time highs. But the broader picture has not broken.

We are not seeing signs of systemic stress or economic deterioration that typically accompany sustained bear markets. Instead, market conditions point to a potential repricing of risk in a more complex environment. Pullbacks driven by macro uncertainty, not deteriorating fundamentals, are typically opportunities. For long-term investors, volatility is not a signal to step aside, but often an entry point to put capital to work.

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