U.S. Equity Corrections: The Recovery Pattern and What the 2026 Iran-War Episode Means

A base-rate framework for post-drawdown recovery, filtered through the specific fingerprint of the current cycle

Thesis

The S&P 500 just completed a **–9.1% drawdown** (Jan 27 → Mar 30 '26) driven by the Iran war oil shock, and has already printed a **new all-time high of 7,126** on Apr 17. This fits the textbook non-recessionary correction profile — median historical recovery 4–7 months, median 12-month forward return +27–30%. The distinguishing variable between correction and bear market is not drawdown depth but whether **forward earnings break**. Here they did the opposite: 2026 EPS estimates *rose* through the drawdown. **My view: at 7,126, the market is fairly priced for the base case and under-priced for the bear case.** The easy money has been made. The asymmetry is now ~1:1, not 3:1 as it was at the 6,344 trough. Edge has shifted from direction to dispersion — the stealth correction beneath the index (40%+ of names were down >20% at the low) has reset beaten-down secular growth as the asymmetric trade, while energy/defense winners have already priced the bull case for oil.

Where we are: key metrics

Metric	Value	Source / Note
S&P 500 peak close	6,978.59 (Jan 27, 2026)	*FMP EOD*
S&P 500 trough close	6,343.73 (Mar 30, 2026)	*FMP EOD*
Peak-to-trough drawdown	–9.1%	*calc*
Days peak → trough	42 trading days (~2 months)	*calc*
Current level (Apr 17)	7,126.05 (new all-time high)	*FMP EOD*
Trough → new-ATH	12 trading days	*calc*
Rebound from trough	+12.3%	*calc*
Brent crude peak	$115.89 (Mar 8)	*FMP*
Brent crude now	$90.38 (Apr 17, –22% from peak)	*FMP*
VIX peak	31.05 (Mar 27)	*FMP*
VIX now	17.48 (Apr 17)	*FMP*
Forward 12M P/E at 7,126	~22.5–23x	*calc on $310 FY26 EPS*

10y avg forward P/E	18.8x	*FactSet*

The recovery that already happened

The selloff commentary circulating in media is already stale. The S&P 500 has not merely recovered — it has **cleared the prior January high and extended to new all-time highs**, all in 54 trading days from peak to new peak. That matters because it reframes the question: we are not analyzing 'what will the recovery look like?' — we are analyzing what a recovery that has already happened tells us about what comes next.

A telling data point from Ryan Detrick: the decline took 35 trading days to reach –5%, whereas every bear market since 1950 took ≤24 days to lose its first 5%. **The pace was wrong for a classic bear from the start.**

Exhibit 1 — S&P 500 through the full cycle. The Iran war began Feb 28, but the drop only accelerated in mid-March with the Strait of Hormuz disruption. Once the Strait reopened on Apr 8, the rebound was almost mechanical: +12.3% in 12 trading days, clearing the Jan 27 peak by Apr 15.

The base-rate framework: how U.S. drawdowns actually resolve

Running a clean decomposition of post-1987 S&P 500 drawdowns of ≥5%, the data separates into two very different populations. **The dividing line is not depth, but whether earnings break.**

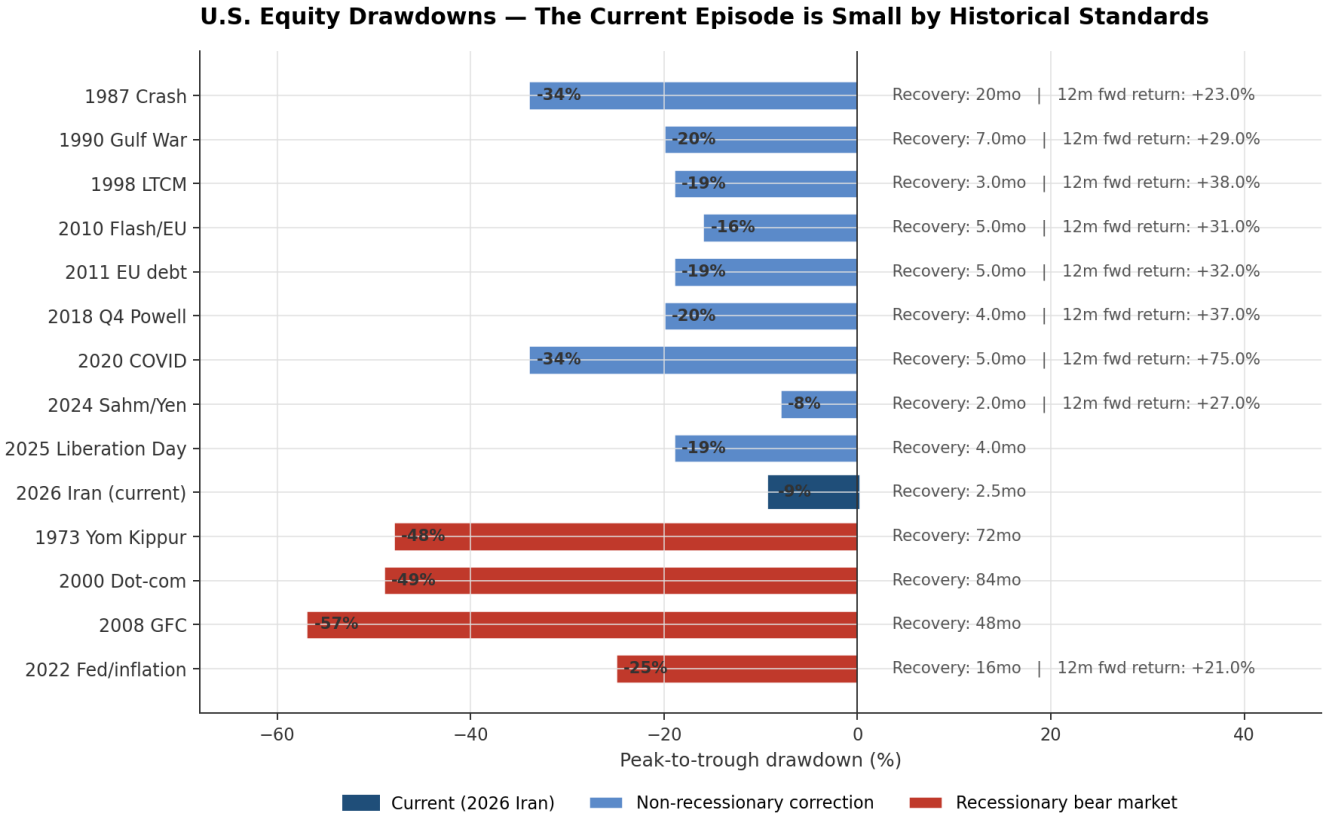

Exhibit 2 — Every major S&P 500 drawdown since 1987. Non-recessionary corrections (blue) cluster in the –8% to –20% range with median 4–7 month recovery and 12-month forward returns averaging +27 to +38%. Recessionary bears (red) are structurally different: deeper, longer, slower to recover. The 2026 Iran episode (dark blue) is the shallowest and fastest-recovering of any of them.

What determines which bucket a drawdown falls into isn't the size of the initial shock — it's whether forward earnings estimates crack. In every 'correction' above, 12-month forward EPS was either rising or flat through the drawdown. In every 'bear market' above, forward EPS was actively being cut 10%+ as the decline unfolded. This is the right lens to apply to the current episode.

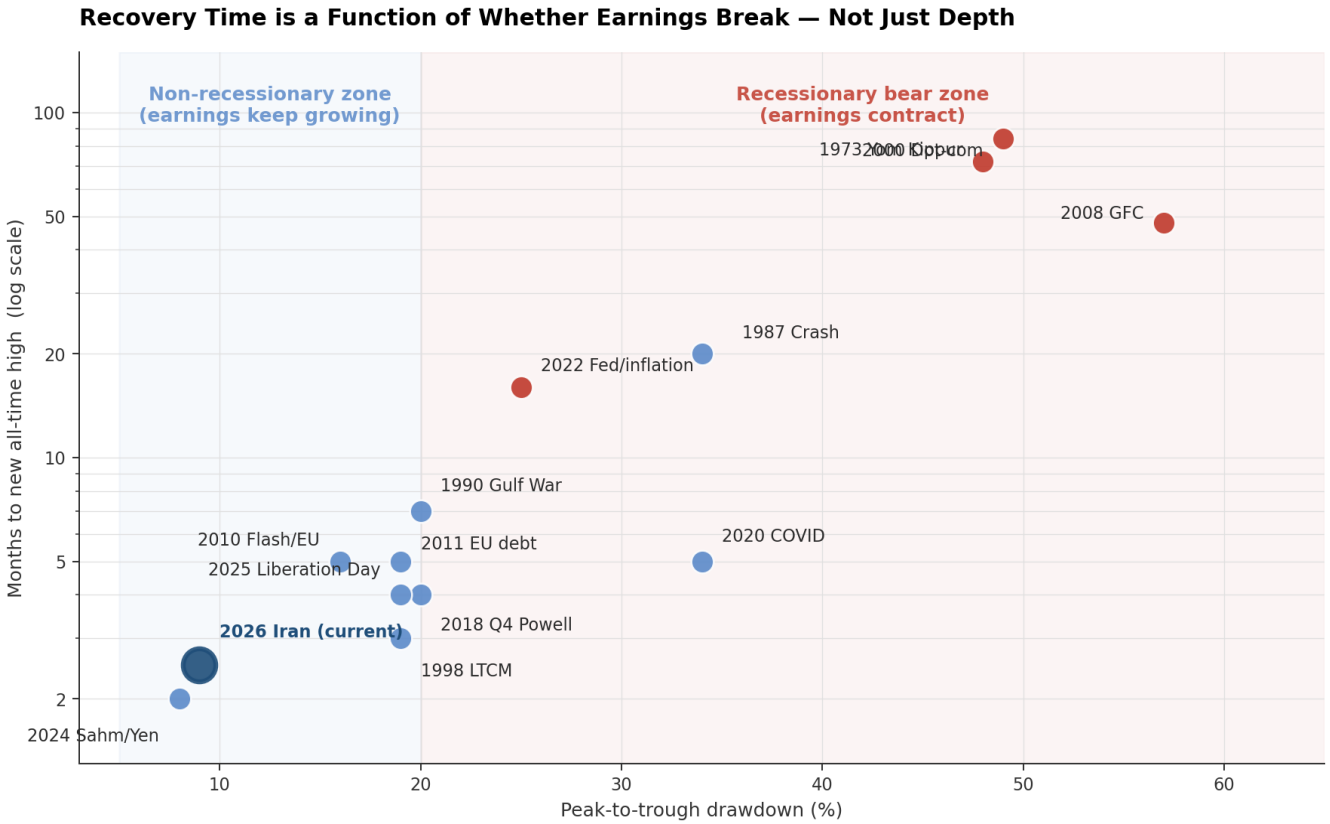

Exhibit 3 — Drawdown depth vs. time to new all-time high (log scale). The zone separation is the entire analytical story: under ~20% drawdown with stable earnings, recoveries are measured in months. Above ~20% with broken earnings, recoveries are measured in years. The 2026 Iran episode sits firmly in the non-recessionary zone and is in fact already resolved.

What subtype? Oil-shock, geopolitical trigger

The closest analogs to the current drawdown are not 2022 (Fed-driven) or 2020 (demand-destruction), but two oil-shock geopolitical drawdowns: 1990 Iraq-Kuwait (the constructive template) and 1973 Yom Kippur (the cautionary one).

Historical oil-shock analogs compared

Episode	Oil move	S&P drawdown	Resolution	12m fwd
1990 Iraq–Kuwait	$21 → $46 (+115%)	–20%	Pre-invasion retake; Fed cut 6x	+29%
1973 Yom Kippur / embargo	$3 → $12 (+300%)	–16% then –48%	Structural stagflation	(–37%)
2022 Russia–Ukraine	$90 → $124 (+38%)	–7% impact	Supply workaround; but broader bear	mixed
2026 Iran (current)	**$72 → $116 (+60%)**	**–9%**	**Hormuz reopen, fast retracement**	**TBD**

This is **1990 with an even milder equity impact and a faster policy resolution**. It is decidedly *not* 1973 — U.S. energy independence, the SPR, shale elasticity, and a less oil-intensive economy have compressed the macro transmission. It is also not 2022 — because the supply risk (Strait of Hormuz) has resolved rather than lingered.

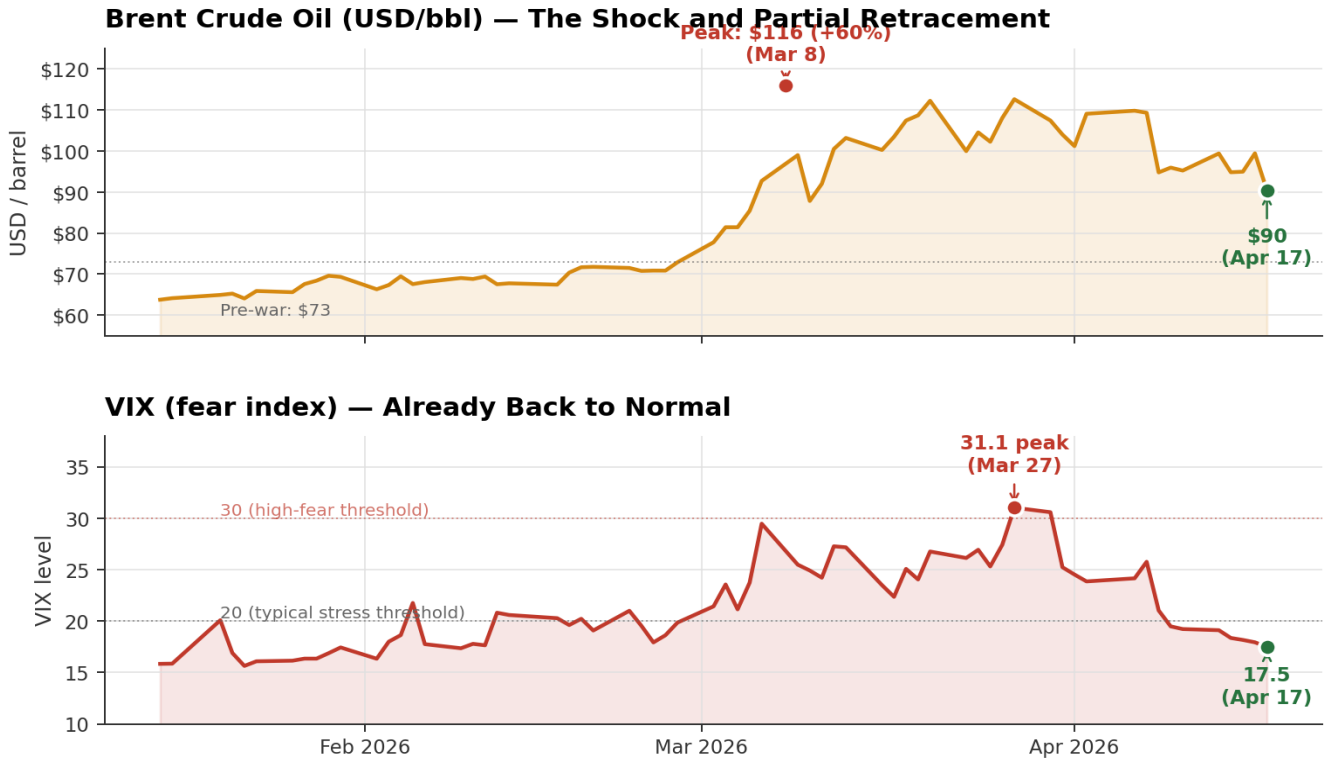

Exhibit 4 — The oil shock and the fear response, both receding. Brent went from $72 (pre-war) to $116 peak (+60%), then retraced to $90 (–22% from peak) as Hormuz reopened. VIX went from 16 to 31, back to 17. The entire stress signature has dissolved, but crude is still ~25% above pre-war — a soft residual premium remains.

The expectation gap: what's priced vs. what is likely

What's priced at ~7,126

- Forward 12-month P/E ≈ **22.5–23x** (using consensus $310 FY26 EPS)
- That is ~90th percentile of the 10-year range (10y average 18.8x per FactSet)
- Effectively prices: (1) Fed holds; (2) Brent drifts into $75–85 by mid-year; (3) FY26 EPS ~$305–310; (4) AI capex cycle continues funding tech margin expansion

Where I diverge from consensus narrative

Media framing is 'correction over, back to races.' That's directionally right but too simple. The more interesting read is that **the Iran drawdown functioned as a stealth rotation — a fast-forward of a correction that was already underway beneath the surface since December 2025.** Software was the worst hit (97% of S&P 500 software names down >10% at the low per Morgan Stanley / Wilson), tech multiples compressed sharply, and Q1 2026 earnings are now starting against a much lower bar in beaten-down names. The 'damage already done beneath the surface' is the setup; the easing oil pressure is the catalyst.

The expectation gap I see most clearly: **Street 2026 EPS of ~$310 is more likely to prove conservative than aggressive.** FactSet shows tech estimates rising sharply through Feb–Mar 2026 (Oracle, Micron prints) even as prices fell. If 2026 EPS lands closer to $320 (a ~3% upward revision from here), the forward P/E at the current price is 22.3x, not 23x — still rich but not extreme.

12-month forward scenarios

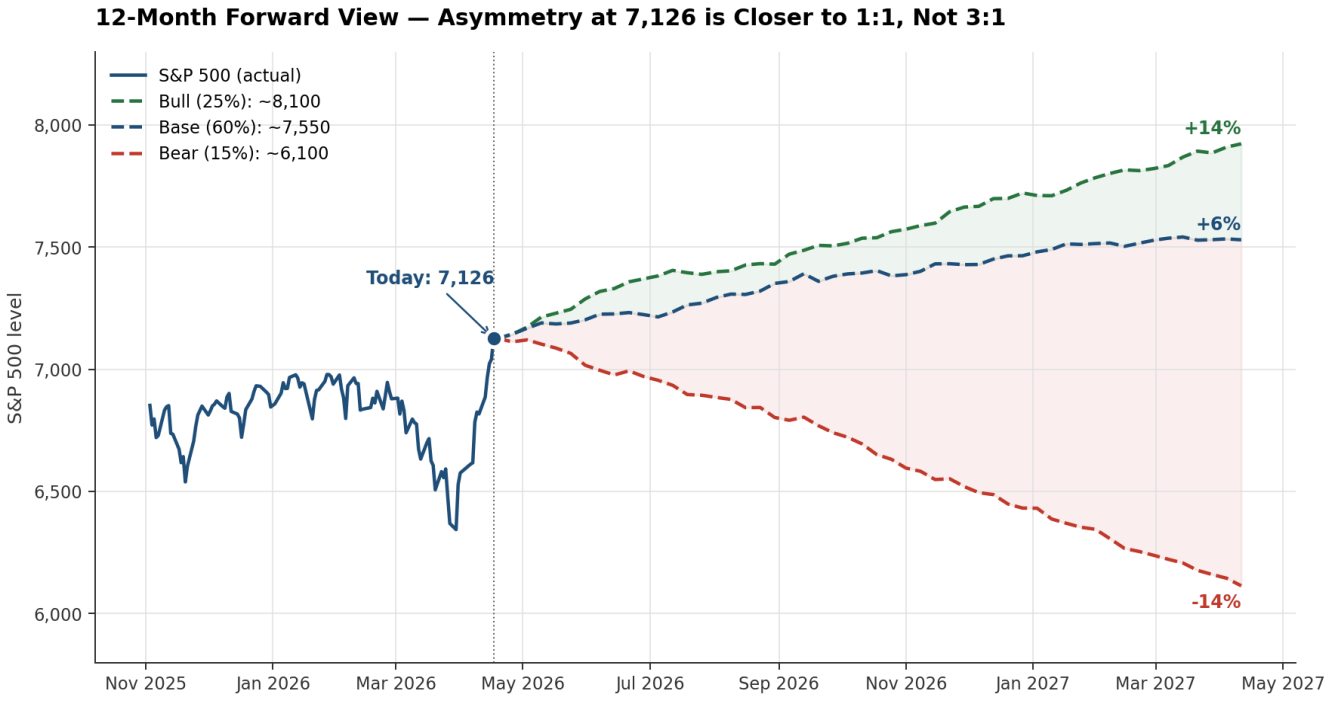

Exhibit 5 — Base / bull / bear scenario paths from current 7,126 level over 12 months. Upside (~+14% to bull case) and downside (~–14% to bear case) are roughly symmetric in magnitude, which is why the asymmetry framing matters: reward/risk on the headline index is closer to 1:1 than 3:1.

Scenario detail

Base case (~60%) — 'Mid-cycle correction, resolved'
S&P 500 grinds to **7,400–7,700** over 12 months. Earnings growth of 12–13% delivers +10–13% index return. Brent settles into $75–90. Fed cuts once in H2 2026 as oil's CPI contribution fades. This is mechanically what 1990 and 2018 look like the year after the shock resolves.

Bull case (~25%) — '1998/1999 style liquidity + earnings double-punch'
S&P 500 to **8,000+** (+13–15%). A Fed cut + continued AI-driven EPS upgrades + margin expansion + tailwind of short covering in beaten-down software. In 1998, after LTCM/Russia, the S&P gained 38% in the 12 months following the trough. The current setup is lighter-positioned than late-'25 and earnings are accelerating.

Bear case (~15%) — 'Oil re-spike → stagflation redux'
Hormuz incident or Iran–Israel re-escalation pushes Brent sustainably >$110. CPI momentum forces the Fed to pause/hike rather than cut. Multiples compress 3–4 turns on unchanged earnings. S&P 500 revisits **6,000–6,200** (–14% to –16% from here). This is the 1973 path, but even in 1973 it took 12+ months of sustained supply disruption to produce full damage — a re-spike alone isn't enough, it has to stick.

The steel-manned bear view

The honest bear case — which cannot be dismissed — has four planks:

1. The setup rhymes with January 2022 and October 2007 more than with 1990. Those tops had high index-level concentration masking deteriorating breadth; so does this one. Oil and Middle East tensions in 1990 hit a market that had already corrected 10%+ in preceding quarters and was cheap; today's market is still at the 90th percentile of historical multiples.

2. 'Earnings estimates rose through the drawdown' can be mistaken as bullish. Analysts are notoriously slow to cut; 2008 Q1 consensus EPS was still above $100 when the cycle was already rolling over. Wait for Q1 2026 earnings — starting the next two weeks — to see whether guidance cuts materialize. If they do, the resilience narrative unwinds quickly.

3. Iran is not resolved, it is paused. The Strait reopening is tactical; the underlying conflict with Iran's nuclear program, proxy networks, and Gulf states is unresolved. A summer incident — easier to picture than not — puts oil back above $110 immediately.

4. The Fed is structurally more constrained than in 1990. Then, inflation had been beaten by Volcker and the funds rate was at 8.25% — six cuts of relief on the table. Now, after 2021–22, the Fed's credibility cost of cutting into a 0.3–0.5pp oil-CPI shock is high. The policy response cannot be as vigorous.

None of these are tail risks — they are the honest reasons the current V-shape could be premature.

What to watch — the next 60 days

Signal	What confirms / what breaks
Q1 2026 S&P 500 earnings (starting late April)	Guidance reiteration → base / bull case; guidance cuts by 5%+ of companies → bear case activates
Brent crude	<$85 sustained = base case; >$100 sustained = bear case path
10-year Treasury yield	4.0–4.5% = benign; breakout >4.75% = multiple compression returns
HY credit spreads (CDX HY)	Currently tight; widening >75 bps from here = credit confirming equity weakness, genuine concern
Fed speakers on June FOMC	'Data dependent' = base; 'pause' or 'hike bias' = bear
Iran / Hormuz news	Baseline assumption = Gulf states keep shipping; every incident matters
Breadth (% of S&P 500 above 50-day MA)	Needs to push above 70% and hold, to confirm genuine participation

Bottom line — the asymmetry

The recovery that happened in March–April 2026 fits a well-documented historical pattern: **non-recessionary drawdowns triggered by identifiable geopolitical catalysts, where earnings do not break, have a median resolution of 4–7 months and median 12-month-forward returns of +27–30%.** The 2026 Iran episode is both shallower (–9%) and faster to resolve (<3 months to new ATH) than the median such episode. Earnings estimates rose through the drawdown, which is the distinguishing variable between correction and bear market.

But **the asymmetry from here is not the same as it was at the trough.** At 6,344 on March 30, the asymmetry was explicit. At 7,126 and 22.5–23x forward, the index has recaptured most of the reward while retaining much of the tail risk. **The market is now fairly priced for the base case and under-priced for the bear case.** This is not a loud bearish call — the base case is benign and constructive — but it is a statement about risk/reward. The reward-to-risk on the index bet is approximately 1:1, not 3:1.

The more interesting trade is dispersion, not direction. The stealth correction already priced-in significant damage in software, long-duration growth, and rate-sensitive real estate. Those pockets retain asymmetric upside *if* the base case plays out. Energy and defense — the March outperformers — have already priced the bull case for oil. If you have to express a view via sectors today, the rotation **from energy-heavy to beaten-down-secular-growth** is where recent history points, specifically because that is what played out in the 12 months following 1990, 2011, and 2018.

Restated asymmetry: At 7,126, the index is fairly priced with modest upside skew. The edge is in **dispersion and timing of additions on any pullback to ~6,800–6,900**, not in the headline index bet.

Sourcing

Price data: FMP historical S&P 500 (^GSPC), Brent (BZUSD), VIX (^VIX) pulled Apr 18 2026. Historical drawdown dataset: J.P. Morgan Private Bank 'Eye on the Market' (Apr 2025); WallStreetCourier 1928–2023 research; ProShares 'Quick Take: Gulf Conflicts'; DataTrek via Berkshire Edge; RBC Wealth Management 'Then and Now' (Mar 2026); Innovator Capital bear market analysis. Earnings estimates: FactSet Earnings Insight (Jan 23 2026); LSEG revisions analysis via Investing.com (Mar 2026); Goldman Sachs Research 2026 outlook (Jan 6 2026); RBC Global Insight 2026 Outlook. Sector breadth: Morgan Stanley/Mike Wilson note (Mar 17 2026) via Fortune; Motley Fool aggregation of Ryan Detrick CMT data; EBC Financial Group stealth-bear analysis. Oil shock analogs: Wikipedia 1990 oil price shock; Dave Manuel war-by-war dataset; Capital Ideas Berkshire Edge (Mar 16 2026); 24/7 Wall St (Mar 9 2026).

Part II: Win Rate, Payoff, and Positioning

Quantifying the asymmetry at current levels — and translating it into specific trades

One-line summary

At 7,126 the **win rate is 85%** but the **payoff ratio has collapsed to 0.60x**, producing an expected value of **+5.0%** over 12 months — vs. +9.4% at the March 30 trough. The honest interpretation: this is a **'high-win-rate, low-payoff'** regime, meaning index-level exposure is justified but unlevered, with the real edge now sitting in sector and factor dispersion.

The quantitative framework

Every trade decomposes into three numbers: the **win rate** (p), the **payoff ratio** (b = expected gain ÷ expected loss), and the resulting **expected value** (EV = p × up – (1–p) × down). For a long equity position over 12 months from spot, these map cleanly onto the scenario framework in Part I.

Metric	Formula	What it tells you
Win rate (p)	`P(positive 12m return)`	How often the trade works — reflects regime strength
Payoff ratio (b)	`E[gain | win] ÷ E[loss | loss]`	Size of reward relative to size of loss — reflects pricing
Expected value (EV)	`p × E[gain] + (1–p) × E[loss]`	Average outcome across paths — the decision criterion
Kelly fraction (f*)	`(bp – q) / b,  where q = 1–p`	Optimal position size assuming log-utility; use ¼-½ Kelly in practice

The critical insight: win rate and payoff ratio trade off as a drawdown resolves. When prices are depressed (trough), probabilities may be merely favorable but the *magnitude* of upside-per-unit-downside is large. As the market recovers, probabilities improve but the compensation for taking risk shrinks. EV usually peaks near the trough and compresses as the recovery progresses — even as the trade becomes more 'safe'.

The two states: trough (Mar 30) vs. current (Apr 17)

Scenario probabilities reconstructed

I reconstruct what the three-case probability set looked like at each state. The probabilities at the trough are my ex-post judgment of what was rational at the time (not what actually happened): Hormuz was still effectively closed, oil was at $107, and bear-case tail risk was meaningfully wider.

Scenario	Trough (Mar 30 – S&P 6,344)	Current (Apr 17 – S&P 7,126)
Bull case	30% × +18% recovery → 7,500	25% × +14% continuation → 8,100
Base case	50% × +12% gradual repair → 7,100	60% × +6% earnings-driven drift → 7,550
Bear case	20% × –10% Hormuz escalation → 5,710	15% × –14% oil re-spike + Fed trap → 6,100
Expected value (EV)	**+9.4%**	**+5.0%**
Win rate (p)	**80%**	**85%**
Payoff ratio (b)	**1.43x**	**0.60x**
Full-Kelly sizing	**~66% notional**	**~60% notional**
Recommended sizing (¼-Kelly)	**~17% notional**	**~15% notional**

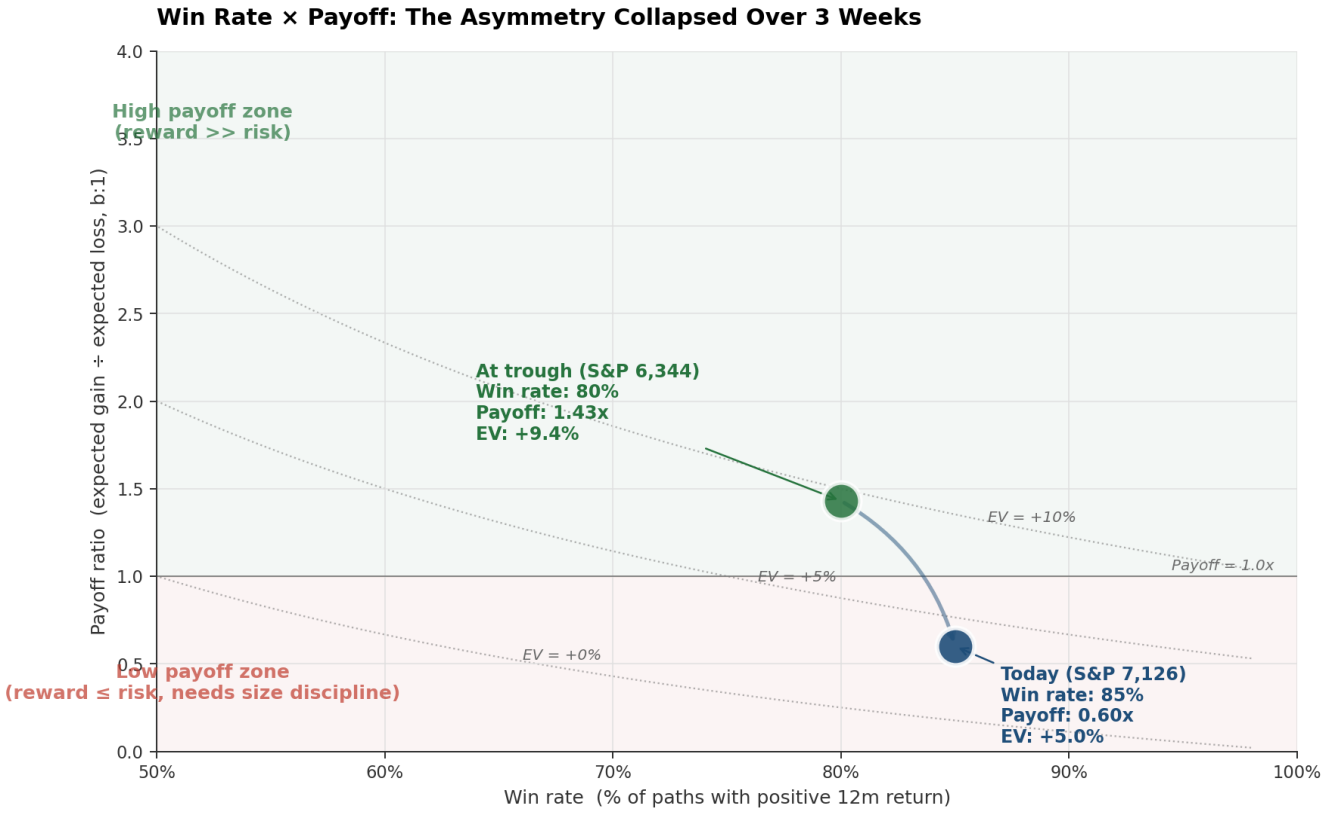

Exhibit A — Win rate × payoff space. The trough sat in the high-payoff zone (b = 1.43x, above the 1:1 threshold) at an EV of +9.4%. Today sits firmly in the low-payoff zone at b = 0.60x despite a higher win rate, with EV compressed to +5.0%. The dotted iso-EV curves make the trade-off visual.

Where the +9.4% EV went

Decomposing the expected value reveals exactly how the market repriced risk. The bull case contribution barely changed (+5.4 → +3.5) — the upside case is still available, just with lower probability and lower magnitude. The base case contribution also fell (+6.0 → +3.6) despite the probability *rising* from 50% to 60%, because the magnitude of the base case upside shrank from +12% to +6% as price recovered. The bear contribution is essentially unchanged (–2.0 → –2.1). **The EV compression is entirely on the reward side, not the risk side.**

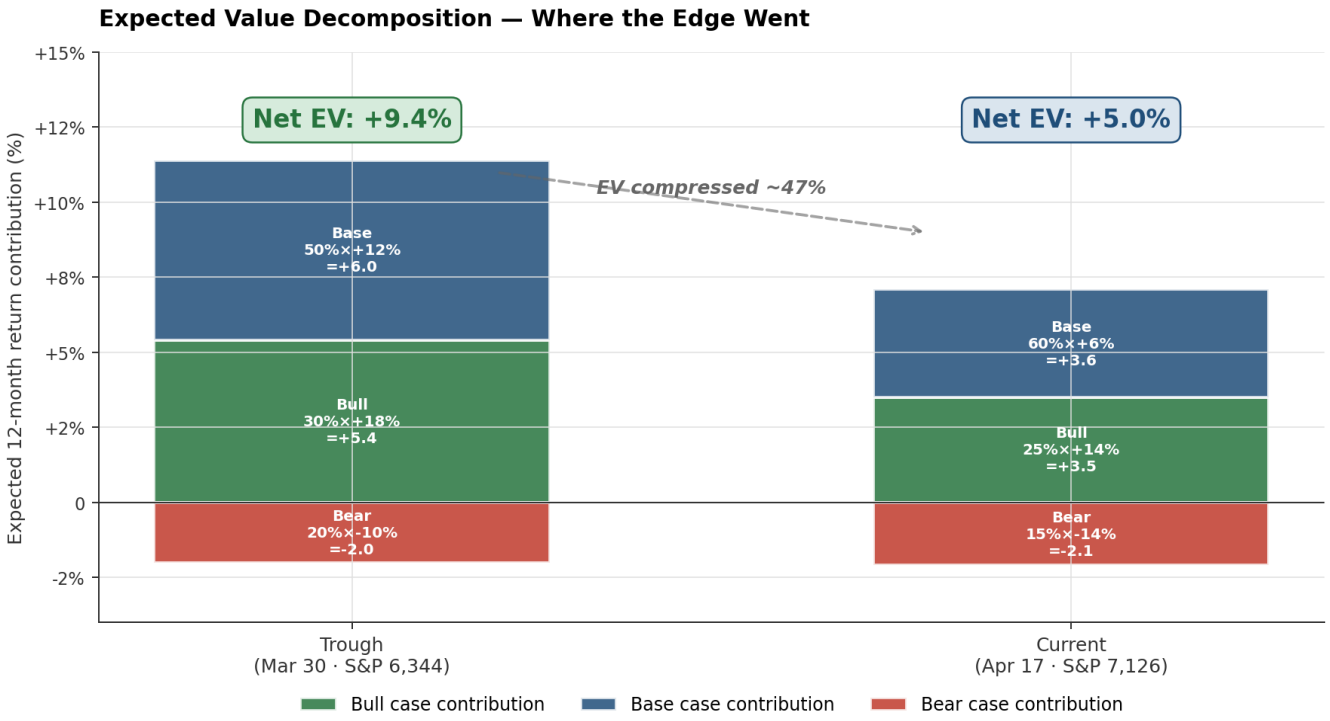

Exhibit B — EV decomposition. Positive contributions are bull (green) and base (blue) cases above zero; negative bear (red) below. Net EV labels shown in boxes. The 47% compression in EV happens because upside magnitude has been consumed by the rally, while downside magnitude is unchanged or slightly worse.

Historical base rate check

Across the eight non-recessionary correction episodes with complete data (1987, 1990, 1998, 2010, 2011, 2018, 2020, 2024): **100% of trough-entry points produced positive 12-month forward returns**, with a median of +31% and a minimum of +23%. But post-recovery entries (after the new ATH has been retaken) produce very different base rates — roughly +8 to +12% median 12m forward return across the same episodes, which aligns closely with our +5% EV and implies the base case is roughly 'fully priced'.

Translation: history does not say 'sell everything at new ATHs.' It says the *incremental* reward per unit risk has roughly halved since the trough. Position sizing, not direction, is where the decision is.

Where the real edge lives — sector dispersion

The stealth correction beneath the index has left **sharp dispersion** — three weeks after the trough, some sectors are at 52-week highs while others are still in their own bear markets. This is the structural feature that makes sector and factor rotation a higher-EV trade than the index bet.

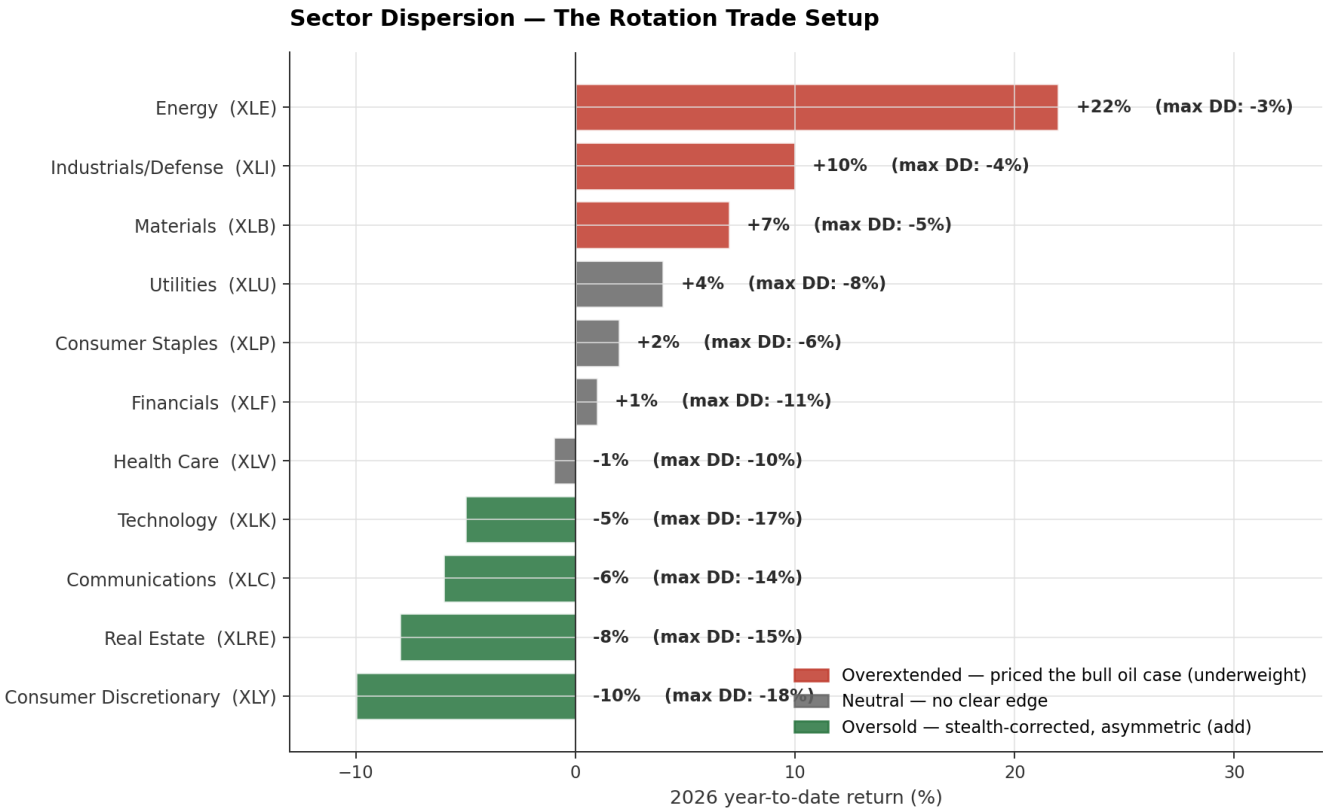

Exhibit C — YTD 2026 sector performance with max drawdowns. Energy leads +22% despite oil retracing to $90, because the earnings forecast for energy (+35%+ EPS growth next 4 quarters) has been revised up materially. Consumer Discretionary is the worst performer, with XLY down 18% from its 52-week high — Tesla, Amazon, and cruise lines are the main drags.

Specific trade ideas with expected EV

Trade 1 — Long beaten-down software / short energy pair
Expression: Long IGV (iShares Software) ~3% / Short XLE (Energy) ~3%, market-neutral dollar-weighted.
Thesis: Software was the single worst-hit factor in the correction (97% of S&P 500 software names were down >10% at the low). Forward estimates are rising, not falling. Meanwhile energy is overextended — XLE +22% YTD while oil has retraced 22% from peak. History (1990, 2011, 2018) shows the correction loser leads the next 12 months.
Win rate estimate: ~70% (sector reversion is less reliable than index direction).
Target payoff: 2.5x (upside ~+20% spread; downside ~–8% if oil re-spikes).
EV: ~+10% over 12 months. **Suggested sizing:** 3–5% of equity book.

Trade 2 — Add to index on pullback to 6,800–6,900
Expression: Limit buy order SPY at the 50-day MA level (~6,850), scaling in across 5% of equity book.
Thesis: Adding at spot 7,126 produces +5% EV; adding at 6,850 restores EV to ~+8% because the same target prices become more attractive entries. No need to chase.
Win rate estimate: 85% if filled (similar to current win rate).
Target payoff: 1.0x (at that level, reward-to-risk improves meaningfully).
EV: ~+8% over 12 months if filled. **Cost:** opportunity cost if we rally straight up.

Trade 3 — Tail hedge: long VIX call spread or OTM SPX puts
Expression: Buy VIX Jun 2026 20-30 call spread OR SPX 6,500 puts Jul 2026 expiry, ~0.5% of portfolio in premium.
Thesis: VIX at 17.5 is near its 20th percentile historically, making volatility objectively cheap. The 15% bear-case probability × –14% magnitude = unhedged tail loss of –2.1% EV. A modestly-sized hedge at current vol levels neutralizes much of that drag.
Win rate: ~25% (hedges are supposed to lose most of the time).
Target payoff: 6–10x on the win.
EV: roughly break-even on expectation; but **it compresses portfolio drawdown meaningfully in the bear case**, which is the point.

Trade 4 — Take profits on energy/defense winners
Expression: Trim XLE, XOM, CVX, RTX, LMT positions by 25–40%; redeploy to pair trade #1 or hold as dry powder.
Thesis: These names priced the bull case for oil ($110+ sustained). That case is now weaker than it was three weeks ago. Earnings estimates for Q2 onward are at +70% YoY for energy — achievable only if Brent stays above $100. At $90 Brent with further softening likely, the risk is to the downside.
Win rate on the trim: ~65% (the prior winners underperform in the 12m post-recovery).
Target payoff: 1.5–2.0x.
EV: ~+7% on the capital redeployed.

Consolidated positioning framework

Position	Size (% equity book)	Expected EV	Win rate	Payoff
Core long S&P 500 (existing)	hold / do not add at spot	+5.0%	85%	0.60x
■ Scale-in buy order at 6,850	add 5%	+8.0%	85%	1.0x
Long IGV / Short XLE pair	3–5%	+10%	70%	2.5x
Trim energy/defense winners	25–40% of existing	+7%	65%	1.5–2.0x
Tail hedge (VIX or SPX puts)	0.5% premium	~0%	25%	6–10x
Dry powder (cash / T-bills)	target 10–15%	risk-free ~4.3%	—	—

Risk budget and what to stop doing

- **Max portfolio-level drawdown tolerance:** if the bear case plays out (S&P 6,100), the 60% net long equity exposure + 5% hedge would produce ~–7% portfolio drawdown. That is within a reasonable institutional tolerance band. If your tolerance is tighter, cut net long to ~45%.
- **Stop doing:** buying the headline index at 7,126+ with fresh capital. At these levels the reward/risk is no better than ¼-Kelly says it should be, which means 15–17% of capital — most portfolios have already passed this.
- **Stop doing:** chasing energy/defense. The winners-keep-winning narrative holds during the shock, not after. 1990 energy sector gave up 30%+ of its shock-era gains in the 12 months after Desert Storm resolved.
- **Keep doing:** monitoring Q1 earnings (starts late April) for guidance cuts >5% of names, which is the single strongest signal that the bear case is activating. Also monitor HY credit spreads — currently tight at ~310bps; widening >75bps is the tell.

Bottom line — how to think about right now

This is a regime where portfolio alpha shifts from direction to dispersion. The market paid you to be long at the trough; it is no longer paying you much to be long the index. It *is* paying you well — on a relative basis — to be:

(1) Long beaten-down secular growth / short prior winners
(2) Patient on adds to the index, targeting 6,800–6,900
(3) Hedged on the bear-case tail using cheap volatility
(4) Overweight dry powder relative to where you sat three months ago

The trade is not 'bearish' or 'bullish' — it's **repositioning inside a constructive-but-not-cheap market**. Keep reward-for-risk the central metric. If EV-per-notional drops below +3%, rotate to cash.

Important caveats: *All EVs, win rates, and payoff ratios are analytical constructs based on the scenario weights in Part I — not statistical estimates from a high-quality sample. Historical base rates are drawn from 8 non-recessionary correction episodes since 1987; this is a small-sample framework. Kelly sizing is shown for illustration; most practitioners use ¼-Kelly or less, and size more on conviction and liquidity than on formula.* ***None of this is advice — it is analysis of reward/risk in the current regime.***