

Through the mists

After a turbulent start to the year, equity markets posted solid gains in the second quarter, supported by easing geopolitical tensions, the resilience of the global economy, and widespread enthusiasm for artificial intelligence (AI). Emerging Markets stood out with spectacular gains, driven notably by the strength of Taiwan and South Korea, two countries closely tied to the semiconductor value chain. This backdrop also benefited U.S. equities, while Canadian equities and the EAFE region posted more modest returns. For its part, the Canadian fixed-income universe delivered a performance in line with yields-to-maturity, despite a period of heightened volatility in May, at the peak of inflation-related concerns.

From an economic standpoint, the main development of the quarter was the sharp decline in energy prices, in a context where tensions in the Middle East now appear less acute, though not fully resolved. While further episodes of volatility cannot be ruled out, the gradual resumption of maritime traffic in the Strait of Hormuz removes a significant headwind for the global economy by easing pressure on supply chains and on consumer gasoline prices. For the Federal Reserve, now chaired by Kevin Warsh, this environment nevertheless remains a major challenge, as the central bank must contend with the highest inflation rate in three years, following a five-year period during which inflation remained above its 2% target.

At the same time, artificial intelligence continues to play a central role in market dynamics. Profit growth has been particularly spectacular among companies involved in the production of chips and high-speed memory, a crucial component of the AI value chain. That said, the high degree of concentration in this single theme makes markets more sensitive to any disappointment regarding the pace of capital spending or earnings growth.

In this context, our base-case scenario continues to anticipate economic growth close to potential, with commodity prices stabilizing and inflation gradually slowing, although the latter is expected to remain above target for some time yet. The positive “Goldilocks” scenario is gaining slightly in credibility, supported by the decline in energy prices and the resilience of the U.S. labour market, while the main downside risk has changed in nature since last quarter. Indeed, the stagflation scenario has given way to one of overheating, in which economic growth remains solid, but inflation becomes more problematic.

From an investor’s perspective, despite the many challenges that remain, the balance of risks continues to favour equity markets. Accordingly, as the macroeconomic environment improved, we adopted a more risk-on tactical stance over the quarter, moving the equity allocation from neutral to overweight as early as the end of April, at the expense of bonds. Within equities, we favour the United States and Emerging Markets over the EAFE region. These two regions appear better positioned to benefit from the current environment, particularly thanks to stronger earnings growth, exposure to the artificial intelligence value chain, and valuations that remain reasonable.

Q3 2026

Key elements and investment implications

Goldilocks (15%)

- Much to the surprise of investors, the rise in commodity prices fades shortly after the Strait of Hormuz fully reopens.
- The impact on inflation proves limited and transitory. Core inflation measures gradually converge toward the 2% target.
- With the labour market in balance, the Fed cuts interest rates between one and three times toward what it considers a neutral stance.
- Buoyed by continued momentum in technology, earnings expectations keep moving higher, pushing equity valuations up as well..
- Earnings prospects remain robust, with significant investment in AI infrastructure continuing.
- A renewed focus on cost-of-living pressures by the U.S. administration helps pave the way for an easing of trade tensions.

Economic implications: Real GDP growth > 2%, stable U.S. unemployment rate

Market implications: ↑↑Equities, ↓Bond yields, ↓Volatility, ↓USD

Trend growth (65%)

- Commodity prices stabilize as maritime traffic slowly begins to recover in the Persian Gulf.
- With the worst of the energy shock now behind us, inflation gradually slows, but remains above target.
- With the labour market broadly in balance, the Federal Reserve opts for patience and keeps interest rates at their current level.
- Earnings expectations remain solid, supported by a resilient economy and sustained technology investment.
- The U.S. administration refocuses on growth-friendly policies; trade tensions persist but remain manageable.

Economic implications: Real GDP growth near 2%, stable U.S. unemployment rate

Market implications: ↑Equities, ↓Bond yields, ↓Volatility, ↓USD

Overheat (20%)

- Sporadic flare-ups in hostilities in the Middle East keep energy prices from returning to pre-war levels against a backdrop of strong global demand. Inflation accelerates as price increases broaden across the consumer basket.
- In the midst of reviewing its analytical framework, the Federal Reserve is slow to act, fuelling impatience in the bond market.
- Profit growth remains solid, but forecasts are revised lower as financial conditions tighten.
- A sharp pullback in capital spending by tech giants creates ripple effects across the entire AI ecosystem.

Economic implications: Real GDP growth > 2%, U.S. unemployment rate low but set to rise

Market implications: ↓Equities ↑Bond yields, ↑Volatility, ↑USD

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