Quarterly base-case scenario

CIO Office | Q4 2026

A narrower path ahead

Despite a growing accumulation of headwinds, equity markets continued to advance in the third quarter, posting modest but positive returns, particularly in North America. The results were less favourable for the Canadian fixed income universe, however, which declined as long-term bond yields reached new highs for the year. Meanwhile, gold and energy prices rose, reflecting an environment in which inflationary and geopolitical risks remain firmly entrenched.

From an economic perspective, a key theme was the persistence of tensions in the Middle East and the pressure they continue to exert on energy prices, particularly refined products such as gasoline and diesel. Although the global economy has remained resilient so far, the duration of the shock is becoming increasingly important. In the absence of a lasting easing of tensions, elevated energy costs risk keeping inflation above target and eventually triggering second-round effects across the consumer basket. Fragmentary information about the evolution of the conflict is adding another layer of uncertainty to an outlook that is already difficult to assess.

For the Federal Reserve and its new Chair, Kevin Warsh, this environment gradually made inaction untenable. The resilience of the labour market, combined with persistent inflation, ultimately prompted the central bank to raise its policy rate for the first time in three years, contributing to the rise in bond yields. Despite this monetary tightening, the earnings outlook remains solid, supported by a resilient economy and continued robust investment in technology.

Against this backdrop, our base-case scenario continues to anticipate economic growth close to potential, despite volatile commodity prices and uncomfortably high inflation. A more favourable outcome also remains possible if the tensions driving energy prices ease on a lasting basis, allowing inflationary pressures to subside more rapidly. However, the balance of risks remains tilted toward a temporary overheating scenario, in which persistent price pressures would force the Fed to tighten monetary conditions more aggressively. Such a development could ultimately weigh on economic growth and earnings, as well as on artificial intelligence-related investment. One thing is certain: from an investor’s perspective, the room for manoeuvre narrowed over the past quarter, which was marked by a simultaneous increase in interest rates and energy prices.

Against this backdrop, we reduced our overall risk exposure in September by taking profits on a portion of our equity overweight. The proceeds were reallocated to bonds, where yields to maturity are near their highest levels in two decades. Within equities, we ended a profitable, year-long overweight to Emerging Markets and increased our allocation to Canadian stocks. Canada’s greater exposure to commodities provides an attractive source of diversification in the current environment, while market dynamics also remain favourable.

Q4 2026	Key elements and investment implications
Goldilocks (10%)	• Contrary to general expectations, the surge in commodity prices subsides after tensions in the Middle East ease on a lasting basis. • 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 adopts a more dovish tone; markets anticipate that interest rates will remain at their current level. • Buoyed by technological momentum, earnings expectations continue to be revised upward. Equity valuations rise. • 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 (60%)	• Persistent tensions in the Middle East keep commodity prices volatile within a broad range, as information remains fragmented. • In the absence of a sustained decline in energy prices, inflation remains elevated, while second-round effects loom on the horizon. • With the labour market remaining resilient, the Federal Reserve opts for modest monetary tightening, raising interest rates slightly. • Despite the challenges, earnings prospects remain solid, supported by a resilient economy and robust AI investment. • The U.S. administration attempts to refocus 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 (30%)	• The absence of any easing in hostilities in the Middle East keeps pressure on energy prices. Inflation accelerates as price increases spread across the consumer basket. • Determined to curb inflation and convinced of the labour market's strength, the Fed opts for a significant tightening of monetary conditions. • Initially strong, economic growth expectations are rapidly revised downward as higher interest rates and energy costs take their combined toll. • A sharp pullback in capital spending by technology giants creates knock-on 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

CIO Office. Last update: September 23, 2026 (updated quarterly). Probabilities are subjective and can change without notice.

CIO Office
CIO-Office@nbc.ca

Martin Lefebvre
Chief Investment Officer
martin.lefebvre@nbc.ca

Louis Lajoie
Senior Director
Investment Strategy
louis.lajoie@nbc.ca

Simon-Carl Dunberry
Senior Director
Portfolio Strategy
simon-carl.dunberry@nbc.ca

Nicolas Charlton
Director
Quantitative Strategy
nicolas.charlton@nbc.ca

Mikhael Deutsch-Heng
Director
Investment Strategy
mikhael.deutschheng@nbc.ca

Zaid Shoufan
Associate
Portfolio Strategy
zaid.shoufan@nbc.ca

Julien Gordon
Analyst
Quantitative Strategy
julien.gordon@nbc.ca

General

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