

New year, new reality?

Global equities extended their winning streak in Q4, albeit with heightened volatility and more subdued returns compared to the robust gains seen during the summer months. Canadian equities outperformed once again, supported by strong performances from banks and gold miners. On the other hand, U.S. equity gains were more restrained as enthusiasm surrounding artificial intelligence cooled, with investors rotating toward more attractively valued laggards, notably in the Healthcare sector. In fixed income, the Canadian bond universe ended the quarter with slight losses, as yields climbed following a series of stronger-than-expected jobs data.

Turning to the macro backdrop, the current environment has become particularly challenging to navigate for U.S. policymakers. While inflation remains stubbornly above target because of tariffs, the labour market has weakened noticeably; job creation has slowed to a crawl, and the unemployment rate sits at its highest level since 2021. Complicating matters even further, the employment landscape is also shaped by structural forces such as tighter immigration policies, which constrain labour supply, and the growing adoption of artificial intelligence, which may already be dampening demand for workers.

Under these conditions, both North American central banks elected to proactively cut their benchmark rates, and the Federal Reserve is expected to further cut rates twice in 2026, gradually moving its policy stance to neutral. On the fiscal side, the positive impact of the One Big Beautiful Bill should start being felt more meaningfully at the start of the year through lower household tax burdens and incentives for added business investment.

Looking ahead, our base case scenario calls for continued economic growth in 2026, benefiting from both monetary easing and fiscal stimulus. However, risks remain two-sided. On the downside, a further deterioration of the labour market would prove problematic, particularly if the current “low hiring, low firing” dynamic shifts toward more meaningful layoffs. On the upside, stronger-than-expected productivity gains from AI-driven investment could bolster economic growth while also keeping inflationary pressures in check. However, with so much stimulus in the pipeline, any disappointment on the productivity front might reignite concerns about economic overheating. In any case, political uncertainty – driven by upcoming midterm elections in the U.S. and a leadership change at the Federal Reserve – should keep market volatility at a relatively elevated level throughout the year, much as it was during the final quarter of 2025.

Against this backdrop, we maintained our moderate risk-on stance through an overweight in equities relative to fixed income. Within equities, we decreased our allocation to the EAFE region and increased our allocation to the United States, the latter benefitting from a stronger track record and a more favourable outlook when it comes to earnings growth, which is going to be key next year. Finally, we remain overweight Canadian and Emerging Markets equities, reflecting strong relative momentum, positive earnings prospects, and sector compositions that are well-aligned with the current environment.

Q1 2026

Key elements and investment implications

Above-trend growth (25%)

- The U.S. labour market strengthens, consumptions surprises to the upside and inflation stagnates above 3%.
- The Fed is unable to deliver the expected rate cuts and instead keeps its monetary policy unchanged.
- In the United States, significant investments in AI continue, and productivity gains are beginning to materialize.
- Globally, fiscal expansion and less restrictive regulatory policies support economic growth.
- Trade tensions are easing, with a slight decline in the average effective tariff rate on U.S. imports.

Economic implications: Real GDP growth > 2.5%, stable unemployment rate around 4%

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

Sub-trend growth (60%)

- The U.S. job market remains sluggish, characterized by few hires and few layoffs.
- Inflation remains above target but avoids surprising to the upside, partly thanks to stable energy prices.
- The Fed gradually brings its monetary policy into natural territory with two additional 25bps rate cuts in 2026.
- The implementation of the Trump administration's fiscal plan provides an important counterbalance to tariffs, which remain stable.
- Thanks to favorable fiscal policy and the AI race, business investment spending continues to grow rapidly.

Economic implications: Real GDP growth near 2%, U.S. unemployment rate around 4.5%

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

Recession (15%)

- The US job market continues to deteriorate, with employment contracting and unemployment rising significantly.
- The Fed rapidly cuts its policy rate into accommodative territory.
- The hype surrounding artificial intelligence starts to fade, leading to a decline in capital spending by technology companies.
- With the midterm elections approaching, the Trump administration attempts to reverse the trend with a series of new measures, but the lack of predictability proves counterproductive.

Economic implications: Real GDP growth ~0%, U.S. unemployment rate above 5%

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

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General

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