

What to watch in the second half?

Highlights

- Despite the magnitude of challenges investors faced during the first half of the year, the picture for 2026 remains overwhelmingly positive. Clearly, equity markets were right to gradually price in a de-escalation scenario in the Strait of Hormuz. So, what should investors be watching for now?
- After reaching its highest level in three years, inflation is now expected by markets to slow markedly over the coming year. If the decline in energy prices is sustained, tariffs remain broadly stable — or even ease — and labour market conditions remain balanced, there are grounds to be reasonably optimistic.
- Of course, moderate rate hikes by the Federal Reserve would also help contain inflation. However, while this is currently the market's expectation, it should not be taken as a foregone conclusion.
- That said, the key question for markets is becoming less purely economic and increasingly thematic, particularly in the context of AI investments. So, where are we in the technology cycle? Based on productivity data and activity in the initial public offering (IPO) market, it still seems too early to blow the final whistle.
- Against this backdrop, we increased our equity allocation for a third consecutive month at the end of June. Within equities, we took partial profits in Emerging Markets and reallocated them to EAFE equities to better manage concentration risk. Finally, we take a closer look at the remarkable outperformance of Canada's banking sector which, despite its unmatched long-term track record, may have run a little too far in the short term.

Global Asset Allocation Views

Asset Classes	-	N	+
Equities	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Fixed Income	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Cash	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Alternatives	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Fixed Income			
Government	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Credit	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Duration	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Equities			
Canada	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
United States	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
EAFE	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Emerging Markets	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Alternatives & FX			
Gold	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Uncorrelated Strategies	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Canadian Dollar	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

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Bottom line

Easing tensions in global energy markets have improved the outlook for the second half of the year. Overall, the macroeconomic backdrop continues to favour Equities over Fixed Income, while calling for heightened vigilance with respect to inflation, the Federal Reserve and, above all, capital investments in artificial intelligence.



Market review

Fixed Income

→ The Canadian fixed-income universe posted gains in June, as the normalization of energy prices pushed down inflation expectations and caused bond yields to decline.

Equities

→ Equity volatility picked up a notch in June, with particularly sharp daily swings in the market segments that have been the hottest performers this year. This trend resulted in monthly underperformance by Emerging Markets and U.S. stocks, particularly in the technology sectors. Nevertheless, global equities ended the second quarter with substantial gains over the period, with Emerging Markets leading the way.

→ In Canada, gold miners, energy, and technology stocks posted losses, but the S&P/TSX managed to remain in positive territory thanks to the spectacular performance of the financial sector, which rose by 26% over the quarter.

FX & Commodities

→ Oil prices fell in June following the signing of an agreement between the United States and Iran allowing maritime traffic to gradually resume in the Persian Gulf.

→ The U.S. dollar appreciated sharply in June amid a significant upward recalibration of expectations regarding the Federal Reserve's rate path this year. The Greenback's appreciation was particularly strong against the Canadian dollar, rising by nearly 3% over the month.

Market Total Returns

Asset Classes	June	Q2	YTD
Cash (S&P Canada T-bill)	0.2%	0.6%	1.2%
Bonds (ICE Canada Universe)	0.5%	1.9%	2.2%
Short Term	0.3%	1.1%	1.4%
Mid Term	0.6%	1.8%	2.3%
Long Term	0.4%	3.3%	3.4%
Federal Government	0.5%	1.4%	1.8%
Corporate	0.3%	2.0%	2.2%
U.S. Treasuries (US\$)	0.3%	0.3%	0.4%
U.S. Corporate (US\$)	0.2%	1.4%	1.0%
U.S. High Yield (US\$)	0.3%	2.5%	1.9%
Canadian Equities (S&P/TSX)	0.5%	7.0%	11.2%
Communication Services	-9.9%	-10.0%	-4.8%
Consumer Discretionary	2.3%	8.9%	4.6%
Consumer Staples	8.0%	5.7%	9.0%
Energy	-4.1%	-5.0%	23.6%
Financials	8.8%	25.6%	23.2%
Health Care	6.0%	14.0%	8.9%
Industrials	3.1%	10.6%	10.3%
Information Technology	-1.6%	6.4%	-17.6%
Materials	-12.1%	-11.5%	-2.1%
Real Estate	3.1%	8.4%	3.8%
Utilities	2.1%	5.9%	17.8%
S&P/TSX Small Caps	-4.0%	5.9%	18.0%
U.S. Equities (S&P 500 US\$)	-1.0%	15.2%	10.2%
Communication Services	-7.8%	8.3%	0.8%
Consumer Discretionary	-4.7%	9.3%	-0.8%
Consumer Staples	0.5%	0.3%	8.0%
Energy	-5.1%	-13.4%	19.7%
Financials	4.4%	9.0%	-1.2%
Health Care	6.6%	8.8%	3.5%
Industrials	7.3%	14.9%	20.2%
Information Technology	-3.3%	31.8%	19.8%
Materials	0.0%	2.0%	12.0%
Real Estate	0.8%	8.5%	11.5%
Utilities	2.7%	-0.5%	7.7%
Russell 2000 (US\$)	3.7%	21.5%	22.6%
World Equities (MSCI ACWI US\$)	-0.8%	15.1%	11.5%
MSCI EAFE (US\$)	0.1%	11.1%	9.8%
MSCI Emerging Markets (US\$)	-1.4%	24.1%	24.0%
Commodities (GSCI US\$)	-9.9%	-11.4%	24.1%
WTI Oil (US\$/barrel)	-22.6%	-31.4%	23.2%
Gold (US\$/oz)	-12.1%	-12.7%	-6.7%
Copper (US\$/tonne)	-1.1%	8.9%	7.2%
Forex (US\$ Index DXY)	2.3%	1.2%	2.9%
USD per EUR	-2.0%	-0.8%	-2.7%
CAD per USD	2.9%	2.0%	3.4%

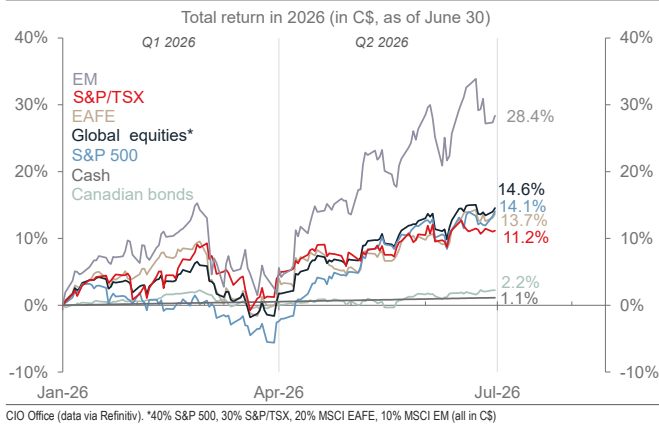
CIO Office (data via Refinitiv, as of 2026-06-30)



Half-time review

Despite the magnitude of challenges investors faced during the first half of the year, the picture for 2026 remains overwhelmingly positive. Equity markets have posted solid gains — particularly in emerging economies — while bond markets have delivered returns broadly in line with their yields to maturity (**Chart 1**).

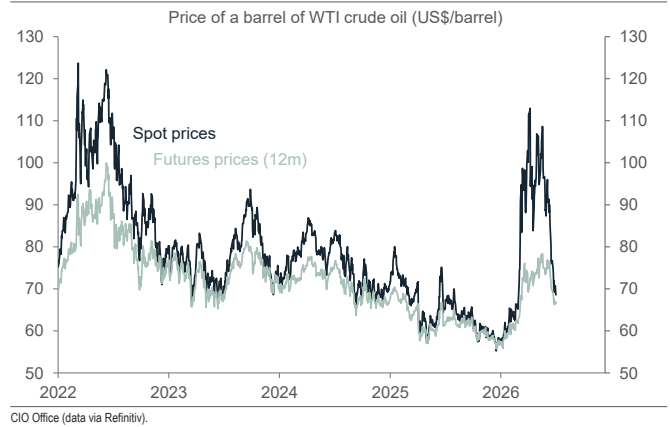
1 | A positive first half of the year, despite everything!



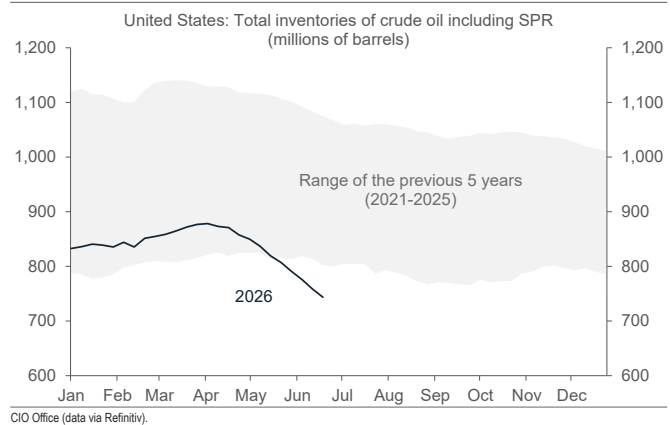
Few observers would have predicted such an outcome in the immediate aftermath of the closure of the Strait of Hormuz, the world's most important oil-shipping chokepoint. Yet recent weeks have confirmed that equity markets were right to gradually price in a de-escalation scenario, as spot prices converged with futures prices following the signing of an agreement between Iran and the U.S. in June (**Chart 2**).

While several indicators pointed to such an outcome¹, the current equilibrium remains fragile whether because of low global oil inventories (**Chart 3**) or, more fundamentally, the inherent incompatibility between the Trump administration's maximum pressure and Iran's maximum patience strategies.

2 | The worst was avoided on the energy front...



3 | ... although the situation remains fragile



Nevertheless, beyond the rhetoric and occasional ceasefire violations, all parties face significant constraints, making a renewed, prolonged closure of the Strait of Hormuz unlikely.

So, with the Iranian issue seemingly set to fade from investors' primary concerns, what should markets be watching this summer? That is the question we explore in this month's edition.

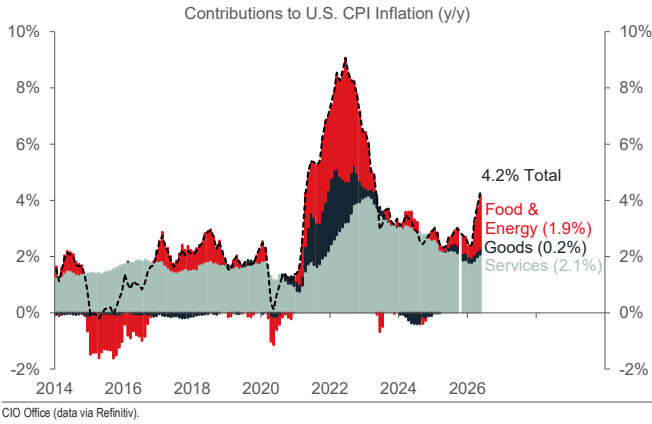
¹ See our previous two monthly reports ([May](#) and [June](#)), in which we returned to an overweight position in equities as the probability of the more severe scenarios for the global economy declined.



What to watch in the second half?

After spending five years above the Federal Reserve's target, inflation rose to its highest level in three years in May — a development that was, to say the least, far from ideal (**Chart 4**).

4 | Inflation is at its highest level in three years...



Fortunately, provided energy prices remain at current levels, their sharp decline all but guarantees a moderation in year-over-year inflation in the coming months. Indeed, much as occurred following last year's tariff de-escalation, market-based inflation expectations reversed sharply following the reopening of the Strait of Hormuz (**Chart 5**).

5 | ... but moderation is expected

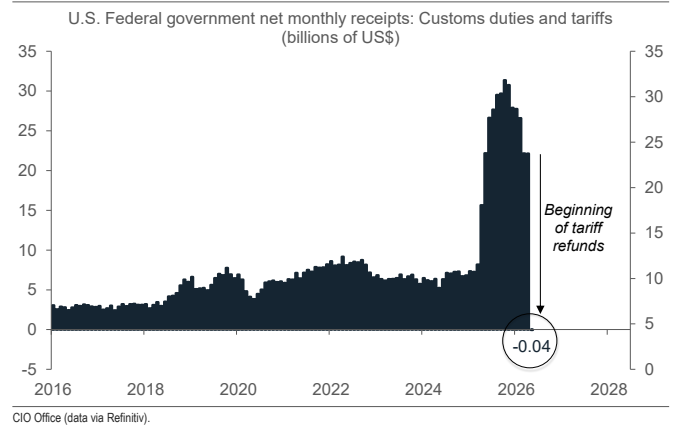


Whether those expectations ultimately prove correct remains to be seen. However, beyond lower energy

prices, several other factors support a relatively constructive inflation outlook.

For instance, while U.S. tariffs could continue to fluctuate over the summer, the likelihood of a meaningful increase ahead of the midterm elections appears limited. Moreover, refunds associated with the reciprocal tariffs that were struck down by the Supreme Court last February, for now — and likely for several more months — are offsetting the cost of the tariffs that remain in place (**Chart 6**). In principle, this could encourage some businesses to postpone or even cancel planned price increases.

6 | Tariffs collected = tariffs refunded



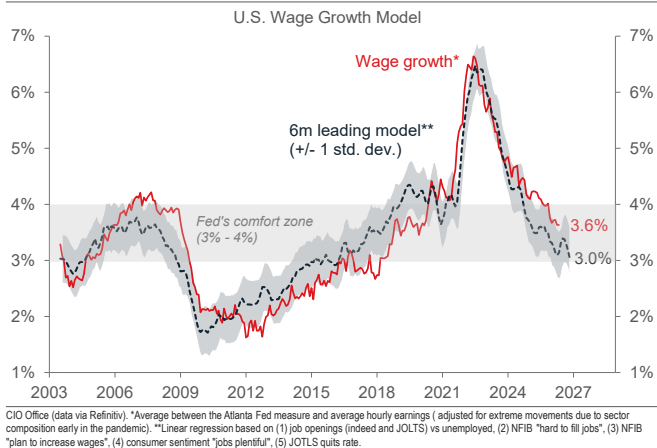
The labour market also bears close watching. For the time being, however, we continue to see no evidence of wage pressures that would jeopardize the prospect of lower inflation (**Chart 7**, next page).

Finally, let's not forget U.S. monetary policy, with markets currently pricing in almost two rate hikes by year-end (**Chart 8**, next page), while assigning a ~20% probability to an initial hike as early as July.

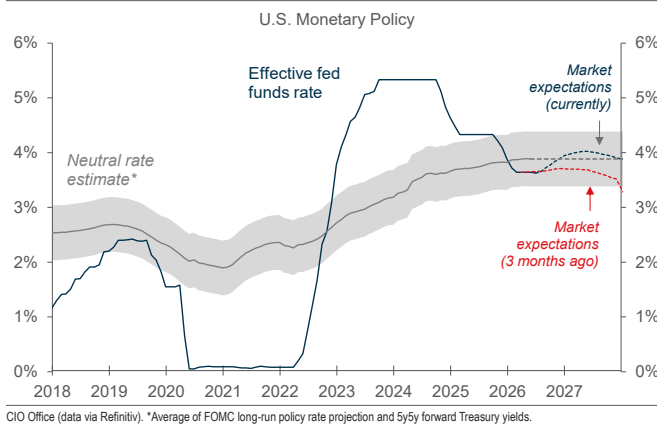
Indeed, a moderate tightening of monetary policy would indeed help contain inflationary pressures — a possibility that the Federal Reserve's new Chair, Kevin Warsh, has not explicitly ruled out consistent with his preference for limited forward guidance.



7 | Wage growth remains moderate



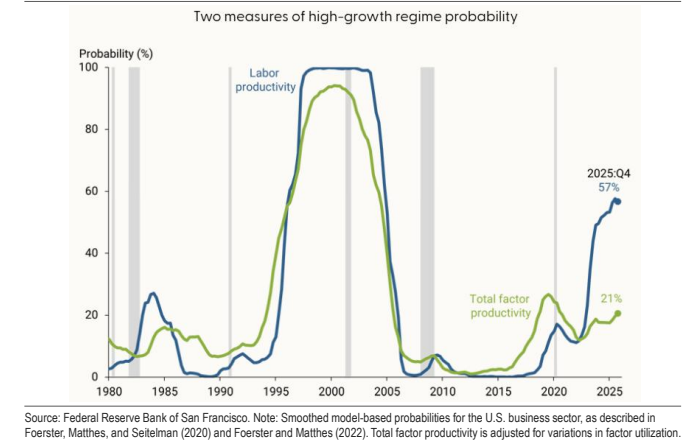
8 | The Fed funds rate could edge higher...



side, proponents are often accused of engaging in wishful thinking; on the other, skeptics are sometimes criticized for potentially relying on outdated analytical frameworks.

What is clear, however, is that an objective analysis of the productivity data — particularly that presented in a recent study by the Federal Reserve Bank of San Francisco² — highlights similarities with the late 1990s, when a sustained cycle of productivity gains was just getting started (**Chart 9**).

9 | ... but let's not forget productivity...



Looking further ahead, massive investments in technology infrastructure, software, and research and development suggest that productivity growth is likely to remain on an upward trajectory over the coming years (**Chart 10**, next page).

Still, we are certainly not immune to disappointments. For equity markets, this is arguably the single most important issue today, given the scale of investment being undertaken by a handful of technology giants (**Chart 11**, next page) which underpin a large share of the artificial intelligence value chain.

That said, such an outcome should neither be interpreted as an inherently negative signal for markets concerned about inflation... nor as a foregone conclusion.

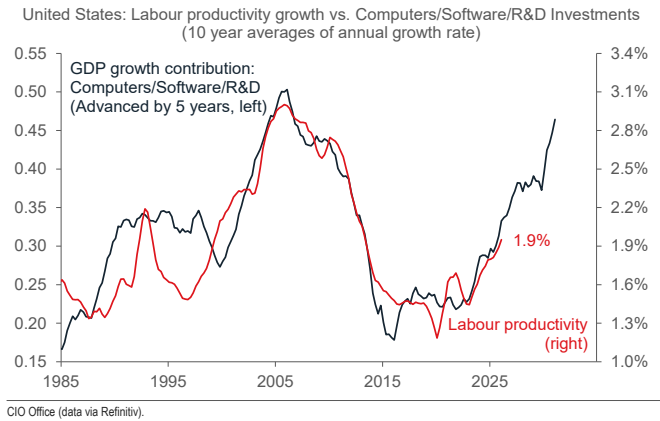
Specifically, one factor that should not be underestimated in the current environment is the potential acceleration in productivity growth. In theory, stronger productivity would allow the economy to sustain robust growth while limiting inflationary pressures, all else being equal.

This possibility has sparked a particularly lively debate within the economics profession. On one

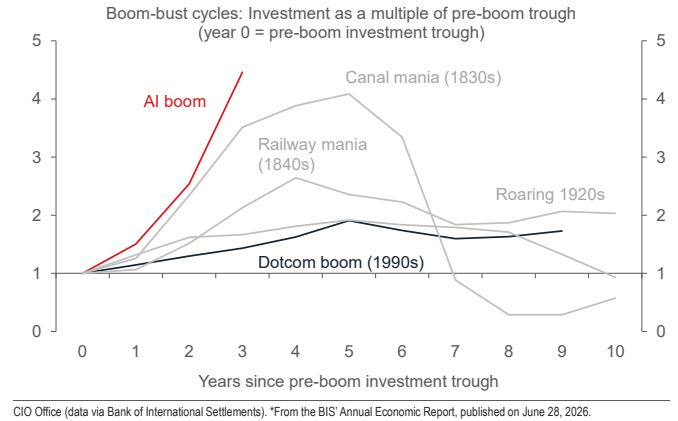
² [Have We Entered an Era of High Productivity Growth?, FRBSF, May 26 2026.](#)



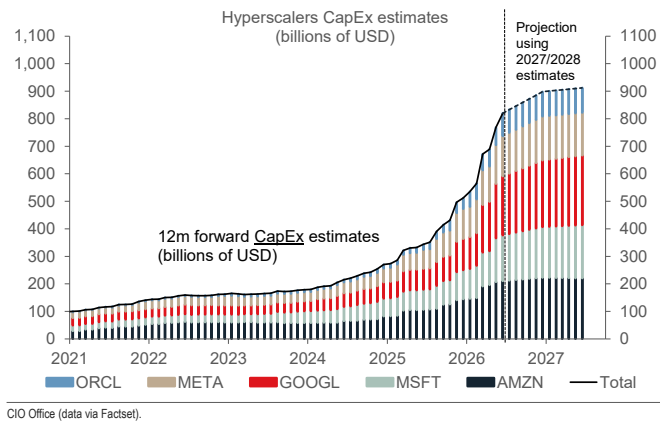
10 | ... which is clearly benefiting from strong tailwinds



12 | ... which is unlikely to last forever

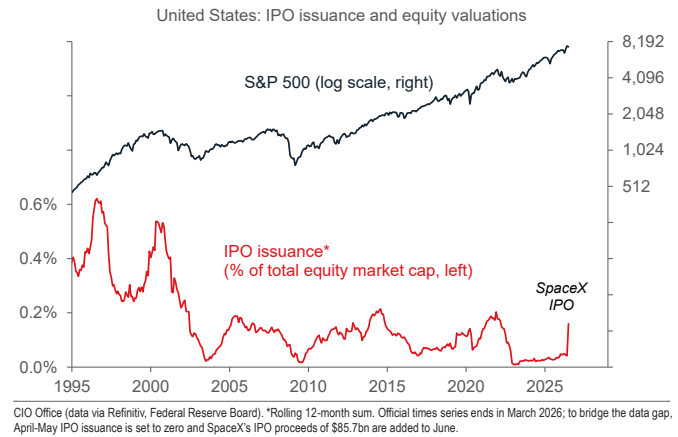


11 | Keep an eye on the AI investment wave...



listing, has reminded many investors of the final stages of the technology bubble in the early 2000s. Yet, when viewed in historical perspective, the data suggest that here also, while vigilance remains warranted, it may still be too early to blow the final whistle (**Chart 13**).

13 | Too early to worry?



History also offers a note of caution. If the experience of major technological innovations over the past two centuries is any guide, there is a strong likelihood that we will eventually reach a point of overinvestment (**Chart 12**), at which markets will need to reassess their optimism.³

Nevertheless, timing is everything. In our view, just as it is too early to conclude with confidence that a sustained productivity boom has either emerged or failed to materialize, it is also too early to conclude that market optimism has become excessive.

Admittedly, the recent wave of initial public offerings (IPOs), sparked by SpaceX's blockbuster June

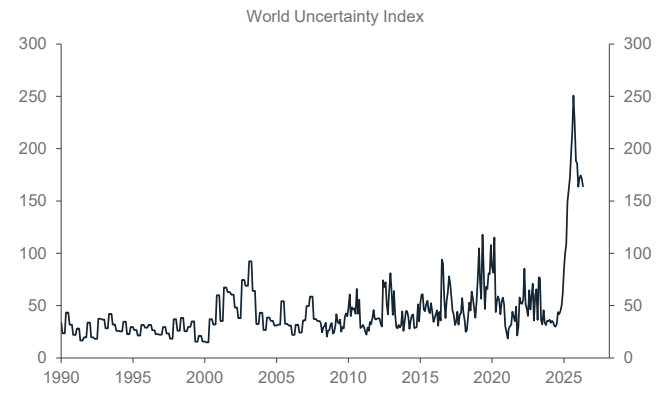
³ AI 'exuberance' risks ending in lengthy investment bust, BIS warns, Financial times, June 28 2026.



The bottom line for investors

Although we continue to navigate a period of considerable uncertainty (**Chart 14**), easing tensions in global energy markets have improved the outlook for the second half of the year.

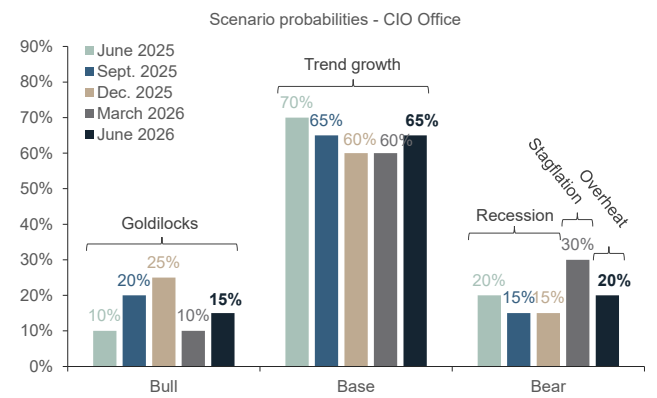
14 | Uncertainty remains widespread...



CIO Office (data via <https://worlduncertaintyindex.com/>).

Our base case therefore continues to call for economic growth to remain close to potential. The downside scenario, however, has evolved: the dominant risk is no longer stagflation, but rather an overheating economy — an outcome whose implications for equity markets would likely be more limited (**Chart 15**).

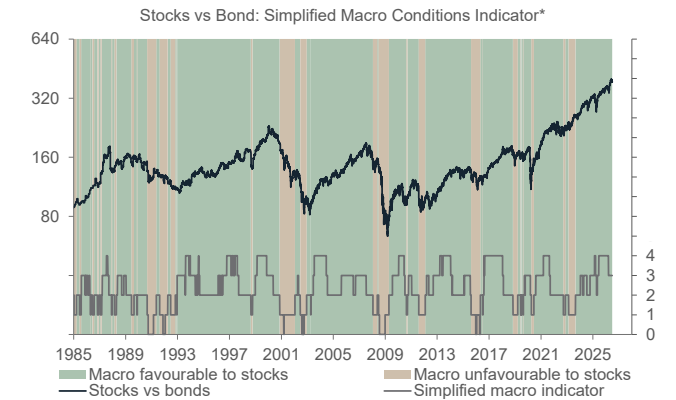
15 | ... but the balance of risks appears favorable...



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Overall, this macroeconomic backdrop remains supportive of equities relative to fixed income (**Chart 16**). Accordingly, we continued to gradually

16 | ... for equities relative to bonds

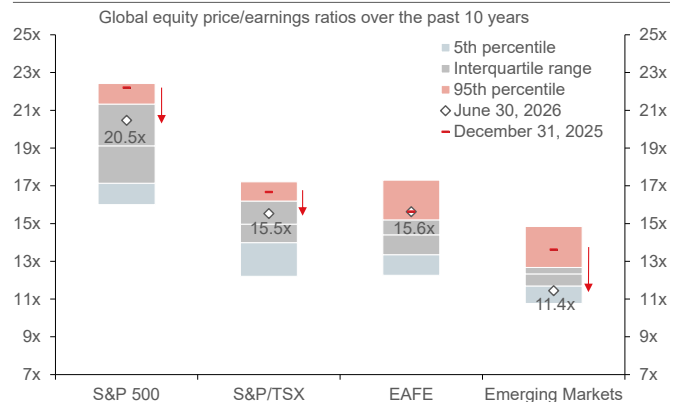


CIO Office (data via Refinitiv). The indicator measures 4 conditions: (1) 12m fwd earnings positive, (2) broad-based global growth, (3) large majority of central banks accommodative, (4) equities positive relative momentum vs bonds.

increase our equity allocation at the end of June for a third — and likely final — consecutive month.

Indeed, despite strong market performance, equity valuations remain below where they stood six months ago (**Chart 17**), while our market sentiment indicator continues to show no signs of excessive optimism (**Chart 18**, next page).

17 | Price-to-earnings ratios have declined this year

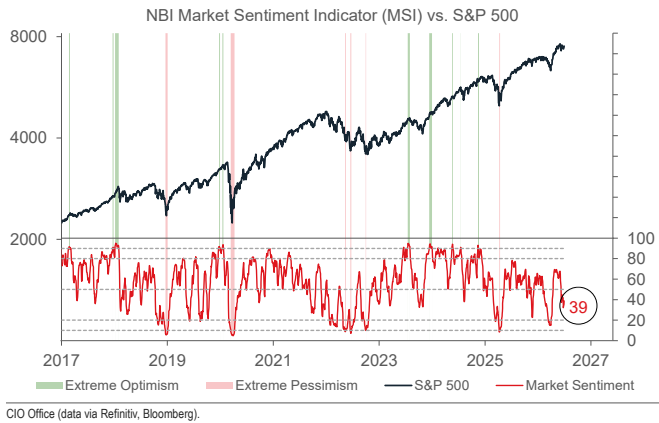


CIO Office (data via Refinitiv).

Within equities, we continue to overweight both Emerging Markets and the United States — the two regions where the technology-driven growth theme is most evident (**Chart 19**, next page). That said, to manage concentration risk, we took some profits in Emerging Markets and reallocated the proceeds to EAFE equities.

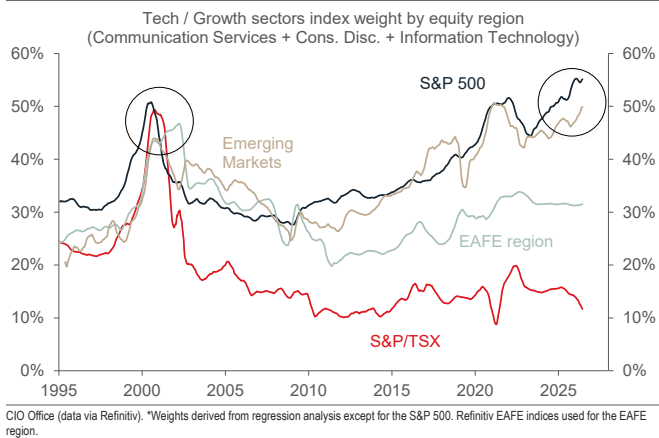


18 | Investor optimism remains measured

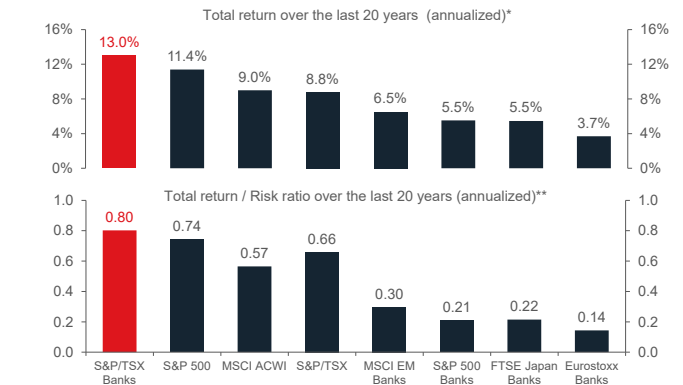


From a long-term investment perspective, this performance underscores the strength of Canada's banking sector. Over the past two decades, the six largest Canadian banks have not only outperformed their major global banking peers by a wide margin, but also the broader global equity market — including the S&P 500 (**Chart 21**).

19 | This time, the tech trade is mostly in the US and EM



21 | Canadian banks are long-standing leaders

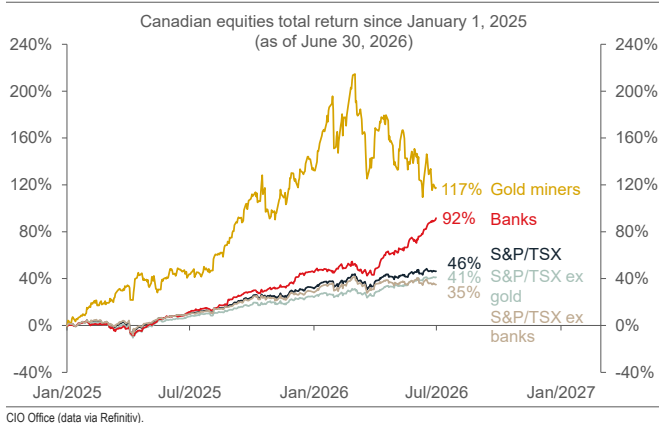


Yet, over the shorter term, the factors behind such an exceptional rally are less obvious. Is it a reflection of more growth-enhancing economic policies — particularly in the energy sector — coming out of Ottawa? Efficiency gains pointing to a sustained improvement in sector-wide return on equity? Stronger capital markets activity? Or simply an influx of investors chasing the market's latest momentum trade?

It's probably a combination of all of the above. Regardless, it is difficult to escape the conclusion that this rally appears vulnerable in the near term, with valuations having reached their highest levels since 2008 in remarkably short order (**Chart 22**, next page). We therefore believe it is prudent to take profits on part of our overweight position in the banking sector across the relevant mandates, much as we did last December when we fully unwound our overweight position in gold mining companies.

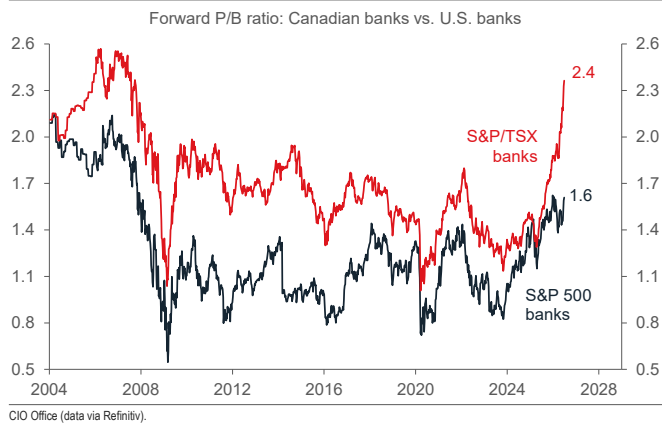
As for Canadian equities, after a 2025 largely driven by gold mining companies, banks appear to have taken the lead in 2026, posting a remarkable return of 32% year to date (92% since January 1, 2025; **Chart 20**).

20 | Canada: banks outshine gold in 2026



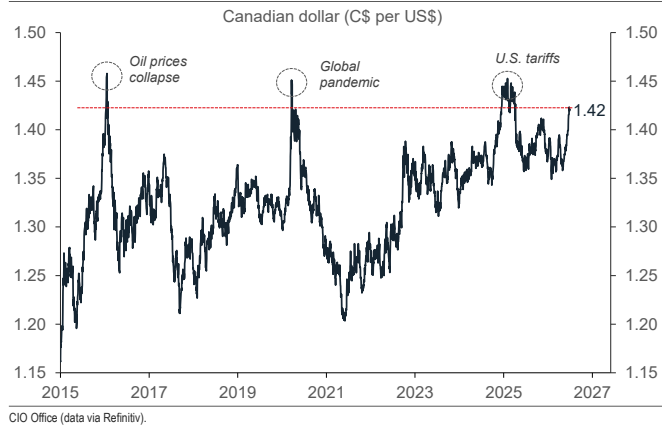


22 | Have expectations become too high?



Finally, the Canadian dollar has also moved sharply in recent weeks — but this time to its detriment against the U.S. dollar. Uncertainty surrounding the renegotiation of CUSMA together with the prospect of further U.S. interest rate hikes has undoubtedly played a major role. At current levels, however, we believe the balance of risks has become more favourable for the Canadian dollar over the medium term (**Chart 23**).

23 | How low (high) can the CAD (USD) go?



In this regard, our economics colleagues’ base case calls for a gradual appreciation of the Canadian dollar, with USD/CAD reaching 1.33 by the end of the first quarter of 2027.⁴

⁴ NBF Economics and Strategy, Forex, June 2026



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