NATIONAL BANK INVESTMENTS

Asset Allocation Strategy

CIO Office | September 2026

Three reasons to worry – or not?

Highlights

- After a rather cloudy July, most equity markets rebounded in August. With economic growth holding firm, inflation proving less concerning than expected, the labour market close to balance, and corporate profits at record highs, it is not hard to see why.
- So, why worry? For several reasons, actually. This month, we examine three of them: artificial intelligence (AI), debt and wars.
- Turning to the AI investment cycle, the latest corporate results suggest that fundamentals remain solid. Admittedly, some factors are temporarily boosting the magnitude of profits, but judging by relatively moderate equity valuations, investors do not appear to be entirely irrational.
- Meanwhile, while total U.S. economy-wide debt — government, households, and businesses — as a share of GDP stands near a 20-year low, it is obviously the trajectory of public finances that remains the main concern. Yet, the most likely consequence is not necessarily a sovereign debt crisis, but rather a continued rise in the risk premium demanded by investors, compounded by uncertainty surrounding the Federal Reserve's next moves.
- Finally, on top of a lingering U.S.–Iran conflict and a Russia–Ukraine war that threatens to intensify, hopes for an easing of the Canada–U.S. trade war collapsed in August. What comes next remains uncertain, but one thing is clear: the U.S. president's room to "wage war" is not getting any wider.

Global Asset Allocation Views

Asset Classes	-		N		+
Equities				■	
Fixed Income		■			
Cash			■		
Alternatives				■	
Fixed Income					
Government		■			
Credit				■	
Duration			■		
Equities					
Canada			■		
United States				■	
EAFE		■			
Emerging Markets				■	
Alternatives & FX					
Gold			■		
Uncorrelated Strategies				■	
Canadian Dollar			■		

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Bottom line

Overall, the past few months have unfolded largely in line with our base-case scenario, and the fundamentals underpinning the bull market remain firmly in place. Still, close attention to risks remains warranted as we enter a potentially more volatile period, notably in the run-up to the U.S. midterm elections.

Market review

Fixed Income

- The Canadian fixed-income universe ended August slightly lower amid growing concerns over government debt levels and central bank credibility, particularly in the United States.
- U.S. corporate bonds performed better, benefitting from their shorter duration and higher yields to maturity.

Equities

- After a more turbulent July, equity markets resumed their upward trend in August, supported by a spectacular earnings season around the world. Against this backdrop, all four equity regions posted fairly similar monthly gains, while Emerging Markets maintained their position at the top of the leaderboard for 2026 as a whole.
- In Canada, gold miners and technology stocks strongly outperformed the S&P/TSX, while the Financials posted a rare decline.

FX & Commodities

- Oil prices ended the month relatively unchanged, despite all the developments surrounding the conflict between the United States and Iran. Gold, however, posted significant gains amid geopolitical tensions and central bank purchases.
- The Canadian dollar appreciated against the U.S. dollar despite ongoing trade tensions between Canada and the United States, helped among other things by elevated commodity prices.

Market Total Returns

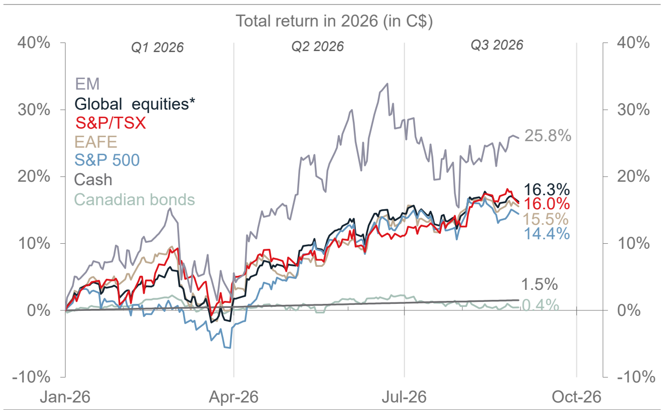
Asset Classes	August	YTD	12M
Cash (S&P Canada T-bill)	**0.2%**	**1.6%**	**2.5%**
Bonds (ICE Canada Universe)	**-0.3%**	**0.3%**	**1.8%**
Short Term	0.1%	1.1%	2.2%
Mid Term	-0.2%	0.6%	1.9%
Long Term	-0.9%	-1.4%	0.7%
Federal Government	-0.2%	0.3%	1.3%
Corporate	-0.2%	0.7%	2.6%
U.S. Treasuries (US$)	0.3%	-0.4%	1.2%
U.S. Corporate (US$)	0.4%	-0.2%	2.0%
U.S. High Yield (US$)	1.0%	2.6%	4.8%
Canadian Equities (S&P/TSX)	**3.1%**	**16.0%**	**29.9%**
Communication Services	4.0%	-4.3%	-7.6%
Consumer Discretionary	-4.2%	1.4%	13.5%
Consumer Staples	-6.9%	3.0%	10.2%
Energy	0.3%	32.5%	42.4%
Financials	-2.9%	20.8%	39.6%
Health Care	-7.0%	3.7%	8.3%
Industrials	-2.5%	8.1%	5.7%
Information Technology	12.9%	-6.0%	-1.4%
Materials	25.8%	19.4%	58.8%
Real Estate	-4.6%	-0.6%	-7.6%
Utilities	-5.6%	12.1%	18.7%
S&P/TSX Small Caps	6.8%	23.0%	47.7%
U.S. Equities (S&P 500 US$)	**2.7%**	**13.1%**	**20.4%**
Communication Services	-1.2%	0.1%	13.4%
Consumer Discretionary	0.0%	0.0%	3.9%
Consumer Staples	-0.7%	9.6%	7.9%
Energy	7.0%	44.2%	45.8%
Financials	1.3%	6.3%	8.6%
Health Care	4.9%	11.1%	26.3%
Industrials	-2.6%	13.6%	16.8%
Information Technology	6.2%	22.9%	33.7%
Materials	6.0%	16.7%	15.5%
Real Estate	-1.9%	12.2%	9.5%
Utilities	-4.8%	0.3%	3.0%
Russell 2000 (US$)	1.0%	20.0%	26.5%
World Equities (MSCI ACWI US$)	**2.7%**	**14.6%**	**22.8%**
MSCI EAFE (US$)	2.0%	14.2%	22.2%
MSCI Emerging Markets (US$)	3.4%	24.4%	39.7%
Commodities (GSCI US$)	**6.1%**	**48.1%**	**50.6%**
WTI Oil (US$/barrel)	1.0%	52.0%	35.2%
Gold (US$/oz)	9.6%	2.6%	28.9%
Copper (US$/tonne)	4.4%	16.0%	47.1%
Forex (US$ Index DXY)	**-0.5%**	**1.1%**	**1.7%**
USD per EUR	1.0%	-1.1%	-0.8%
CAD per USD	-1.2%	0.9%	0.8%

CIO Office (data via Refinitiv, as of 2026-08-31)

Three reasons to worry – or not?

After a rather cloudy July, summer ended on a positive note for investors. Most equity markets posted gains in August, further consolidating their clear lead over fixed-income securities (**Chart 1**).

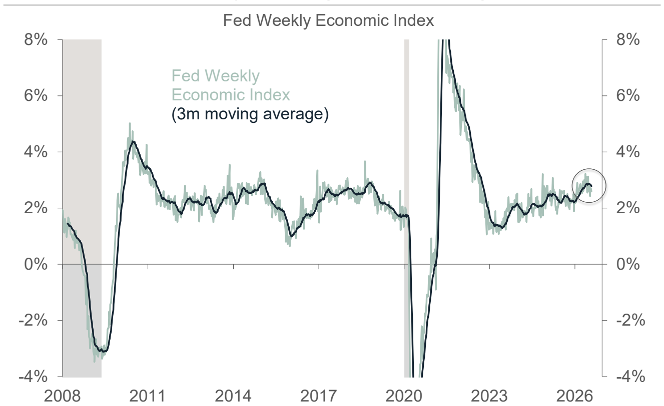
1 | Equity markets consolidate their gains…



CIO Office (data via Refinitiv). *40% S&P 500, 30% S&P/TSX, 20% MSCI EAFE, 10% MSCI EM (all in C$)

Taking a step back, it is easy to see why. For one, economic growth remains solid, with U.S. real GDP expanding at a cruising speed of close to 3% according to the Federal Reserve's weekly index (**Chart 2**).

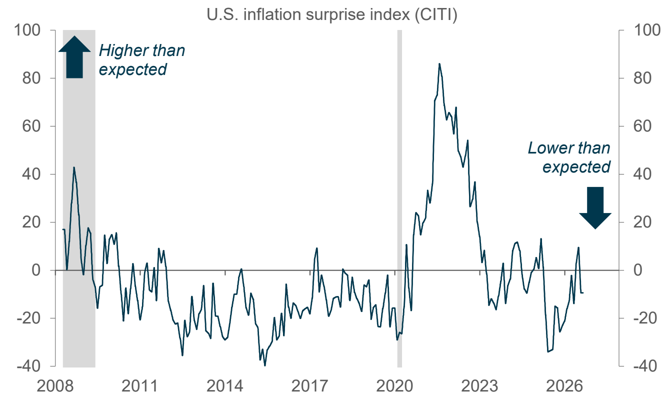
2 | … supported by strong economic growth…



CIO Office (data via Refinitiv).

Meanwhile, inflation, while still far from ideal, has delivered relatively few negative surprises lately (**Chart 3**) against a backdrop in which wage growth remains close to levels consistent with price stability

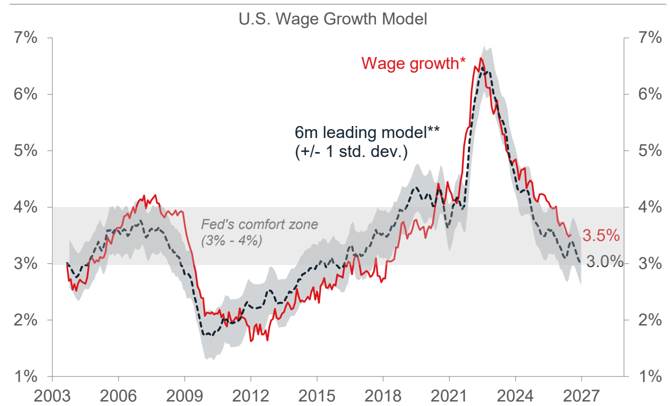
3 | … inflation surprises near zero…



CIO Office (data via Refinitiv).

— a sign that the labour market remains broadly balanced (**Chart 4**).

4 | … a balanced labour market…

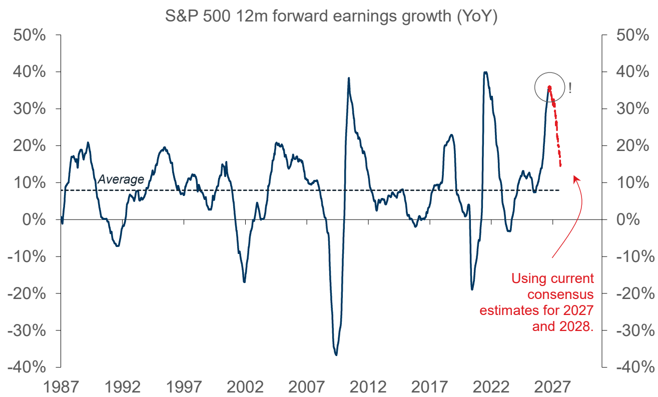


CIO Office (data via Refinitiv). *Average between the Atlanta Fed measure and average hourly earnings (adjusted for extreme movements due to sector composition early in the pandemic). **Linear regression based on (1) job openings (indeed and JOLTS) vs unemployed, (2) NFIB "hard to fill jobs", (3) NFIB "plan to increase wages", (4) consumer sentiment "jobs plentiful", (5) JOTLS quits rate.

Finally, corporate profits remain excellent, with expected S&P 500 earnings up nearly 38% over the past year—a performance without precedent when excluding the rebounds that followed the financial crisis and the pandemic. And while this pace of growth will inevitably slow over the coming year, expectations still point to a significant increase above the historical average (**Chart 5**, next page)

So, why worry? For several reasons, as it turns out. Let's take a quick look at three key risk factors to watch for financial markets over the coming months: artificial intelligence (AI), debt, and wars.

5 | … and record earnings

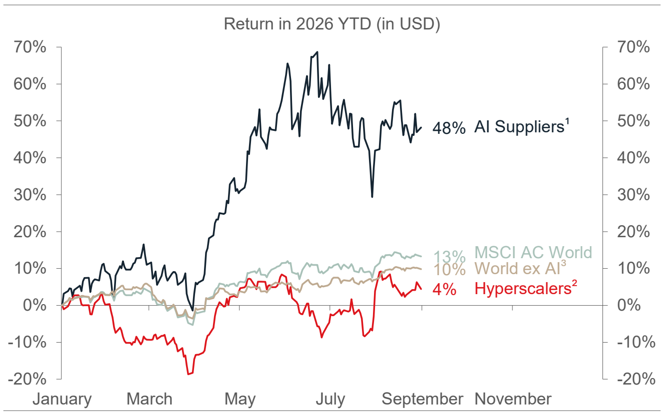


CIO Office (data via Refinitiv).

#1: AI

At the outset, it is worth noting that while several AI-related stocks pulled back over the summer, other segments of the market stepped in to take the lead (**Chart 6**). In our view, this is both a sign of resilience in the bull market and a reminder never to underestimate the importance of diversification.

6 | AI takes a breather, markets move forward

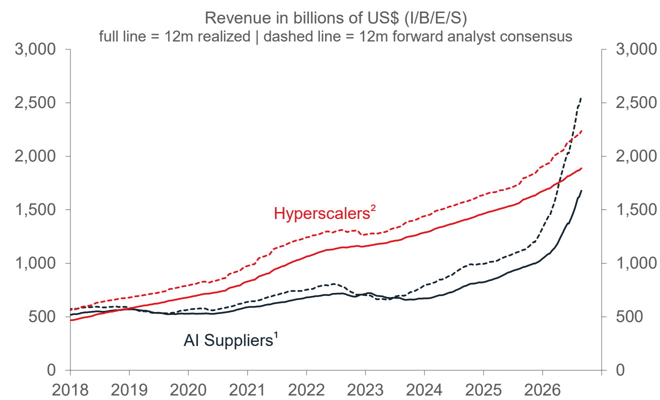


CIO Office (data via Refinitiv). 1. AI Suppliers = Nvidia, AMD, Broadcom, Marvell, Intel, ARM, TSMC, Samsung, SK Hynix, Micron, ASML, AMAT, LAM, KLA, Dell, Arista, Vertiv. 2. Hyperscalers = Microsoft, Amazon, Alphabet, Meta, Oracle. 3. Proxy using S&P Global BMI market cap.

That said, a full-blown collapse in the technology investment cycle would inevitably spill over to the broader equity market. Fortunately, the latest earnings season proved rather reassuring from a fundamental standpoint.

On the revenue side, both hyperscalers (those “buying” AI infrastructure) and AI suppliers (those “selling” AI infrastructure) continue to see actual revenues as well as projected revenues climb (**Chart 7**).

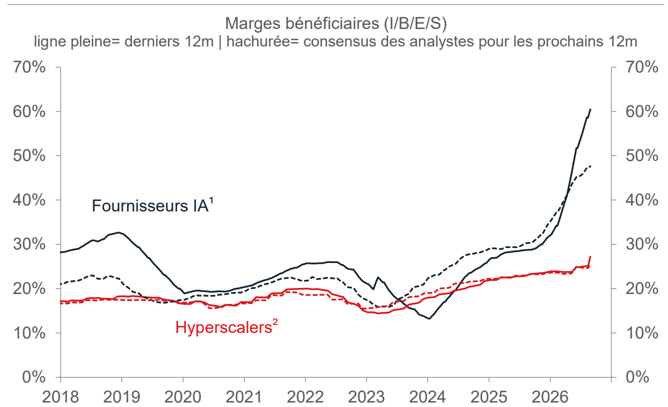
7 | Revenue growth remains strong…



CIO Office (data via Refinitiv). 4-week moving average. 1. AI Suppliers = Nvidia, AMD, Broadcom, Marvell, Intel, ARM, TSMC, Samsung, SK Hynix, Micron, ASML, AMAT, LAM, KLA, Dell, Arista, Vertiv. 2. Hyperscalers = Microsoft, Amazon, Alphabet, Meta, Oracle.

The trend is similarly strong on the margin front, where exceptionally high margins among AI suppliers continue to reflect a persistent imbalance between supply and demand (**Chart 8**). And judging by hyperscalers’ investment plans — which continue to be revised higher (**Chart 9**, next page) — demand still looks set to remain strong.

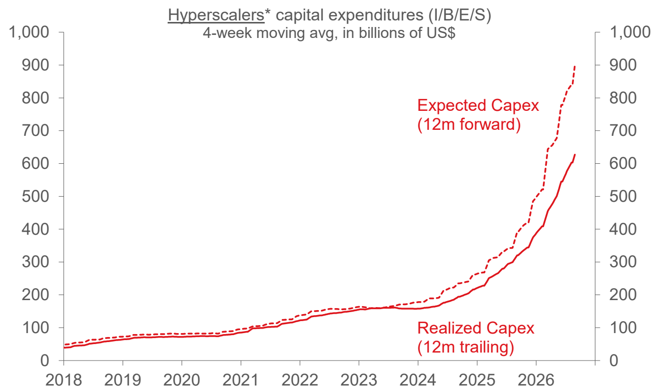
8 | … as do profit margins…



CIO Office (data via Refinitiv). 4-week moving average. 1. AI Suppliers = Nvidia, AMD, Broadcom, Marvell, Intel, ARM, TSMC, Samsung, SK Hynix, Micron, ASML, AMAT, LAM, KLA, Dell, Arista, Vertiv. 2. Hyperscalers = Microsoft, Amazon, Alphabet, Meta, Oracle.

That said, even if these trends do persist over the next year, such growth rates clearly cannot be extrapolated indefinitely. Eventually, the bottleneck

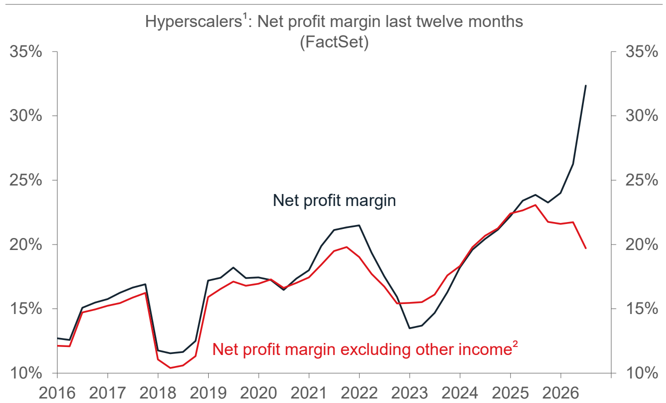
9 | … and capital investment



CIO Office (data via Refinitiv). *Hyperscalers = Microsoft, Amazon, Alphabet, Meta, Oracle.

in technology infrastructure will ease. And for hyperscalers, a meaningful share of the increase in profit margins — which now stand at record highs — has not come from improved performance in their core operations. Rather, the increase is from a sharp rise in “other income,” largely reflecting estimated changes in the market value of their investments in private companies such as OpenAI and Anthropic (**Chart 10**).

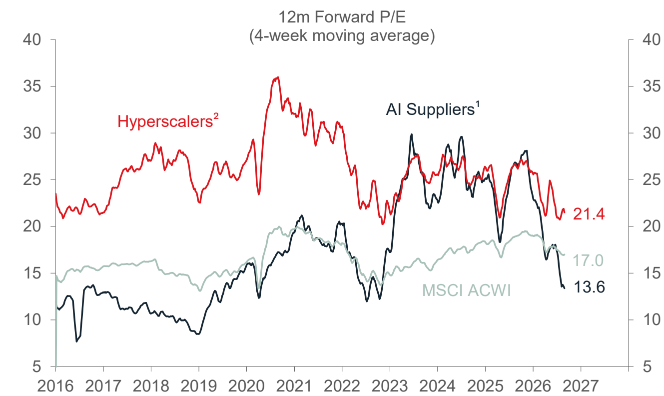
10 | Important caveats apply…



CIO Office (data via FactSet). 1. Microsoft, Amazon, Alphabet, Meta, Oracle. 2. Other income = Unrealized valuation gain/loss on investments and other miscellaneous income.

Fortunately, looking at equity valuations, markets do not appear to be under any illusions about the extent to which these profits can be sustained. Indeed, the price that investors are willing to pay for a dollar of expected earnings over the next year is now at its lowest in three years for AI suppliers, and at its lowest in at least a decade for hyperscalers (**Chart 11**).

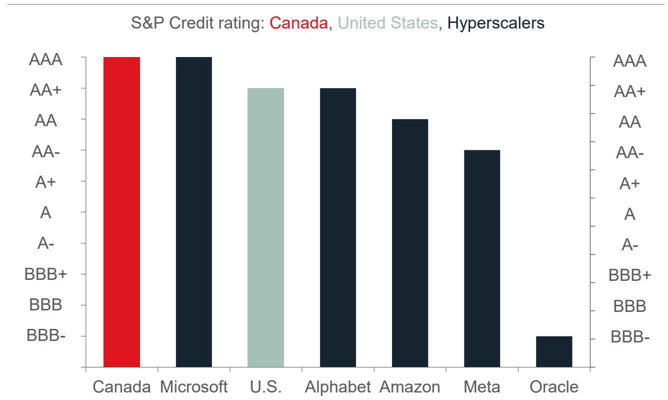
11 | … but markets do not appear exuberant



CIO Office (data via Refinitiv). 1. AI Suppliers = Nvidia, AMD, Broadcom, Marvell, Intel, ARM, TSMC, Samsung, SK Hynix, Micron, ASML, AMAT, LAM, KLA, Dell, Arista, Vertiv. 2. Hyperscalers = Microsoft, Amazon, Alphabet, Meta, Oracle.

Now, does the growing use of debt by several of these technology giants leave them more vulnerable in the event of a sharp reversal in fundamentals? Absolutely. But before jumping to bearish conclusions, it is worth remembering that these companies remain very lightly leveraged, which helps explain why their credit ratings rival — and, in one case, even surpass — that of the U.S. government (**Chart 12**).

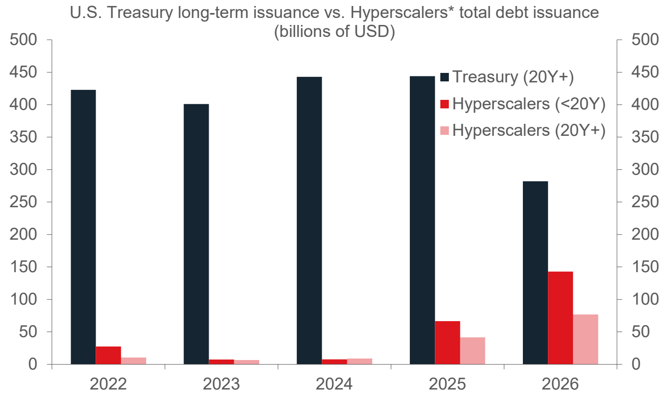
12 | Hyperscalers are highly rated



CIO Office (data via S&P Global)

As a result, the more immediate and tangible impact of such heavy issuance of high-quality corporate debt — often at maturities extending beyond 20 years (**Chart 13**, next page) — may instead have

13 | Long-term high-quality debt supply is rising



CIO Office (data via SEC EDGAR, Federal Reserve, US Treasury). * Hyperscalers = Microsoft, Amazon, Alphabet, Meta, Oracle. Gross issuance from Jan. 1 through Aug. 31, 2026. Treasury comparison excludes bills, TIPS and floating-rate notes.

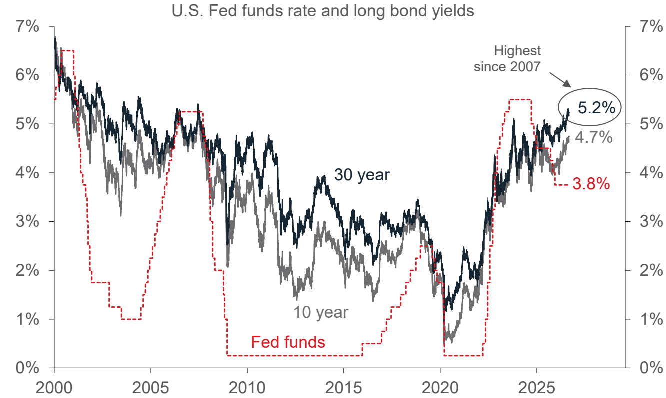
been felt in the long end of the U.S. Treasury market, where investor appetite has been less than robust.

#2: Debt

Over the past two months, U.S. Treasuries have come under sustained pressure, with 30-year yields briefly reaching their highest level since 2007 this mid-August (**Chart 14**). Since then, U.S. Treasury Secretary Scott Bessent's announcement of an expansion in the buyback program for longer-dated debt appears to have helped contain the move. But should this be seen as an early warning sign of more serious problems ahead for U.S. sovereign debt?

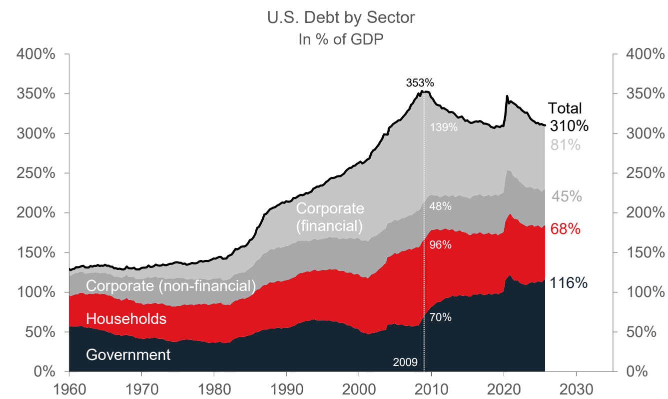
First, a brief reminder to put things into perspective. While U.S. government debt as a share of the economy has risen almost uninterruptedly since 2009, the opposite has occurred among households and businesses. As a result, total gross debt across the U.S. economy — government, businesses, and households — remains near its lowest level in the past two decades (**Chart 15**).

14 | Pressure is mounting on sovereign yields



CIO Office (data via Refinitiv).

15 | Debt is not rising everywhere…

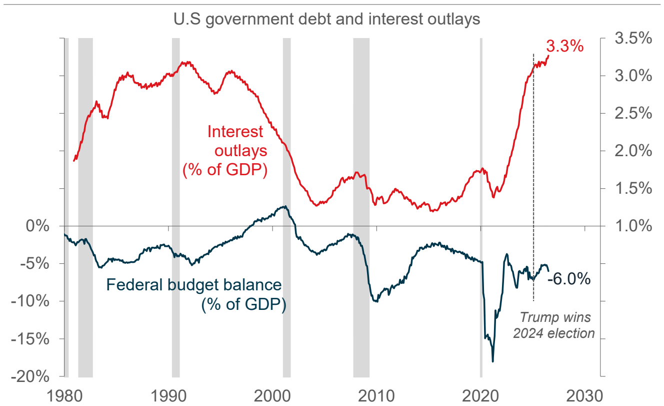


CIO Office (data via Refinitiv).

Yet, that doesn't change the fact that the U.S. government's fiscal trajectory is problematic. The budget deficit is still running at roughly 6% of GDP, nearly half of which reflects the cost of servicing the debt which has recently reached unprecedented levels (**Chart 16**, next page).

Sooner or later, policymakers will have to address this situation more seriously. Until then, however, the most likely consequence is not necessarily a U.S. sovereign debt crisis, as some have been

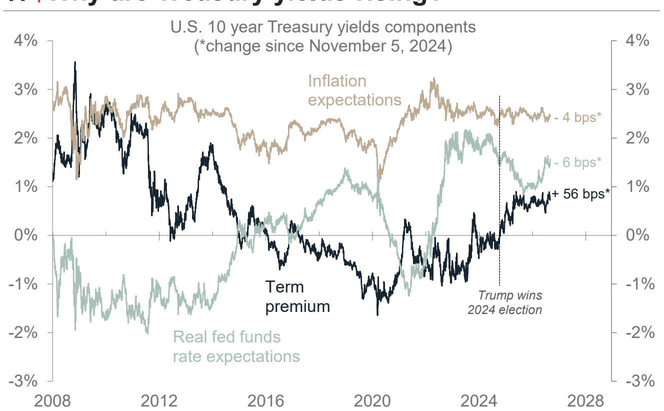
16 | … but it is a problem for the U.S. government



CIO Office (data via Refinitiv).

predicting for decades, if not centuries,[1] but rather a continued rise in the risk premium investors demand to hold U.S. Treasuries. That premium recently reached a 12-year high and, on its own, accounts for the entire increase in U.S. 10-year yields since President Trump's election in November 2024 (**Chart 17**).

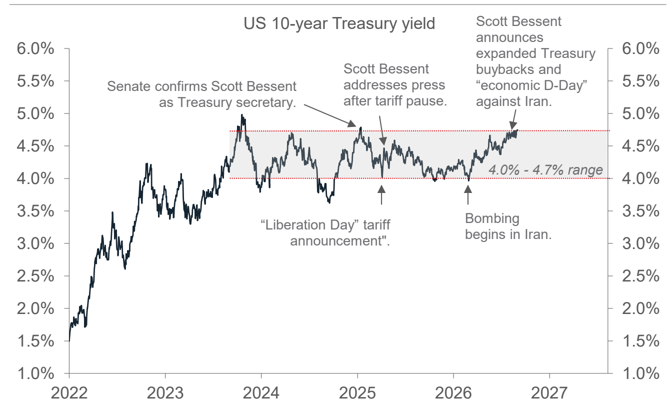
17 | Why are Treasury yields rising?



CIO Office (data via Refinitiv).

Indeed, beyond the fiscal arithmetic, episodes of stress in bond markets over the past two years appear to have coincided with periods when the credibility of the Trump administration itself came into question: concerns surrounding a controversial Treasury Secretary appointment early in the administration; the April 2025 tariff announcement targeting even uninhabited territories (penguins notwithstanding); and, more recently, a "two-week excursion" into Iran that has now stretched beyond six months. In each instance, the U.S. president's response to financial market stress appears to have been to turn to Treasury Secretary Scott Bessent, who now seems to have effectively taken the reins of U.S. strategy toward Iran (**Chart 18**).

18 | Bond markets are not fond of chaos

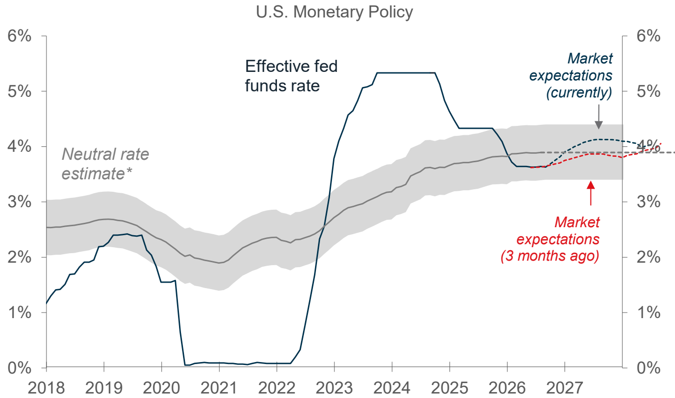


CIO Office (data via Refinitiv).

To be clear, this playbook is not foolproof, as evidenced by the U.S. 10-year Treasury yield, which ended August just above 4.7%. Adding to the pressure is the Federal Reserve, which appears to be considering a rate hike in September — a probability markets currently put at 67% (**Chart 19**, next page) — while preferring to keep its future intentions close to the vest, doing little to alleviate the risk premium.

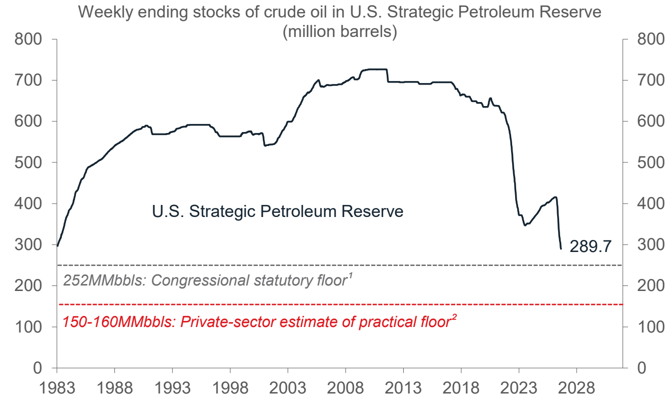
[1] Concerns over U.S. sovereign debt date back virtually to the founding of the United States (*Brutus No. 8*, 1788, Yates) and continued throughout the 19th century (*Is Our Prosperity a Delusion? Our National Debt and Currency*, 1864, Stetson). The past three decades have likewise produced several books warning of an eventual crisis, including *Bankruptcy 1995* (1992, Figgie and Swanson), *The Coming Generational Storm* (2004, Kotlikoff and Burns), *The Debt Bomb* (2012, Coburn), and, more recently, *How Countries Go Broke* (2025, Dalio).

19 | Will Kevin Warsh's Fed move rates higher?



CIO Office (data via Refinitiv). *Average of FOMC long-run policy rate projection and 5y5y forward Treasury yields.

20 | Strategic oil reserves hit a record low



CIO Office (data via Refinitiv). 1. Under U.S.C. 6241(h), limited SPR drawdowns cannot reduce inventories below 252.4 million barrels; this does not apply to full emergency drawdowns. 2. According to JPMorgan energy analysts back in March 2026.

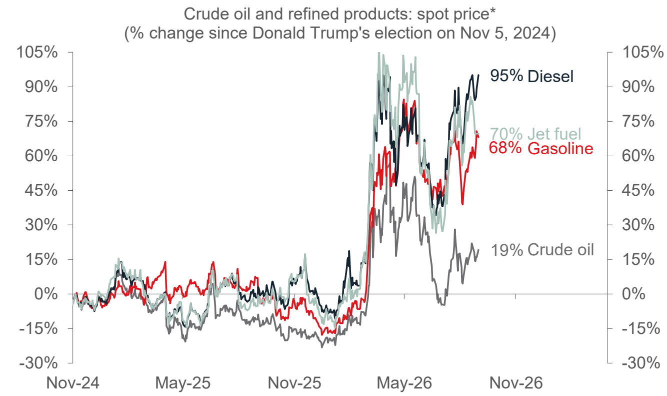
Yet, one thing is clear: the U.S. president's room to "wage war" is not getting any wider — and not just when it comes to Iran.

#3: War(s)

With strategic oil reserves at their lowest level on record and nearing critical thresholds (**Chart 20**), the United States would be well advised to avoid renewing large-scale military hostilities in Iran. This is precisely the message being conveyed by the bond market.

Meanwhile, the war between Ukraine and Russia could deliver some near-term surprises, as highly effective Ukrainian strikes on Russian refining operations put additional upward pressure on gasoline and diesel prices (**Chart 21**), while also raising the risk of an escalation in the conflict.

21 | Pressure is very high on refined products



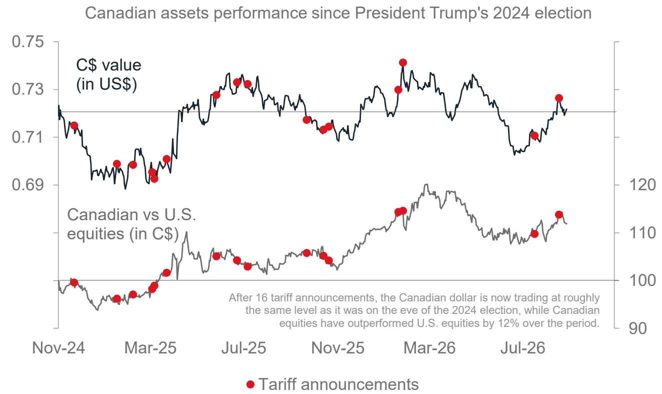
CIO Office (data via Refinitiv). Front month futures price for: Crude oil WTI, RBOB Gasoline, NY Harbor Ultra-low-sulfur diesel, U.S. Gulf Coast Kerosene-Type jet fuel.

However, it was the trade war between Canada and the United States that drew most of the attention on our side of the hemisphere in August.[2] Yet, one would hardly know it from looking at financial markets, which reacted rather modestly to the announcement that negotiations had failed (**Chart 22**, next page). How can this be explained?

As we noted last month, after so many tariff announcements, investors have learned not to extrapolate the U.S. president's rhetoric too far into the future. That was true when he declared on August 19 that "we have a deal with Canada."[3] It remains just as true today, amid the latest round of toponymic revisions.[4]

[2] For more details on the context and the potential impact on the Canadian economy, see the special report by our colleagues at NBF Economics and Strategy: Canada-U.S. Trade: New Tariffs Raise the Stakes, August 24, 2026.
[3] https://globalnews.ca/video/embed/playlist/12027288,4382023/
[4] https://globalnews.ca/video/12039645/lake-ontario-thats-gone-trump-says-a-good-pen-and-some-intelligence-enough-to-change-lakes-name/

22 | Canada holds up, despite it all

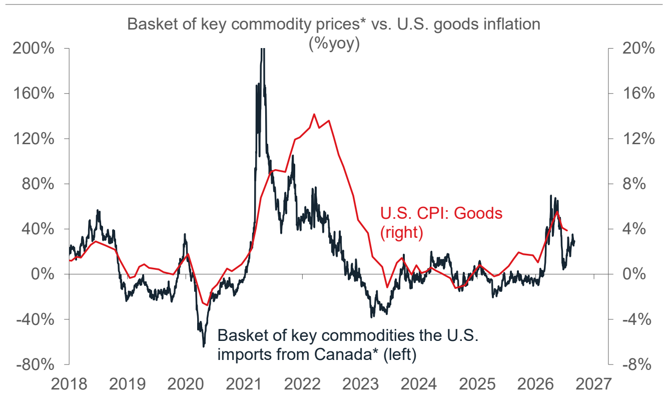


CIO Office (data via Refinitiv).

To be clear, this does not mean that recent events are unimportant. It may simply be that, from a broader perspective, we are reaching a point where the short-term costs of these tensions are becoming more balanced against the gains Canada is seeking over the long term — well beyond the Trump administration's term in office.

In the meantime, no amount of rhetoric can change the fact that the United States imports a wide range of raw materials from Canada — including oil, aluminum, and lumber — whose prices are closely tied to U.S. goods inflation (**Chart 23**).

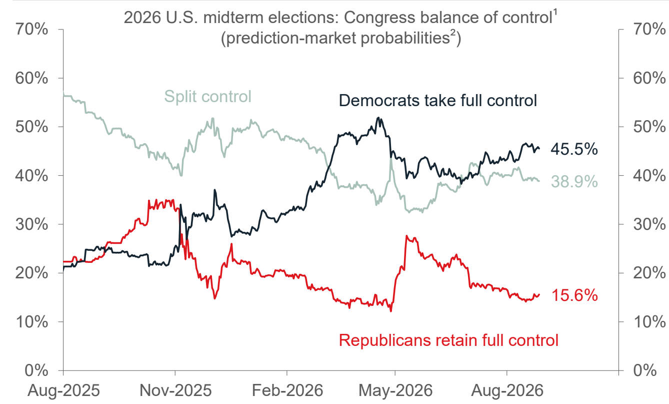
23 | Turning away from Canada at the cost of inflation?



CIO Office (data via Refinitiv, UN Comtrade). *Basket includes WTI crude oil, gold, silver, copper, aluminum and lumber, weighted by their respective shares of 2025 Canadian exports of these commodities to the U.S. All prices are front-month futures.

And, the more the Trump administration disregards this constraint by pursuing policies that risk fueling inflation, the greater the political price it may ultimately pay. With the midterm elections now just two months away, the probability that Republicans lose full control of Congress has risen to 84% (**Chart 24**).

24 | Republicans face headwinds in the midterms



CIO Office (data via Kalshi, Polymarket). 1. Full control means control of both chambers (House + Senate). 2. Kalshi from Dec. 13, 2025; Polymarket before.

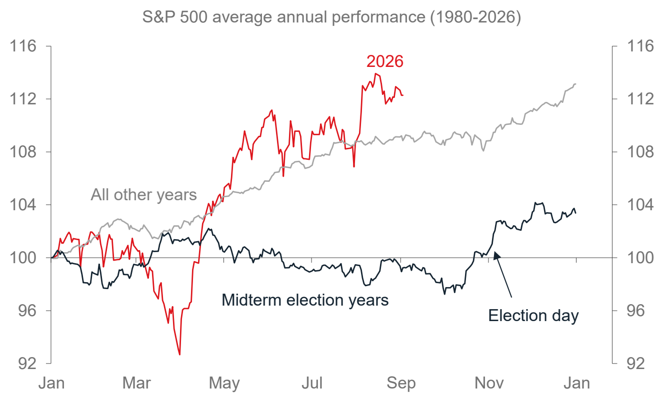
The bottom line

Overall, the past few months have unfolded largely in line with our base-case scenario. Economic growth has remained solid, while oil prices have stayed elevated but below their recent peaks. Corporate earnings have come in well above expectations, and the artificial intelligence investment cycle remains firmly on track. Finally, equity market behaviour has been more rational than it may appear at first glance, characterized by a consolidation of gains and generally moderate valuations.

Nevertheless, while this backdrop remains supportive for equity markets, it is not without risks. At the top of the list is the persistent pressure on bond markets, which are demanding greater clarity from a White House that too often appears to be improvising, as well as from a Federal Reserve that seems increasingly impatient to bring inflation back to target.

Moreover, while we generally remain skeptical of seasonality analysis, it is nonetheless true that, on average, equity markets tend to trade without a clear direction between September and October, particularly during midterm election years (**Chart 25**).

25 | Choppy weeks ahead for equities?



CIO Office (data via Refinitiv).

Against this backdrop, we are maintaining our current positioning, which remains tilted toward an overweight in equities relative to bonds. However, we would not rule out reducing the magnitude of that overweight over the coming weeks as we continuously reassess the evolving risk-reward outlook across markets.

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General

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