

Quick take: 2025 review and 2026 outlook

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2025: Resilience amid uncertainty and sector leadership

Fixed income

The fixed income landscape in 2025 was defined by heightened uncertainty, notably stemming from new US tariffs and their ambiguous impact on consumers and corporations. This volatility drove elevated recession fears, which ultimately did not materialize.

Central bank policy was a key driver, with US fixed income—particularly at the mid-to-long end—benefiting from rate shifts. Core bond market exposure proved advantageous, even as expectations for rate cuts became more hawkish throughout the year, resulting in attractive yields but persistent questions about inflation and future policy direction.

Credit market dynamics

Both public and private credit markets presented pockets of opportunity, though spreads in public markets reached historic lows. Within public credit, selectivity was crucial. Corporate bond exposure was concentrated in shorter maturities and defensive sectors, with a cautious approach to high yield and long-dated corporates due to tight spreads and elevated valuations. Investment-grade corporates remained supported by strong fundamentals, but selectivity and credit discipline were essential for capturing incremental yield.

On the private credit side, the focus was on defensive, non-cyclical companies with recurring cash flows. Sponsor-backed direct lending was favoured, given the additional support from private equity sponsors in times of financial difficulty. For those seeking lower risk, investment-grade infrastructure debt offered stability, supported by long-dated, critical assets and predictable cash flows.

Risk management

Duration management and curve steepening strategies were effective, allowing investors to capitalize on policy divergence between Canada and the US. Tactical adjustments to duration contributed positively, as interest rate sensitivity shifted from a source of downside risk in prior years to a driver of upside. By year-end, portfolios had shifted towards de-risking in response to macroeconomic ambiguity.

Equities

Canadian equities delivered exceptional returns, with the TSX rising over 25% and outperforming the S&P 500 by more than 10%. This strength was underpinned by robust earnings growth, attractive valuations, and a healthy dividend yield advantage over US markets.

Despite economic challenges, Canadian companies thrived due to their global revenue streams and operational adaptability. The divergence between the Canadian economy and its stock market reinforced the importance of focusing on company fundamentals over macroeconomic headlines. High-quality, defensive compounders remained the preferred investment approach for sustainable long-term growth, while momentum and lower-quality stocks led the rally.

A significant pickup in M&A activity signalled growing management confidence, driven by synergy opportunities and the need to acquire technological capabilities swiftly. This trend is expected to continue, with transformational M&A likely to accelerate as companies pursue external growth and adapt to rapid technological change.

Sector highlights

- **Materials and gold:** The materials sector, especially gold equities, surged over 100% on record-high bullion prices and sustained central bank demand. Despite a recent pullback in gold on easing geopolitical tensions, underlying forces—such as foreign central bank buying and strong free cash flows—remain intact, presenting buying opportunities.
- **AI and operational efficiency:** Companies across sectors expanded margins through cost-saving initiatives, notably leveraging AI for efficiency gains in manufacturing, service delivery, and supply chain management. These changes reflect a post-pandemic shift toward faster technology implementation and greater corporate flexibility.
- **Energy and nuclear power:** Rising AI-driven demand for power supported the energy sector, with notable developments in nuclear infrastructure. The US government's \$80 billion partnership with Westinghouse, involving Canadian firms Brookfield and Cameco, is expected to catalyze further investment and benefit Canadian engineering expertise.

2026: Positioning for volatility, selective growth, and macro risks

Fixed income

As 2026 approaches, unresolved questions around inflation, economic growth, and interest rate policy remain central. The AI investment surge and its broader economic impact will be closely monitored. Elevated valuations in corporate credit call for caution, with a disciplined focus on high-quality, lower-risk opportunities.

- **Public credit:** Continued preference for defensive corporates, shorter maturities, and reduced high yield exposure. Tactical duration management remains a tool for alpha generation amid volatile rate environments.
- **Private credit:** Senior-secured infrastructure lending and sponsor-backed direct lending remain attractive, prioritizing predictable cash flows and essential services. Portfolio oversight and underwriting discipline are paramount, given the influx of capital and deployment challenges in private credit.
- **Risks:** Key risks include repricing around the soft-landing narrative, liquidity concerns, and lagging effects of higher rates, especially in private credit. Aggressive leverage and light covenants in recent vintages warrant close monitoring for emerging stress.

Equities

The outlook for Canadian equities remains constructive, supported by relatively attractive valuations, dividend yield, and sector diversification compared to the US.

The TSX is projected to deliver low double-digit returns, anchored by 10% earnings growth and a 2.7% dividend yield. Cyclical sectors and materials/natural resources stand to benefit from global stimulus, infrastructure spending, and robust demand for technology and commodities. Sustained margin improvements from AI and cost-saving initiatives are expected to persist, supporting earnings across a broad group of sectors.

Watchpoints include potential change to the valuation premium assigned to AI-related spending, normalization (upward) of market volatility, and geopolitical factors such as the upcoming USMCA review, which is critical for Canadian exports and employment.

In our multi-asset mandates, a small tactical equity overweight is maintained, reflecting the historical outperformance of equities during non-recessionary Fed rate cutting cycles. Should global tech investment broaden more rapidly across industries, further increases in equity exposure may be warranted. Conversely, signs of recession risk—such as a US labor market slowdown or resurgence in inflation—could prompt a neutral stance.

Emerging markets may benefit from global stimulus and strong investment demand for natural resources, with central bank rate cuts providing additional support for both equities and local debt.

Macro outlook and recession risks

The probability of recession remains contained at 35%, with expectations that it will decline over the next few quarters due to global monetary and fiscal stimulus, diminishing tariff effects, and strong investment in technology, mining, and military equipment.

- **Upside risks:** Expected rate cuts realized at faster pace, continued stimulus, infrastructure agendas, and resilient demand for natural resources and tech investment.
- **Downside risks:** Potential US labor market slowdown due to restrictive immigration and aging demographics, negative spillovers from AI automation, and resurgence of inflation in the second half of 2026. The USMCA trade agreement review is a key factor to monitor for Canadian economic stability.

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