Third Quarter Review

Most global equity markets moved higher in the third quarter of 2026. The Canadian market gained 1.6% during the quarter and is up 13.0% for the year. The U.S. market gained 2.4% during the quarter and is up 16.8% for the year. Developed Markets outside of North America gained 1.0% during the quarter and are up 14.8% for the year. Emerging Markets, however, were down 0.2% during the quarter, but are up 28.2% for the year[1].

Every major market is up double digits for the year, so once again the most important decision has been simply staying invested. Given the near impossibility of determining which markets will outperform in the short-term, holding a broad basket of domestic, international and emerging market stocks, and fixed income (where and when appropriate) is the best way to hedge against missed opportunities.

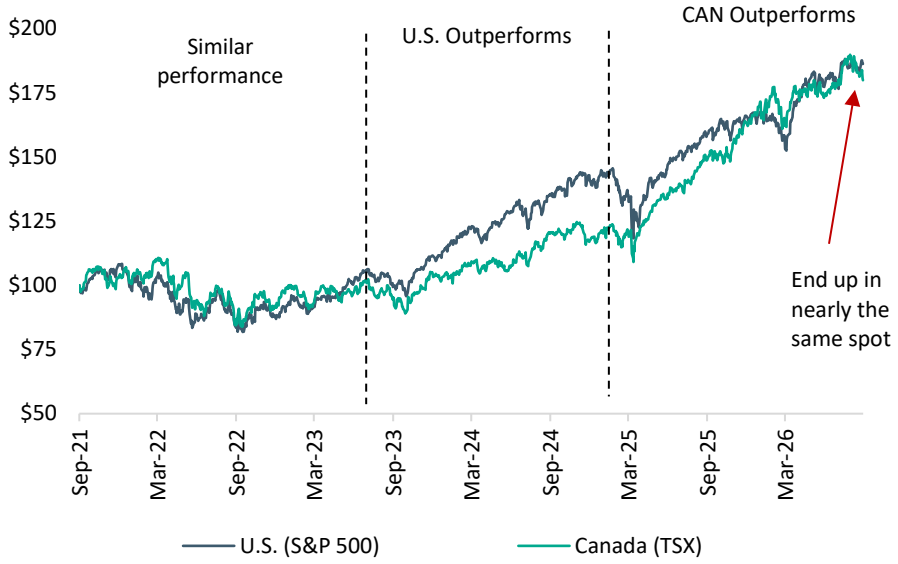
In bond-land, the benchmark Government of Canada 10-Year Bond yield rose to 4.0%, having started the quarter at 3.4%.

Don't just do something, stand there… the perils of chasing performance

Over the past five years, Canadian and U.S. equities have taken very different paths, but have ended up in almost the same place. An investor who put C$100 in the S&P 500 in September 2021 and another who put C$100 in the TSX would have roughly the same amount today, C$186 for the S&P 500 vs. C$180 for the TSX.

For the first two years, the two markets moved in lockstep, both falling through 2022 as central banks raised rates aggressively, showing that geography offered little protection against global macro shocks.

From Q3/23 until Q1/25, the U.S. market took over, driven largely by a run-up in Technology and AI stocks until early Q2/25, when the markets corrected with the "tariff tantrum". Finally, over the past year and a half, the TSX outperformed the S&P 500 due to higher Energy and Materials weights as well as a strong run from Canadian Financials. Some of the TSX's recent strength came from Gold, which, as we discussed in our year-end letter, we hold only as a small position. Diversification means one will never be fully invested in the market or asset class that is leading at any given time, and we are comfortable with that trade-off.



Notes: S&P 500 total return index, TSX total return index, Sept 2021 = 100 in C$.
Source: Bloomberg.

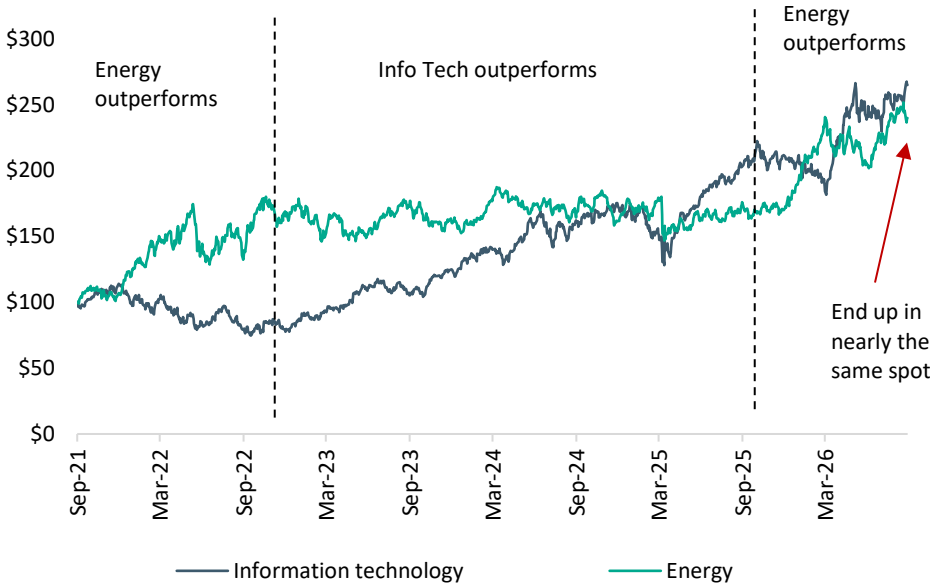
The key takeaway is that leadership tends to rotate but it is impossible to predict when. For example, an investor who sold Canadian stocks in early 2025 to chase the AI trade in the U.S. would have potentially caught a larger drawdown in the U.S. and missed the catch-up that followed in Canadian stocks. Staying diversified across markets would have delivered a smoother ride (and less stress). We aren't trying to predict which markets will outperform in the short-term, rather we are trying to build portfolios that perform well in a variety of markets, this means holding Canadian, U.S., International and Emerging Market equities.

We witness similar rotations across sectors. Take the Information Technology and Energy sectors in the U.S. In 2022 Energy was the winner. Russia's invasion of Ukraine

[1] Index returns: S&P/TSX TR Index; S&P 500 (C$); MSCI EAFE TR (C$); MSCI Emerging Markets TR (C$). Data as of 9/30/26. Source: FactSet.

sent oil prices above US$100 a barrel, and Energy stocks rose roughly 71%[2]. Meanwhile rising interest rates had negative implications for Technology stocks given the long duration of their cash flows. By early 2023, an investor could easily conclude that Energy was the place to be.

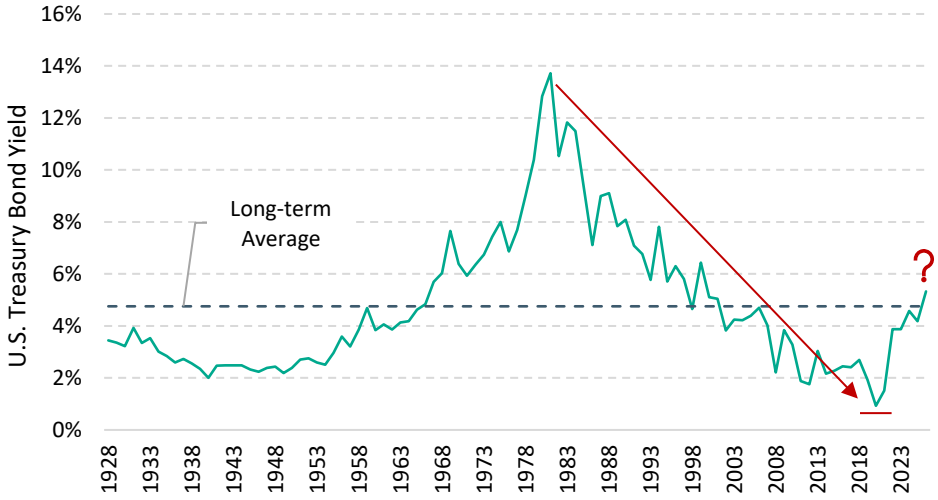
However, the following two and a half years proved the opposite. With the launch of ChatGPT in late 2022, the Technology sector took off, overtaking the Energy sector by mid-2024. However, since mid-2025, the pendulum has swung back in favour of Energy as the conflict involving Iran threatened global oil supplies.



Notes: Information Technology and Energy Sector total return indices, Sept 2021 = 100.
Source: Bloomberg.

Over the full five-year period, the two sectors ended up in nearly the same place. This is similar to the Canada vs. U.S. story, where the TSX leans towards Energy, Materials and Financials, while the S&P 500 is dominated by Technology. Again, the lesson is that the sector that led for one year is unlikely to be the sector that leads for the next, and that investors who chase winners tend to arrive late and may underperform in the long run. Back in our first quarter 2024 letter, we showed that an investor who moved each year into the prior year's best-performing asset class would have earned about 4.2% a year from 2009 to 2023, compared with 9.9% for a diversified basket of equities. Holding a mix of sectors, geographies and asset classes is the best way to ensure reasonable returns through various economic environments.

Looking at asset classes. Below we see that bonds were a great place to be from a return perspective from the early 1980s until 2020. As interest rates fell from the mid-teens to near zero, bondholders earned both income from healthy bond coupons and capital gains. Bonds also served as a shock absorber over this period during the equity market sell-offs of 1987, 2000-2002, 2008 and early 2020.



Notes: U.S. 10-year Treasury bond yield.
Source: Damodaran, A. (2026). Historical returns on stocks, bonds and bills: 1928–2026 U.S. 10-yr Treasury Bond Yield. Damodaran Online, NYU Stern School of Business, Cypress Capital Management

However, that era ended in the lead up to 2022 when central banks raised rates at the fastest pace in a generation to fight inflation. Because bond prices fall when yields rise, bonds had one of their worst years on record in 2022, falling 11.0%[3]. What's worse is that Canadian equities fell 5.8%[3] over the same period, so investors who were taking cover in bonds to reduce volatility were actually worse off.

[2] S&P 500 Energy TR Index (in C$). Source: FactSet
[3] Solactive Canadian Bond Universe Total Return Index (C$), S&P/TSX TR Index.

The good news is that yields have reset higher. The 10-year Government of Canada bond ended the quarter at 4.0%, and the 10-year U.S. Treasury was around 5.0%, compared with under 1% for both back in 2020. Higher starting yields provide a meaningful cushion for investors. Without getting into detailed bond math, a 5-year bond's price falls by about 4.5% for every 1% rise in yields. At a 5% yield, a full 1% rise in rates over a year would be offset by that year's interest income. Compared with buying the same 5-year bond back in 2020 at a 1% yield, the same increase would have meant a loss closer to 4%. For investors holding bonds to maturity, any interim price swings disappear as the bond gets paid out at its full face value. While we don't know where yields go from here, it certainly makes bonds more attractive than they were back in 2020.

Some clients will note that these letters have consistently argued against owning bonds and may wonder if we are changing our stance. We have no issues with bonds, or any other asset class for that matter; what we care about is return potential. For years the return potential for long-term bonds was so low that bonds were an unattractive investment. As yields rise, return potential rises, so bonds become a more viable asset class beyond short-term spending needs and we adjust portfolios accordingly.

Even with the rise in rates the expected return for bonds remains well below what it was in the 1980s and 1990s and below what we expect to earn from owning equities. As such, most of the bonds we hold today are for income and shorter-term expenses/obligations rather than for capital appreciation. Which brings us to our consistent refrain that funds that are needed in the next two to three years should be set aside in assets not subject to market volatility, such as short-term fixed income, while longer-term funds can be allocated to equities to generate higher expected returns. Please keep us informed of any upcoming spending or liquidity needs so we can plan accordingly.

Outlook and Strategy

Our outlook and strategy remain unchanged:

- Keep material near-term spending needs, typically the next two to three years, in an asset not subject to the volatility of the equity markets, such as short-term fixed income.
- Allocate long-term capital to the asset class with the highest expected return over the contemplated holding period, generally equities, but bonds may play an increasing role as yields rise.
- Stay diversified across sectors, geographies and asset classes. Leadership will rotate and it is impossible to know when.

As always, please keep us up to date on spending needs and liquidity requirements. If you are unsure about your asset allocation or have any concerns about your portfolio, we are here to help, so please reach out.

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