

Equity Team Commentary: Earnings, Tariffs, and Shifting Leadership

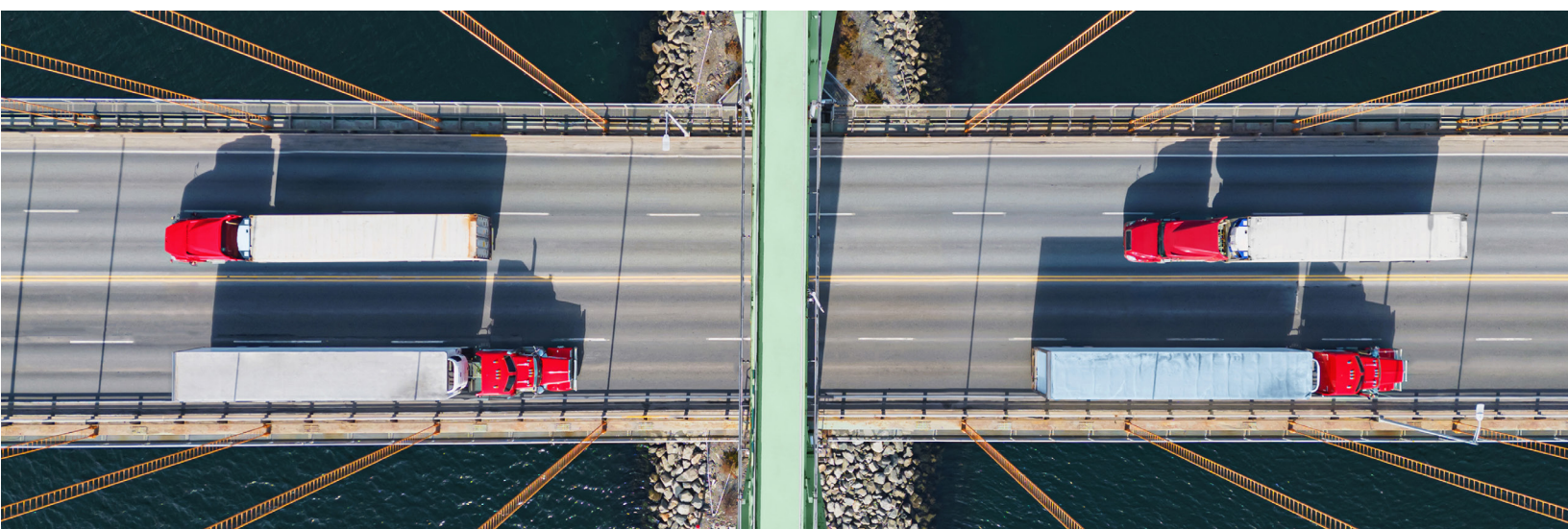
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Key takeaways

- **Narrow market leadership persists:** August saw steady market performance, with the S&P 500 up 1.9% and the Nasdaq up 0.9%. However, leadership remains narrow. Late-month momentum in lagging sectors like cyclicals and small caps hinted at a potential broadening of market participation.
- **Federal Reserve policy shifts and economic data:** Disappointing U.S. non-farm payrolls data and dovish comments from Fed Chair Powell at Jackson Hole have increased expectations for a September rate cut, as unemployment risks are gaining focus.
- **Tariff developments and Canadian economic weakness:** Tariff headlines persisted, with Canada removing retaliatory tariffs under USMCA to restart negotiations. Canadian Q2 GDP contracted by 1.6%, driven by declining exports and tariff-related uncertainty.
- **AI and energy sector updates:** AI stocks consolidated in August despite Nvidia's strong results, which reaffirmed long-term growth potential. In the energy sector, Cenovus announced a bid for MEG Energy, but Strathcona's growing stake may complicate the deal.
- **Canadian banks report results:** Canadian banks delivered better-than-expected Q3/25 earnings, with varying performance across institutions. CIBC and BMO remain preferred picks due to consistent growth and strong U.S. positioning.

In August, markets continued a measured march higher driven largely by better-than-feared earnings results. The S&P 500 was up 1.9% and the Nasdaq up 0.9%, steady, albeit unexciting. The S&P/TSX Index outperformed, up 4.8% on the month, led by Materials, primarily gold. Market leadership since the "Liberation Day" sell-off has been extremely narrow, with the S&P 500 outperforming the S&P 500 Equal Weighted Index by 7% since April 2nd. Towards the end of the month, the market made attempts at broadening out. The Mag 7—market darlings for the better part of the last two years—retrenched, while laggards such as interest sensitives, cyclicals, and small and mid-caps showed signs of momentum. At the time of writing, a full rotation had not yet been established; however, the risks of narrow positioning and theme concentration should be top of mind for investors.

President Trump reinitiated attacks on the Federal Reserve this month, demanding lower rates, firing Fed governor and Biden-appointed Lisa Cook, and vowing to replace Federal Reserve Chairman Powell. The reaction from bond markets has been fairly muted so far. Ultimately, macroeconomic data moved Fed sentiment towards a more dovish stance. U.S. July non-farm payrolls data disappointed, with growth of 73k jobs versus expectations of 104k. In addition, negative prior-month revisions erased 258k job additions from May and June. On the flipside of the Fed's dual mandate, inflation readings ran a touch hot, with core annual CPI up 20 bps to 3.1%, but well shy of levels indicating tariff cost pass-throughs that some had feared. At Jackson Hole, Chairman Powell emphasized for the first time the downside risks of unemployment over inflation. The comments were interpreted as dovish, causing markets to rally and the yield curve to steepen with the front end declining. A rate cut in September is now viewed as a near certainty, with an additional 3-4 cuts expected over the course of the next year.

Tariff headlines continued throughout the month of August; however, the market has become increasingly desensitized to the news. India and Switzerland were targeted with increased tariffs while China was afforded an additional delay. Tariffs for copper and gold were floated and abandoned, wreaking temporary havoc on commodity markets. Long-awaited sectoral tariffs for pharmaceuticals and semiconductors have yet to be formally announced. Perhaps the most meaningful shift in tariffs came from the Canadian government, which announced the removal of retaliatory tariffs on many U.S. products under USMCA in an attempt to restart negotiations with the U.S. government.

Canadian Q2 GDP growth was released in August, showing a contraction of 1.6%, worse than expectations of -0.7%. Exports declined 27%, driven by U.S. tariffs and normalization of pull-forward experienced in Q1. This was partially offset by slightly better consumer and government spending. Jobs data was also weak as uncertainty remains related to tariffs and potential USMCA renegotiation. The banks have indicated that they are starting to see credit deteriorate on unsecured consumer loans at lower income and FICO levels. Expectations remain for a rate cut in September.

Presidents Trump and Putin met in Alaska to discuss a ceasefire to the war in Ukraine. Conversations were described as productive but concluded without any announcement. Ukrainian President Zelensky, notably absent in Alaska, was invited to Washington afterwards. Trump seemed more amenable to providing security to the Ukrainians, a top request from Zelensky. While peace is proving to be elusive, an end to the war remains a goal of the U.S. government. An end to the war could have meaningful implications for commodity prices such as potash, uranium, and natural gas, while rebuilding efforts could drive significant economic activity.

Corporate reporting wrapped in August with results broadly better than expectations and cautious optimism related to outlooks. By all accounts, the U.S. consumer continues to spend and tariff-related inflation has not materialized in a meaningful way. Stock reactions to earnings results were somewhat counterintuitive as strong performers that met or beat expectations were sold while laggards were bought. Across our funds, we took advantage of the disconnect from fundamentals and increased positions in companies such as Element Fleet, Quebecor, Intact Financial, and WSP.

The AI trade unwound somewhat in mid-August after a very strong rebound from April lows. The stocks consolidated while awaiting confirmation from Nvidia as to the direction of trade. Nvidia reported solid results in late August, modestly beating expectations. Strength of AI-related capex was confirmed with Nvidia increasing its estimate to \$3-\$4 trillion of AI-related capex by the end of the decade, vs. previous estimates of \$1 trillion. Revenue guidance was a little light, but for the first time excluded any contribution from China given the geopolitical environment. Ultimately, these results were enough to satisfy the market that AI growth continues to accelerate although share prices continued to consolidate.

M&A in the Canadian energy sector continued with the announcement of Cenovus's (CVE) bid for MEG Energy. Recall that a takeover bid from Strathcona put MEG in play back in May. Cenovus has long been thought of as the natural acquirer for MEG given their contiguous asset base and potential for synergies. CVE's offer, while lower on a total consideration basis, has a greater cash component and more attractive paper. The market rewarded CVE for its price discipline, lifting shares 7% on the day of announcement. Since the announcement, Strathcona has increased its stake in MEG to 14.2%, presumably to vote down the CVE deal which requires 2/3rds approval or extract a greater premium. It remains to be seen whether the current offer is enough to get a deal across the line.

Canadian banks reported Q3/25 results at the end of August. Bank earnings topped expectations as capital markets activity and better credit drove the beats. Generally, the banks are cautiously optimistic on the remainder of the year and 2026, citing renegotiation of the USMCA as the biggest source of uncertainty. The near-term outlook favors the U.S. economy, which appears to be inflecting positively. Individual performance across banks varied significantly, driven by magnitude and quality of beats as well as outlook. Royal Bank posted the largest beat and underlying business growth and was rewarded with a 6% move, despite industry-high valuation. National Bank merely met expectations this quarter and disappointed in Capital Markets where they have consistently delivered in the past. The stock lagged as a result. TD's results, while strong, were met with selling as the outlook for its U.S. business and growth strategy was unclear as the bank continues to remediate AML issues. Across our portfolios, we have a preference for CIBC and BMO. CIBC continues to deliver consistent growth driving a re-rating in shares while BMO is in a strong position to grow in the U.S. Bank of Nova Scotia delivered solid results and many are hopeful that an inflection in International Banking is coming. We will be watching the next few quarters' results for confirmation.

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