ETERNA FINANCIAL GROUP

PERSPECTIVES

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Each month, our experts decipher trends, opportunities and strategies shaping the financial universe of informed investors. Discover nuanced analysis and insights to guide your wealth management decisions. Forged by experience and driven by innovation, our perspectives help you build a sustainable financial legacy.



IDENTIFYING OPPORTUNITIES BEYOND THE DOMINANT THEMES

As 2025 draws to a close, the economic landscape is filled with contrasts. While Canada experiences near-stagnant economic growth and U.S. stock market valuations reach historic highs, global financial markets are rife with uncertainty. The Trump administration, with its unpredictable trade policy and relentless questioning of the Federal Reserve's independence, is fuelling instability. Paradoxically, it is this type of climate that creates opportunities for investors. Against this backdrop, two of our senior managers share their outlook for 2026, addressing economic trends and the dominant themes of the past year that continue to influence the markets.

ECONOMY: COPING WITH WEAKNESS

Canadian growth under pressure

Canada's economic growth is expected to be modest in 2026. The latest data show hesitation: GDP grew at an annualized rate of 2.6% in the third quarter, following a 1.8% decline in the previous one. Productivity has been sluggish for several years, and the labour market is deteriorating as the economy continues to adjust to the unpredictability of U.S. trade policy.

The Canadian economy faces four risks: the revision of the Canada-United States-Mexico Agreement (CUSMA), household mortgage debt, slowing immigration, and a weak labour market.

In this context, we expect that inflation, which stood at an annualized rate of 2.2% in October, will continue to moderate as interest rates, rents, and mortgage payments decline. This should lead to a slowdown in services inflation, partially offsetting the pick-up in goods inflation.

A stagnant job market

The Canadian labour market is expected to experience a hiring freeze in 2026. In the Business Outlook Survey published by the Bank of Canada at the end of October, half of businesses did not plan to increase their workforce over the following 12 months. In addition, the share of businesses that planned to reduce their workforce, at 13%, was similar to that in previous quarterly surveys. If this status quo scenario were to materialize, the unemployment rate could remain relatively stable, in an environment where lower immigration is helping to stabilize the labour force. According to Statistics Canada's latest data, the unemployment rate stood at 6.5% in November, down by an unexpected 0.4 percentage points from the previous month.

The Bank of Canada on the sidelines

As Bank of Canada Governor Tiff Macklem has already mentioned, the institution is currently on the sidelines, with a key interest rate of 2.25% after two 25-basis-point cuts in September and October. However, the traditional tools of monetary policy are proving insufficient to counter the negative effects of tariffs. This task therefore falls to the federal government, which must strive to create and maintain programs aimed at spurring growth. In this regard, the 2025 Budget recently presented by Prime Minister Mark Carney's government provides possible solutions.

To promote increased business productivity, it aims to convince companies to resume investing by supporting innovation, competition, and the adoption of new technologies, particularly those related to AI.

BONDS: A MODERATE STEEPENING IN THE CURVE

Over the past two years, the Canadian bond market has been characterized by a steepening curve, with short-term rates falling and long-term rates rising. In our view, this trend is likely to continue in 2026, but at a much more moderate pace.

Given the current economic environment, we do not anticipate a cut in the key interest rate at this time, unless inflation falls significantly below 2% or economic growth becomes extremely weak.

Instead, we anticipate a slight increase in long-term bond rates, fuelled by several factors; while Japan and Germany will be launching major investment programs requiring substantial bond issuance, the United States and Canada will be doing the same to fund their deficits. In addition, U.S. companies in the AI industry have also been turning to the bond markets, borrowing at the long end of the curve. The combination of significant long-term bond issuance and declining demand is likely to put upward pressure on rates.

In this environment, our approach to duration will be tactical. We favour increased exposure to the 5- to 10-year portion of the curve, while reducing duration at the long end of the curve.

Credit spreads: caution required

We remain very cautious about corporate bond spreads, which are at historically low levels. Canadian corporate earnings have shown signs of slowing, which is incompatible with spreads this tight.

We therefore favour corporate bonds rated A and above, particularly those issued by banks and companies with strong financials. On the other hand, we limit exposure to BBB-rated securities as much as possible and avoid high-yield bonds, which would be the first to be affected in the event of a downturn.

STOCK MARKETS: KEY THEMES AND OPPORTUNITIES WORTH SEIZING

AI: winners, losers and uncertainty

A number of major themes dominated 2025, with AI topping the list. Those benefiting most from the excitement were the “Magnificent Seven” and their suppliers, as well as companies specializing in electricity generation and uranium, given data centres’ huge energy requirements.

This theme also created many losers, not due to disappointing results, but because of uncertainty surrounding the future impact of AI on their business models; this concern weighed on software, IT consulting, engineering, and data companies.

As is often the case, until such time as the market is able to gauge the actual impact, it chooses the potentially worst-case scenario.

Looking ahead to 2026, one of the key questions will be whether the current valuations of AI-related companies are justified and whether the stocks that have suffered will be able to demonstrate their business model’s viability. Take engineering companies, for example: while AI could certainly exert downward pressure on pricing for services, it could also lead to workforce reductions, which could support profit margins.

Precious metals as a safe haven

Precious metals enjoyed an exceptional year in Canada, with gains exceeding 100% for the vast majority of stocks in the Canadian sector due to political uncertainty and general instability in the United States. In recent years, the U.S. dollar and U.S. bonds have served as safe havens. This paradigm shifted during the year, and precious metals resumed their role in this regard.

We believe that how precious metals perform in 2026 will depend largely on the new Federal Reserve chair and the path of interest rates, which was the main concern for markets in 2025.

With so many changes within the Trump administration, investor confidence regarding the quality of government data is waning. If investors were to start questioning inflation and employment data, or if Fed rate cuts were perceived as further stimulating inflation, the U.S. dollar could suffer, which would in turn benefit gold. Investor concerns over interest rates and inflation trends will continue to be a major factor in 2026.

Defence: a deep-seated trend

Military budgets are increasing worldwide, creating a significant impact on the sector. According to the United Nations, global military spending reached US$2.7 trillion in 2024, marking the sharpest increase in three decades.

This trend continued in 2025, steering a significant portion of investment flows toward companies related to defence and the industrial sector. A key factor to watch will be the awarding of contracts to Canadian and European companies, which could continue to drive stocks higher in 2026.

Valuations providing opportunities

Although the S&P 500 reached record highs in the United States, valuations don’t seem totally out of line when AI-related stocks, including the “Magnificent Seven,” are excluded.

As for the Canadian market, the sharp rise in the S&P TSX index in 2025 was largely driven by the natural resources sector and selected technology stocks. Banks, which also performed well in 2025, are trading at valuations slightly above their historical average, while the consumer and industrial sectors are standing at below-average valuations.

While this situation calls for some caution, it also creates many opportunities for judicious stock selection. We have identified several companies with solid fundamentals that trade at attractive valuations simply because they are not part of popular themes.

The market is cyclical, with timing impossible to predict; a few months ago, few market observers could have predicted that the "Magnificent Seven" would skyrocket, even though valuation ratios were already very high.

With this in mind, we believe that stocks with solid fundamentals—but left at a disadvantage in 2025—could catch up in 2026, as geopolitical concerns and high valuations of AI-related stocks gradually draw attention back to indicators of financial health, profitability, low debt ratios, etc.

International markets remain attractive

Beyond Canada and the United States, international markets continue to offer attractive valuations, with gaps to U.S. indices that remain wide. After outperforming in 2025, EAFE (Europe, Australasia, and the Far East) equities could continue to catch up with Wall Street. We are closely watching European markets, particularly due to renewed interest in domestic purchasing as a reaction to trade tensions with the U.S.

As for Japan, the stock market performance of its companies remains stellar, with the Nikkei index up about 30% in 2025. This number rises to more than 60% when focusing solely on the period from April to today. That said, the country's situation remains complex, with the first interest rate hike in 15 years raising questions about both the impact on the yen and the competitiveness of Japanese industries on a global scale.

Opportunities amid uncertainty

The year 2026 is already shaping up to be volatile, with the U.S. administration taking a unique approach and altering its positions without warning. Forecasting of any kind is risky, and we are not dealing with a normal world: the rules of the game are constantly changing.

Paradoxically, this uncertainty creates opportunities in certain sectors. We will target companies with solid fundamentals that have been overshadowed by dominant themes. We believe this approach will enable us to manage uncertainty while seizing opportunities as they arise.



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