

QUARTERLY COMMENTARY



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This is Another Fine Mess

What a difference a month makes. The first quarter of 2026 was proceeding nicely and on track until all Hell broke loose in March with the breakout of hostilities in the Middle East. Markets hate uncertainty and no-one can possibly know how this war is going to play out – even though the US and Iran have temporarily agreed to a ceasefire. The negotiations for a peace deal broke down and now President Trump has announced a naval blockade of all maritime traffic in and out of Iran’s ports. The scenario changes on almost a daily (hourly?) basis and for now at least there remains the potential for another round of negotiations. As it is a very fragile truce, at any time renewed military activity may reverse the most recent gains in the markets. Considering everything though, the markets are acting incredibly resilient and of all the equity markets around the world, Canada’s is the best situated to ride it out with the least amount of harm. The S&P/TSX has significantly more exposure to commodities like energy and materials than global peers like the S&P 500 so its performance is heavily influenced by the fluctuations in the price of crude oil, and precious and base metals (higher commodity prices are here to stay for some time so get used to those higher prices at the pump, even with the excise tax removed). With the closing of the Strait of Hormuz it’s not just energy prices that have been affected - all kinds of goods pass through that particular international passageway including fertilizers (one third of the seaborne fertilizer trade), helium (impacts semiconductor manufacturing), aluminum, petrochemicals used in the production of plastics and coatings, etc....

Luckily for the Saudis, they have an escape route for their oil – and have started piping seven

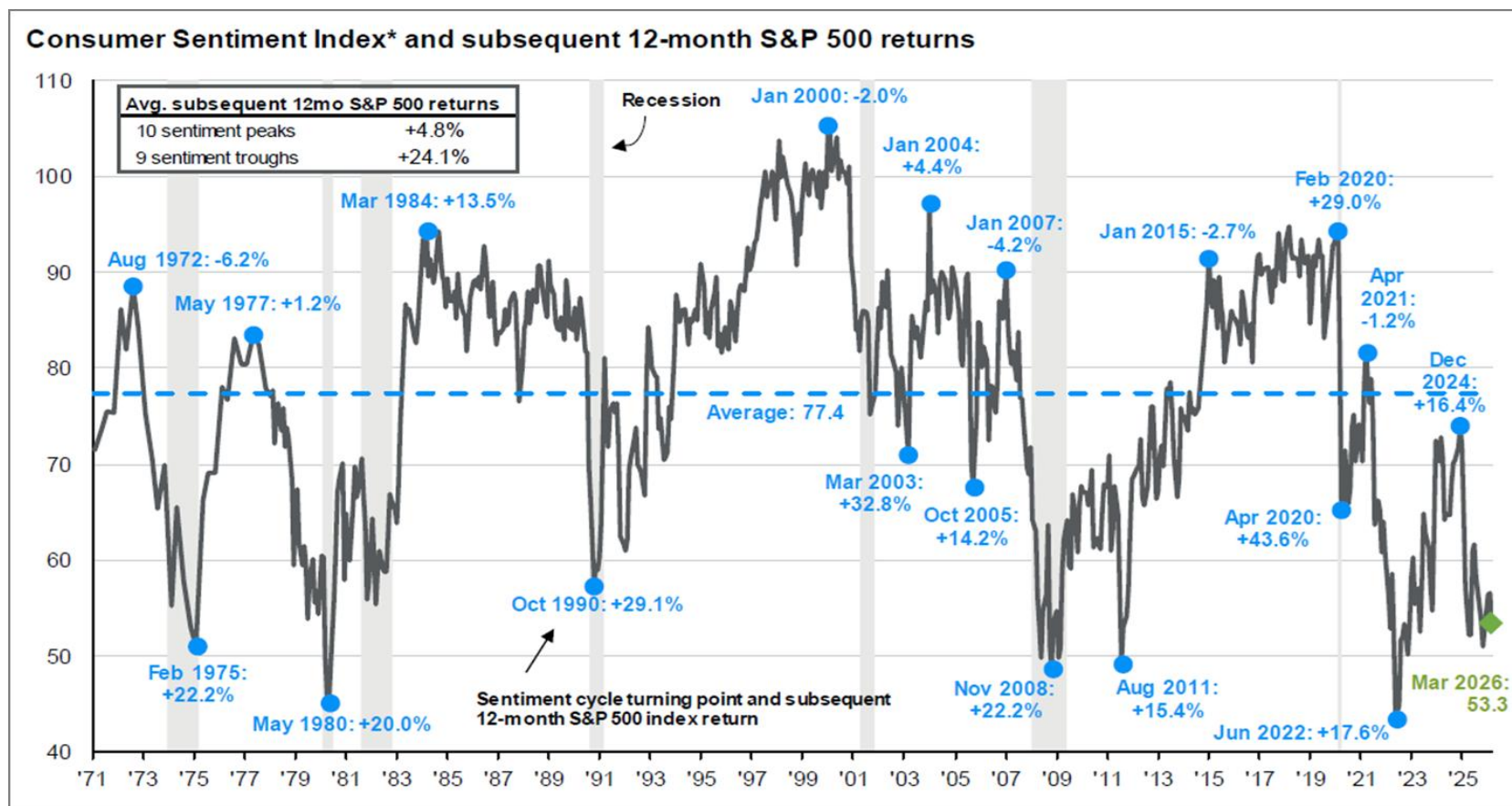
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million barrels a day of their production to their Red Sea port of Yanbu in order to bypass Hormuz. The potential difficulty though is whether the Houthis who are strategic partners of Iran, allow free passage of that oil through the Bab-el-Mandeb which is the 16-mile-wide maritime choke point through to the Gulf of Aden and the Indian Ocean. Iran's turning Hormuz into a toll booth claiming this international waterway as their own is what prompted the Americans to counter with their own blockade of Iranian ports which would lock in their oil production, a key component of their economy.

Advanced economies such as the US and Canada will fare much better than those that depend more on oil imports but the fact that oil prices are declining now at all while this is happening indicates that the markets expect either a quicker resolution to this crisis or a major economic slowdown that will depress the demand for energy. My guess is the latter of those two scenarios. The IMF suggests that global growth could drop by 2% with inflation increasing by up to 6%. Even with an expeditious conclusion and the Strait reopening sooner than later there will still be considerable economic damage. At the very least inflation will increase and global growth will slow. So how is it possible that the markets are really not being hurt so badly right now? The key factor remains low interest rates – it's possible that the Fed treats the uptick in inflation as temporary when considering whether to move rates higher. As I've said in the past, stock valuations are mostly affected by corporate profitability and interest rates. A new factor to be considered relating to the movement of interest rates is that the use of AI lowers corporate costs which helps to fight inflation helping keep rates low as well. So, the markets are trading right now approximately where they were before the war broke out. It's not what most market participants expected and so the FOMO (fear of missing out) trade is back on pushing the markets ahead. At this point some sort of a pause or slight pullback could occur as it seems things are getting ahead of themselves but with such a strong recovery of late, new highs are much likelier than new lows.



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Fidelity Canada

Here is a lookback at 12-month forward returns investing at sentiment extremes. Investing while sentiment is at its lowest, returns 24%, while investing when sentiment is at peak positivity only returns 4.8% on average over the next 12 months.

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There is a lot of skepticism on whether the war will end on favourable terms for the U.S. Nevertheless, if a final positive resolution were to take place, then we'd likely see a knee-jerk reaction of the market moving even higher. It would be hard for the markets to move significantly more once the euphoria wears off though. Investors know the situation is a difficult one right now, but the stock market is a barometer weighing out the expected negative outcomes of the war on the supply chain and inflation and investors seeing a resolution in the near future that could bring about positive circumstances in six to nine months.

As always if you have any questions, are interested in a particular investment or you would like to have a comprehensive financial plan created for you please don't hesitate to call. In the meantime, enjoy the return of Spring!

Regards,



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