



When The Playbook Does Not Play Out

Commentary

When equity markets are consistently going up, many investors wonder why they bother holding diversified portfolios. In these positive market environments that have generally characterized the last decade-plus, it seems that the appeal of having exposure beyond growth stocks and to “safer” asset classes that generate comparatively meagre returns is greatly diminished.

Periods of heightened market volatility and sharp declines highlight the value of holding assets that typically do not all move in tandem, as they can serve as a ballast in the storm, helping to offset any equity losses and better preserve portfolio capital.

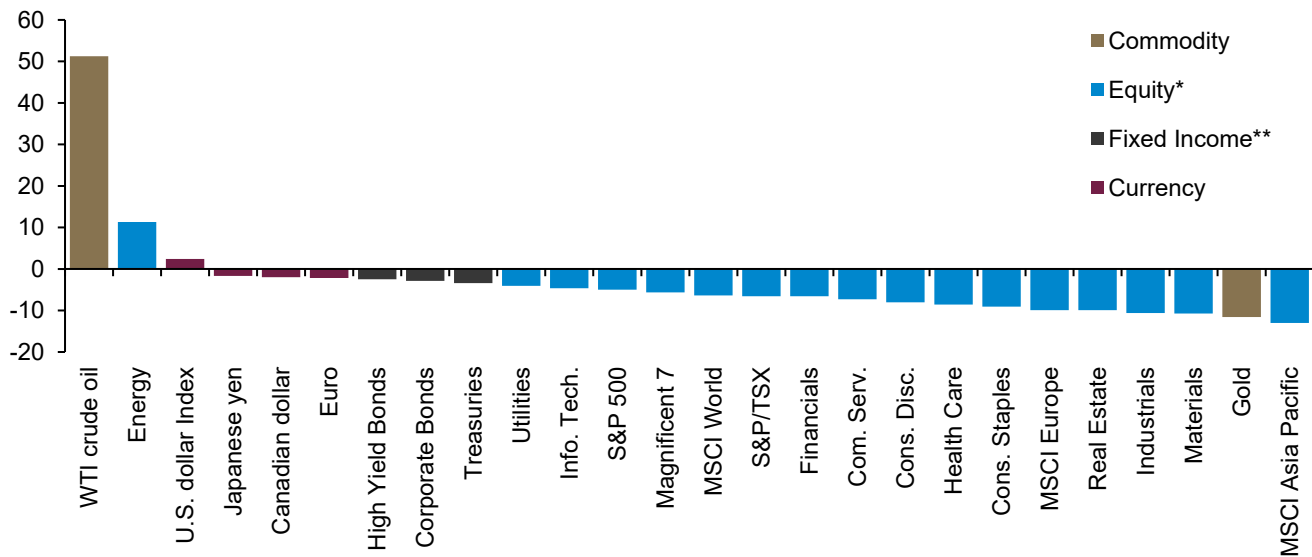
It is therefore understandable that investors may find themselves flummoxed by the performance of their diversified, multi-asset portfolios so far this year, and especially over the last month.

The standard playbook of a market sell-off is that when investors react negatively to a shock and related rise in uncertainty by selling their exposure to “risk assets”, they typically reallocate to assets that, historically, have lower volatility, lower correlation with stocks, and offer more certainty in their returns. In practice, this typically means selling stocks, particularly those most geared toward growth, and lower quality credits, and buying government bonds that offer fixed interest payments and other “safe haven” assets such as gold and real estate.

As the chart below shows, equities sold off across regions and sectors through March, but so too have bonds, with government bonds faring the worst among them. Gold, with a reputation as a safe haven, has been among the biggest laggards, having turned in its worst month since October 2008.



March global asset class performance (percent total return; U.S. dollar basis)



*Equity sectors are those of the MSCI World Index¹; **Fixed income indexes are Bloomberg Global Aggregates; source: Guardian Capital, using data from Bloomberg from February 27 to March 31, 2026

The reason the playbook is not playing out, and the assets that are supposed to provide a “hedge” against the riskier parts of the portfolio are failing to do so, is tied to the nature of the shock experienced.

While the onset of a war and potential escalation represent a negative shock to economic growth — and therefore a headwind for overall corporate earnings — the conflict is concentrated in a region that produces and exports a significant share of global energy (especially for Europe and Asia, a factor in their underperformance) and has resulted in the closure of a key trade route, which has created a supply shock that has sent energy commodity prices soaring. Cue the 50% jump in crude oil prices that has underpinned the strength in global energy stocks.

The uncertainty created by the war and rising energy costs is likely to restrain demand. However, market attention has so far centred on the resulting inflationary impulse and the growing expectation that energy-driven price increases will force central banks into a sharp policy reversal and renewed rate hikes. As a result, market interest rates have moved significantly higher, pushing global bond prices lower.

¹ The MSCI World Index captures mid- and large-cap representation across 23 developed market countries.



As well, the U.S. is comparatively insulated from the energy supply shock, given it is now the largest oil producer in the world and imports little from the Middle East. Alongside higher interest rates and stronger relative economic fundamentals, this has bolstered the U.S. dollar, including against the typically oil-linked Canadian dollar.

In turn, higher interest rates and a stronger U.S. dollar have served as a headwind to gold prices, and have seen a wave of speculators that had helped send prices up to record highs exiting their positions en masse.

Unfortunately, sometimes the best-laid plans do go awry, but that does not mean that planning is not worthwhile. If anything, the unexpected and exogenous nature of this shock, which came against an increasingly upbeat macroeconomic and market backdrop, serves as an example of why managing portfolio risk exposures is so important. Good investing requires us to manage downside risk when markets are rising, knowing that the reward is in the future. It always is.

Equity Commentary

A three-year streak of gains across Developed Market (DM) equities paused to begin 2026, with major European, Asian and American stock benchmarks declining over the quarter. An outlier to this was the S&P/TSX Composite Index², managing to post a 3.9% gain on the strength of oil, natural gas and other commodity prices. The Canadian stock market performance stands in contrast to major European and Asian markets (the MSCI EAFE benchmark³), which fell 1.2% in U.S. dollar terms. In the U.S., the S&P 500 Index⁴ fell 4.3% in U.S. dollar terms and 2.6% in Canadian dollar terms, continuing a shift in momentum that saw this world-leading index of the past decade relinquish top performance status for the year in 2025.

Within all markets, Energy was the standout performing sector, rising 30.1% in Canada, 40.8% in the U.S. and 42.7% in the EAFE markets (all in Canadian dollar terms), following the U.S. attacks on Iran and the closure of the critical Strait of Hormuz. Conversely, Information Technology, a top-performing sector for much of the past decade, was a laggard globally, falling 22.5% in Canada and 7.5% in the U.S., but managed to post a minor 0.3% gain in the EAFE markets. A second cohort exhibiting weakness during the quarter was the Real Estate and Financials sectors, falling in all major regions in reflection of weakness in housing markets and the associated rising potential for credit problems.

The move lower in most stocks over the first three months of 2026 marks an end to three straight years of impressive equity market gains in North America, Europe and Asia.

² The S&P/TSX Composite Index is the benchmark Canadian index, representing roughly 70% of the total market capitalization on the Toronto Stock Exchange (TSX) with about 250 companies included in it.

³ The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. & Canada.

⁴ The S&P 500 is an index of 500 stocks designed to reflect the risk/return characteristics of the large-cap US equity universe.



Investment in infrastructure supporting the artificial intelligence boom continues onward, although wavering stock price performance suggests a level of wariness has arisen for investors regarding the level of investment and the ultimate economics of the outlay. A new factor in 2026 has been the conflict in Iran, sharply curtailing the transit of many commodities for an uncertain duration and adding the risk of drawing in other nations to the war. The conflict has already introduced a marked change to prior expectations for interest rate cuts in 2026 due to new inflationary pressures.

Performance of equity markets from here is likely to be linked to any expansion or conclusion of the war in Iran, along with the developments in artificial intelligence related to its cost and impact on employment. Importantly, one positive outcome from the recent volatility has been a retracement in share prices back to very reasonable levels for many high-quality businesses with dependable economics across all regions.

Fixed Income Commentary

Despite hopes that the volatility experienced in the traditionally staid fixed income markets last year would abate, the first three months of 2026 have continued to whiplash bond investors.

The assumption was that global central banks' satisfaction that inflation was behaving well (still above target, but gradually moving lower), combined with ongoing concerns about growth momentum, spurred by soft employment data to start the year, would keep a general easing bias in place.

The attacks on Iran drove a surge in oil and gas prices, and the market focus has returned to inflation for central banks, with the assumption being that energy-induced increases in inflation and inflation expectations would drive central banks to begin a sharp course reversal and hike rates in the coming months.

Bond yields, especially those at the front-end of the curve, moved higher in response and wiped out earlier gains in Canadian bond markets — the benchmark FTSE Canada Universe Bond Index⁵ fell 2.0% in March in its worst month since September 2023, and finished the quarter effectively unchanged (+0.2%), with that performance broadly mirrored by all main sub-indexes.

Looking ahead, while there is some potential for tightening policy, central bankers flagged the upside risks to inflation posed by higher energy costs in recent communications, but the rising expectations of such action appear to be misplaced for now.

For starters, the situation in the Middle East is highly fluid; however, there is scope for a relatively swift resolution that would open the Strait of Hormuz and likely drive a sharp reversal in energy prices. This would limit the overall impact on inflation that policymakers would likely look through.

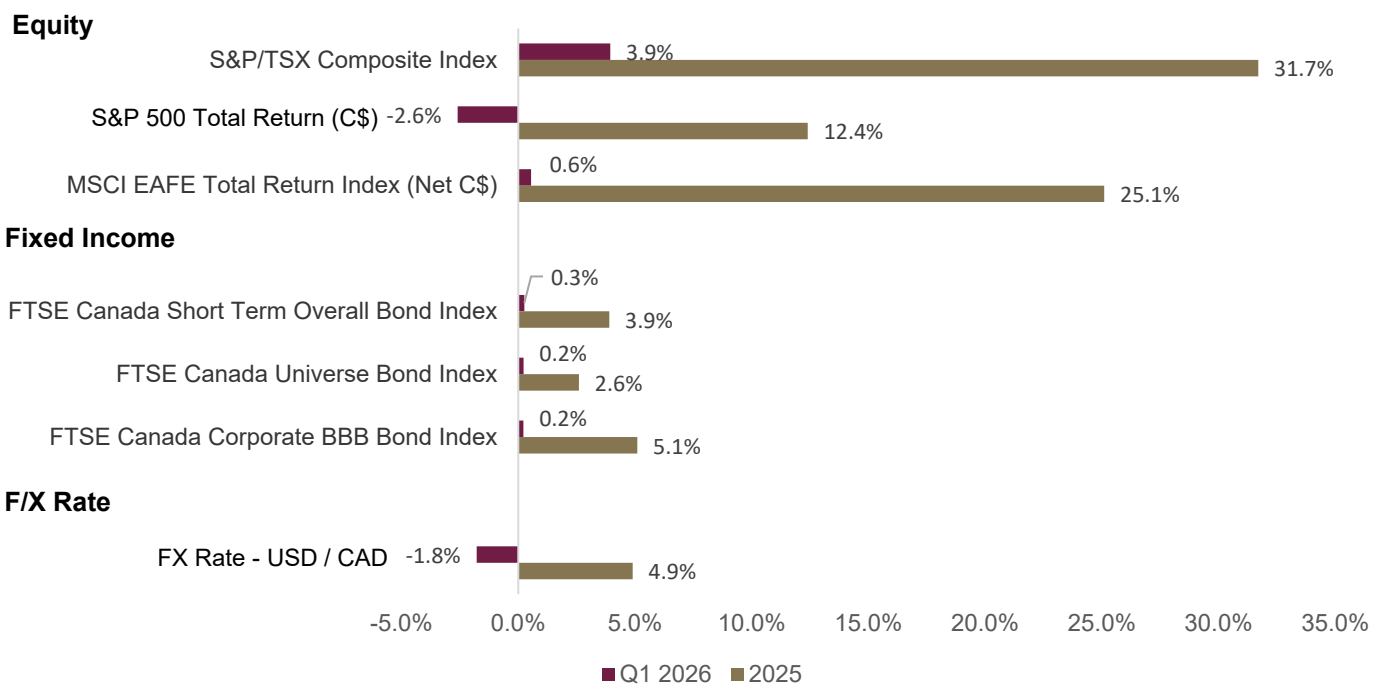
⁵ The FTSE Canada Universe Bond Index is the broadest and most widely used measure of performance of marketable government and corporate bonds outstanding in the Canadian market.



Further, the existing downside risks to growth and the associated disinflationary pressures, particularly in Canada, are likely to be amplified by any energy-driven increases in the cost of living that erode households' discretionary spending capacity and weaken demand, with higher interest rates only compounding the effect.

Taken together, this suggests that markets appear to be a little overzealous in anticipating how central banks will react to energy prices. Instead, holding steady and evaluating developments seems like a more reasonable path, with the focus likely to be more on the negative effects of higher prices on demand than on a potentially short-term increase in inflation.

Market Indices Performance (C\$ - March 31, 2026)



Source: Guardian Capital, using data from Bloomberg as of March 31, 2026

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