Swerving Market Drivers

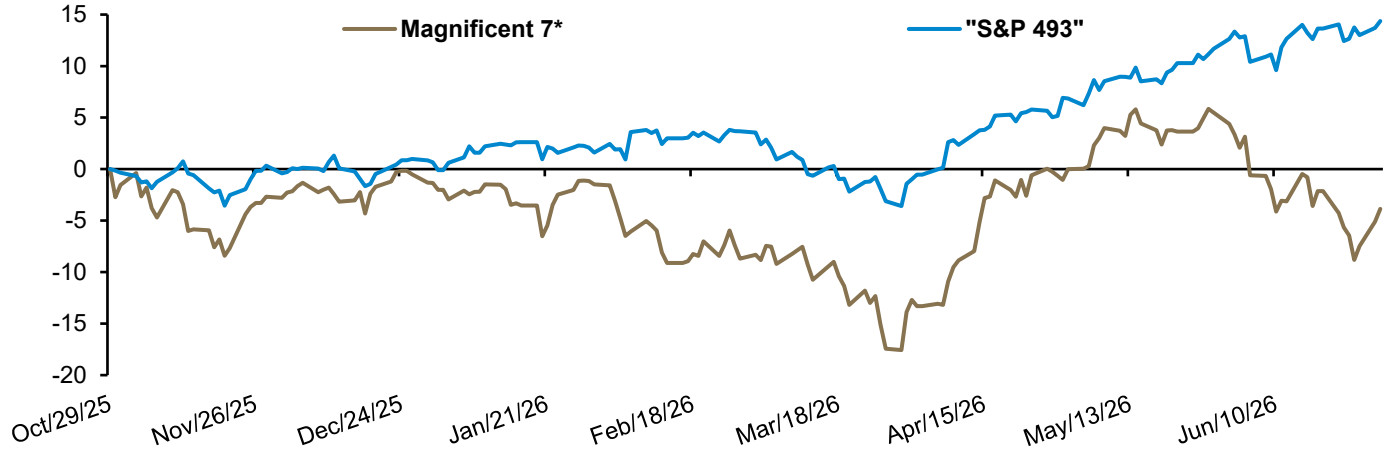
Commentary

One of the more fascinating developments in markets this year is that despite the resurgence of the focus on artificial intelligence (AI) and related technologies and infrastructure following the blowout earnings season, these stocks have actually moved out of the driver's seat with respect to market performance.

The AI-adjacent mega-cap Magnificent 7[1] (Mag7) stocks, which have accounted for an outsized share of market gains in recent years, rallied following the onset of the war in the Middle East and narrowed the performance gap that had emerged since the fall. However, June saw markets sour on these names, despite their still strong profitability.

Whether it has been due to risk management related to the growing exposure and concentration of these names in portfolios, concerns about fundamental growth forecasts implied by their valuations, or the better-than-expected improvements seen elsewhere (the outsized earnings growth recorded so far this year has come as more than 80.0% of companies within the S&P 500 Index[2] have beaten estimates), investors have been shifting out of these and into other areas of the market. The Mag7 are down 1.9% year-to-June and -2.4% since October, compared to +14.5% and +14.8%, respectively, for the rest of the S&P 500 Index in those periods, with June seeing the Mag7 fall 8.9% while the rest of the U.S. benchmark rose 2.4%.

Cumulative price return since October 31, 2025
(percent, U.S. dollar basis)



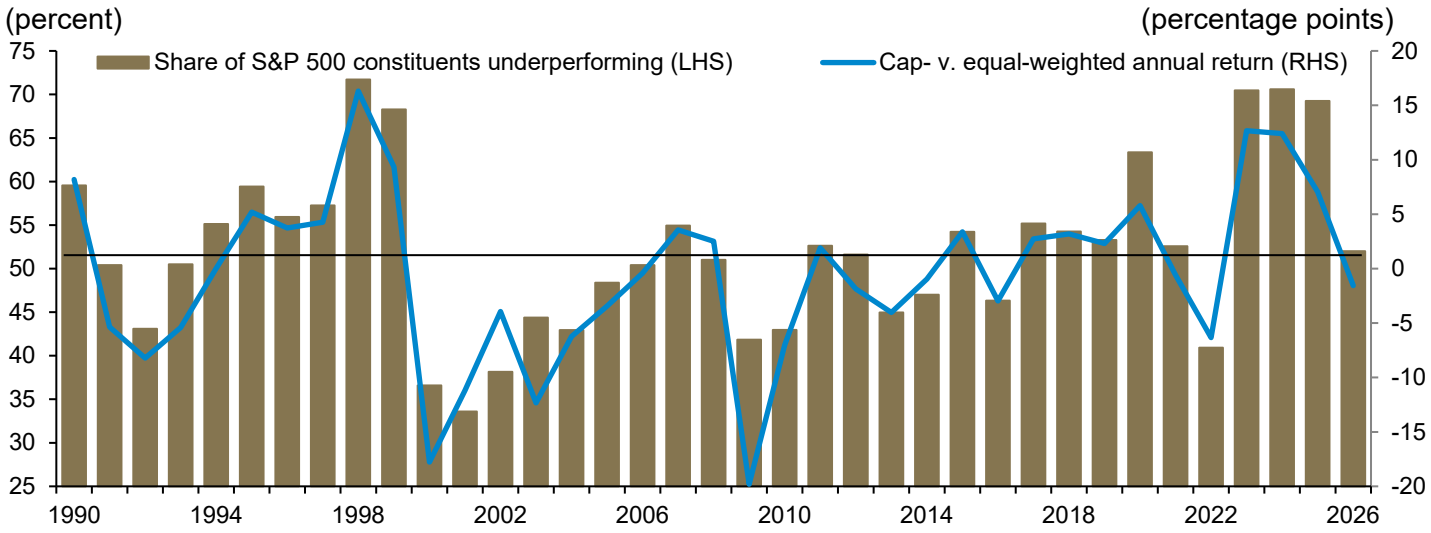
*Magnificent 7 stocks include Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla; while the S&P 493 consists of the remaining stocks from the S&P 500 Index.
Source: Guardian Capital based on author's calculations using data from Bloomberg from October 31, 2025 to June 30, 2026.

[1] Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.
[2] The S&P 500 Index (S&P 500) is an index of 500 stocks designed to reflect the risk/return characteristics of the large-cap US equity universe.

Despite the narrow media focus on AI and Information Technology — which has been exacerbated by massive new companies in the space going public — it is still somewhat remarkable that performance to the halfway point of 2026 has actually been quite broad-based.

As of the end of June, almost half of constituent companies in the S&P 500 Index are outperforming the overall market benchmark this year, and that share rose to two-thirds in June — outside of the down-year in 2022, that is the best breadth of performance since 2016. Echoing this development and the relative weakness of the Mag7, the version of the S&P 500 Index[3] that assigns an equal weight to each individual stock (+11.1%) is outperforming the standard capitalization-weighted index (+9.6%) by its widest margin since 2016 (again excluding the 2022 down-year).

Share of S&P 500 constituents underperforming S&P 500 and S&P 500 Index return relative to S&P 500 Equal Weight Index



*2026 is year-to-June; source: Guardian Capital based on data from Bloomberg and Ned Davis Research.

A market environment in which gains extend beyond a very narrow subset of stocks is one that tends to be beneficial for more active investment strategies that have lagged the market benchmarks and their passive investment vehicles in the highly concentrated leadership of recent years. Any portfolio that does not have exposure to those highly concentrated names/subsectors/sectors, or is underweight versus the benchmark, has been essentially guaranteed to underperform.

[3] The S&P 500 Equal Weight Index (EWI) is the equal-weight version of the widely used S&P 500 Index, which is capitalization-weighted. The EWI index includes the same constituents as the S&P 500, but each company in the EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

There are fundamental reasons to anticipate that this market rotation could continue. Economic growth is becoming increasingly broad-based, with business capital investment (largely targeted at AI-related tech) driving growth in manufacturing activity. This is complementing the continued resilience of consumer spending in the face of cost headwinds. At the same time, government investment is slated to ramp up on the back of large-scale infrastructure investment commitments — and this is the case worldwide, not just stateside.

This suggests there is scope for these broadening performance trends to continue as investors re-evaluate the (more upbeat, especially with the prospect of a sustained resolution to the situation in the Middle East) outlook beyond just AI to areas of the market that potentially offer better relative value for investors willing to tolerate the ongoing potential for near-term volatility.

Equity Commentary

The early setback in global equities in 2026 proved short-lived, with major European, Asian and American stock benchmarks recovering sharply over the second quarter. The domestic S&P/TSX Composite Index[4] rose a strong 7.0%; however, that trailed the rebound seen in its international peers as the commodity strength behind its first-quarter gains went into reverse. The MSCI EAFE Index[5], the benchmark of major European and Asian Developed Markets, returned 12.7% in Canadian dollar terms (+10.8% in USD), while the S&P 500 Index climbed over 17.1% in Canadian dollar terms (+15.3% in USD), erasing its first-quarter loss and pushing past 7,600 for the first time before drifting lower into the close of June.

Sector leadership essentially flipped from the first quarter. Energy gave back the advantage it held to start the year, as crude prices gave back their entire move (both Brent and WTI prices slipped to pre-war lows in June as traffic through the Strait of Hormuz picked up and Persian Gulf exports were restored under a U.S.-Iran interim accord). Materials was another underperformer, giving back gains, particularly late this quarter, as the prospect of higher rates moved into view as the U.S. Federal Reserve (Fed)'s more hawkish projections and the broader rising-rate backdrop weighed on the gold price and, in turn, on the precious-metals producers that had contributed to the sector's strength earlier in the year. Information Technology led the way, helped by renewed appetite for AI infrastructure and a strong recovery in semiconductor shares (memory pricing especially).

Taken together, the second-quarter recovery reinstated the multi-year upward trend across North American, European and Asian equities, casting the first quarter decline as a short interruption rather than a deeper drawdown.

Equity market performance from here will largely hinge on a potential global energy value chain recovery, due to resolutions in the Middle East, along with unresolved questions around the cost of artificial intelligence and its bearing on the labour market. The first quarter declines had marked valuations down to undemanding

[4] 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.
[5] 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. and Canada.

levels for a range of well-run companies. Still, with the major indices now sitting at near-record highs, the straightforward gains available from oversold conditions have largely been collected.

Fixed Income Commentary

Fixed income markets navigated another quarter shaped by crosscurrents rather than a single clear trend. Bond investors were confronted with a challenging mix of still elevated geopolitical uncertainty, ongoing trade-policy noise, and renewed sensitivity to inflation, particularly as higher energy prices pushed headline inflation measures higher in both Canada and the United States. At the same time, signs of softer economic momentum — especially in Canada — reinforced the view that central banks remain constrained in how aggressively they can respond. 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.

In Canada, economic data showed weakness early in the quarter, including a negative Q1 GDP report suggesting the country entered a "technical recession" (defined as two consecutive quarters of negative GDP growth). As a result, the Bank of Canada opted to leave its policy rate unchanged at 2.25% in April, despite the near-certain probability of impending higher-than-target inflation due to elevated energy prices. Later in the quarter, these trends reversed; Canada posted an impressive May employment report, adding 88,000 jobs, while global energy prices steadily marched lower. Despite the strong jobs data, economic uncertainty remains as CUSMA[6] negotiations kick off, and given the decline in energy prices, interest rates decreased throughout the period.

U.S. fixed income followed a different path in Q2. The market entered the period expecting interest rate cuts later in 2026, due to their "low hire, low fire" job market and the potential deflationary impact of AI. In addition, the new Fed Chair, Kevin Warsh, was widely speculated to have earned the nomination from President Trump due to his preference for lower interest rates. However, continued strong economic data and Warsh's surprising commitment to lower inflation in his first press conference introduced expectations for rate hikes later in the year. Balancing these trends, the Fed opted to leave its policy rate unchanged from its April and June meetings.

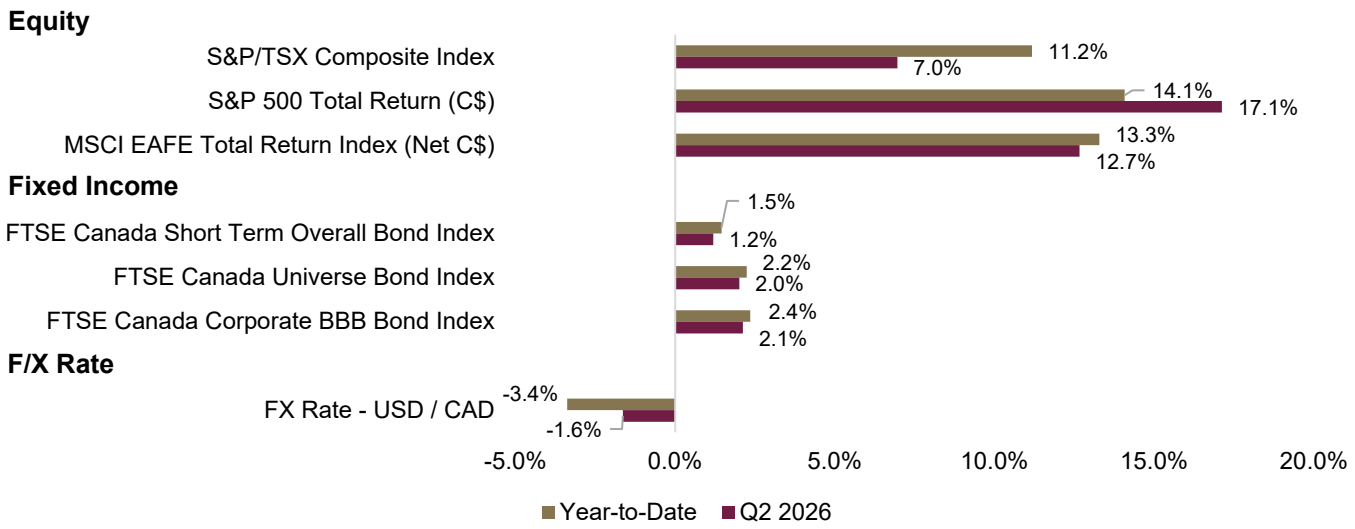
Against that backdrop, bond yields remained volatile. In Canada, yields broadly moved lower, while in the U.S., shorter-term yields increased, while longer-term yields decreased. Within the corporate market, company earnings remained resilient, and bonds continued to recover from volatility in Q1. Driven by monumental spending on AI, Alphabet and Amazon both issued Canadian dollar bonds for the first time, becoming Canada's two largest bond deals ever at C$8.5 billion and C$14 billion, respectively.

[6] The Canada-United States-Mexico Agreement

The Canadian fixed income benchmark, FTSE Canada Universe Bond Index[7], returned +2.0% in the quarter, with the FTSE Canada Short Term Overall Bond Index[8] returning +1.2%, the FTSE Canada Long Term Overall Bond Index[9] returning +3.4%, the FTSE Canada All Government Bond Index[10] returning +2.0% and the FTSE Canada All Corporate Bond Index[11] returning +2.1%.

Looking ahead, the most likely path for fixed income appears to be one in which central banks remain patient while markets react to incoming data on inflation, growth and geopolitics. For investors, that should keep the opportunity set in bonds constructive, even if capital gains are harder to come by than they were during earlier easing cycles. With yields still offering meaningful income and economic uncertainty lingering, fixed income continues to offer both a source of cash flow and a stabilizing counterbalance to riskier assets.

Market Indices Performance (C$ - June 30, 2026)



Source Bloomberg: All figures stated in Canadian dollars as of June 30, 2026.

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[7] 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.
[8] The FTSE Canada Short Term Overall Bond Index, a measure of short term bond performance in the Canadian domestic bond market.
[9] FTSE Canada Long Term Bond Overall Index, a measure of long term bond performance in the Canadian domestic bond market.
[10] The FTSE Canada All Government Bond Index measures the performance of the Canadian dollar-denominated investment- grade fixed income market, covering Canadian government and quasi-government bonds.
[11] The FTSE Canada All Corporate Bond, a measure of investment grade corporate bond performance in the Canadian domestic bond market.

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