

2026 Capital Markets Outlook

Downsize, Rightsize and Upsize

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All data references are as of November 15, 2025, unless otherwise stated.

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Executive summary

Constructive outlook amid moderating gains

We remain optimistic on global economic and capital market prospects for 2026, supported by solid fundamentals in economic growth, earnings, and monetary and fiscal policy. Our base case anticipates returns across cash, bonds, equities and alternatives broadly in line with long-run averages. We expect moderating equity market performance given the starting point for valuations and exuberant sentiment in certain areas.

Economic backdrop: resilient growth

Despite tariff-related disruptions in 2025, global fundamentals held firm – a firmness we expect to carry on into 2026. We see conditions where global growth can surprise to the upside as deferred spending and investment resume. Fiscal stimulus remains a key driver, shifting from household transfers to industrial policies that bolster infrastructure, manufacturing and technology. The U.S. benefits from deregulation, tax cuts and productivity gains, while Europe and Japan see structural improvements and fiscal support.

Inflation, monetary and fiscal policy: manageable pressures, supportive conditions

Inflation is expected to stay slightly above central bank targets but within tolerable ranges, aided by soft labour markets and easing trade frictions. Tariff impacts are proving less severe than feared, with price adjustments spread over time. Central banks are positioned to maintain accommodative stances: the Fed is likely to cut rates toward 3.25–3.5% while the Bank of Canada holds near 2.25%. Loose financial conditions, combined with fiscal stimulus, create a favourable backdrop for risk assets.

Capital market implications

Cash returns should approximate inflation (2–3%). Canadian fixed income is expected to deliver 3–3.5%, aligned with current yields. Equities remain supported by percentage earnings growth expectations in the mid-teens globally. Valuation compression tempers price appreciation, resulting in high single-digit to low double-digit returns. Alternatives such as private equity, credit, real estate and infrastructure remain useful tools for diversification and return enhancement.

Strategic positioning: balanced and diversified

We maintain overweight positions in Canadian and U.S. equities and neutral weight in international and emerging markets. Within fixed income, we favour investment-grade corporate bonds and underweight lower-quality high yield bonds.

Risks and opportunities

While fundamentals remain supportive, elevated valuations and pockets of exuberance bear watching – particularly in gold stocks and AI-related sectors. We categorize equity opportunities into three themes: downsize (disciplined exposure to overheated segments); rightsize (maintain positions in sectors priced for continued earnings growth); and upsize (increase exposure to under-owned sectors poised to benefit from global growth).

Bottom line

The bull market is “middle-aged,” not overextended. Risks from overvaluation or policy missteps remain low for 2026. Globally, there is a powerful alignment of stimulative monetary and fiscal policy, combined with solid economic and earnings growth that supports further gains, albeit at a moderated pace. Our approach emphasizes diversification across geographies and asset classes, disciplined rebalancing, and prudent risk management to achieve our clients’ long-term financial goals.

S&P/TSX price target: 34,000

S&P 500 price target: 7,400

10-year bond yields: Canada = 3.5%

10-year bond yields: U.S. = 4%

Canadian dollar: C\$1.35 or US\$0.74.

Overview

We remain constructive on the global economy through 2026. Our base case calls for cash, bonds, stocks and alternatives to deliver results commensurate with their long-run averages and consistent with the solid underlying fundamentals currently in place. Our outlook is optimistic yet realistic, given that we’ve experienced solid equity market gains over the past three years. We say that equity market gains have been solid, not exuberant (a word many are using) because the so-called “rally in everything” needs context. First, it is a recent story. Second, it hasn’t been a rally beyond expectations in everything, nor has absolutely everything rallied.

This bull market’s performance can be attributed to three factors: the starting point, where stocks were largely undervalued; a move up that was genuinely justified by fundamentals; and potential over-exuberance.

The starting point matters

It is worth remembering that the current bull market advance started in late 2022, a year of significantly negative returns for both stocks and bonds. Since then, just about all stock markets have gone up each year. However, it hasn’t been a universal, straight upward advance, and not every year was above average for all markets. Equity markets outside the U.S. started off slowly. The S&P/TSX gained steam in 2024, but international developed and emerging markets have only come on strong this year. Opportunities remain, including a broad swath of U.S. equities outside of the largest companies that have dominated headlines and index performance. These high-flyers may continue to present opportunities, too; we should just acknowledge that expectations for their performance are high. Investing in good companies at reasonable prices (rather than the bargain basement prices that we saw 2022) is always a prudent strategy.

Earnings growth matters

Some of the equity market gains are justified upward movements in share prices based on earnings growth, the only fundamental that matters in the long run. These fundamental advances are not limited to companies in the AI space. Earnings growth is broadening out to other geographic regions, sectors and companies. Our base case forecast calls for this widening in participation to continue, but we anticipate that the pace of gains for equity markets will moderate.

Over-exuberance – probably

We believe there are pockets of over-exuberance in equity markets. Investors who remain disciplined and diversified both participate in these areas and mitigate the risks that may be brewing here.

Summary of our views

Part of our forecasting framework asks, “Why would an asset deliver returns different from its long-run average?” For 2026, we see nothing to suggest a significant disconnect between cash and bonds and the fundamentals that drive their valuations.

We expect cash to deliver returns close to the rate of inflation (2% to 3%), which is a totally normal and healthy situation.

We see a similar situation in the bond market, given the growth and inflation backdrop plus expectations that central banks will do relatively little compared to the last four years. Our expectations for Canadian fixed income align with current yields to maturity, which for the FTSE Canada Universe Bond Index is 3.4%.

Looking ahead for equity markets, there are plenty of positives while the negatives have shown they can be muted or transitory. We do not expect the heady yearly percentage gains of the past three years to continue considering where many equity market valuations stand at the aggregate index level. Reasons for caution remain; investors should be mindful of their time horizon and risk tolerance, and rebalance back to well-diversified portfolios.

We anticipate percentage earnings growth in the mid-teens across most global markets. Allowing for some downward wiggle room on valuations, we see gains in the high single-digits to low double-digits for most equity markets.

In the alternative asset space (private equity, private credit, real estate, hedge funds and infrastructure), the opportunities are never homogenous. Recent weakness in private credit, likely confined to a subset of the asset class (subprime auto loan companies), are a reminder that when money flows heavily into one area, some lax discipline is often the result. These flare-ups are a healthy reminder of the importance of doing the requisite homework on any asset before investing. Our partners are world-class experts in private credit and world leaders in all these asset classes. Like all strategies we employ, we rely on well-diversified solutions to reduce risk.

Our views on alternatives continue to evolve as these asset classes grow. We increasingly see them as important sources of diversification and return enhancement when they are used judiciously, applying expertise and rigorous research.

Macroeconomic backdrop – pardon the interruption

When formulating our base case, we examine scenarios that ask what if things are worse and what if things are better. Despite all of 2025's chaos, the fundamentals equity markets care about most (economic and earnings growth, interest rates and bond yields) all delivered numbers as expected or better. We see good reasons why these fundamentals can carry forward into 2026. Equity markets see this too, which is why they have performed so well. Stocks are a leading indicator; they move up (and down) ahead of earnings and economic data.

Tariff chaos created a situation that can be summarized by “pardon this interruption – our regularly scheduled programming will return shortly.” Uncertainty prompted a pause on some household and corporate spending decisions, pushing some of the spending, hiring and business expansion that might have otherwise occurred in 2025 into 2026.

Just about every economy displayed some level of weakness at some point throughout the year – for some, a level of weakness is still ongoing. All of this culminates in an environment that isn't recessionary per se but has nonetheless produced a slowdown or disruption that sows the seeds for a mini rebound. It is similar to typical slowdowns driven by more traditional factors like the inventory cycle or a tightening of financial conditions.

In the U.S., growth continued at a solid clip. However, concerns have arisen that growth is slowing. The fundamentals still look decent: private-sector leverage remains low, and economic growth is moderating but from a brisk pace. A mild slowdown in U.S. GDP growth would still leave the U.S. growing faster than most developed economies.

We expect global growth to improve from its current sluggish patch. Businesses and households are proving resilient at digesting the tariff shocks. Reduced trade uncertainty will prompt businesses and consumers to resume purchases and investments, boosting global growth.

Fiscal policy – still priming the pump, favouring capitalists

Global growth will get a lift from fiscal spending around the world. That includes government spending in Europe and Canada, stimulus in China, and in the U.S., positive impacts to businesses and households from the full tax impact of the One Big Beautiful Bill.

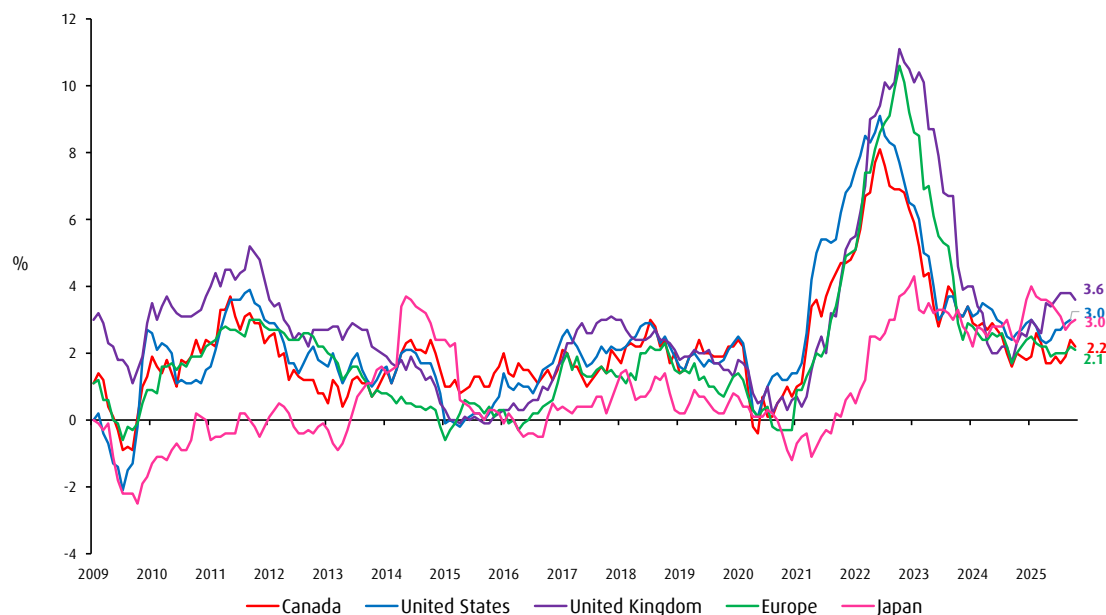
Fiscal spending is different from the past. Previously, support was primarily directed to the household sector – e.g., COVID cheques, and healthcare entitlement increases (ACA, dental care, pharmacare). Today's initiatives are aimed at industrial policies that support key industries, including infrastructure, defence and manufacturing. Government spending will flow more directly to the private sector and increasingly to justifiable investments for the future. Spending will pivot away from outsized growth of the public service or entitlement spending consumed immediately with little multiplier effect.

Add deregulation in the U.S. that is also spreading elsewhere plus ongoing healthy consumption by households. Business investment will continue in a number of areas: AI and AI-adjacent industries; energy; infrastructure; near-shoring manufacturing; and nation-building projects in Canada. We see multiple avenues and conditions that will allow global growth to remain buoyant while it accelerates in the weakest areas, namely China and Europe.

Inflation – a tad warm but tolerable

Year-over-Year Change in CPI for Selected Global Economies

January 2009 – September 2025 (United States) / October 2025



Source: Bloomberg

It is natural to worry that the anticipated uptick in global growth will stoke inflation. We expect inflation to remain above central banks' targets, likely driving volatility in the process. However, we believe inflation will remain manageable enough that central banks will continue to tolerate it slightly above target under the cover of soft labour markets and lingering trade issues.

The pass-through effects of tariffs on inflation are proving less concerning than feared. U.S. Federal Reserve Chair Jerome Powell has described tariffs as a one-time shift in prices, but not all at once. We agree. Corporations adapt to tariffs over time, eventually maximizing profits and passing at least some of the tariff costs on to consumers. "One-time, but not all at once" dampens the impact of tariffs and spreads it out over time, easing the shock to the economy.

Inflation can stay elevated provided it doesn't go too high (which would be north of 3% for longer than a month or two). Despite the Fed's 2% inflation target, inflation has chronically undershot and overshoot that target for extended periods since the 1990s; an overshoot of around 2.6% above target has been the most common. Clearly, the U.S. economy can run smoothly when inflation is above 2%. That's important because inflation is likely to remain somewhat elevated for a while.

For Canada, retaliatory tariffs are off, removing that inflation risk. The loonie is soft, which is an inflationary impulse for Canada, but our currency remains at levels we have seen before. Canada's weak labour market is leading to moderating wage pressures – a key lynchpin that should keep inflation from becoming unhinged. Cool housing markets, which we're currently experiencing, also exert a downward influence on inflation.

Globally, deflationary forces are at work. Emerging market inflation continues to fall. China and India have low to no inflation, a situation echoed in parts of Europe (France, Italy, Switzerland, Sweden and Finland all have annual CPI below 1.5%).

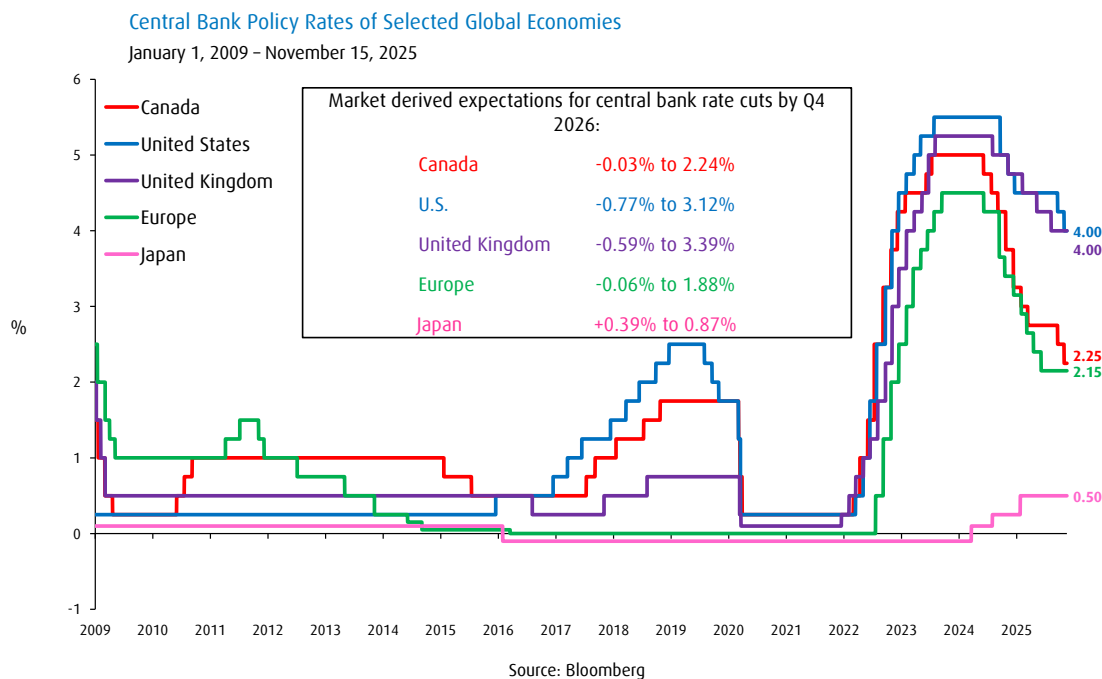
We like equities for many reasons, including their ability to protect wealth from inflation. Equities are a good inflation hedge. Companies are a part of the inflation mechanism. If companies aren't raising prices, inflation doesn't happen. Earnings are a nominal measure, driven by nominal economic activity – real economic growth, plus inflation. We prefer earnings growth based on real economic growth, productivity, innovation and entrepreneurship. However, the share prices of well-managed companies tend to rise as earnings increase even if some of that is due to inflation.

Trade – tariffs are becoming understood, managed and navigated

Once again, corporations are proving resilient. Muscle memory is deeply entrenched after training on Trump tariffs 1.0, COVID, Ukraine, a significant inflation shock and Trump 2.0. Steering through all of this, businesses are churning out solid earnings growth and are generally supported by solid balance sheets.

Reasonable outcomes in North American free trade factor into the magnitude of the upside potential in 2026. The past year illustrates that the choices made by the U.S. administration are ultimately calibrated through key feedback loops that bring policy to a place where the U.S. and the rest of the world can digest and adapt to it. We anticipated that signals and feedback from inflation, currencies, stocks, bond yields, public opinion, the judiciary, Congress and business lobbyists would help. These feedback loops are now dependably established. Uncertainty remains, but we expect the loops will continue to be reliable checks that will keep policy within reasonable guardrails.

Monetary policy – take it easy



Economic growth outside the U.S. has been picking up as interest-rate-sensitive economies (Europe, Canada) responded to prior monetary policy easing. That easing is only now approaching an end; the lagged impacts will flow into 2026.

The U.S. Federal Reserve paused its easing campaign. Still, the past rate decreases plus additional rate reductions in 2026 are a positive backdrop not only for the U.S. economy but also for the world. Borrowing costs in the U.S. have spillover impacts (in this case, positive) on the rest of the world. Further steps by the Fed to add stimulus via technical adjustments to its balance sheet should be net positive for the risk backdrop.

For capital markets, the labour market is a balancing act. It is okay if employment remains weak enough to temper wage inflation and prompts central banks to ease monetary policy but not so weak that it risks constraining the almighty consumer. We should remember that many labour markets are in transition due to immigration (U.S. and Canada), demographics, decades-long skills mismatches and possible early impacts from productivity enhancements created by AI and other technological deployments. While these are longer-term issues, in 2026 they will allow central banks to keep financial conditions loose either by easing (in the U.S.) or by staying on hold (in Canada and Europe). Easy financial conditions against a backdrop of solid GDP growth and strong corporate earnings are a good set up for risk assets like stocks and higher-yielding credit options in fixed income.

There is a risk the Fed will ease too much, leading to asset or price inflation and the eventual need to stomp on the brakes. If it materializes, we see this risk as a 2027 event, but we are watching for early indications.

Putting it all together, our outlooks for economic growth, inflation, central bank policy and bond yields are supportive of further gains from the capital markets (cash, bonds, stocks, and alternatives).

Capital market implications – equities

Last year, we didn't factor in further expansion of equity market valuations when arriving at our equity market forecasts. Still, we noted that there is plenty of historical precedent for market enthusiasm to get carried away. We pointed out that if this scenario unfolded, equity markets could rack up another excellent year in 2025 – we do see a “You Are Here” arrow on the map.

We believe 2026 is a mildly riskier environment for stocks than 2025. We don't think a growth scare, an inflation scare or whatever scare is any likelier than in 2025 (we think the opposite – that growth can surprise to the upside). Rather, we caution that when sentiment is ebullient, asset valuations reflect a lot of good news, leaving less margin for disappointment (not just for stocks – gold and crypto, plus some parts of the credit markets too).

Business cycles and bull markets don't die of old age. They collapse under their own success, or they are arrested by higher interest rates from central banks and the bond market due to inflation fears – two risks we are monitoring, but assign a low probability over our forecast horizon.

Collapsing under its own weight would mean popping the AI bubble, if there is one, and spreading contagion to the rest of the stock market or the real economy. Contagion to the real economy usually occurs through debt or the labour market. The footprint of AI in both realms is still relatively small. If AI companies falter or the theme runs out of steam, the real economic damage should stay contained to the sector and not spread to the rest of the economy.

Contagion to equity markets is another story. Here the damage to risk sentiment would likely spread to the rest of the equity market. But if there is limited spillover to the real economy (it doesn't spark a recession because there are limited ripple effects through credit or labour markets) then the non-AI segments of the equity market should recover quickly, even if the AI theme requires extra patience.

This bull market has pockets of exuberance but many areas of opportunity, especially opportunity leveraged to an uptick in global growth and less chaos on tariffs. We size up the risks and opportunities in stocks across three themes: downsize, rightsize, and upsize.

Downsize

Parts of the market exposed to AI and AI-adjacent themes need to downsize; in general terms globally, we're talking about the information technology and communication services sectors. For Canadians, in our view gold stocks (part of the materials sector) have some froth. There is a risk that share prices of some of these companies are either ahead of where the fundamentals could go in the short term, or at a minimum the current trajectory should not be extrapolated to move upward in a straight line in perpetuity to justify valuations. This isn't the entire subset of businesses; market movements in November are doling out discipline.

Oracle and Nvidia are good examples. Investors erased the lion's share of Oracle's parabolic gains in 2025 amid concerns about debt and spending. Nvidia delivered a stellar earnings report, but even better-than-perfect results didn't earn further appreciation in share price, which lines up with cooling enthusiasm and valuations across a wide swath of businesses. This is the kind of healthy, discerning behaviour that can extend the market cycle, preventing it from collapsing under its own weight.

Rightsize

Other areas of the market are priced for more good news and simply need earnings growth to continue delivering. Given the positive backdrop we expect, this is reasonable. In the current environment, share price appreciation slows down, remains positive, but not at the same pace or too far ahead of fundamentals. Sectors globally include financials, industrials and consumer discretionary. Good things are happening in these businesses; their share prices have correctly reflected these developments. We expect to see more of this, which is normal behaviour for equities.

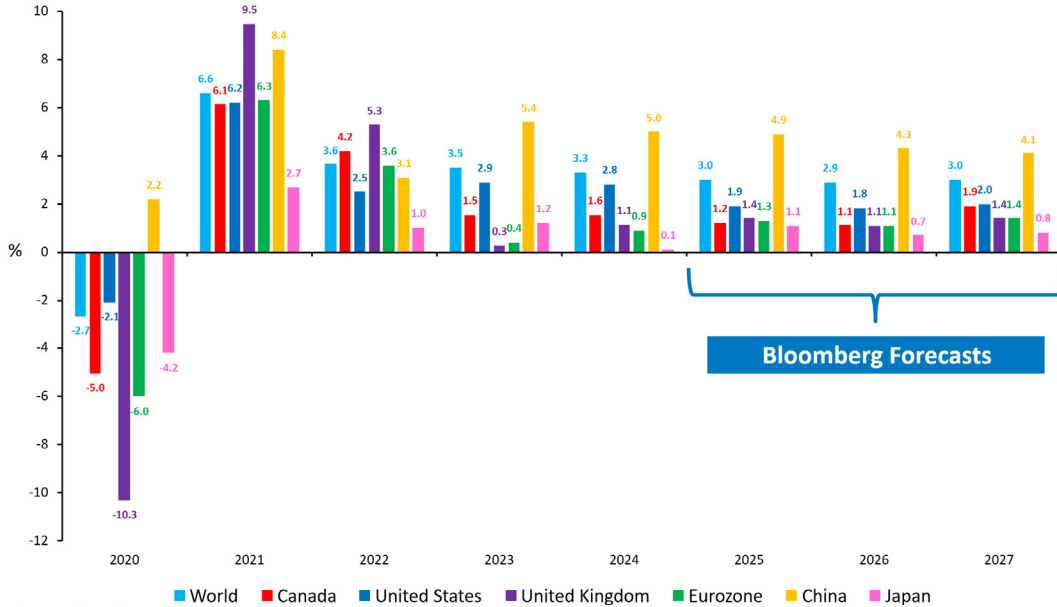
Upsize

Then we have the upsize beneficiaries. We're talking about areas that have been less loved over the past three years of the bull market and are levered to our improved global economic growth backdrop. Global sectors in this basket in our order of preference include healthcare, energy, consumer staples and real estate. All these sectors may not see catalysts for above-average returns, but they have been unloved over the past three years. Take healthcare, for example. Despite the explosion in the use of GLP-1 medicines and an aging population, the compound annualized price return from the MSCI Global Health Care sector for the three years ended October 2025 is a mere 4%, which is less than the U.S. Government Bond Index over the same period.

The bottom line is that upsized growth provides benefits to all parts of the equity market, but different sectors have moved to varying degrees to reflect this scenario. While not predicated on it, spreading productivity gains from the deployment of new innovations would bolster the story.

Economic growth – upside surprise potential

Actual and Forecasted Year-over-Year GDP Growth Rates of Selected Global Economies
Actual: 2018 – 2024; Forecasts: 2025 – 2026 (as of November 14, 2025)

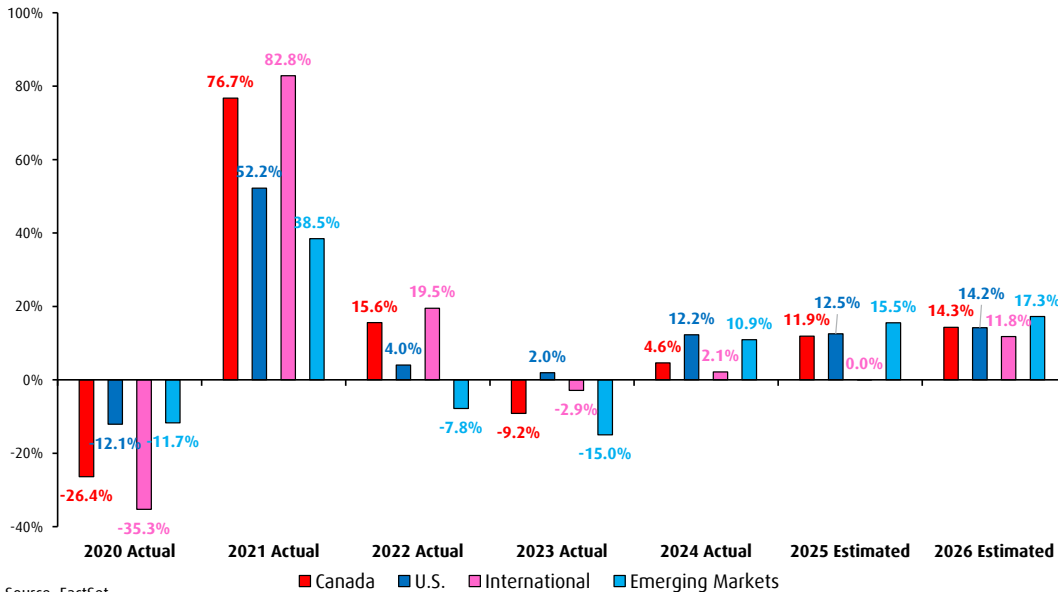


Source: Bloomberg

Regional equity market insights

Global earnings growth – solid forecasts

Earnings per Share Growth Estimates for Selected Global Markets
as of November 14, 2025 / November 17, 2025 (Canada)



Source: FactSet

Canada: S&P/TSX Composite Index; U.S.: S&P 500 Index; International: STOXX Europe 600 Index; Emerging Markets: iShares MSCI Emerging Markets ETF

Canada

The S&P/TSX Composite Index has enjoyed a solid rally during 2025, besting many other equity markets. For the most part, tariffs on Canada have turned out to be less impactful than originally feared. The USMCA remains in force, leaving tariff rates in the low single-digits for most of Canada's U.S.-bound trade. The trade war has yet to significantly dampen corporate earnings at the index level in Canada. However, future investment and sentiment have been negatively impacted. Clarity on U.S.-Canada trade is imperative. In the meantime, the government's fiscal spending plans are a formidable near-term shot in the arm and target investments for the long term.

Significant sectors of the Canadian economy facing targeted higher tariffs are clearly hurting. Why is Bay Street faring better than Main Street? For one, the Canadian economy has been performing better than first feared. Forecasts for a recession have been unwarranted so far. Significantly, we remind folks that the S&P/TSX is not the Canadian economy: 65% of the index is in financials, energy and materials.

Tariffs on Canadian oil and minerals are 10%. Our low currency helps, plus U.S. buyers have few options for substitution. There are no tariffs on gold. Because the price of gold has jumped over 50% year to date, the S&P/TSX gold subsector has doubled, driving roughly one-third of the S&P/TSX return. The financial sector is benefitting from a more favourable interest rate environment (lower short rates versus higher long rates favour banks' core lending business). The largest Canadian companies in many sectors have significant U.S. earnings exposure thanks to their U.S. operations, where there are no tariffs at all. Our weak loonie boosts exporters and inflates U.S. dollar profits, including repatriated profits from these Canadian companies' U.S. operations.

Thanks to ebbing inflation, the soft Canadian economy and trade war overhang, the Bank of Canada has cut the overnight rate from 5% to 2.25% in 18 months and the bond market has followed suit. Additionally, the sluggish economy and labour market are moderating wage growth, helping profit margins as Canadian companies sell abroad but borrow and hire at home. Canadian equity market valuations are above their longer-term average; lower interest rates tend to lead to higher valuations.

S&P/TSX earnings growth estimates for 2026 sit at 14.6%. Our forecast allows valuations to decline fractionally, resulting in an S&P/TSX price target of 34,000, representing a 12% price return from November 15, 2025, to December 31, 2026. Add in the estimated 2.7% dividend yield for 2026 and Canada continues to be our favoured market.

United States

A variety of crosscurrents are in play for the U.S. market. U.S. equities are not cheap, but they also feature solid earnings-growth expectations. The market remains home to some of the world's best companies – and not just in technology. We don't see room for valuation expansion at the index level, but we do see room for a rotation within U.S. equity markets that can drive further returns.

Outside the mega-companies, valuations are more reasonable in other parts of the U.S. stock market. An examination of the equally weighted version of the S&P 500, which adjusts for the outsized impact of the largest companies, shows valuations at a more reasonable 20 times earnings. The S&P 400 and 600, which measure small and medium-sized companies, also have valuations around 20 times earnings. All these measures are below their 10-year averages; small caps are meaningfully so. Smaller companies are poised to benefit from lower borrowing costs since they tend to rely more on the traditional banking sector, where the fed funds rate plays a larger role in guiding borrowing costs.

We see powerful ingredients for continued expansion in U.S. equities. There are solid indications that the U.S. is enjoying a productivity boom; this feeds strong profit margins, earnings and GDP growth. Benefits are also flowing from corporate tax cuts, deregulation, and a central bank trying to catch up to the rest of the world on rate cuts.

S&P 500 earnings growth estimates for 2026 sit at 14.2%. Our forecast allows valuations to decline, resulting in an S&P 500 price target of 7,400 or a 10% price return from November 15, 2025, to December 31, 2026. Add in the estimated 1.4% dividend yield for 2026 and the U.S. market remains attractive.

Europe, Asia and the Far East (EAFE)

Valuations for developed markets in Europe, Asia and the Far East (EAFE) have moved from below their longer-run average to slightly above it. However, the landscape has also changed. Europe, the U.K. and Japan faced various structural constraints, including slower economic growth, war, geopolitical instability, demographic challenges and weak productivity growth. While these issues haven't gone away entirely, there is reason to celebrate a meaningful improvement.

For Europe, the fundamentals are improving. A lot of focus is on Germany, the region’s largest economy, but on the periphery yesteryear’s laggards have quietly sorted themselves out and are seeing better economic growth. What Germany brings to the table is money. The dramatic turn toward fiscal stimulus will show up in 2026, and German companies will participate just from their sheer size. The whole region stands to benefit from a stronger global growth environment. The European Central Bank is inclined to remain accommodative even if mildly higher inflation (like elsewhere) deters the bank from making additional cuts. Should the AI theme stall (or worse), this region’s equity markets are less exposed.

Japan is also seeing a renaissance in the investing landscape. A return to mild inflation and a weaker yen are benefitting exporters. A longstanding grievance against Japanese companies has been their weak corporate governance and a less shareholder-friendly attitude compared to companies in other developed markets. Reforms have been enacted, and C-suite attitudes are shifting toward greater emphasis on profitability and operational efficiency, resulting in increased shareholder returns, higher dividends and share buybacks.

Earnings growth expectations for international developed markets of 11.8% are the highest in three years. Stack this on reasonable valuations and an estimated 2026 dividend yield of 3.2% and we favour a neutral weighting toward EAFE markets.

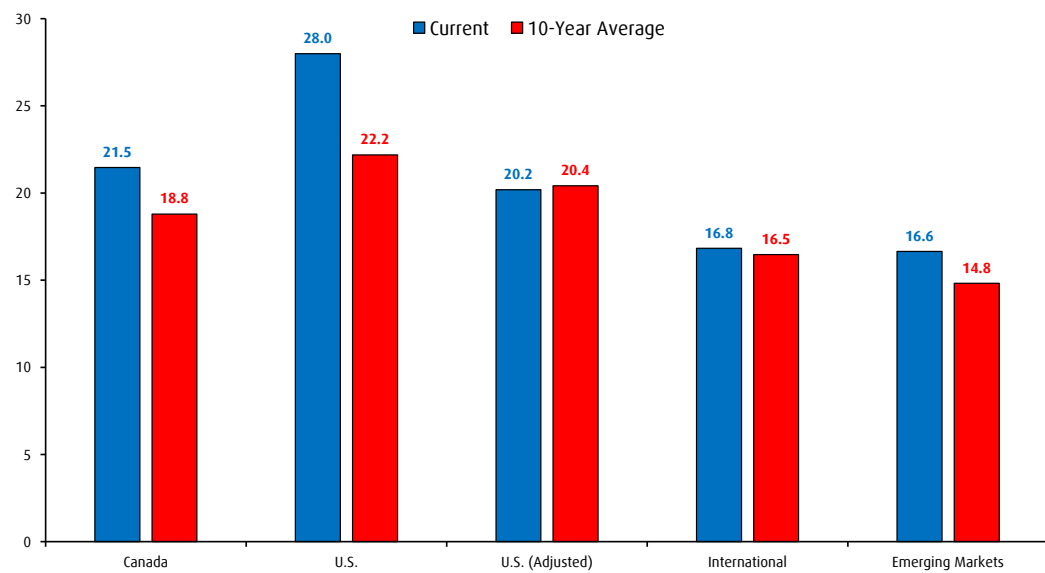
Emerging markets

Emerging markets are not a homogeneous asset class. To us they are satellite positions for growth-oriented investors. Although the region has high equity market volatility, the growth outlook here has improved. Trade tensions with the U.S. remain, but as China’s surprising export strength in 2025 demonstrates, these markets can pivot away from the U.S. and trade more among themselves. For China itself, economic malaise that has persisted over many years looks to be improving at the margin. Trade tensions are shifting government attitudes toward additional stimulus, which is being directed more toward the household sector than the corporate sector. This is the opposite of what we see in the developed world, but since Chinese household consumption and savings rates are considerably below those of Western societies, China needs this to shift the economy toward a better balance.

Earnings growth expectations for emerging markets top the list at 17.3%. However, given almost 30% returns in 2025, valuations are no longer cheap. The estimated 2026 dividend yield is 2.8% and we recommend a neutral weighting to emerging market equities.

Valuations – some headwinds, but earnings are delivering

Current vs. 10-Year Average Price-to-Earnings Ratios of Selected Global Equity Markets as of November 15, 2025



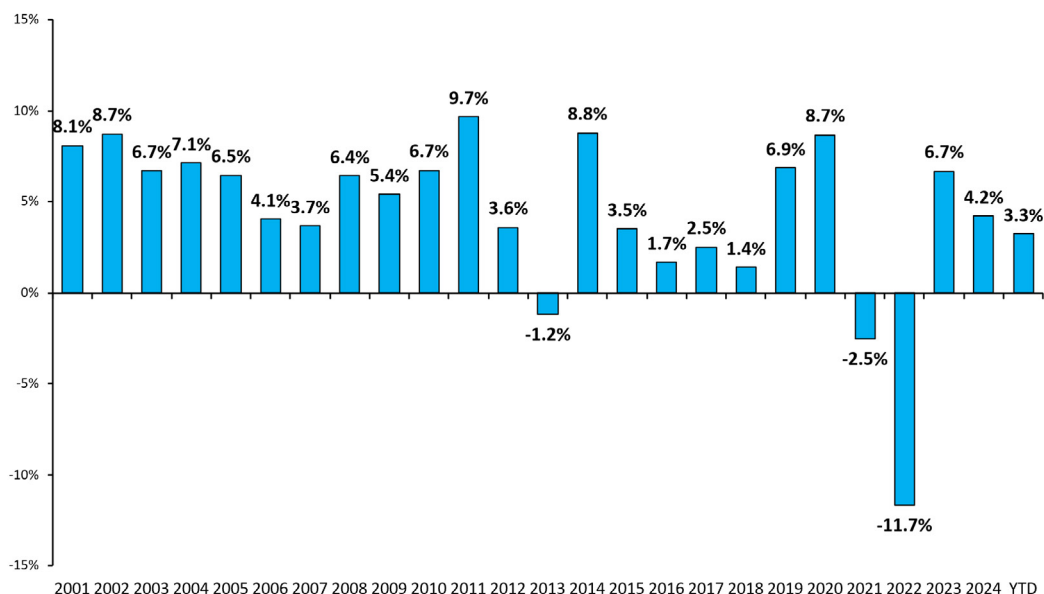
Source: Bloomberg
 Canada: S&P/TSX Composite Index; U.S.: S&P 500 Index; U.S. (Adjusted): S&P 500 Equal Weight Index; International: MSCI EAFE Index; Emerging Markets: MSCI Emerging Markets Index

Capital market implications – fixed income

Bonds doing their job

FTSE Canada Universe Bond Index Annual Total Return

2001 – 2025 YTD (as of November 15)



Source: Morningstar, Bloomberg (2025 YTD)

Fixed income markets have been volatile over the last few years due to inflation's spike and retreat and central banks' responses. We believe we are entering a period of relative calm. Importantly, the bond market and central banks in concert have ample room to deliver safety and stimulus should the backdrop deteriorate.

We expect a few rate cuts from the U.S. Federal Reserve, but most other central banks including the Bank of Canada have finished, or nearly finished, their rate-cutting cycles. This is a recent development, meaning the benefits of these rate cuts will continue to course through the economy.

We are calling for the U.S. 10-year Treasury to yield 4% driven by a combination of inflation at or above 2.5%, stimulative fiscal policy and stubborn deficits. We see the Treasury extending issuance duration in the second half of 2026 after flooding the market with T-bills. The Fed's scheduled return to purchasing bonds to manage its balance sheet as a part of normal monetary policy will help keep 10-year yields contained.

For Canada, we see limited downside for bond yields from current levels. The yield curve is aligned with expected growth, inflation and central bank outcomes. Canadian bond yields face greater upside risk, but it would come on the back of welcome news. Additional economic growth surprises and clarity on U.S. trade relations on top of the fiscal boost in the pipeline to combat these current headwinds would be enough to see Canadian bond yields move mildly higher.

Weighing these probabilities, **we expect 10-year Government of Canada bond yields to stay closer to 3% for at least the first half of 2026. But when the upside scenario comes into focus and the bond market looks toward 2027, we call for 10-year yields to move toward 3.5%.**

Like the U.S., Canada will face its own fiscal risk and higher debt. However, concerns about debt issuance are less acute. The BoC ended quantitative tightening in January 2025 and is expected to start adding long-term bonds to its balance sheet later next year. The expectation of bigger deficits is priced in because bond issuance has already increased. Despite larger deficits, the debt-to-GDP ratio in Canada is only projected to rise from 42.5% to around 43%, still the best among the G7 countries.

The bank's current 2.25% policy rate is already at the bottom of its 2.25% to 3.25% neutral range. **We expect the Bank of Canada to remain on hold** (one additional 0.25% insurance cut is possible).

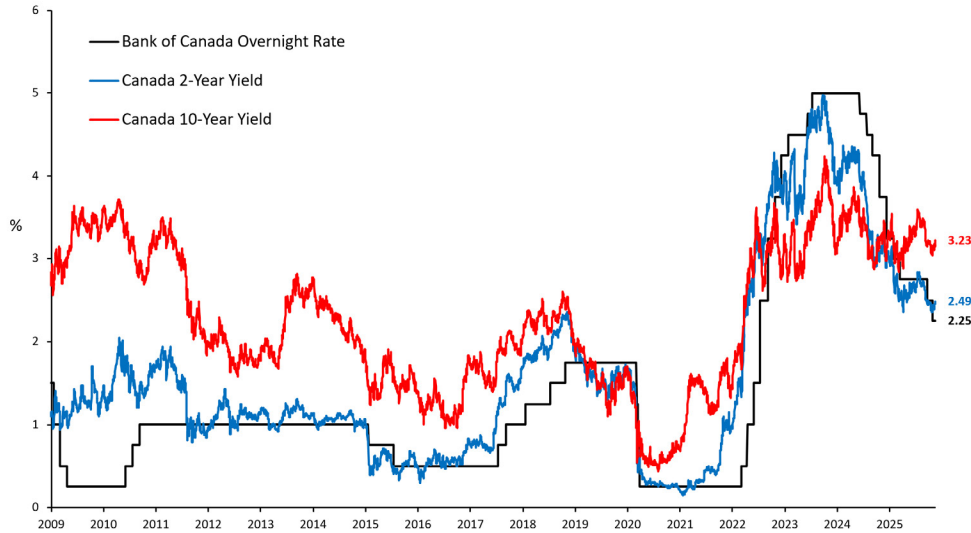
For the Fed, we expect a decline from the current 4.0% level to 3.25% to 3.5% by the end of 2026, at (or a touch below) its 3.5% neutral range.

Our various bond yield forecasts culminate in a **Canadian fixed income total return that aligns with current yields to maturity in the range of 3% to 3.5%.**

Bond yields in line with fundamentals

Canada Interest Rates

January 1, 2009 – November 15, 2025



Source: Bloomberg

Currency outlook

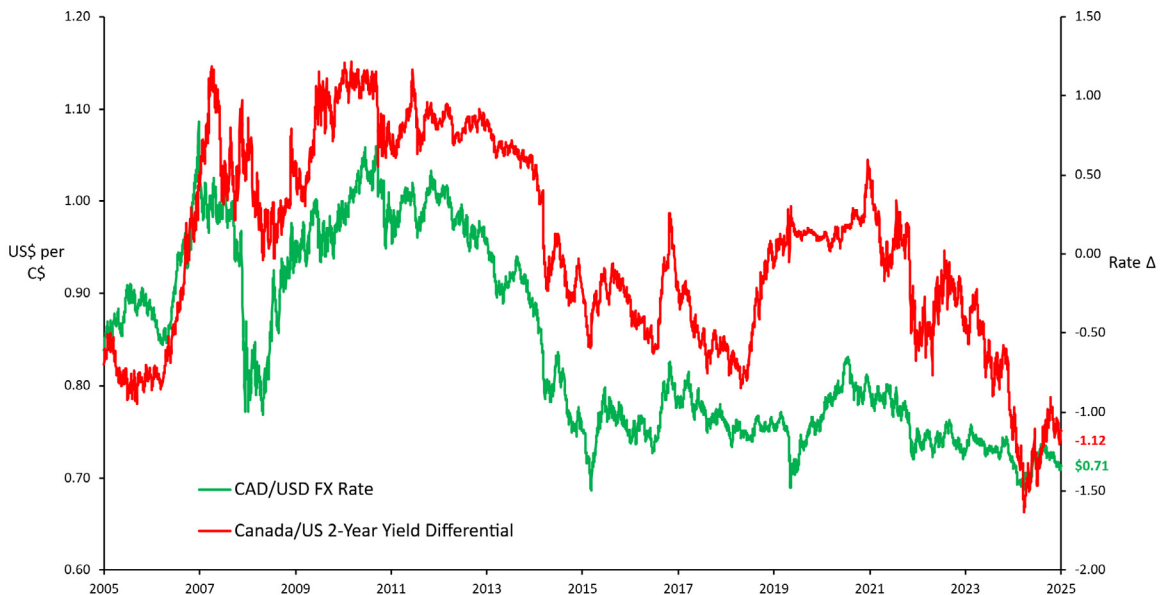
We are more optimistic than many on the loonie’s prospects. Fundamentally, the major factors are interest rate differentials, more U.S. central bank easing than in Canada, and the prospect of a mild global growth acceleration lifting oil prices. All of this points to a stronger Canadian dollar. Unsurprisingly, the overhang of U.S.-Canada trade relations holds the key to the loonie’s fortunes.

Clarity on trade by the end of 2026 has us calling for an end-of-year exchange rate of C\$1.35 or US\$0.74.

The loonie and interest rates

Canada/U.S. 2-Year Yield Differential vs. CAD/USD FX Rate

November 15, 2005 – November 15, 2025



Source: Bloomberg

Our positioning

Our portfolios remain well-diversified and balanced. **We favour equities over fixed income** but see opportunities in cash, bonds, stocks and selected alternative investment strategies to enhance returns or mitigate risk.

Overall, in our broadest representative portfolios, we are overweight Canadian and U.S. equities and neutral weight to international developed markets (Europe and Japan) and emerging markets.

Throughout 2025, we took the opportunity to rebalance regularly into equity market strength to ensure our equity exposures remained prudent. We will continue to employ that strategy when it is required. Through this harvesting of gains, we have reduced our excess risk exposure by cutting our overweight to equities roughly in half from the higher levels we deployed earlier in the bull market. While we are optimistic on the outlook, we are realistic that the magnitude of equity market returns we have enjoyed over the last three years could be difficult to repeat. We have some risk-on, but today is not the time for extended risk allocations.

Within fixed income, we are overweight investment-grade corporate bonds and underweight the lowest-quality borrowers in high yield.

The current yield of our well-diversified bond portfolio as of October 31 is very competitive at 3.8%.

The last word – don't fear what is to be expected

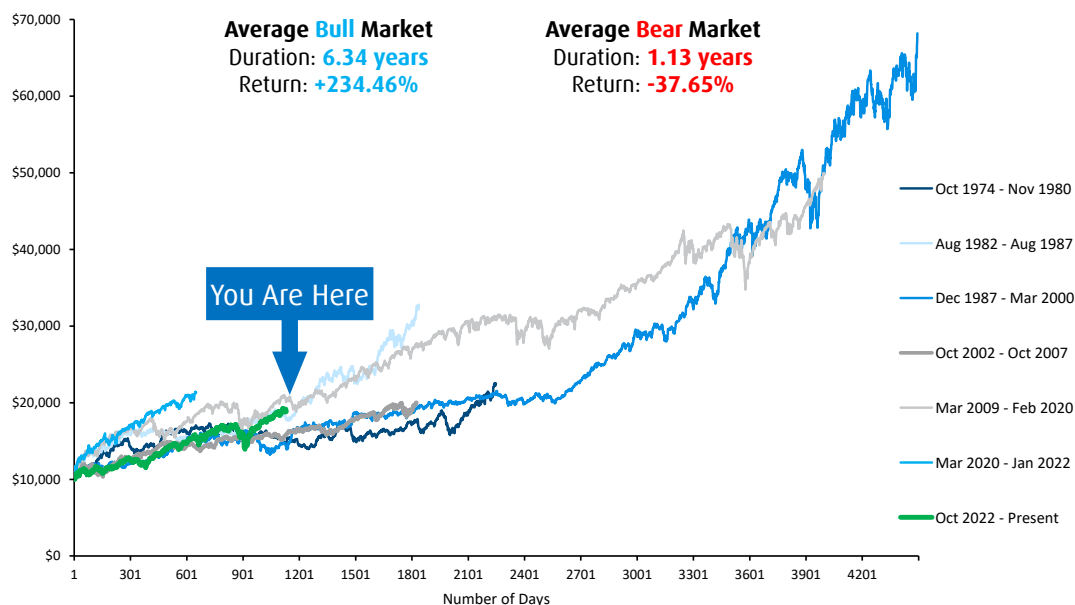
Many of our client conversations centre on the fear that we are in a bubble – or even if we aren't we must be close to some capital market calamity because we have made substantial gains in recent years. Considering that we experienced two severe equity market declines over the last quarter-century and bear markets in 2020 and 2022, it is understandable that investors are wary. We are also on watch.

However, simply because some stocks have enjoyed significant gains and some areas may be overextended with enthusiasm doesn't mean we should paint the entire equity market universe with a broad brush of, "Oh my, everything is overpriced or priced to perfection." We should not fear what equity markets are supposed to do. Nor should we shy away from investing in stocks because the outcomes have delivered on the long-term promise of why we invest in stocks in the first place: the demonstrated ability to grow wealth over time and protect our wealth from inflation.

Bull markets don't die of old age

S&P 500 Growth of US\$10,000 Normalized USD Price Return During Bull Markets

October 3, 1974 – November 15, 2025



Source: Bloomberg

In our [2025 Capital Markets Outlook: Bunches and Punches](#), we talked about positive equity market returns coming in bunches. We were only two years into the bull market then, a teenager by historical standards. To this we've added another 12 months, making the current bull market somewhere around middle-aged. Comparing the current bull run to the six bull markets of the past 50 years, only one has been shorter. The pace and trajectory of the advance are nothing out of the ordinary.

We conclude that the fundamentals of economic growth, corporate earnings, inflation and bond yields remain supportive. Valuations are mixed, but generally elevated; we've accounted for this in our forecasts and reduced our risk exposure accordingly. We continue to rely on diversification across geographies and asset classes – stocks, bonds, cash and alternatives – to meet our clients' individual investing objectives.

Strategy summary

Asset class outlook

Category	Economy	Policy	Valuation	Sentiment	Our Positioning			Rationale
					Under	Neutral	Over	
Major Asset Class								
Fixed Income		Prior						Yields are at the lower end of their trading range as inflation stays contained, growth is modest, and fiscal concerns stabilize. Yields can move lower in a recession scenario.
Equities	Prior	Prior		Prior				Few signs of stress. Economies showing resilience, upside potential. Solid earnings outlook. Belief that companies can navigate modest tariff impact. Bubble watch flashing amber not red.
Equities by Geography								
Canada	Prior	Prior		Prior				Improved tone on tariffs – can outperform if North American regional trading block theme returns. Attractive dividend. Levered to global growth
United States	Prior			Prior				No room for valuation expansion, earnings growth outlook improved on solid margins, GDP growth, tax cuts, deregulation, Fed rate cuts.
Europe		Prior		Prior				Geopolitical and tariff uncertainty improved but remains. Valuations remain reasonable. ECB has room to cut. EZ fiscal spend a positive.
Japan				Prior				Monetary policy slight headwind. Weak yen and low borrowing costs, levered to global growth. Improved shareholder friendly climate vs past decades.
Emerging Markets			Prior					Trade is pushing more policy stimulus. Negative sentiment on politics and geopolitics. Valuations no longer cheap

Changes from 2025 Outlook published December 2024



As of November 15, 2025

Please contact your BMO Private Investment Counsellor if you have any questions or would like to discuss your investments.

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