A Note of Caution in a Chorus of Corporate Earnings

BMO Private Wealth

BROCK Wealth Management

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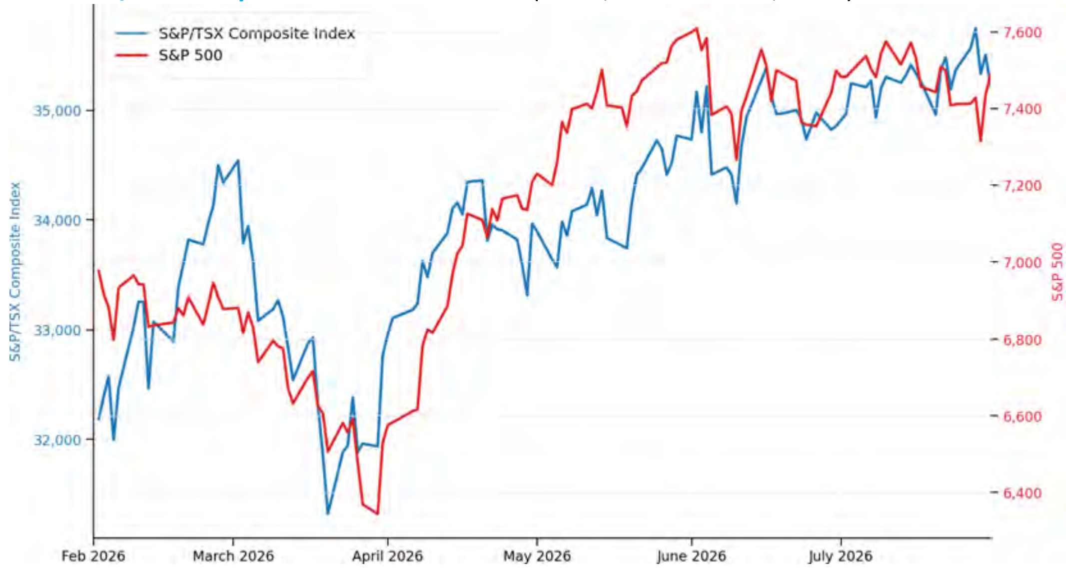
Philip’s Comments

I had the chance again this year to write the summer edition of this newsletter in cottage country; for the last number of years that has meant spending some time in beautiful Bala, Ontario, near the stores of Lake Muskoka. This year’s trip to Bala included an evening spent at the locally famous ‘KEE to Bala’, a small venue that has a long history of hosting some very big acts (including Louis Armstrong, Duke Ellington, The Tragically Hip, and Blue Rodeo). We were there to watch a Fleetwood Mac cover band perform the album ‘Rumors.’ The audience was a somewhat binary generational split of fans who would have had fond memories of Stevie Nicks belting out those songs live in the late seventies, as well as fans who may have grown up listening to their parents’ favourite music. Either way, everyone knew the words, and it was a lovely evening spent with my wife, who was one of those who grew up with those songs playing on cassette in her family’s living room.

The next day marked the start of the drafting process for this newsletter, so I suppose I had music on the mind. The bass line of our three previous letters expressed a note of caution to our clients, however, markets have so far advanced meaningfully, with little interruption (except for the April 2025 “Liberation Day” correction, as well as some volatility this spring due to events in the Middle East). During this time, we have deliberately moderated our recommended allocation to equities to 90% of each client’s target. While we are not changing that recommendation at this time, corporate earnings have generally kept up with lofty market expectations, providing some justification for the performance we have seen. I will touch further on this below.

Since the publication of our last newsletter, Canadian equities have advanced by 10.35%, significantly outpacing US equities, which posted an advance of 8.07% (see Figure 1)[1].

Figure 1: S&P/TSX Composite Index vs S&P 500 (Feb 1, 2026 – Jul 31, 2026)



Sources: Yahoo Finance, FactSet

The Loonie declined slightly in value, easing by 2.86%, undoubtedly in part due to gold’s 13.45% decline, though mitigated by the Iran-driven 29.84% jump in the price of crude oil (see Figure 2)[2]. Clearly, we are a petrocurrency no longer!

*Figure 2: Gold (NYM $/ozt) vs **Crude Oil WTI ($/bbl)** vs CAD/USD (Feb 1, 2026 – Jul 31, 2026)*

Sources: FactSet

In the first half of 2026 we have been witness to a steady drumbeat of accelerating corporate earnings, and this seems to have drowned out the constant presence of elevated geopolitical risk. Taken alone, the positive corporate earnings would be unabashedly good news, but strong corporate earnings can be a contributing factor to inflation which, as we mentioned in our last newsletter, is a growing danger to the health of this market rally.

Corporate Earnings Rocking

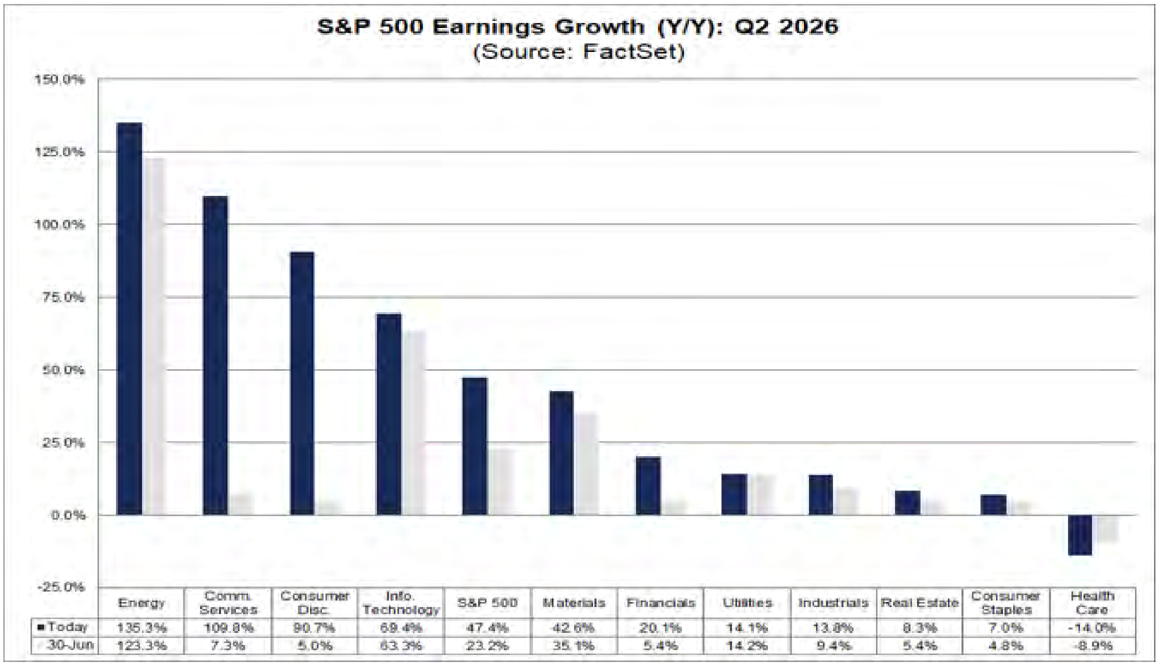
The opening track for this newsletter is always the start of second quarter earnings season, which gets underway in July every year. Corporate earnings are a critical element of our assessment of the value and of the riskiness of stocks - after all, investors would do well to perceive their investments as they are: businesses seeking to make a profit and increase their profitability year after year.

The first quarter of 2026 yielded very strong earnings results, posting year-over-year earnings growth of over 28%[3], among the highest measures recorded since the artificially boosted numbers of the COVID recovery. Such a strong result for Q1 has meaningfully raised expectations for Q2.

Some of the first earnings reports we received this season were from the banks south of the border (indeed, many Canadian banks now boast a real presence in the American market, but they report earnings in late August). Granted, we have favored ownership in Canadian banks in the Model Portfolio, but the reality is that the strength or weakness of bank earnings serve as good gauges of overall economic health. A softening economy was nowhere to be seen in the latest results, which were very strong[4]. It is not a stretch to read this as a direct sign of the strength of the US economy and consumer.

Earnings growth in the US sits just under 50% (see Figure 3). This number is incomplete, as it represents only partial results for Q2, and incorporates estimates for the companies that haven't reported yet[5], but if things continue on this path this will represent the strongest earnings growth seen since the COVID recovery of 2021.

Figure 3: S&P Earnings Growth (Y/Y) by Sector (August 1 2025 - July 31 2026)

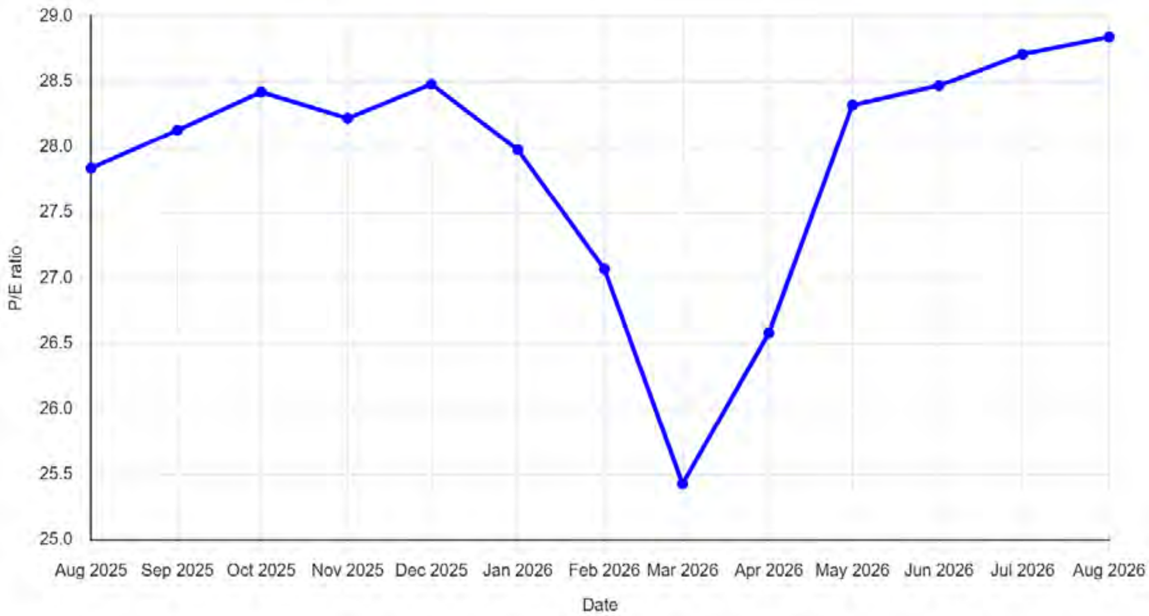


Source: Butters, John; insight.factset.com

It is useful to look back at the past to try to understand the implications of such strong corporate earnings growth rates. As Francois Trahan, Chief Investment Strategist for BMO Capital Markets reminds us, *"It is not common to see earnings growth run over 20%, but when it has, it almost always leads to a rate hike by the Fed."*[6] Indeed, growing corporate profits (a good thing) can lead to increased hiring (another good thing) which can result in a tighter labour market, and rising wages (yet another good thing), which in turn, can lead to inflation (not so good…). More on the inflation question on the "B" side…

If I am focusing to such a great degree on corporate earnings, it is because in all cases, a stock's price movement can be boiled down to being the product of two factors: growth in earnings, or growth in the market multiple that is applied to those earnings. The price movement we have seen in the last 12 months has been almost exclusively led by actual corporate earnings growth, not multiple expansion. This can be confirmed through the fact that the trailing P/E ratio of the S&P 500 has remained in a narrow range over the last year (see Figure 4) with the exception of an Iran-related blip this spring. The overall multiple remains very high, however, on a historical basis.[7]

Figure 4: S&P 500 PE Ratio using trailing 12-month earnings (Aug 1 2025 – July 31 2026)



Sources : www.multpl.com/s-p-500-pe-ratio

In our Winter 2025 newsletter, titled *Leaving the Neutral Zone*, we outlined one possible scenario for improving the attractiveness of equity markets. We spoke of *"an environment where corporate earnings increase at a faster pace then the stock prices of those corporations, such that their valuation becomes more reasonable."* The strong earnings we have witnessed have made this possibility more likely, even though we are not yet at a market multiple that strikes the right chord.

A Crescendo of Inflation

One of the main messages we communicated in last winter's newsletter was that the economic backdrop appeared to be setting up a crescendo of inflation. Fueled by moderate interest rates, stimulative tax policy in the United States, ramped up defense spending by governments worldwide[8], and private spending on AI data centres[9], inflation risks flaring up like the algae bloom in the reflecting pool in Washington DC, and if it does it may be very hard to stop. Through this spring, it very much looked like that was going to be the case, though we have seen a bit of relief in the most recent inflation numbers on both sides of the border (see Figure 5).

Figure 5: US and Canadian Inflation, measured by 12-month change in CPI, not seasonally adjusted (August 2016 – July 2026)

Source: US Bureau de Labor Statistics, multpl.com, Statistics Canada

This week, we heard from the individual primarily responsible for combatting inflation, Kevin Warsh, the freshly minted Chair of the US Federal Reserve. In a divided vote, the Fed decided to hold rates steady.[10] He also emphasized verbally the continuation of the 2% inflation target, denying the widely held belief that the Fed is deliberately tolerating a higher range for inflation.[11] The market didn't believe him: 5-year and 10-year bond yields rose during his press conference, a sign that the market is expecting higher inflation in the future.

It is this risk of higher rates — on the basis of inflation concerns as well as the very credibility of debtor nations and corporations – that has motivated us to modify our approach to fixed income investments in our clients' accounts. In June, we sold our most widely held fixed income mutual fund which had a duration (an average term to maturity) of over 7 years, in favour of a laddered fund structure with a duration of 2.5 years. This measure is meant to reduce the risk to our fixed income holdings of rising interest rates, either in anticipation of – or response to – inflation. Bonds underperform when rates rise, and the longer the bond's time left until its maturity, the more pronounced its underperformance is bound to be.

It isn't an understatement that spiking inflation and a higher interest rate environment constitute some of the loudest risks to markets. It was only four years ago, in 2022, when we were reminded of the financially destructive effect of inflation, when rates jumped in response to out-of-control post-COVID price increases. In that environment, both equities and fixed income securities were affected and yielded negative returns, rather than their typical pattern of one rising when the other falls. When inflation is high, most types of financial assets tend to suffer.

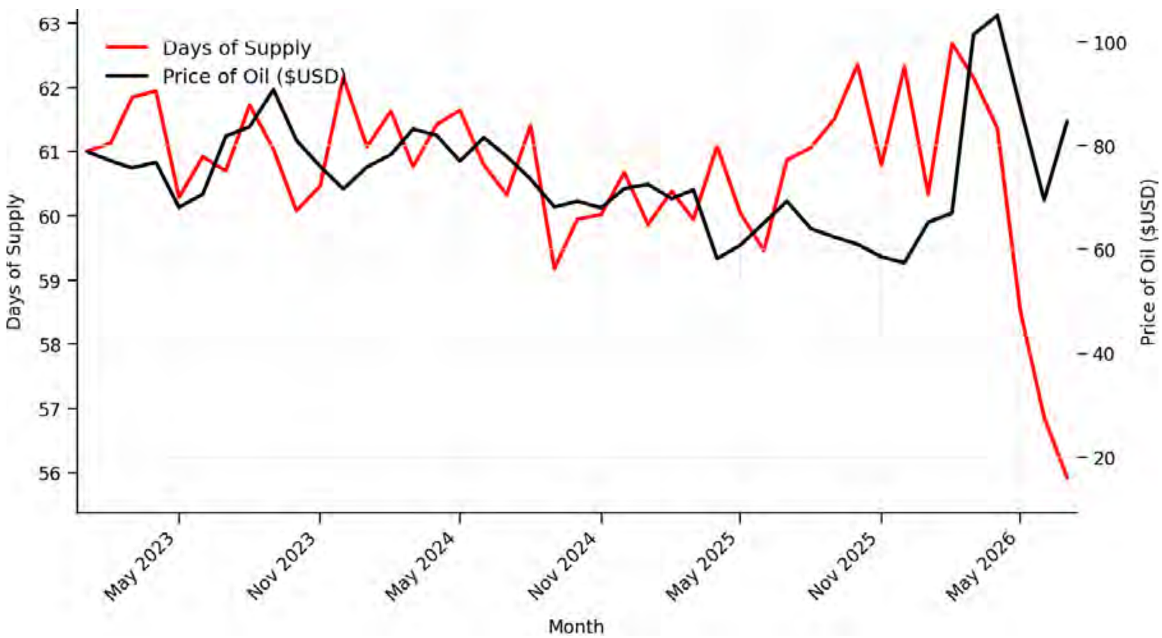
Of course, baseline economic data is not alone in impacting inflation. Exogenous forces can affect prices as well, such as the conflict in the Persian Gulf.

Discordant Geopolitics

The geopolitical scene has been fraught with new risks for financial markets since the post-COVID era and the escalation of violence in the Middle East. It is too early to know what the full effects will be of the combined American and Israeli attack on Iran, but at this early stage it would seem that there will almost certainly be a permanent shift in the cost structure of oil shipments out of the region[12], whether by way of the oft-closed Strait of Hormuz, or by way of Houthi pressure on Red Sea shipping lanes.

We have seen significant volatility in oil prices since the attacks this spring, but the real effect of the dispute has been dulled (or delayed) using existing oil reserves (see Figure 6).

*Figure 6: **OECD Commercial Stocks of Crude Oil and Other Liquids**, in days of supply (left) vs. **Crude Oil WTI** (NYM $/bbl) (right) (Jan 2023 – Jul 2026)*



Sources: U.S. Energy Information Administration, Short-Term Energy Outlook, July 2026, FactSet

It stands to reason that the true impact on the price of oil (and therefore the price paid at the pump) will be felt when reserves have been exhausted, or at least further reduced. Could this be why the US administration seems so keen on "escalate-to-de-escalate" tactics? There have been times since the launch of hostilities where it seemed that the US was negotiating with itself[13]; likely feeling a sense of urgency stemming from the overuse of oil reserves. What is more, the supply-chain disruption that this conflict has caused is broader than oil alone. Fertilizers, sulfur, methanol, and other products are affected[14] – and the inflationary impact of a broken supply chain is a familiar tune, taught to us by the global pandemic.

The conflict between Russia and Ukraine seemingly has no end in sight, amid recent escalating bombardments in Kyiv. Russia's aggression against Ukraine has had the effect of spurring policy change in greater Europe. Germany, for example, has removed its longstanding prohibition against budgetary deficits to invest in its defense, and NATO has ramped up the pressure on member countries to meet their defense spending obligations, not to mention a growing chorus of proponents of a permanent increase to defense budgets, with some speaking of targets as high as 5% of gross domestic product.[15]

Trade issues remain outstanding as well. As expected, the United States has communicated its intention not to renew the CUSMA agreement, thereby pointing North America toward an annual cycle of renegotiation, until a “deal” is reached.[16] Please interpret the quotation marks as a way to underscore the lack of credibility of any agreement with the current US administration, which has not been hesitant to set aside longstanding multilateral partnerships and to break all kinds of norms. The direction of travel is likely towards bilateral deals between the CUSMA member countries, and from the outside it would currently appear that Mexico is closer to an agreement than Canada[17]. On August 19th we will see if the newly announced 50% tariffs against some Canadian goods - many of which were previously exempt under CUSMA - are put into place.[18]

The geopolitical situation remains fraught, and any one of these issues, and indeed issues that are yet to emerge such as this fall’s mid-term election in the United States, may trigger a situation that causes the market’s recently ebullient music to stop.

Experimental Music

We’re not currently operating in a riskless environment, but we never are. To be an investor in equity markets is to understand that there will be periods of time where stocks move in the wrong direction, where the news is not good for the investing public, but that over the long run earnings and economic growth will drive appreciating security prices.

What drives our caution beyond the risk of inflation picking up again or the risk of geopolitical events destabilizing markets is that we appear to be seeing exuberance in the system. A security trading at a normal price-to-earnings ratio can take some bad news and stay relatively steady, as it already has a certain margin of safety built into it. When the valuation is stretched, that safety is harder to find.

Investor enthusiasm around artificial intelligence as a new industrial revolution has been a major contributor to lifting equity valuations. That enthusiasm can be quantified by measuring how much money is being borrowed to invest. Leveraged investments carry with them significant risks and increase the sensitivity of the market to bad news. As things currently stand, levered investing - one version of which involves the use of margin in investment accounts - has climbed to concerning levels (see Figure 7).[19]

Figure 7: Margin owed by US Investors as a percentage of total free credit balances (February 2010 – June 2026)

Sources: FINRA

You could be forgiven for feeling that it is more than a mere note of caution that weaves through this summer's newsletter but rather a concern that we may be shifting to a minor key. The truth is that the symphony playing around us is a complex one, but there are actions that we have taken to try our best to harmonize with this new melody:

- Given some of the risks and excesses we are perceiving in the current market structure we feel that it is appropriate to maintain our recommendation, initially made in the Winter 2025 newsletter, for investors to be exposed to slightly less than their long-term strategic equity target. In our view this means targeting approximately 90% of one's normal target. We consider this shift to be temporary, and we are always prepared, given the right market conditions, to reverse this defensive posture, but we will not do so until we judge the conditions to be right.

- It remains important to us that the equities that we are invested in, as a whole, present volatility metrics that are less than that of the broad market so as to provide another layer of defense. Our Model Portfolio's beta, the degree of volatility of the portfolio versus the broad market, which currently rests at a modest 0.67, is a good illustration of this.

- Should we enter into a period of more difficult markets, revenue generation from the portfolio in the form of dividend yield will be an important component of what will allow us to outlast that kind of market environment. In a market defined by stretched equity valuations, dividend yield becomes harder to find. The recent inclusion into the model of a company like Brookfield Renewable Holdings Corporation (BEPC) is a good example of a security selected on the basis of its fundamentals, but whose selection is strengthened by its 4.56% dividend yield[20].

- Artificial intelligence and the investment themes that surround it has caused investors to re-evaluate business models and industries and, in our view, to throw the baby out with the bathwater, creating mispricing in certain securities that opportunistic value investors can take advantage of. The addition to the Model Portfolio of WSP Global (WSP) is a good example of this phenomenon.

- As mentioned previously in this commentary, we have adopted a more conservative posture in clients' fixed income holdings. In defense against the risk of spiking inflation, we have shortened our fixed income duration.

- While gold bullion is volatile in its own right, we continue to believe that a small exposure to it and to profitable gold producers provides diversification benefits and reduces the portfolio's volatility as a whole.

- Finally, controlling currency risk by using Canadian depository receipts (CDRs) for some of our US holdings offers us another way to prioritize portfolio stability.

Our sincere hope, dear reader, is that each of these elements will resonate in a way you find pleasing to the ear, and, most importantly, to the wallet.

Conclusion

We continue to see strong markets, driven by strong corporate earnings, but against a backdrop of budding inflation, geopolitical risk, and market excesses. Market conditions continue to lead us to believe that investors should be positioned in a way that respects their investor profile, while maintaining a slight underexposure to stocks.

- Corporate earnings have provided encouraging datapoints, helping to justify the market growth that we have witnessed. Equity valuations, however, have yet to moderate enough to cause us to reconsider our defensive posture.

- Inflation and geopolitics – two factors that are linked in particular through oil prices – stand out to us as the likeliest reasons the market may interrupt their current ascent.

- Portfolio actions, beyond the equity underweight already discussed, including a focus on dividend income, a low-beta approach, currency hedging, and – on the fixed income side – shorter duration, all contribute to a portfolio that we feel can meaningfully participate in market upside, while providing support should this bull market's music stop.

Asset Allocation

Every investor's asset allocation target should be determined through a financial planning process. The portfolio's equity allocation should be in line with this target when our view on the markets is "neutral". At times, financial markets will present us with possibilities for greater growth or greater risks. Modifying the asset allocation of the portfolio to account for these factors is appropriate, so long as the investor's actual asset allocation does not deviate too severely from their plan and remains within their investor profile and risk tolerance boundaries.

At this time our view is that portfolios should be tilted as follows (deviations are a percentage of equity exposure, not a percentage of the total portfolio):

For example, a portfolio with a long-term strategic target of 60% equity should currently be targeting a 54% equity weight, which represents 90% of the long term equity target.

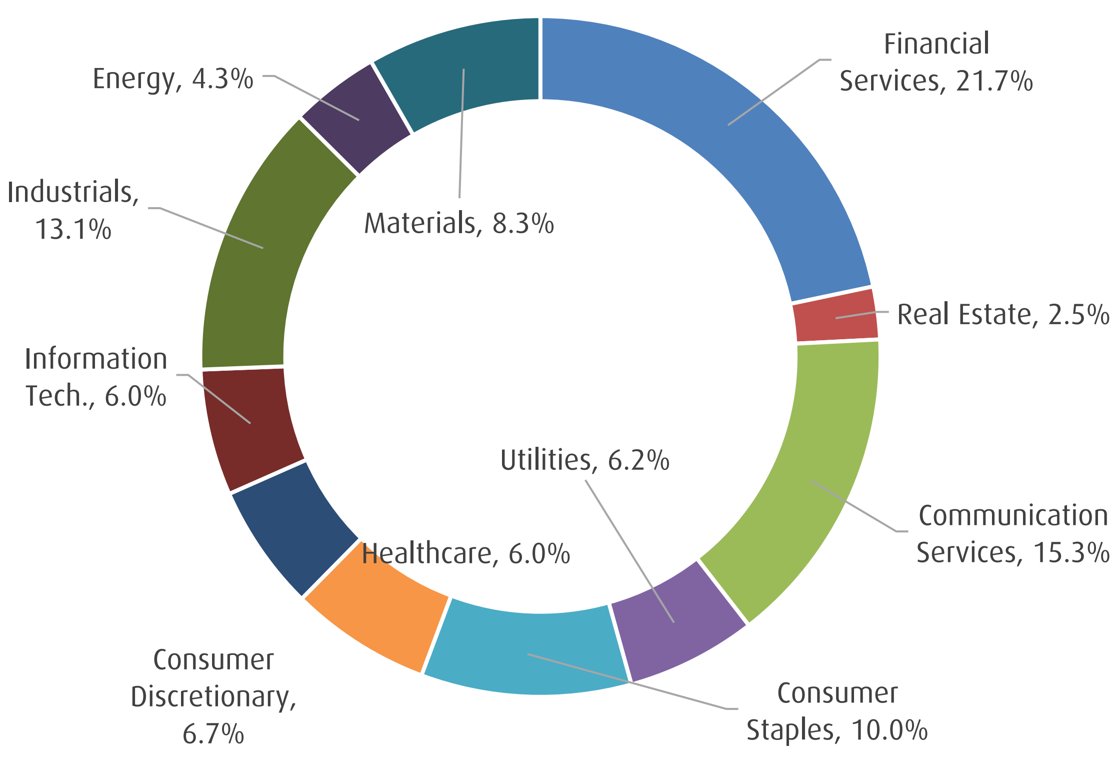
Please note that our Model Portfolio is meant to be a guide as to the equity portion of our clients' portfolios – not their entire portfolio. Clients who have *Balanced* or *Income* investor profiles will require significant assets in fixed income securities in addition to the equities they hold.

Model Portfolio Metrics

	Model Portfolio	S&P/TSX Composite[21]
Yield*	2.29%	2.16%
Portfolio Beta*	0.67	1.00
Number of Holdings	35	219

Sector Allocation (Core Portfolio)

	Model Portfolio	S&P/TSX Composite
Financial Services	21.7%	36.1%
Real Estate	2.5%	1.3%
Communication Services	15.3%	1.6%
Utilities	6.2%	3.6%
Consumer Staples	10.0%	3.3%
Consumer Discretionary	6.7%	3.1%
Healthcare	6.0%	0.3%
Information Tech.	6.0%	7.2%
Industrials	13.1%	10.5%
Energy	4.3%	17.4%
Materials	8.3%	15.6%



*As at 2026-07-31; source: S&P Global, FactSet

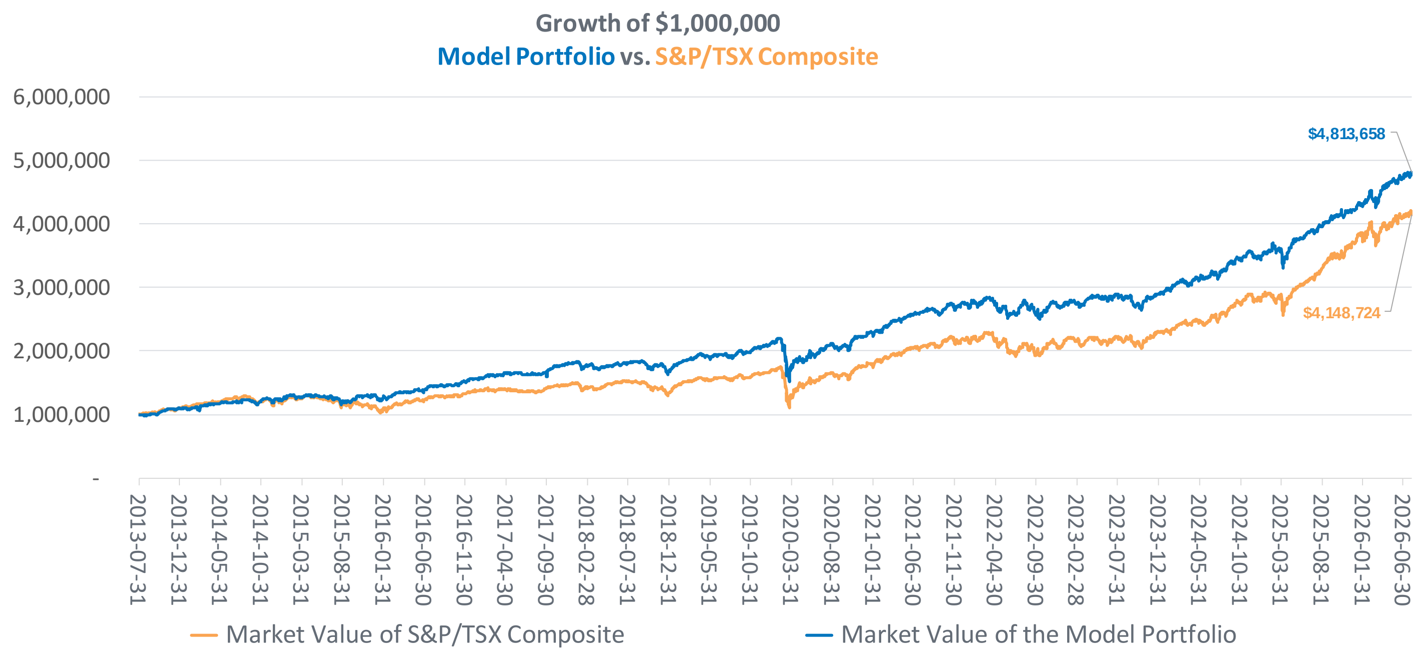
Model Portfolio Performance History

Portfolio Mandate

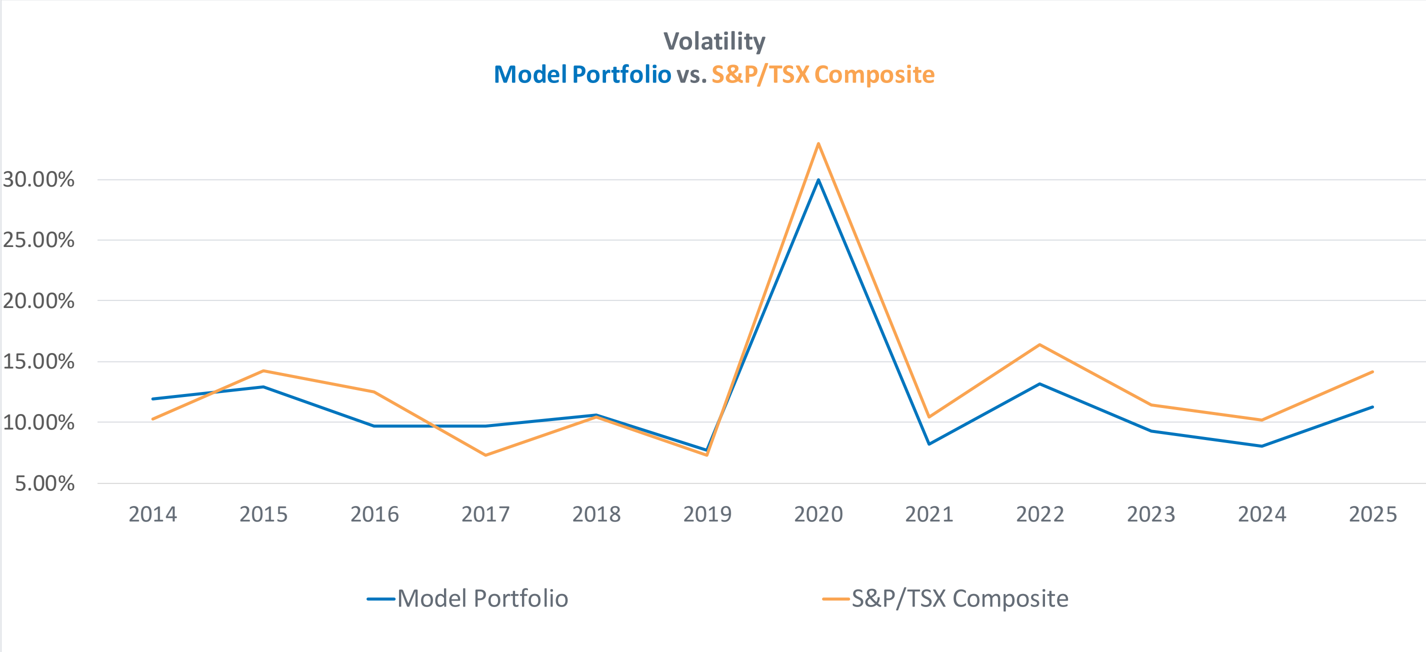
The Model Portfolio is an equity portfolio seeking to provide a Canadian investor with long-term capital appreciation and income, while targeting lower-volatility investment outcomes. The security-selection approach diversifies holdings by industrial sector, with a bias for Canadian holdings in areas where, in our view, Canadian companies hold a competitive advantage.

Key Facts

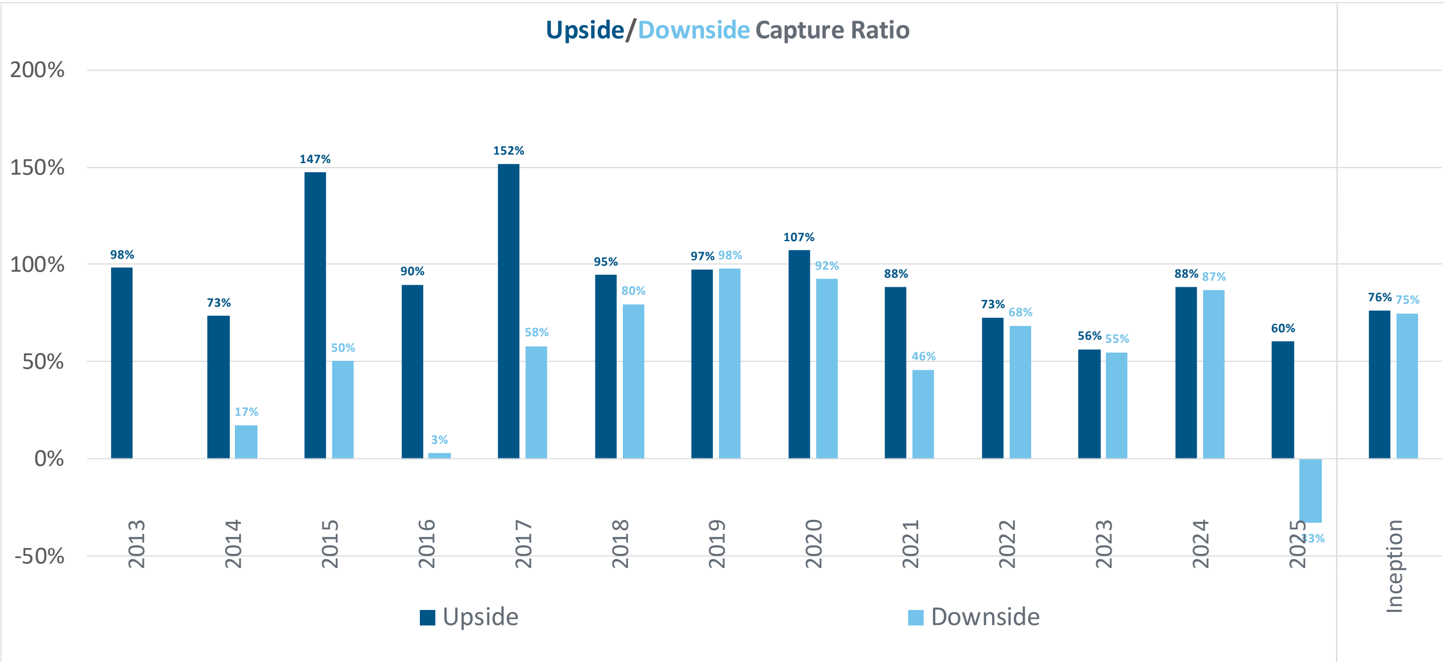
Inception date:	01-Aug-13
Benchmark:	S&P/TSX Composite Index
Number of holdings:	35
Valuation date:	31-Jul-26
Rebalancing frequency:	Semi-annually
Currency:	CAD



The chart above assumes that a hypothetical investor invested $1,000,000 in the model portfolio and benchmark on August 1, 2013. The chart shows the relative growth of the $1,000,000 initial investment, on a gross-of-fee basis, assuming no additional cash contributions and assuming the reinvestment of dividends.



The chart above leverages the same data as the "Growth of $1,000,000" chart, and depicts the relative volatility between the model portfolio and the S&P/TSX Composite, measured by standard deviation. Lower volatility is favorable.



The chart above depicts how much of the benchmark gains and losses were captured by the model portfolio. Higher upside capture and lower downside capture ratios are favorable.

RETURN

	Cumulative			
	YTD	3 months		1 year
Model Portfolio	14.43%	3.94%		24.27%
S&P/TSX	12.52%	4.29%		32.26%
	Annualized			
	3 years	5 years	10 years	Inception
Model Portfolio	18.57%	12.98%	12.74%	12.85%
S&P/TSX	22.93%	14.95%	12.50%	11.57%

RISK

	Annualized Standard Deviation			
	3 years	5 years	10 years	Inception
Model Portfolio	8.64%	9.52%	10.58%	10.02%
S&P/TSX	10.82%	12.48%	12.96%	12.10%
	Sharpe Ratio			
	3 years	5 years	10 years	Inception
Model Portfolio	1.75	1.04	1.03	1.12
S&P/TSX	1.80	0.95	0.82	0.82

CALENDAR YEAR PERFORMANCE

Calendar Year	Model Portfolio	S&P/TSX Composite
2026*	14.43%	12.52%
2025	21.54%	31.68%
2024	19.42%	21.65%
2023	7.98%	11.75%
2022	-2.18%	-5.84%
2021	22.79%	25.09%
2020	7.72%	5.60%
2019	22.22%	22.88%
2018	-5.59%	-8.89%
2017	15.94%	9.10%
2016	20.13%	21.08%
2015	4.38%	-8.32%
2014	12.15%	10.55%
2013*	10.28%	10.48%

** Indicates a partial year*

Meet Our Team

Philip Brock, CFA, CFP, F.Pl., B.Com
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Philip made his entry in the financial industry over two decades ago, in 2004, and joined BMO Nesbitt Burns as an Investment Advisor in March of 2006. Since then, Philip has advised many families on retirement and estate planning, personal credit, and investment management. In addition to his work with clients, Philip served as Assistant Branch Manager for the Ottawa Dalhousie/Lansdowne branch of BMO Nesbitt Burns between 2014 and 2019. Philip holds a B.Com. from the University of Ottawa with options in finance and international management and holds the Chartered Financial Analyst (CFA) designation. In addition, he has been practicing financial planning as a CFP® certificant since 2007 and has held the *Institut Québécois de planification financière*'s F.Pl. designation since 2015. Philip is happy to offer his services in English and French.

Born in Montreal, Philip has lived in the National Capital Region since 1987. He calls Orléans home along with his wife Kathleen and their young sons, David, Jonathan and Nicolas. When he's not providing financial advice to his clients, he and his family can usually be found on the ski hill, camping, cottaging, or travelling.

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Elyse joined the financial services industry in 2017 following her undergraduate and graduate studies at St. Francis Xavier University and the University of Toronto. A Chartered Professional Accountant (CPA), Elyse was a Dean's List graduate receiving her BBA in Accounting, and subsequently received a Graduate Diploma in Accounting. She holds the Chartered Financial Analyst (CFA) designation and has completed the Canadian Securities and Canadian Professional Handbook courses. Prior to joining BMO Nesbitt Burns in January 2023, Elyse was a manager at Ernst & Young where she participated in a variety of financial statement audits and the preparation of corporate tax returns. During 2022, Elyse pursued an international transfer to the EY Paris office to further her professional development, including her proficiency in French.

Outside of work, Elyse is most passionate about staying active, traveling and reading. Elyse will always find time to prioritize a workout and participates in a bi-weekly book club. She strives to visit at least one new country a year.

Clara Augustine, BBA
Senior Wealth Associate

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Clara brings a strong background in service management to our team. She earned her Bachelor of Business Administration from the University of New Brunswick before beginning her career in financial services more than 15 years ago. Clara spent several years in management roles across BMO Bank of Montreal branches before joining BMO Nesbitt Burns in 2018. She has continued to strengthen her professional expertise by completing the Canadian Securities Course and, most recently, the Wealth Management Essentials course.

As our team has evolved, Clara's role has expanded accordingly. She now serves as a Senior Wealth Associate and our estate subject matter resource, working closely with the advisory team to prepare portfolio reviews, manage day-to-day transactions, and guide clients and their families through the estate resolution process with care, diligence, and expertise.

Raised on the East Coast, Clara now calls the Ottawa Valley home, where she lives with her husband and their young children. Outside of work, she is passionate about fitness, cooking, and spending quality time with her family.

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Sandro began his wealth management career with the Brock Wealth Management team shortly after earning his Bachelor of Commerce in Finance from the University of Ottawa. Driven by an entrepreneurial goal, he later stepped away to build a multimedia marketing company. Running a business gave him hands-on insight into cash-flow management, budgeting, and everyday financial decision-making, reinforcing how clarity and discipline can help people feel confident about their long-term goals.

This experience inspired his return to wealth management with a more grounded and client-focused perspective. He expanded his knowledge as a Senior Associate in Wealthsimple's high-net-worth division, supporting client relationships and gaining deeper exposure to modern financial planning. Sandro has since rejoined Brock Wealth Management, where he contributes through client service, relationship support, and planning and investment-management assistance. His next step will be to pursue his Chartered Investment Manager (CIM®) designation in order to continue strengthening his technical expertise.

Outside of work, Sandro loves traveling, creating photo and video content, and paddling the lakes around the Ottawa region. He's fluent in English, French, and Italian, with a dash of conversational Spanish.

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Megan entered the financial services industry in 2016, completing her Canadian Securities Course and Conduct and Practices Handbook course to become a licensed investment representative. Megan earned her DEC from Heritage College in 2013 and was a Dean's List graduate of St. Francis Xavier University's BBA degree with a focus on leadership in management. Before BMO Nesbitt Burns, Megan's career was in hospitality with five years of experience in front office operations at hotels of varying size. She is dedicated to fostering strong client relationships and trust, as well as careful attention to detail, and loves keeping the team organized. She is pleased to offer assistance in English and French.

Megan was born and raised in Aylmer, and is now settled in Ottawa. In her spare time, she enjoys cooking, spoiling her chihuahua Flash, listening to audiobooks, traveling the world with her wife, and has a passion for advocating equality and LGBTQ+ rights.

[1, 2, 20] *FactSet*
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