

Robust Growth & Macro Headwinds

BREZER, MANDELL, REEMS & HAO GROUP

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AGENDA

- i. Overview
- ii. S&P 500 Earnings Growth
- iii. Cash In, Cash Out
- iv. Free Cash Flow Transfer
- v. Computer Memory Prices per GB
- vi. Hyperscaler and Nvidia New Debt Issuance
- vii. Software Comeback
- viii. U.S. Federal Deficit
- ix. U.S. Debt Interest Costs Remain in Line with History
- x. S&P 500 Returns Around Midterm Elections Since 1970
- xi. Wars, Supply Bottlenecks and Political Pressure
- xii. U.S. Inflation
- xiii. Canadian Inflation
- xiv. New Federal Reserve Chair: Kevin Warsh
- xv. Rising Bond and Equity Yields
- xvi. Mega-Cap Earnings Compression
- xvii. Nasdaq Returns ChatGPT vs Netscape Launch

OVERVIEW

"Sell in May and go away, come back on Midterm Election Day?"

It's been a choppy summer, but things are starting to heat up again with the U.S. midterm elections now less than six weeks away. Meanwhile, corporate earnings have remained remarkably strong. Earnings expectations have increased considerably over the year, led by companies benefiting from the AI infrastructure buildout. Capital continues to pour into semiconductors, memory, storage, servers, data centers, and power infrastructure, creating strong demand and supply shortages across parts of the hardware market.

The next phase of the AI investment cycle is also becoming more capital intensive. Hyperscalers are now reinvesting nearly all their operating cash flow into AI infrastructure, while also issuing significant amounts of debt to fund the buildout. This has been highly profitable for semiconductor and hardware providers, but investors are starting to pay closer attention to the potential return on this spending, particularly as financing costs rise.

Software shares have started to recover after concerns that agentic AI could replace parts of the traditional software industry pushed valuations sharply lower earlier this year. Cybersecurity has led the rebound, supported by strong earnings and growing concerns around AI related security risks. However, performance remains highly differentiated as investors assess which companies can protect their competitive positions and successfully adapt their products.

OVERVIEW

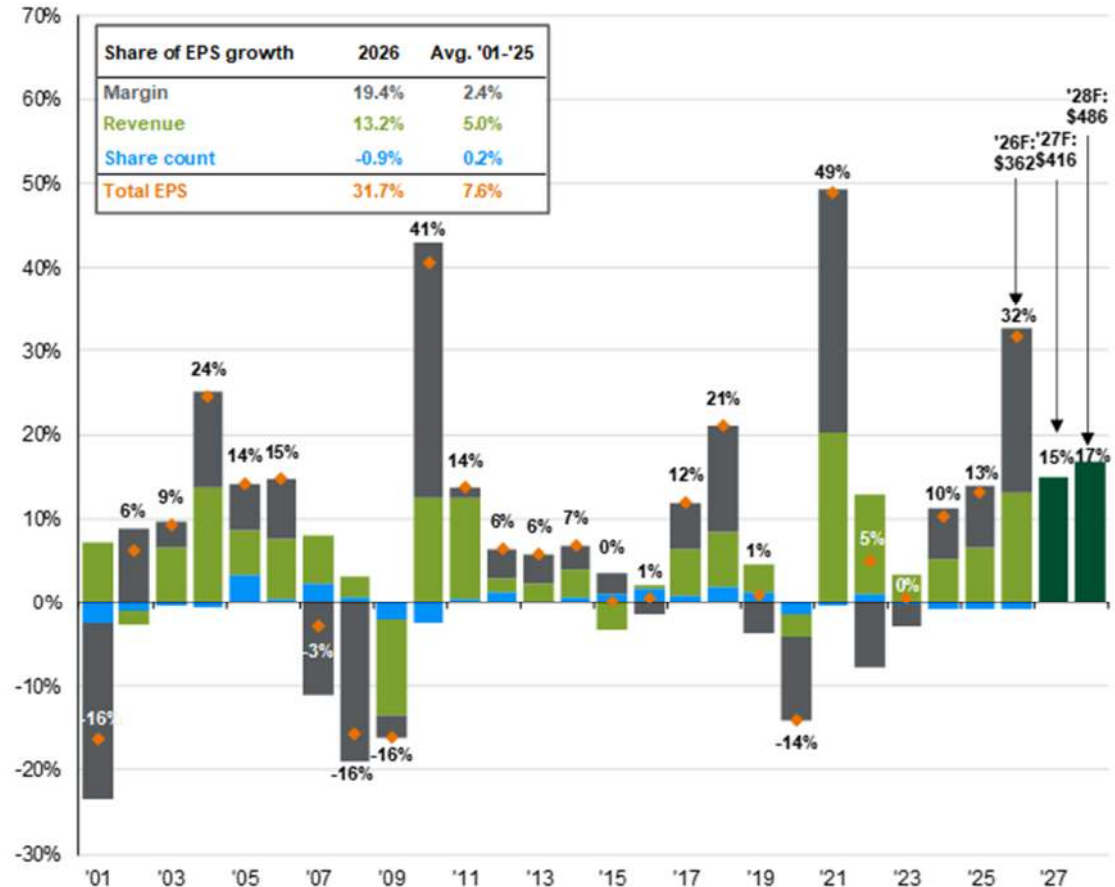
At the same time, the macroeconomic backdrop has become less supportive. Higher energy prices are contributing to renewed inflation pressure in both the United States and Canada. Government borrowing and new debt issuance from hyperscalers are also increasing the supply of bonds in the market, placing upward pressure on yields and the cost of capital. The Federal Reserve has responded by raising rates, while moving away from detailed forward guidance and placing greater emphasis on broader economic trends.

Overall, earnings remain strong, but the combination of higher rates, increased borrowing, and more capital-intensive growth is making the market increasingly selective, contributing to narrowing market breadth. Balance sheet strength, free cash flow, and the returns companies generate on new investment are becoming more important. While higher yields have placed pressure on valuations, much of the recent compression in mega-cap technology has come from earnings growing faster than share prices, rather than a deterioration in underlying fundamentals.

As always, thank you for your continued support of our team.

S&P 500 Earnings Growth

S&P 500 earnings are expected to grow 31.7% in 2026, which would be the strongest growth rate in more than 20 years outside a market recovery year. The increase reflects well above average revenue growth of 13.2%, margin expansion of 19.4%, and a modest 0.9% reduction in share count through company buybacks.



Source: JP Morgan Global Asset Management

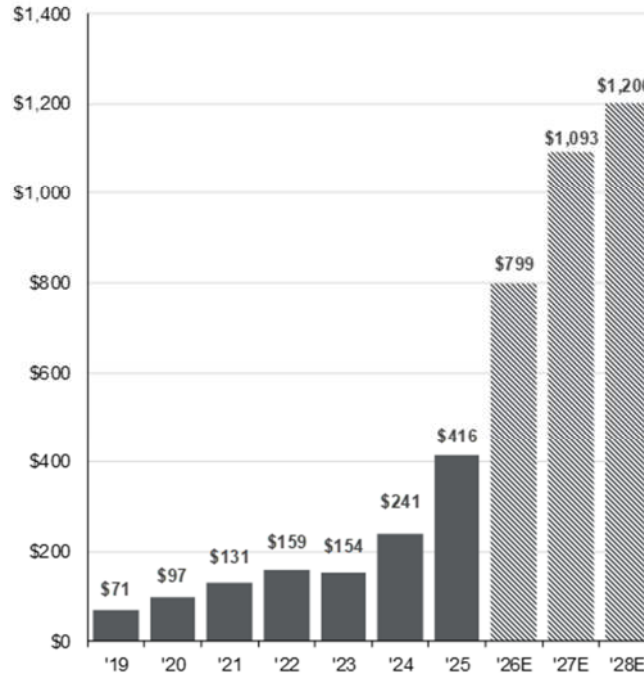
Cash In, Cash Out

According to Goldman Sachs Chief Investment Strategist Ben Snider, AI-related investment spending is expected to drive roughly half of S&P 500 earnings growth in 2026.

Hyperscale companies have shifted from returning significant amounts of cash to shareholders toward reinvesting more than all of their operating cash flow into AI infrastructure. They're not quite "all in" yet, but if current spending trends continue, they may eventually get there.

Capex from the major AI hyperscalers*

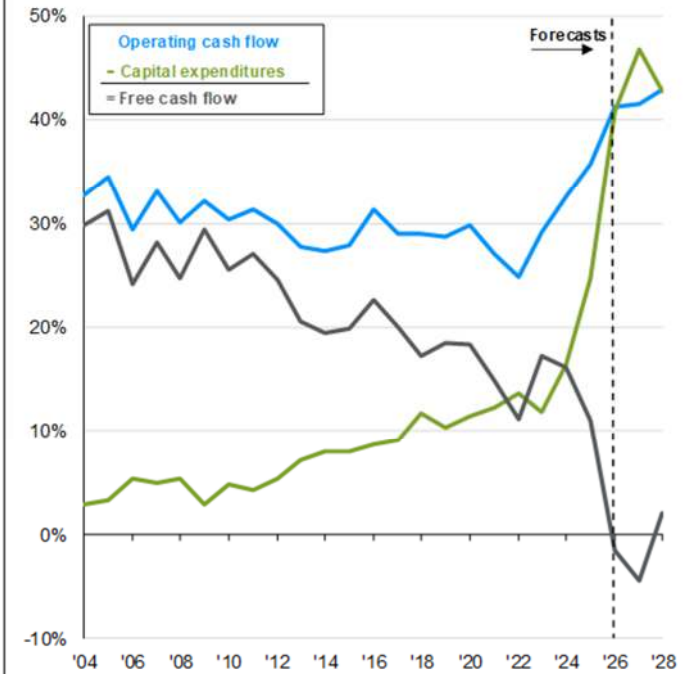
USD billions; Alphabet, Amazon, Meta, Microsoft, Oracle



Source: JP Morgan Global Asset Management

Hyperscalers' cash flow and capex

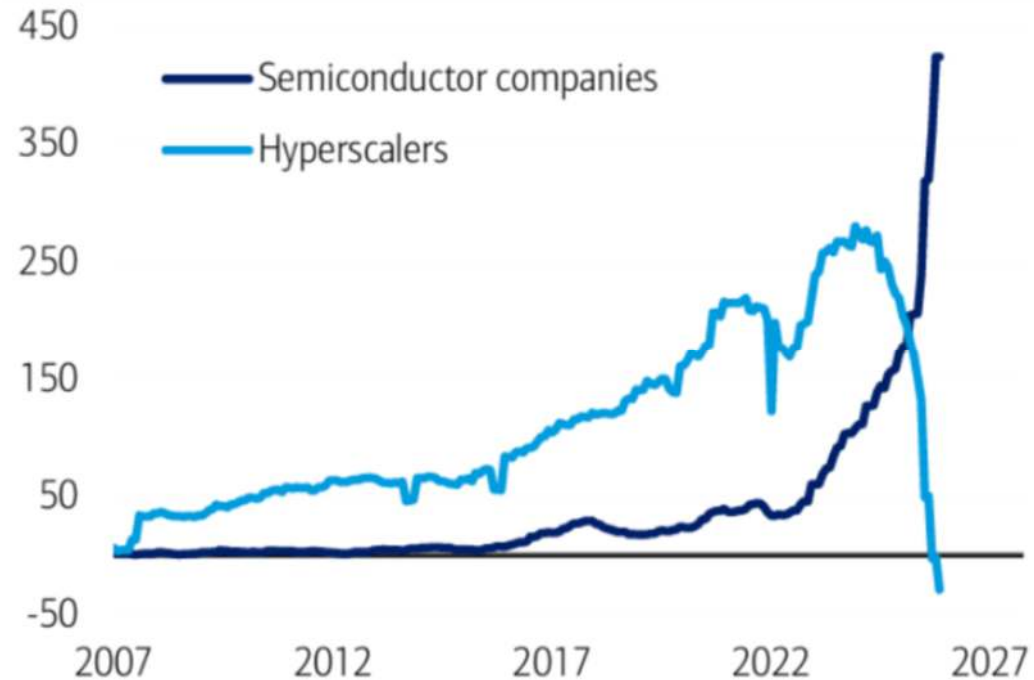
% of sales



One company's capital expenditure is another company's revenue. The AI infrastructure cycle is creating a significant transfer of free cash flow from hyperscalers to semiconductor and hardware providers as the industry races to expand computing capacity.

This also helps explain the concern around vendor financing earlier this year. When a company provides credit to help a customer purchase a product carrying an 80% gross margin, only about 20% of the transaction represents product cost. That does not eliminate the financing risk, but it provides some context around the economics behind it.

Free Cash Flow Transfer



Source: BofA Global Research

The race to build computing capacity is broadening beyond advanced processors into memory, storage, servers, and other data centre components. This growing supply and demand imbalance has pushed memory prices more than 400% higher in a little over a year, showing how the AI investment cycle is spreading across the broader hardware supply chain.

Computer Memory Prices per GB

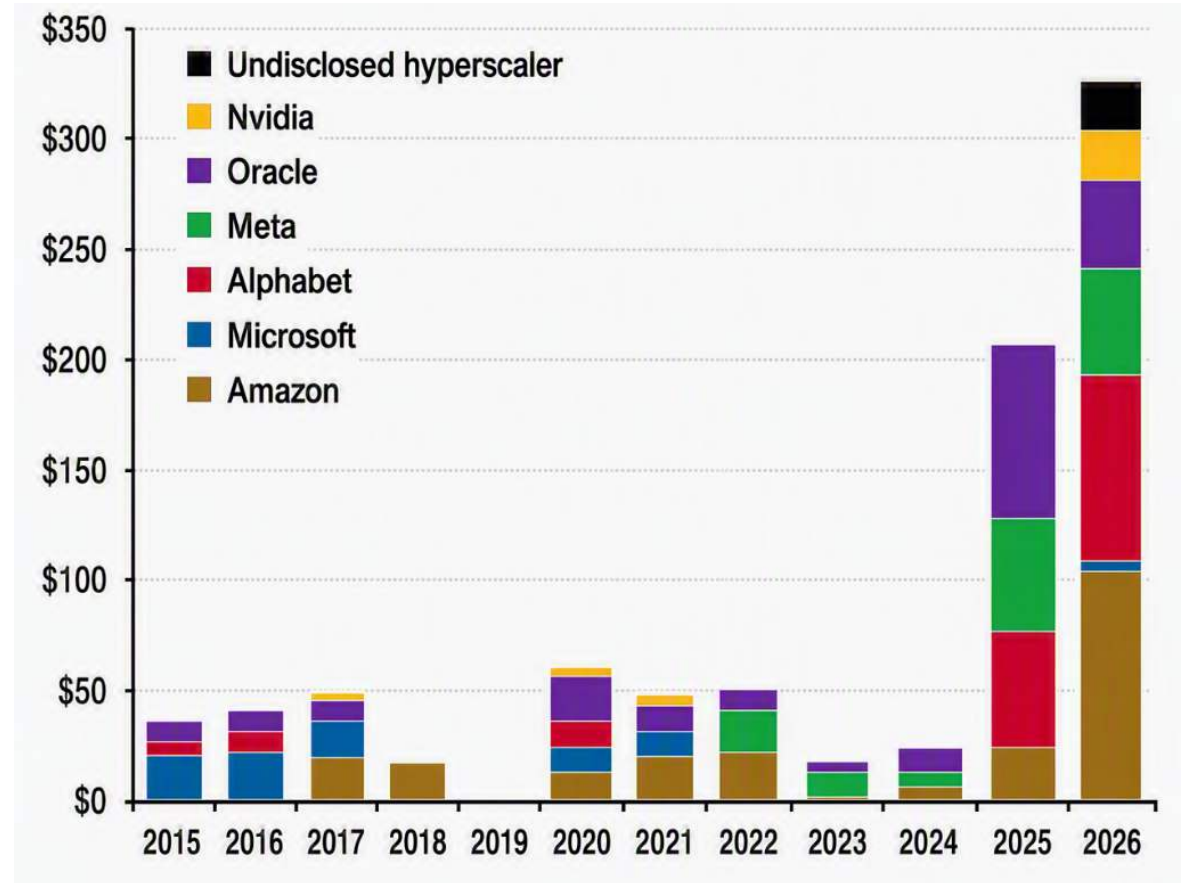


Source: Memory Tracker

Operating cash flow is no longer the only source funding the AI buildout. Hyperscalers and Nvidia have raised more than \$300 billion through investment grade debt markets this year to support continued capital spending.

Investors initially gave these companies the benefit of the doubt and often rewarded them for announcing larger AI investments. More recently, the macroeconomic backdrop has changed. Higher financing costs are causing investors to pay closer attention to the expected return on that spending, particularly among the largest issuers.

Hyperscale's + Nvidia New Debt Issuance

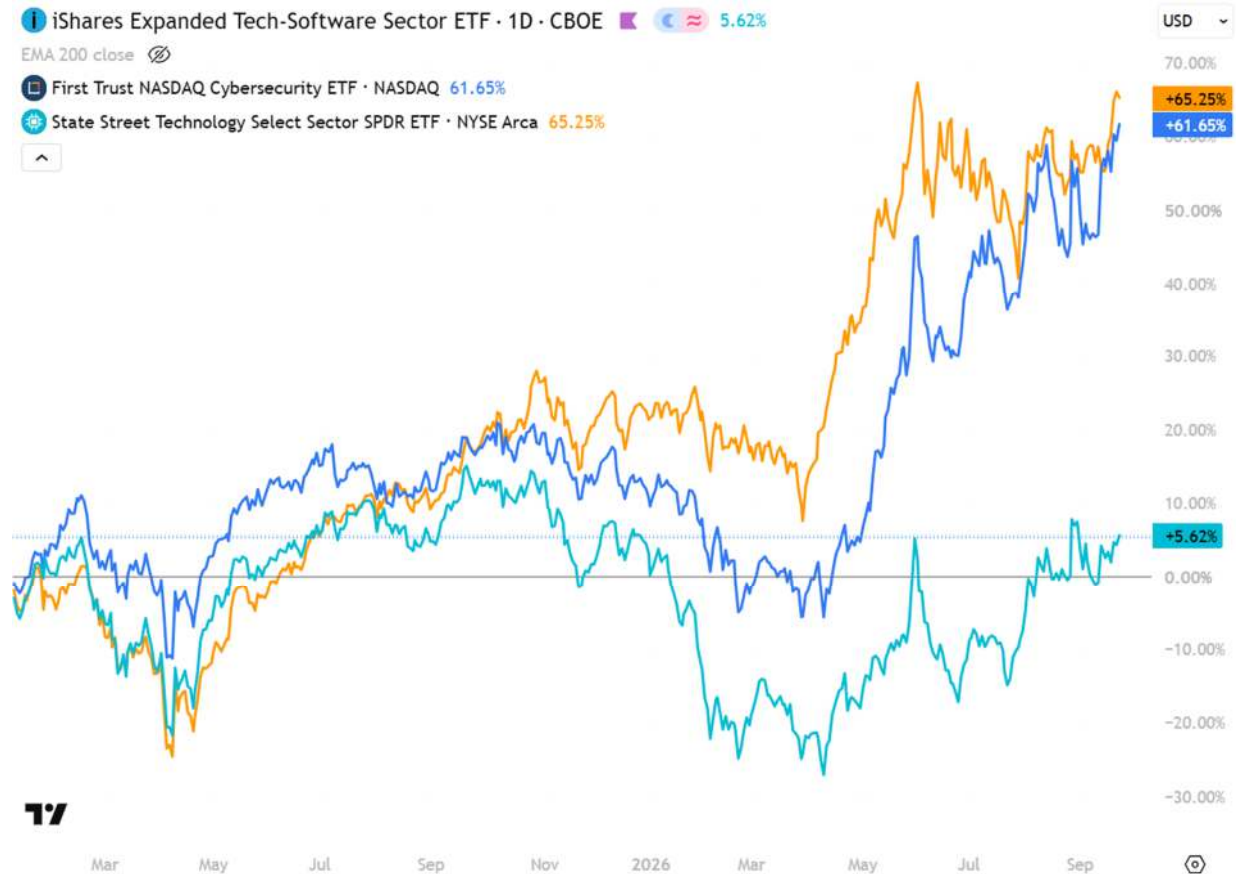


Source: Bloomberg | JPM Asset Management

Earlier this year, concerns that agentic AI could displace traditional software pushed sector valuations toward levels last seen during the 2008 financial crisis. Valuation multiples were cut roughly in half, even as many of the largest companies continued to report strong earnings.

Software shares have since started to recover, led by cybersecurity companies benefiting from both strong earnings and increased concerns around AI related security risks. However, performance remains highly differentiated as investors assess which companies can sustain growth and successfully adapt their products to an AI driven environment.

Software Comeback



Source: Trading View

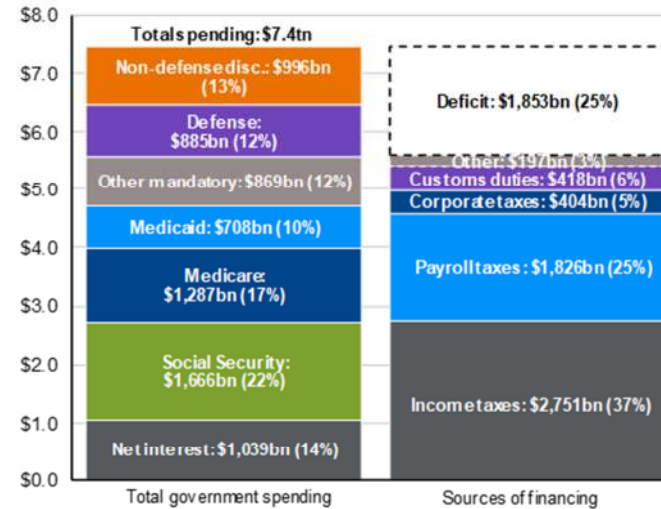
U.S. Federal Deficit

So much for the Department of Government Efficiency (DOGE). The U.S. federal deficit remains elevated despite efforts to restrain government spending. Continued borrowing is increasing the supply of Treasury debt and placing upward pressure on longer term interest rates.

Strong nominal economic growth can help contain the debt burden relative to the size of the economy. However, without greater fiscal discipline, the current trajectory will become increasingly difficult to sustain over time.

The 2026 federal budget

USD trillions



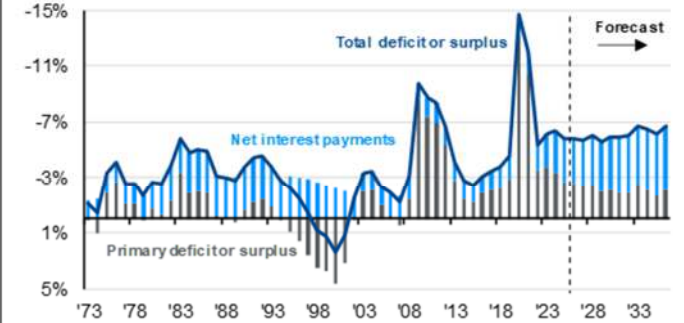
CBO's Baseline economic assumptions

	2026	'27-'28	'29-'30	'31-'36
Real GDP growth	2.3%	1.9%	1.8%	1.8%
10-year Treasury	4.1%	4.3%	4.3%	4.4%
Headline inflation (CPI)	3.0%	2.5%	2.3%	2.3%
Unemployment	4.6%	4.5%	4.4%	4.2%

Source: JP Morgan Global Asset Management

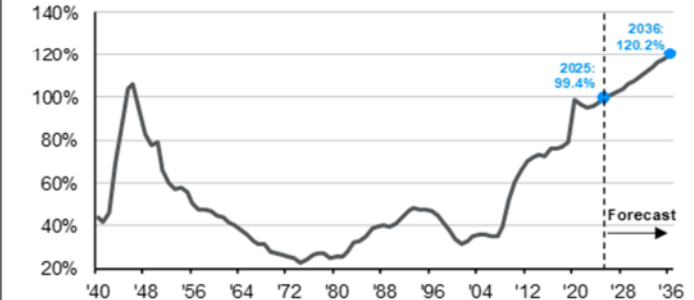
Federal deficit and net interest payments

% of GDP, 1973 - 2036, CBO Baseline Forecast



Federal net debt (accumulated deficits)

% of GDP, 1940 - 2036, CBO Baseline Forecast, end of fiscal year



US Debt Interest Cost Are In Line with History

The size of the debt matters, but its affordability is ultimately determined by the government's interest costs relative to its revenues. Current interest costs remain broadly in line with their long-term average. However, the burden could increase quickly as existing debt matures and is refinanced at higher interest rates.

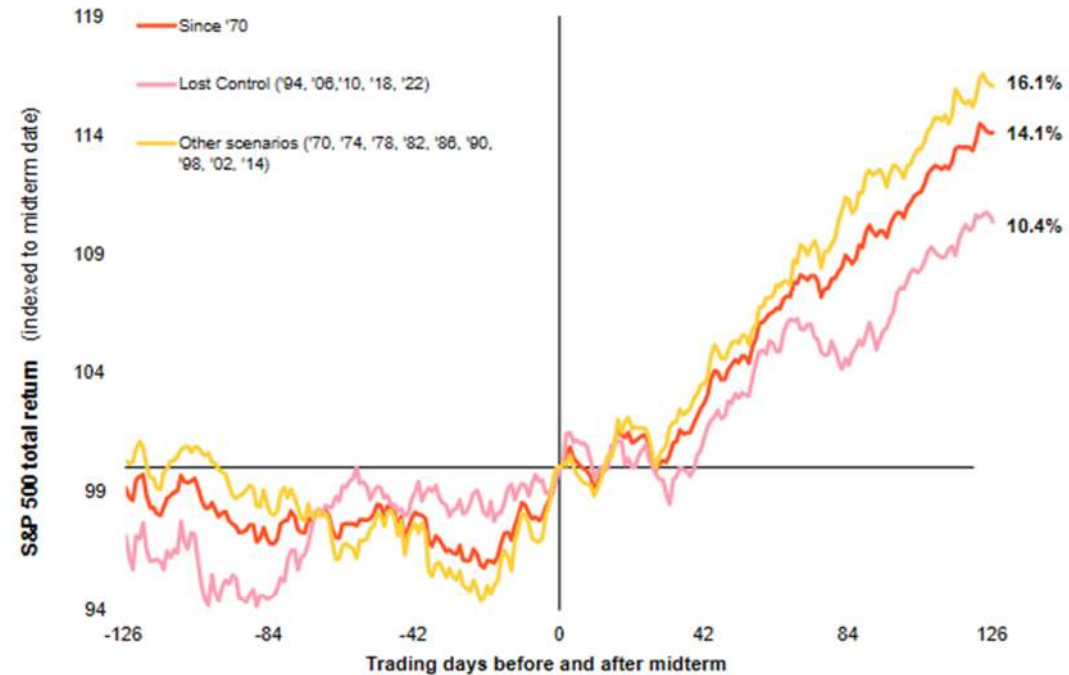


Source: A wealth of Common Sense | Exhibit A

S&P 500 Return Around Midterms Since 1970

Regardless of the outcome, the market tends to respond well to greater political certainty. Since 1970, the S&P 500 has generally strengthened around midterm elections, with the strongest rebounds historically occurring in years that started with a negative first quarter.

The recovery has also tended to begin before election day as polling data provides a clearer view of the likely outcome. The main takeaway is that waiting for complete certainty can mean missing the early part of the recovery.



Source: Bloomberg, data as of March 30, 2026. Based on Average S&P total return since 1970 indexed to midterm dates for midterm years: 1970, 1974, 1978, 1982, 1986, 1990, 1994, 1998, 2002, 2006, 2010, 2014, 2018, 2022. The "0" on the x-axis represents the Midterm election date, which falls on the first Tuesday in November. Month approximations based on average of 21 trading days in a month. Y-axis numbers represent total return of approximately 6 months before and after a midterm indexed to midterm date, with the value of the midterm date being 100. "Lost Control" defined as scenarios where government was controlling the presidency and both chambers of congress heading into the midterms, and lost control of at least one of them. **Index performance is for illustrative purposes only. Index performance does not reflect any management fees or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.**

Wars, Supply Bottlenecks and Political Pressure

This decade wars and recurring supply disruptions have kept energy markets vulnerable to sudden price increases. Releases from the Strategic Petroleum Reserve have helped moderate previous shocks, but lower reserve levels may limit the government's ability to offset future disruptions.

With hurricane season underway and winter approaching, supply risks remain elevated, particularly for refined products such as diesel, jet fuel, and natural gas liquids. These pressures could keep energy prices higher for longer and further complicate the inflation outlook.

Change in production and consumption of liquid fuels

Production, consumption and inventories, millions of barrels per day

Production	'23	'24	'25	'26*	'27*	'23-'27
U.S.	22.0	22.8	23.6	24.2	25.0	13.9%
OPEC	28.5	28.4	29.3	23.1	29.3	2.8%
Russia	10.9	10.5	10.5	10.5	10.7	-2.4%
Global	102.5	103.1	106.1	99.0	109.3	6.7%
Consumption						
U.S.	20.3	20.5	20.6	20.7	20.7	2.2%
China	16.0	16.4	16.6	16.4	16.9	5.9%
India	5.4	5.6	5.7	5.8	6.1	13.2%
Global	101.4	102.8	104.0	102.9	105.3	3.8%
Inventory Change						
	1.0	0.3	2.1	-3.9	4.0	

U.S. crude oil inventories

Million barrels



Source: JP Morgan Global Asset Management

Price of oil

WTI crude, nominal prices, USD/barrel



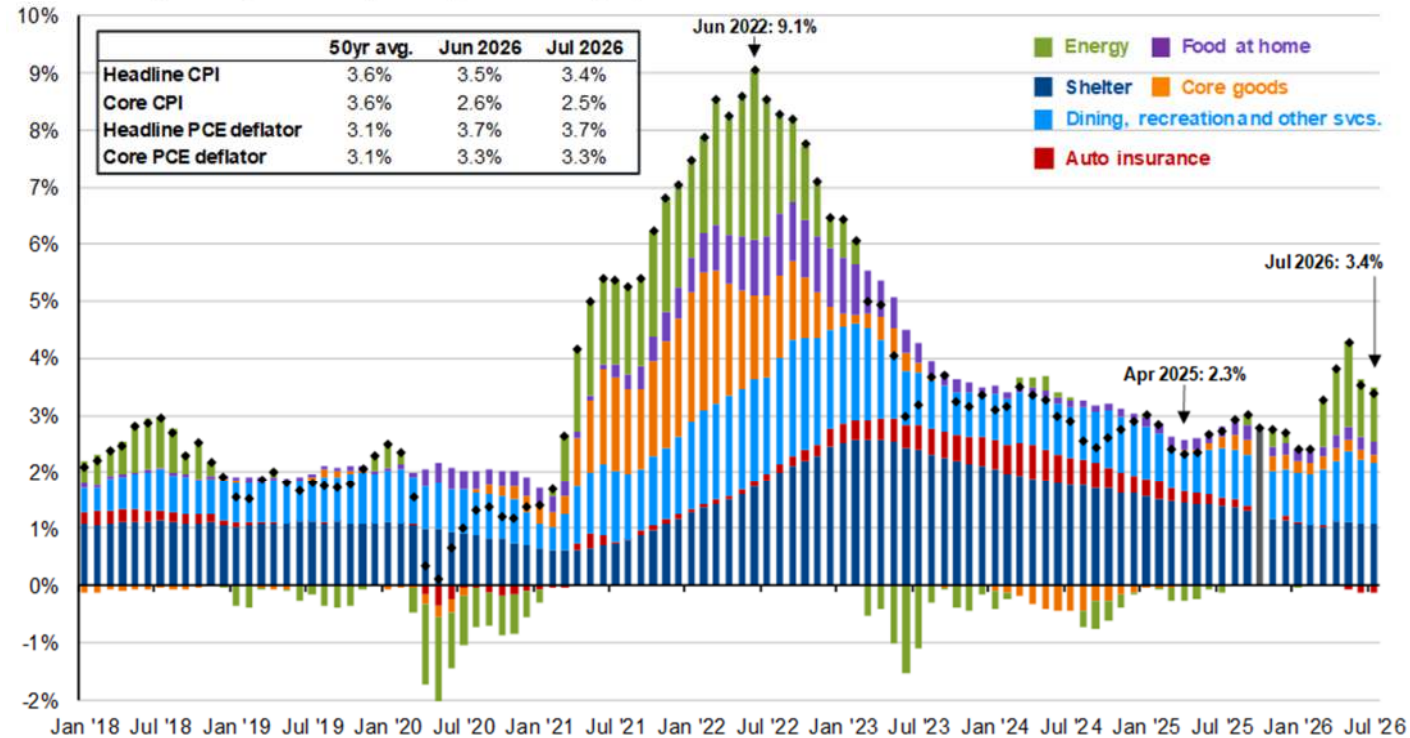
U.S. Inflation

While several components of inflation continue to moderate, higher food and energy prices have contributed to the largest increase in headline inflation since 2021. This renewed pressure gives the Federal Reserve less flexibility and increases the likelihood that interest rates remain elevated.

The market is now anticipating another one or two 25 bps rate increases before year end. Interestingly, the next federal reserve meeting is on October 28th, one week before the midterm election.

Contributors to headline CPI inflation

Contribution to year-over-year % change in CPI, non-seasonally adjusted



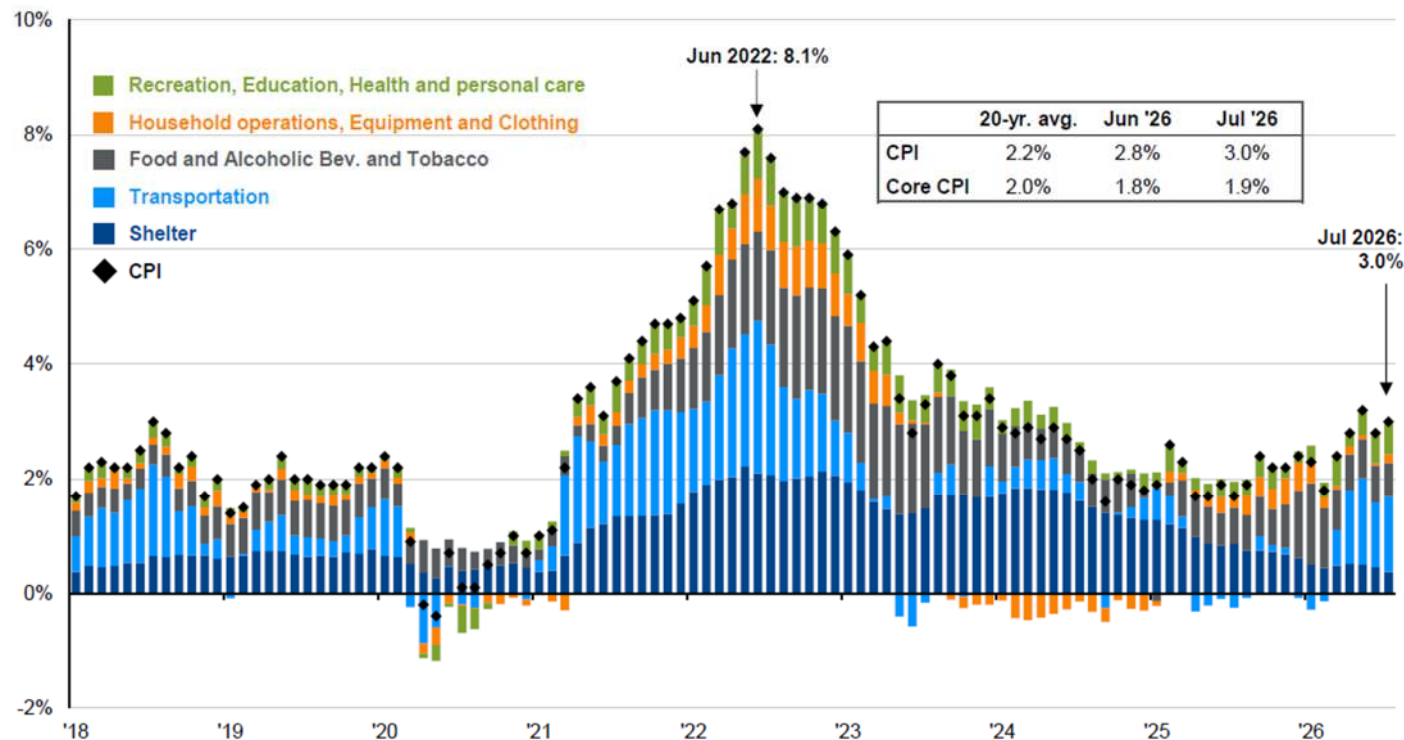
Source: JP Morgan Global Asset Management

Canada is experiencing a similar increase in headline inflation, with higher energy prices contributing to a significant rise in transportation costs. As a result, the market is now pricing in one or two additional 25 basis point rate increases before year-end.

Canada Inflation

Contributors to headline CPI inflation

Contribution to y/y % change in CPI, non-seasonally adjusted

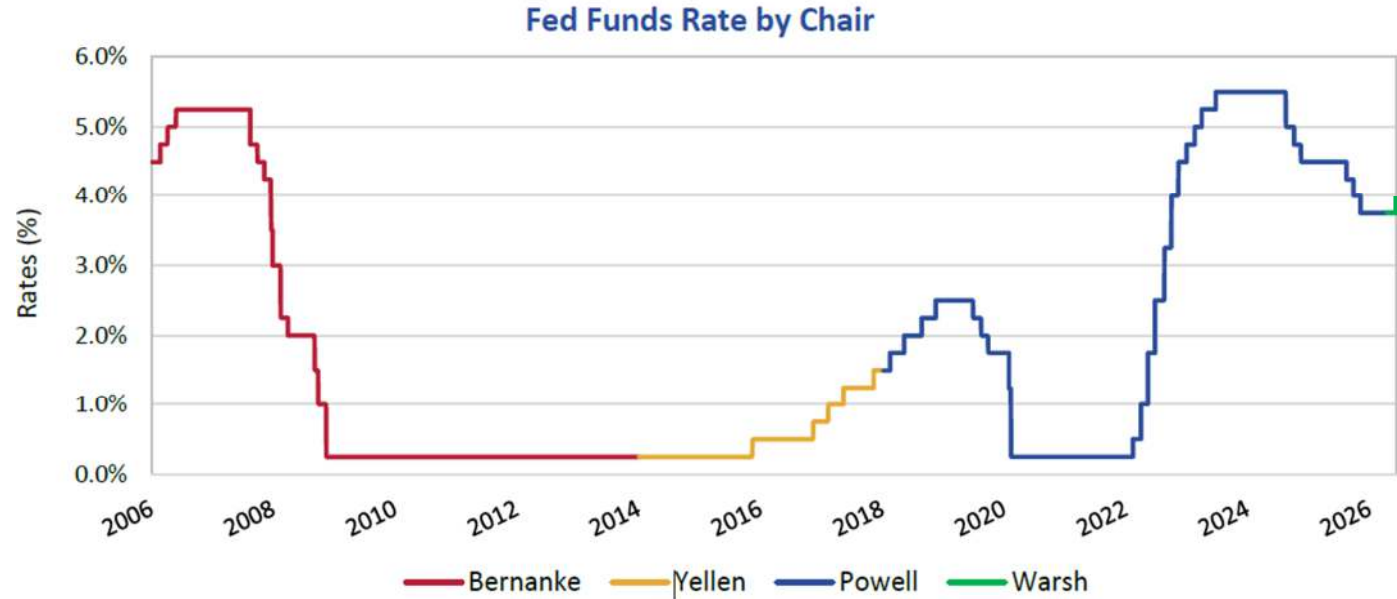


Source: JP Morgan Global Asset Management

Kevin Warsh became Chair of the Federal Reserve on May 22, 2026. His approach places less emphasis on detailed forward guidance and committing to a future path for interest rates. Instead, he has emphasized preserving flexibility and following broader economic trends.

At his second meeting as Chair, the Federal Reserve raised rates for the first time in more than three years in response to a resilient labour market and renewed inflation pressure.

New Fed Chair: Warsh



Source: Bloomberg

The 10-year U.S. Treasury yield recently reached its highest level since 2007 as inflation concerns returned to the forefront. Higher bond yields mean lower bond prices and can also place pressure on equity valuations by increasing the return investors require to own stocks.

For equities, the pace of the increase often matters more than any single yield level. Rapid changes in rates can force the market to reprice valuation multiples before earnings have time to adjust. This has been less noticeable because earnings remain strong, but equity valuations have still been consolidating for much of the year.

Rising Bond and Stock Yields

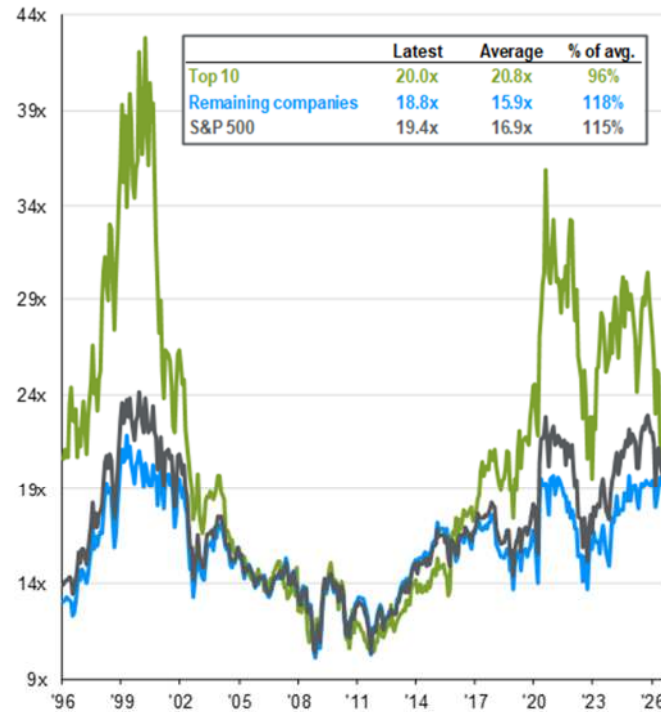


Source: Gurufocus Charts

Mega cap technology companies once commanded significant valuation premiums because of their superior growth and monopolistic profit margins. Those premiums have narrowed over the past year as growth expectations normalized and competition for agentic AI business increased.

Although the chart looks concerning, much of the valuation compression has come from earnings growing faster than share prices, rather than a deterioration in company fundamentals. If margins remain resilient and earnings continue to exceed expectations, lower starting valuations could leave room for multiple expansion toward year end and into 2027.

Mega Cap Earnings Compression



Source: JP Morgan Global Asset Management

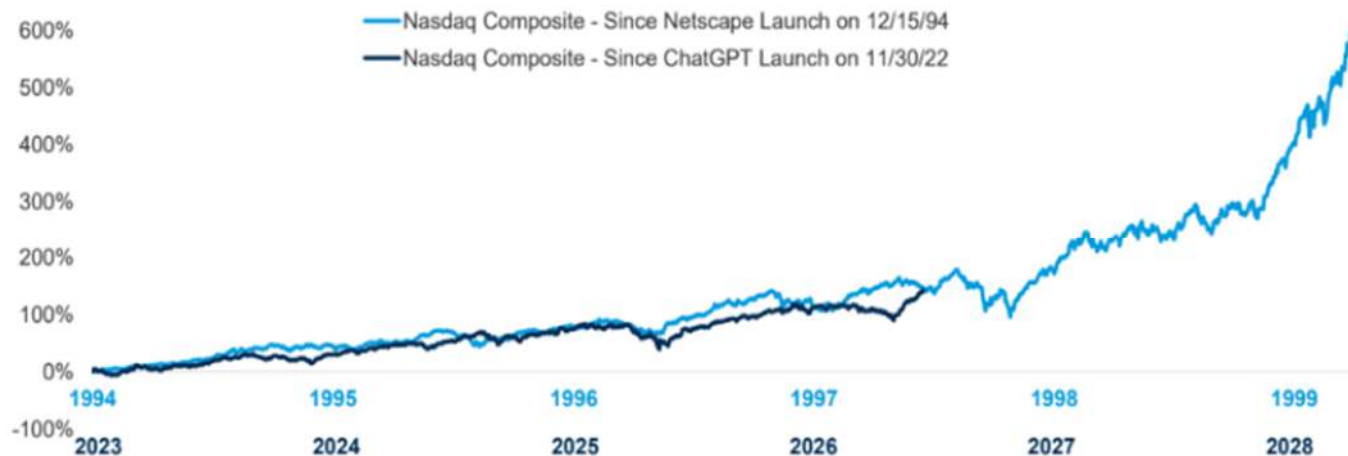


Following the launch of Netscape in 1994, enthusiasm around the internet helped fuel several years of strong U.S. stock market returns. ChatGPT's debut may have sparked a similar wave of AI-driven investment and optimism.

The question is whether we are still in the early innings of the AI cycle, or in the later stages, similar to 1998.

"History doesn't repeat itself, but it often rhymes."

Nasdaq Returns ChatGPT vs Netscape Launch



Source: Factset & Nasdaq

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