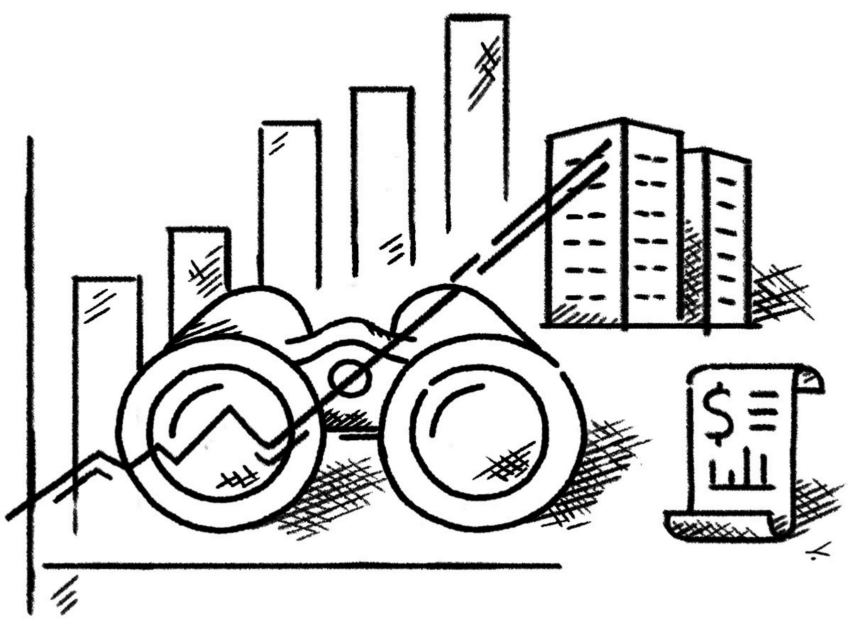
NEXUS

The Nexus Report

Markets Climb Through Good News and Bad



Second Quarter 2026

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Investment Outlook

Second Quarter, 2026

The AI Economy

The second quarter of 2026 provided another reminder that financial markets do not always react to world events the way many would expect. The conflict between the United States and Iran raised fears of a wider regional war, disrupted shipping through the Strait of Hormuz, drove energy prices sharply higher, and reignited concerns about inflation. Yet despite these developments, stock markets around the world delivered remarkably strong returns. The S&P 500 gained 17.3% during the quarter, while the TSX Composite advanced 7.0%. Strong gains were also recorded in international markets, with the MSCI EAFE Index returning 12.9% and the MSCI Emerging Markets Index surging 26.3%. While geopolitical tensions dominated headlines, continued investment in artificial intelligence remained a powerful theme in financial markets, driving substantial spending on the infrastructure and technologies needed to support its growth.

The scale of that investment has only become more striking over time. Technology companies continue to commit vast sums of capital to data centres, semiconductors, software development and power infrastructure.[1] A recent report from CIBC estimates that AI-related activity is expected to account for nearly 30% of U.S. real GDP growth in 2026.[2] If correct, that would make artificial intelligence one of the most important drivers of economic growth in the United States today.

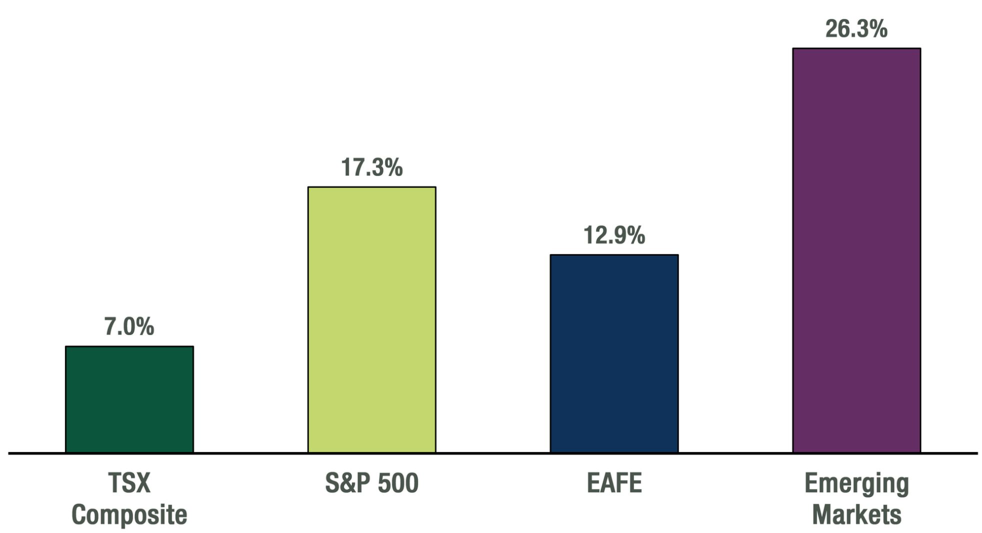
The opportunity is clearly substantial. Yet history teaches that periods of intense investment in new technologies can also come with unrealistic expectations. As Bank of Canada Governor Tiff Macklem recently observed, “The internet proved to be better than anybody imagined, but we still got the dot-com bubble.”[3] Investors are increasingly asking whether today's AI spending boom will ultimately deliver returns that justify the capital being committed. Their caution is understandable. The S&P 500 has risen almost 60% over the last two years, one of the strongest advances of the past six decades.[4]

Better Than Expected

The Canadian economy appears to be finding its footing after a prolonged period of sluggish growth. Real GDP surprised to the upside early in the quarter and the labour market rebounded after a difficult start to the year, with unemployment falling from 6.9% in April to 6.5% by June. While higher energy prices pushed headline inflation higher, core inflation remained relatively well contained, allowing the Bank of Canada to maintain its policy rate at 2.25%. At the same time, the regulatory barriers that once delayed major energy and infrastructure projects are beginning to give way, helping to revive investment activity. Taken together, much of the recent Canadian economic data has been encouraging. Nevertheless, as we have discussed with clients in recent quarters, the principal challenge remains uncertainty surrounding Canada's future trade relationship with the United States, which continues to weigh on business confidence and capital spending decisions.

The U.S. economy also continued to display

Total Returns – 3 Months Ended June 30, 2026 (C$)[5]



NOTE: Unless indicated otherwise, all Nexus returns are compound annual average, time-weighted, total rates measured in Canadian dollars and calculated after deducting such direct and indirect costs as applicable withholding taxes, trading commissions, custody fees and other fund/account expenses, but without deducting Nexus's management fees (which are charged to client accounts and vary by client). Returns for market indices and benchmarks are presented on the same basis, but without any such deductions. Stock-specific returns are price-only returns, and for U.S.-listed stocks are in U.S. dollars. Past performance is not indicative of future results. For more information about benchmarks, please refer to https://tinyurl.com/NexusOnBenchmarks.

1 Gartner estimates that global AI spending will approach US$2.6 trillion in 2026, with more than US$1.4 trillion directed toward AI infrastructure, including the computing, data centre and cloud resources required to support AI workloads. *Cap Ex, Still Moving Higher*, BMO Capital Markets, July 7, 2026.

2 *Quantifying the AI Hit to US Inflation*, CIBC Capital Markets, July 9, 2026.

3 *The World's Top Economists Are Sounding the Alarm on AI*, The Wall Street Journal, July 1, 2026.

4 *Hydration Break Recap: Win Some, Lose Some*, BMO Capital Markets Economic Research, July 3, 2026.

5 Bloomberg.

surprising resilience through the quarter. Consumer spending held up well despite the energy shock caused by the conflict in the Middle East. Business investment remained healthy. The economy also entered the quarter with growth running slightly above 2%, even as labour market conditions softened modestly. Corporate earnings were a notable source of strength, posting a sixth consecutive quarter of double-digit profit growth. As discussed above, the wave of investment in AI infrastructure appears to be the single biggest factor behind that performance.

Inflation was a more complicated story. Higher oil prices pushed U.S. headline inflation above 4% during the quarter, prompting investors to reassess their interest rate outlook. By quarter-end, the ceasefire between the United States and Iran and the partial reopening of the Strait of Hormuz had led many investors to conclude that the worst of the energy shock was behind them. However, with the ceasefire now under strain in early July, the inflation outlook has become less clear. Against this backdrop, the Federal Reserve struck a tougher tone on inflation than many expected, causing investors to shift from anticipating interest-rate cuts to pricing in future rate hikes.

Despite their differences, both the Canadian and U.S. economies have proven more resilient than many expected at the beginning of the year. For now, economic fundamentals remain constructive. Still, recent events have been a reminder that uncertainty is simply a part of investing.

Market Outlook

Artificial intelligence will almost certainly change the economy. The central question facing investors is how it will change. More specifically, how will the economic benefits ultimately be distributed, and will today's market expectations prove justified? Undoubtedly, some of the investment in AI infrastructure will ultimately prove uneconomic, just as in the 1999/2000 technology euphoria. That reality reinforces the importance of business fundamentals, valuation discipline, and a long-term perspective.

Importantly, participating in the growth of artificial intelligence does not require abandoning those principles. Across our portfolios, we own companies exposed to different parts of the AI value chain, including businesses supplying the electricity and infrastructure needed to build new data centres, companies developing foundational AI models and technologies, and traditional businesses that are finding practical ways to use AI to improve productivity and strengthen their competitive position. While the specific technologies may be new, our approach remains unchanged: identify durable businesses, pay sensible prices, and allow time for their value to compound.

We do not know how quickly artificial intelligence will transform the economy, nor can we predict the path of interest rates, inflation, or geopolitical events. What we do know is that periods of rapid change create both opportunities and uncertainty. By remaining disciplined, diversified, and focused on business fundamentals, we believe investors can benefit from long-term economic progress without relying on short-term predictions.

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Equities Were Defiantly Strong

Like a dedicated soldier, stock markets marched ahead in the second quarter despite challenging and occasionally contradictory macroeconomic conditions. As the Middle East conflict settled into an intermittent ceasefire, AI regained its hold on investor attention and supported elevated levels of speculative behaviour. The debate on AI winners and losers will persist for some time, although some clarity is beginning to emerge. The resulting market volatility has provided opportunities for active investing and disciplined rebalancing.

North American equity markets roared ahead during the period. The S&P/TSX added 7.0% while the S&P 500 gained 17.3%. These are remarkable 3-month returns. The U.S. stands out with exceptional, but concentrated, performance from the Technology sector which surged 31.8% (in US$). The advance was primarily driven by companies that design and produce specialized semiconductors, especially memory chips, critical to the buildout of AI data centre infrastructure, with several stocks doubling or tripling in price. The magnitude of this quarterly performance is exceedingly rare, which underscores the extraordinary nature of this market cycle.

North American Equities

Our Canadian holdings performed well, advancing 11.2%, and comfortably outstripping the S&P/TSX Index's 7.0% return. Gains were anchored by our positions in three Canadian banks which benefited from simultaneous operational tailwinds across their businesses and subsequent multiple expansion. The Industrials sector was another key driver with robust contributions from Toromont, Finning, and CN Rail. Additionally, our underweight in the Materials sector, specifically gold, proved advantageous as a correction in the price of gold weighed on the sector.

In the U.S., our holdings increased 12.1%, which is remarkable on an absolute basis, although it trailed the S&P 500 Index's 17.3% return. Our performance was led by gains in holdings of Cisco, Texas Instruments, and Alphabet, as well as Citigroup. However, relative performance was held back due to underperformance in our pharmaceutical holdings and our relative underweight in the Technology sector.

We were more active in trading during the quarter than is typical in a three-month period. This is not a change in philosophy, but rather a tactical response to the heightened volatility created by the shifting narratives around AI. Rapid price appreciation in several names led to stretched valuations and outsized position sizes, prompting us to prudently trim our exposure to Cisco, Alphabet, Finning, and Toromont. We redeployed these proceeds into existing holdings where valuations remained attractive.

We also acquired two new holdings after share price declines – Constellation Software and A.J. Gallagher. Constellation owns hundreds of vertical market software companies and while the market was concerned about potential disruption from AI, we view its decentralized acquisition model and deep competitive moats as highly durable. A.J. Gallagher is a U.S.-based commercial insurance broker. Shares softened due to short-term concerns over AI and a cooling insurance pricing cycle. We are comfortable with the pricing cycle and confident that the firm's scale, distribution power, and relationship-driven model give it the tools to successfully evolve and remain a leader.

International Equity Investments

International markets were strong in the second quarter, especially in emerging markets. We continue to hold two externally-managed international pooled funds.[6] EQIT (international developed market equities) increased 10.4%, and EMEC (emerging market equities) rose 26.3%. While the gains in the developed markets mirrored North America, the returns in the emerging markets were even more exceptional. The decline in oil prices acted as a structural tailwind for energy importing nations, while the resurgence of investor enthusiasm around AI-driven capital investment benefitted the advanced technology supply chain in Asia.

Developed stock markets delivered solid second quarter results. The Japanese market performed well led by a standout Technology sector which is deeply integrated in the global AI supply chain. As a net energy importer, Japan also benefited from lower oil prices, which mitigated domestic inflationary pressures. In Europe, economic growth continues to struggle while the European Central Bank raised interest rates in response to sticky inflation. Despite these macro headwinds, the Financials and Technology sectors showed notable strength.

The magnitude of the second-quarter stock market gains across emerging markets, particularly in Asia, was the strongest since 2009. Performance was heavily concentrated in companies and regions supporting the global buildout of AI infrastructure. While semiconductor manufacturers in South Korea and Taiwan dominated investor attention, capital flows lifted stocks across the entire Asian advanced electronics supply chain. This coincided with the cease-fire in the Middle East conflict which lowered oil prices and eased inflation for oil-importing nations.

International equity exposure remains an important diversification tool within our portfolio. It provides us with essential access to a broader universe of companies with distinct growth profiles and attractive valuations. The macro factors that influence international markets are often unique to those regions, which provides uncorrelated performance and volatility characteristics that complement our North American holdings.

NOTE: The overall and geographic level return data in this section are for the Equity Fund. Equity returns within the Balanced Fund were similar. For specific performance, please refer to your own quarterly report.

[6] Both pooled funds are managed by teams from J.P. Morgan Asset Management in the U.K. and are held in our International, Equity, and Balanced Funds.

Solid Returns Amid Volatility

Like the first quarter, the second quarter was characterized by elevated political and macroeconomic volatility, and the modest point-to-point move in interest rates understated the significant intra-quarter swings. Despite this volatility, fixed income markets delivered solid returns, with the FTSE Canada Universe Bond Index gaining 2.0% during the quarter. Our bond portfolio returned 1.5%. Over the past 12 months, the index returned 3.5%, while our bond portfolio generated a 3.7% return.

Canada's Economic Climate

Canada's economy remained subdued through the quarter but saw a gradual recovery compared to the previous quarter. After a 0.1% contraction in the first quarter, real GDP growth has resumed and, while we await data, current estimates peg annualized quarter-over-quarter growth closer to 2%. This shift was supported by stronger consumer spending and a modest housing recovery. Inflation trended higher throughout the quarter, with headline CPI rising from 2.8% in April to 3.2% in May, driven primarily by higher energy prices. Core inflation remained close to the Bank of Canada's 2% target.

The Bank of Canada

There were no surprises out of the Bank of Canada this quarter. While holding rates steady, policymakers acknowledged that headline inflation had risen above 3%, driven largely by higher energy prices linked to the Middle East conflict, but emphasized that core inflation remained close to target and that there was limited evidence of broader price pressures.

The Bank's messaging throughout the second quarter stressed a patient, data-dependent approach, balancing inflation risks against an economy still adjusting to U.S. tariffs and weak business investment.

Following its June meeting, the Bank signalled a commitment to remain nimble, noting that policy could move in either direction should inflation prove persistent or growth weaken.

The Real Yield Story

One of the biggest adjustments for fixed income investors in recent years has been recognizing that yield is once again a primary driver of bond returns. The average yield on the 10-year Government of Canada bond was 1.69% between 2012 and 2021, compared with 3.15% since 2022.

These higher yields should be viewed in the context of inflation. Over the same periods, Canada's average inflation (headline CPI) was roughly 1.7% and 3.7%, respectively. This is not a perfect comparison as bond yields represent expected returns over time, whereas inflation is measured contemporaneously; however, it is helpful to put current, "higher" nominal yields into the context of real returns.

Over the past 12 months, both our bond portfolio and the Canadian bond index generated returns that closely matched their starting yields. Despite significant volatility stemming from politics, commodities, and trade, the overall Canadian interest rate environment has changed relatively little. The 12-month movement in Government of Canada bond yields is illustrated in the chart below.

AI Hits Bond Markets

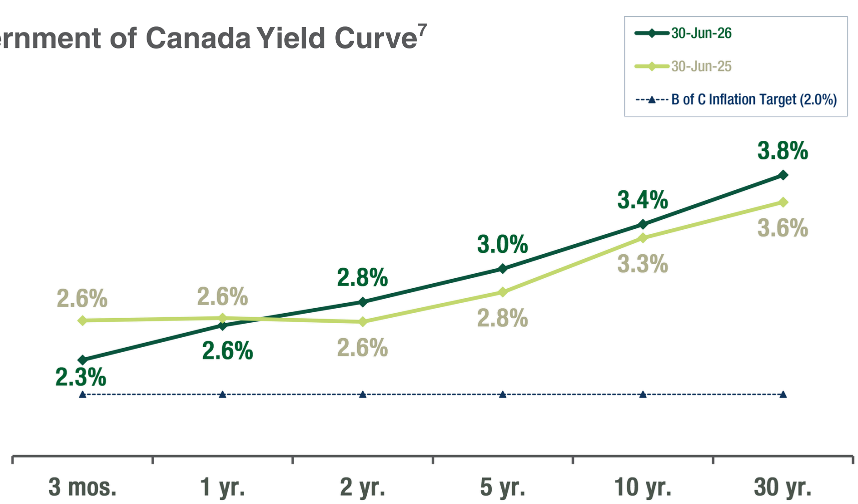
Bond issuance by large U.S. technology companies has become a defining theme in global credit markets. In Canada, this trend was highlighted by transactions from Alphabet (Google) and Amazon, which issued approximately C$8.5 billion and C$14 billion, respectively, representing two of the largest Canadian-dollar corporate bond offerings on record.

These transactions are part of a broader global trend. Large U.S. technology companies, including Amazon, Alphabet, Microsoft, Meta, Oracle, and now SpaceX, issued approximately US$122 billion of bonds in 2025, and by the second quarter, 2026 had already exceeded the prior year's total. While investor demand for these highly rated issuers has remained strong, more recent deals have received some scrutiny over the sheer volume of issuance and growing issuer concentration.

Portfolio Positioning

Our bond portfolios continue to be positioned with a shorter duration than the broad bond index. We modestly extended our average duration during the quarter as we deployed cash into slightly longer-term bonds. These purchases included Amazon's new maple bonds.

Government of Canada Yield Curve[7]



[7] Bloomberg.

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