

Key takeaways

Executive summary

Equity markets have remained resilient despite geopolitical conflict, higher oil prices and rising global bond yields. Stronger-than-expected earnings have helped offset the pressure that higher real yields have placed on valuations, supporting the view that market gains continue to be grounded in fundamentals rather than broad speculative excess.

At the same time, risks are building beneath the surface. Oil prices remain an important link between geopolitics, inflation and interest rates, while low energy inventories leave the global economy with less capacity to absorb another supply disruption. A de-escalation in the Middle East could provide relief, but an extended conflict could intensify inflation and rate pressures.

The longer-term investment backdrop remains constructive. AI-related spending continues to support earnings, but the opportunity is expanding beyond the largest technology companies. Defence spending, infrastructure renewal, power demand, cybersecurity and the reshoring of supply chains could contribute to a broader capital-investment cycle across sectors and regions.

Higher yields have also made fixed income more relevant. Bonds once again offer meaningful income and lower absolute volatility, although they may not provide the same negative correlation to equities seen during lower-inflation periods. This places greater emphasis on understanding the specific role bonds are expected to play within a portfolio.

Although headline equity indexes remain near record levels, performance beneath the surface is considerably more uneven. Narrow leadership, shifting interest-rate expectations and growing dispersion reinforce the importance of looking across asset classes, sectors, regions and investment styles for more balanced sources of return.

Strong earnings and a broadening investment cycle continue to support markets, but rising geopolitical and inflation risks are increasing the importance of finding opportunities beyond narrow market leadership.

Key takeaways

1. **Earnings remain the foundation of market resilience.** Higher real yields have compressed equity valuations, but stronger-than-expected earnings have more than offset that pressure. Earnings growth is also extending beyond the largest technology companies into small caps, emerging markets and other global regions, providing broader fundamental support for equities.
2. **Oil is connecting geopolitics, inflation and interest rates.** Higher oil prices are contributing to inflation pressure and rising bond yields, while depleted oil and refined-product inventories leave less room to absorb further disruptions. While an extended conflict presents meaningful downside risk, de-escalation could lower oil prices and yields and provide support for both bonds and equities.
3. **The capital-investment cycle is expanding beyond AI.** AI infrastructure remains an important driver of earnings and capital spending, although investors are increasingly scrutinizing financing costs, profitability and evidence of monetization. At the same time, defence, power generation, infrastructure, cybersecurity and supply-chain reshoring are extending investment activity across the broader economy.

4. **Bonds are attractive again, but their role has changed.** Yields near 5% offer meaningful income, improved long-term return potential and lower absolute volatility. However, bonds may remain positively correlated with equities when inflation is elevated or volatile, meaning their portfolio value may come more from income and risk reduction than consistently offsetting equity declines.
5. **Record indexes are masking narrow market participation.** Despite the strength of the S&P 500, approximately 60% of its constituents were at least 20% below their respective highs. This disconnect points to both concentration risk and potential opportunity in less expensive sectors, regions and investment styles outside the dominant market leaders.
6. **Canada's investment push could create a longer-term tailwind.** Increased domestic investment, infrastructure development, reduced interprovincial trade barriers and greater export diversification could help address Canada's longstanding productivity challenges. The potential benefit depends on whether announced investments translate into completed projects, but Canada's exposure to resources, financials and capital-intensive industries may be well positioned if momentum continues.
7. **Focus on what changes fundamentals, not just sentiment.** Elections, policy changes and geopolitical developments can create meaningful volatility, but their lasting impact often depends on whether they ultimately affect earnings, investment activity, productivity or economic growth. For advisors, the challenge is helping clients distinguish between developments that alter long-term fundamentals and those that primarily influence short-term market sentiment.

The bottom line

For advisors, the challenge is no longer whether opportunities exist, but where they may emerge. Narrow market leadership, changing bond dynamics and a broadening investment cycle suggest a diversified approach that draws from multiple sources of return may be better positioned to navigate an increasingly complex market environment.

Watch the Q3 market review and outlook webinar for deeper insights on earnings resilience, the capital-investment cycle and portfolio construction in a higher-rate environment.

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