



2026 THIRD QUARTER MARKET REVIEW

Markets defied
expectations as
earnings strength met
rising rate pressure

IG Investment Strategy Team



The beat goes on, as earnings and growth keep markets moving forward

The third quarter was ultimately a test of how much the markets could absorb higher interest rates without a meaningful deterioration in equity performance. The U.S. 10-year Treasury yield rose roughly 80 basis points (0.8 of a percentage point) during the quarter and moved above 5%, reaching its highest level in nearly two decades. Yet equity markets remained remarkably resilient. That tension defined the quarter: rising yields increased the hurdle for risk assets, but the economic strength helping push those yields higher also continued to support earnings and corporate investment.

The rise in yields reflected more than a change in central-bank expectations. U.S. growth remained solid, with manufacturing indices improving and business investment continuing to strengthen into the third quarter. At the same time, energy added a new inflationary pressure. West Texas Intermediate crude rose by roughly 31% during Q3, as the conflict in the Middle East disrupted supply. The combination of resilient demand and higher energy costs forced markets to reassess how quickly inflation could normalize and how restrictive monetary policy might ultimately need to become.

This is where the level of yields becomes a problem. Rising rates driven by stronger growth are very different from rising rates driven by deteriorating inflation expectations or fiscal concerns. So far, the growth side of that equation has remained supportive. Earnings expectations for the S&P 500 increased from already extremely high levels during July and August, an unusual development since analysts normally reduce estimates as a quarter progresses. The earnings story has also broadened beyond a small group of mega-cap companies. That strength has allowed equities to absorb a much higher discount rate, but the margin for disappointment is clearly smaller when investors can earn more than 5% on long-term government bonds.

Canada entered the quarter from a somewhat different position. Second-quarter GDP rebounded at a 3.3% annualized pace, but momentum moderated afterward, with economic activity flat in July and Statistics Canada estimating a modest 0.2% increase in August. Higher commodity prices remain supportive for parts of the Canadian market, particularly energy and materials, but they also complicate the inflation outlook. The Bank of Canada held its policy rate at 2.25% in September. Headline inflation remained around 3%, largely because of gasoline prices, while inflation excluding gasoline and core measures remained much closer to 2%.

AI investment remained another important source of economic and earnings strength. The infrastructure buildout continues at an extraordinary pace, but higher yields are changing the question investors are asking. Spending alone is no longer enough. As the cost of capital rises, companies increasingly need to demonstrate that AI investment can translate into revenue, productivity, margins and ultimately free cash flow. The theme remains powerful, but the financial hurdle is becoming higher.

That leaves markets entering the fourth quarter in an unusual but relatively healthy tension. Strong growth and earnings remain important supports for equities, while higher yields are steadily increasing the cost of capital and putting pressure on valuations. Even gold, which finished the quarter higher, fell sharply in September as rising bond yields competed with its appeal as an inflation hedge. The key question is therefore not simply whether yields remain high. It is why they remain high. If growth and profits continue to justify them, equities can remain resilient. If yields keep rising while growth begins to fade, the balance becomes considerably more difficult.

Earnings kept the market moving, while higher yields tested how much investors were willing to pay.

– Philip Petursson



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Economic signals

Growth holds, but the pressure points have changed

Seven recession indicators are still pointing to a low-risk backdrop.

Overall recession risk



Yield curve	● Steepening
Manufacturing	● Improving
Financial conditions	● Accommodative
Housing starts	● Stagnant
Leading indicators	● Improving
Unemployment	● Stable
Inflation	● Above target

- The yield curve is steepening, but long-term yields remain elevated.
- Financial conditions remain supportive.
- Manufacturing and leading indicators are improving.
- Labour markets remain stable.
- Inflation and long-term yields are the main constraints.

**The economy is still supporting earnings.
Inflation and long-term yields are the risks to watch.**

Index returns

2026 equity price returns and fixed income total returns

Table 1 - 2026 equity price returns

	Currency	Q3	YTD	1-year
S&P/TSX Composite Index	CAD	1.1%	11.1%	17.4%
S&P 500 Index	USD	2.0%	11.8%	14.4%
	CAD	2.1%	15.8%	16.8%
MSCI EAFE Index	USD	0.3%	8.1%	13.0%
	CAD	0.3%	12.0%	15.3%
MSCI Europe Index	EUR	-1.3%	7.4%	13.7%
	CAD	-1.9%	7.5%	12.0%
MSCI Emerging Markets Index	USD	-1.0%	21.4%	26.7%
	CAD	-1.0%	25.8%	29.3%

Table 2 - 2026 fixed income total returns

	Currency	Q3	YTD	1-year
FTSE Canadian All Government Bond	CAD	-3.2%	-1.1%	-1.6%
FTSE Canada Universe Bond	CAD	-3.0%	-0.8%	-1.1%
ICE BofA U.S. Corporate Bond	USD	-3.8%	-2.8%	-2.0%
	CAD	-3.7%	0.7%	0.0%
ICE BofA U.S. High Yield Composite	USD	-1.8%	0.0%	1.4%
	CAD	-1.7%	3.6%	3.5%
Bloomberg Global Aggregate Bond	USD	-2.5%	-2.7%	-2.4%

Source: IG Wealth Management; Bloomberg; 1-year, September 30, 2025-September 30, 2026.
Equity benchmark returns are quoted as price returns, excluding dividends. Canadian bond market to September 30, 2026.

Drivers of market performance

Canadian equities

The S&P/TSX Composite Index advanced 1.1% in the third quarter, but the headline gain masked relatively narrow participation beneath the surface. Only three of the index's 11 sectors were positive, with materials and information technology accounting for most of the strength.

Materials gained 12.6%, driven by strong performance across gold and precious-metal miners. Gold benefited from continued central-bank buying and efforts to diversify official reserve holdings.

Information technology led, supported by solid earnings growth across the sector. AI and data-centre investment provided an additional tailwind in some areas, helping establish a second source of leadership alongside materials and showing that Canada's gains were not solely commodity-driven.

Higher oil prices also supported energy, with WTI crude peaking at US\$106/bbl late in the quarter. Together, those gains were enough to offset weakness across much of the rest of the index.

Financials were not a headline driver, but bank earnings remained resilient, supported by capital-market activity, trading income, fee revenue and contained credit costs.

U.S. equities

The S&P 500 Index advanced 2% in U.S. dollars during the quarter, but performance beneath the surface was uneven. Leadership remained concentrated in sectors benefiting from higher energy prices and continued technology investment, while rising bond yields weighed on more rate-sensitive areas.

Energy led with a 16.5% gain, as higher crude prices improved the earnings outlook for the sector. Information technology also advanced, supported by continued AI investment and resilient demand across digital businesses. By contrast, utilities came under pressure as higher long-term yields reduced the relative appeal of income-oriented equities and increased financing costs.

The more important support for the broader market remained earnings. Second-quarter profits grew more than 53% from a year earlier, while estimates for the third and fourth quarters point to continued growth of roughly 27% and 26%, respectively.

Strong earnings remain the key support for equities, but higher yields are raising the hurdle for valuations and increasing the importance of sustained profit growth.

International equities

International equities were broadly flat to modestly lower during the quarter. The MSCI EAFE Index was essentially flat, while MSCI Europe fell 1.9% in Canadian dollars and 1.3% in euros. Emerging markets declined 1% in both U.S. and Canadian currencies.

Developed markets experienced a notable mid-quarter pullback, with Europe facing pressure from higher energy prices and changing rate expectations. The European Central Bank (ECB) raised rates again in September, as inflation remained elevated, adding to the pressure on valuations and contributing to volatility.

Performance across Asia was more mixed. Japan was one of the stronger markets in the region, supported by improving corporate fundamentals and continued investor interest. Korea was considerably more volatile and finished the quarter well below its earlier peak, despite continued AI-related demand across the regional technology supply chain.

While market leadership narrowed during the quarter, international equities continued to benefit from generally resilient economic conditions and ongoing investment in technology and artificial intelligence.

Fixed income

Fixed income delivered negative returns in the third quarter, as rising yields globally outweighed coupon income. The FTSE Canada Universe Bond Index declined 3%, while the Bloomberg Global Aggregate fell 2.5%.

The move in yields was broad and significant. Canada's 10-year government bond yield climbed to 3.99%, and the U.S. 10-year Treasury yield reached 5.29%, rising 61 and 81 basis points respectively over the quarter.

As yields rise, existing bonds become less valuable because new bonds are being issued at higher rates. The longer the maturity, the greater the price sensitivity, which is why duration was the main headwind this quarter.

Corporate credit was more mixed. High-yield bonds still outperformed investment-grade bonds, but high-yield spreads widened meaningfully late in the quarter, as investors demanded more compensation for taking on credit risk.

Canadian equities

Chart 1 - S&P/TSX Composite Index performance

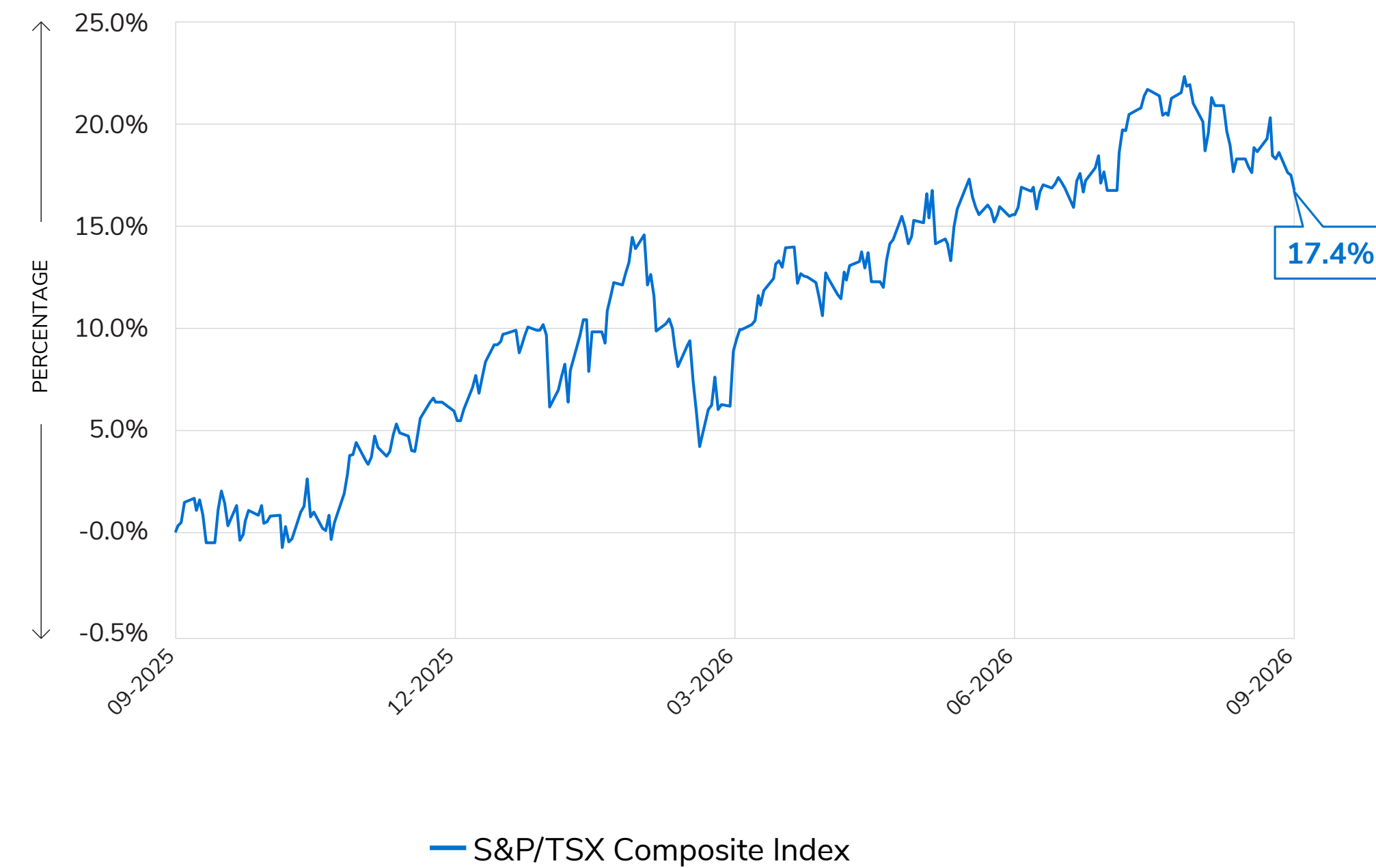
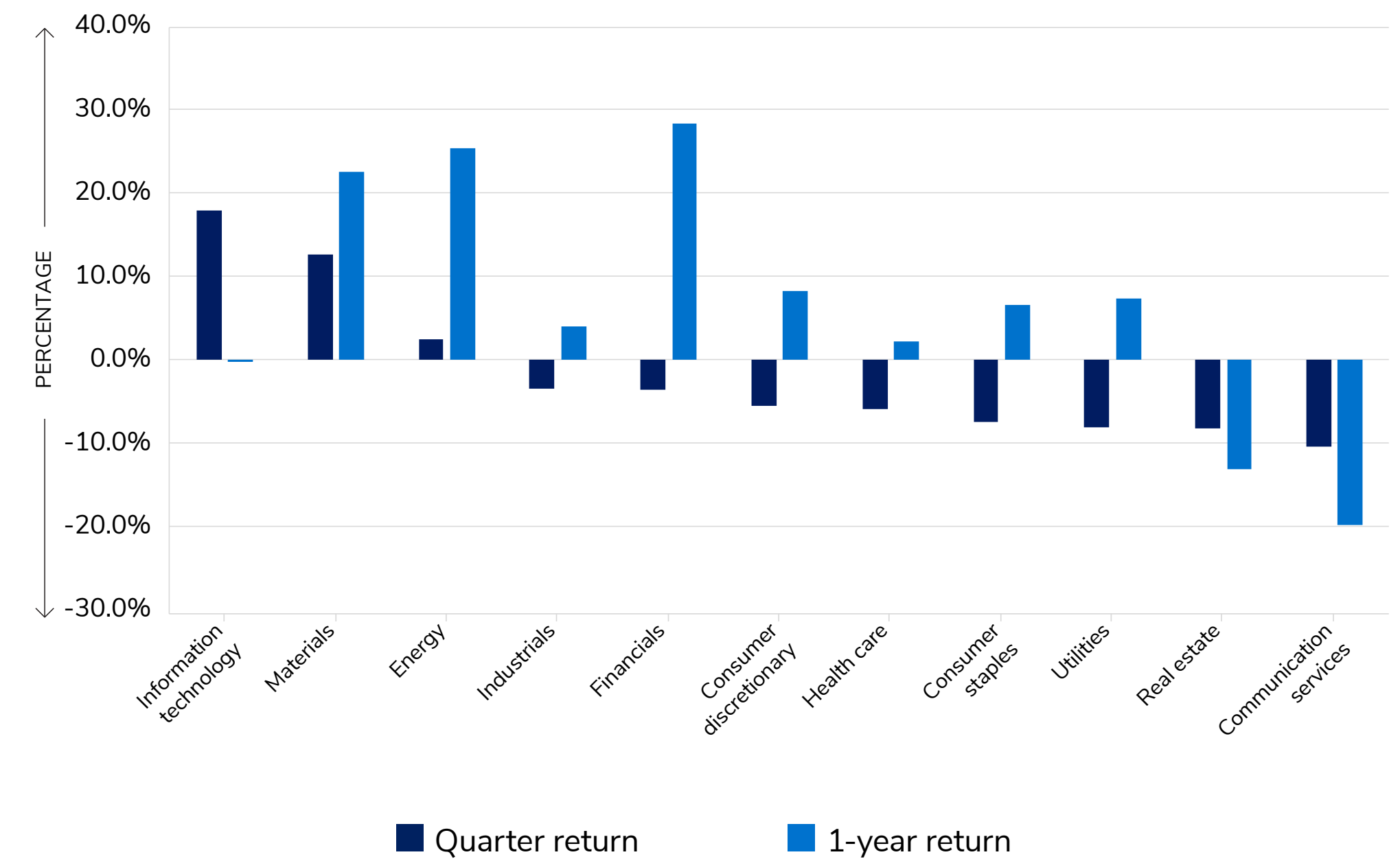


Chart 2 - S&P/TSX Composite sector level returns



U.S. equities

Chart 3 - S&P 500 Index performance (USD)

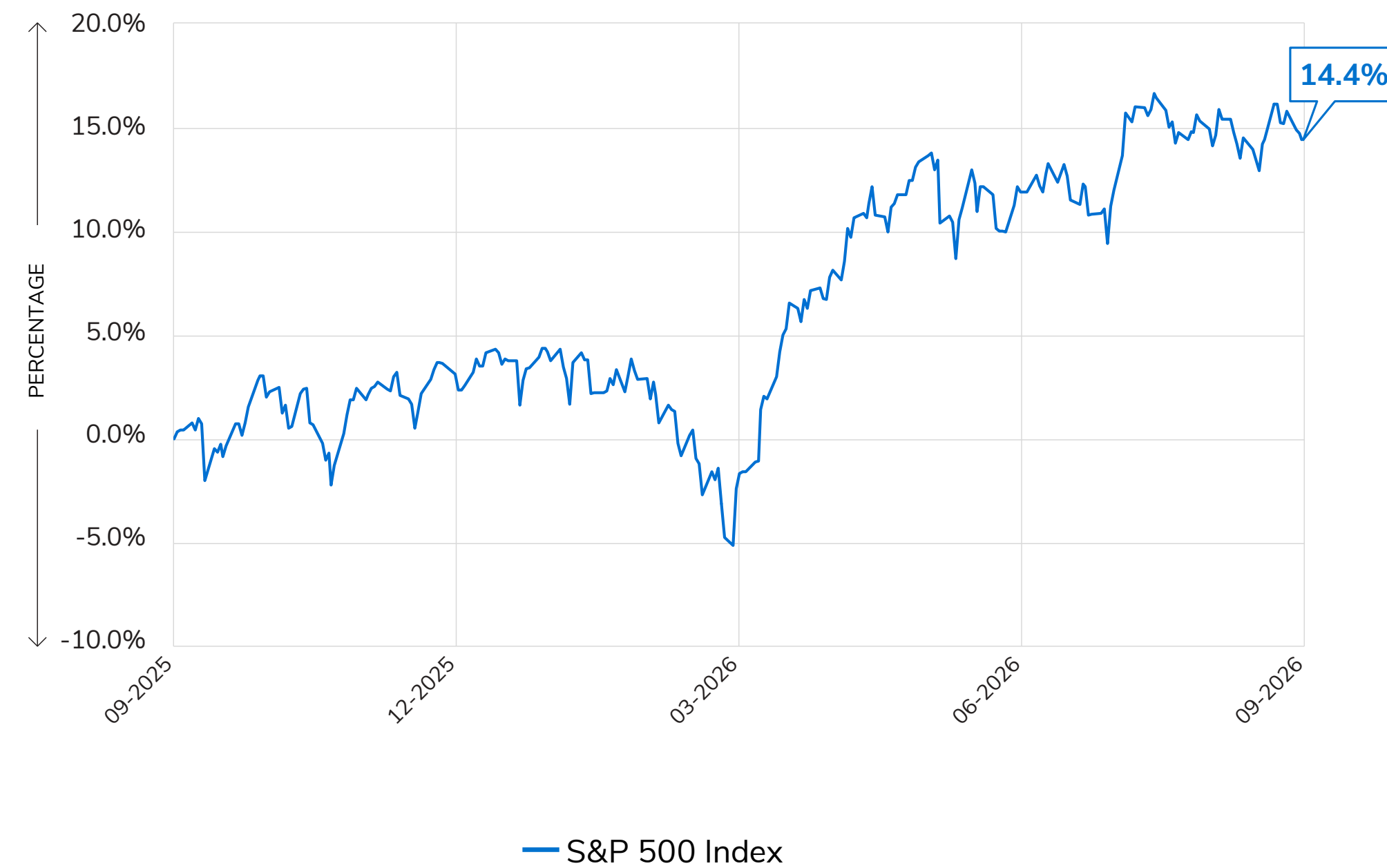
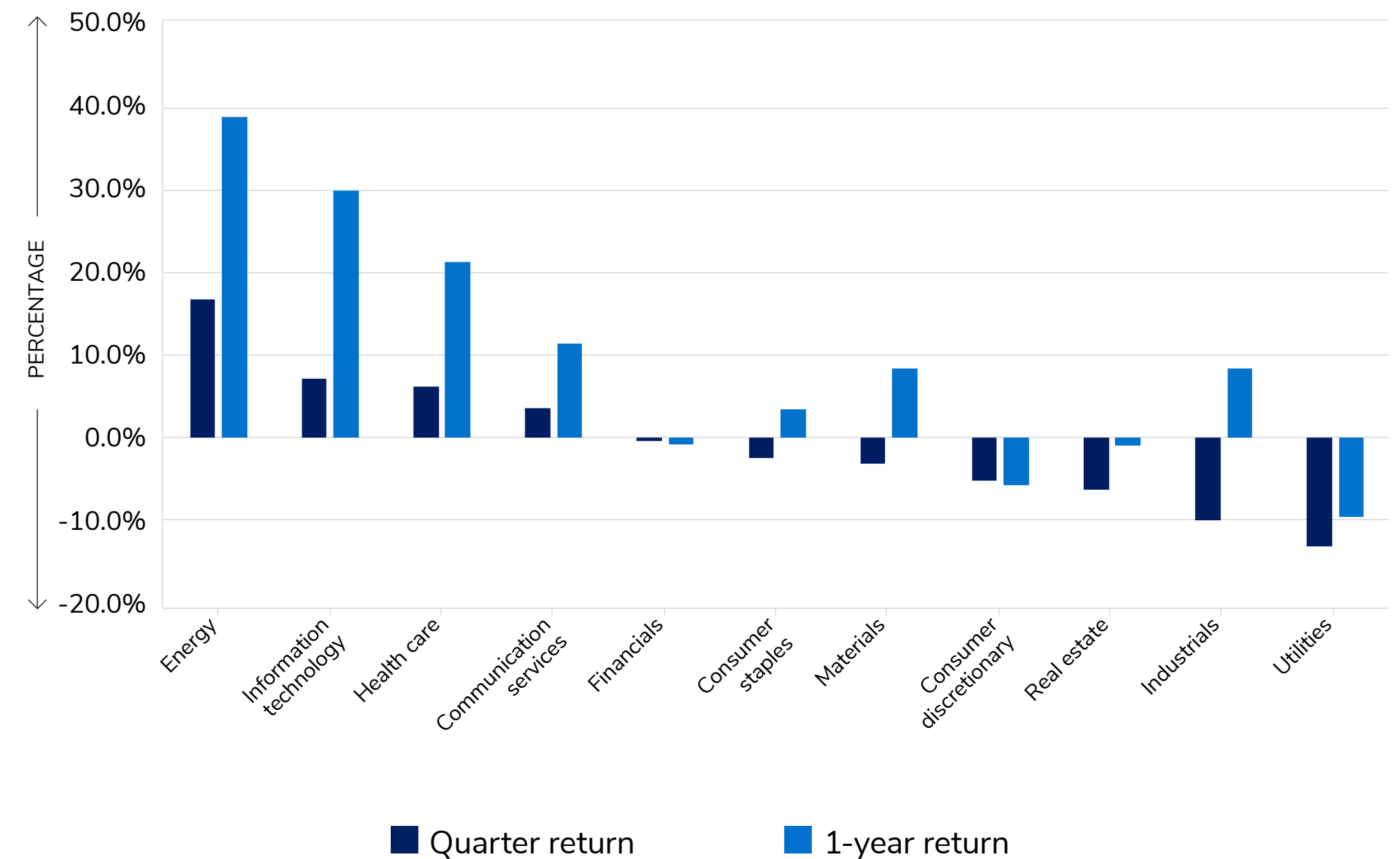
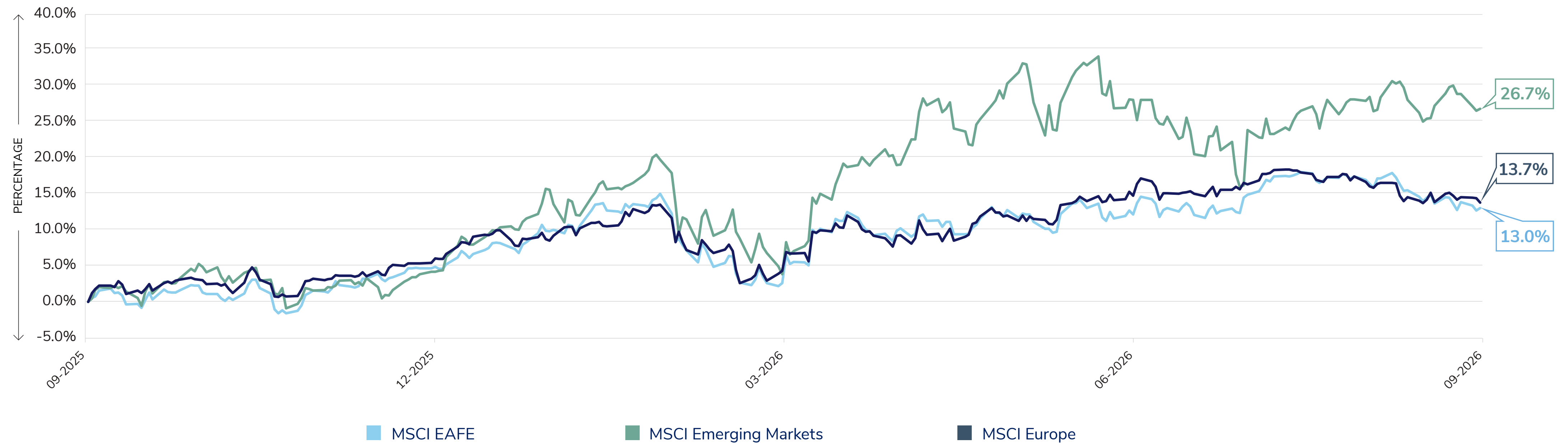


Chart 4 - S&P 500 Composite sector level returns



International equities

Chart 5 - MSCI Emerging Markets (USD), MSCI Europe (EUR) and MSCI EAFE (USD) indices performance



Fixed income

Chart 6 - Global central bank policy rates

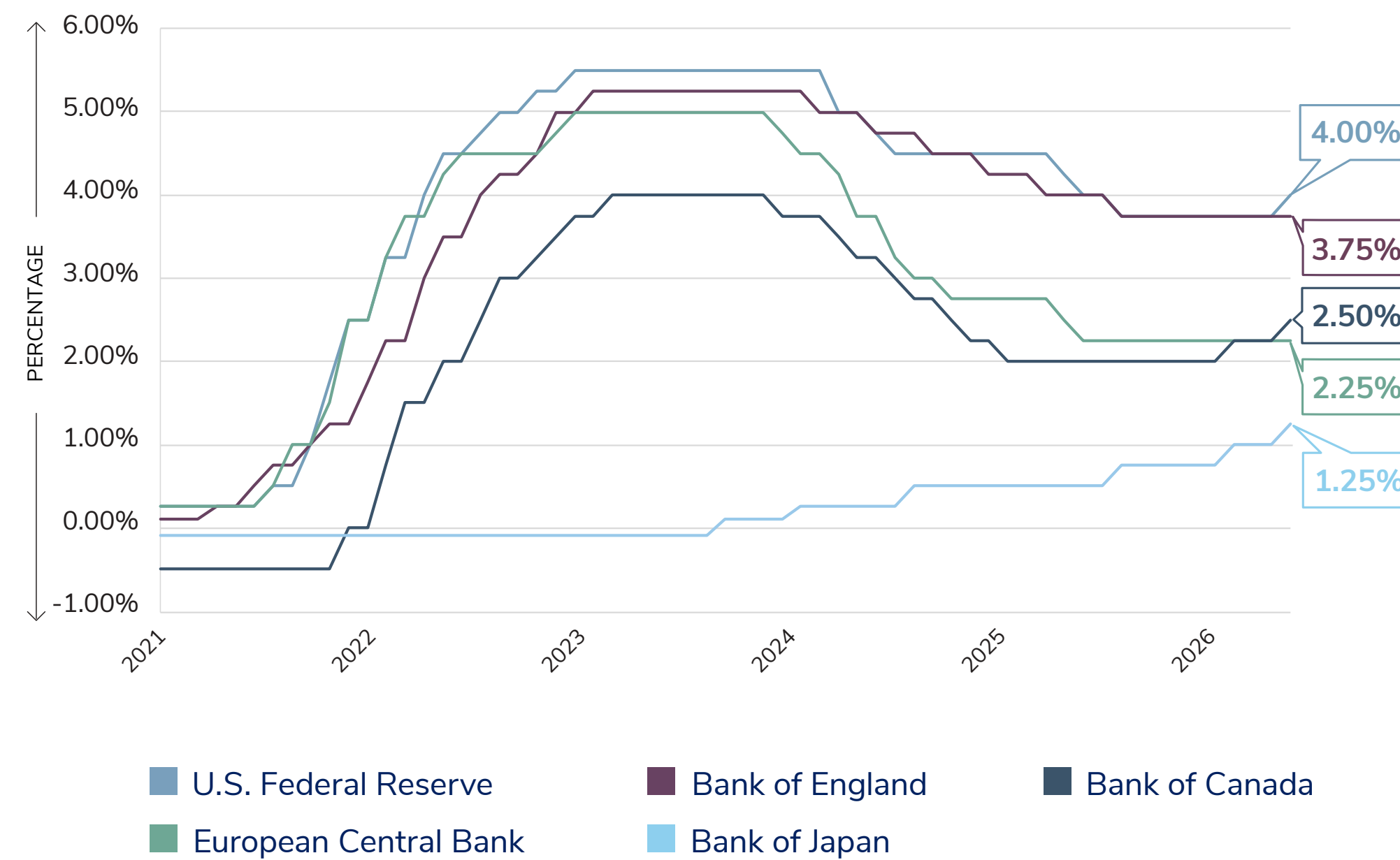
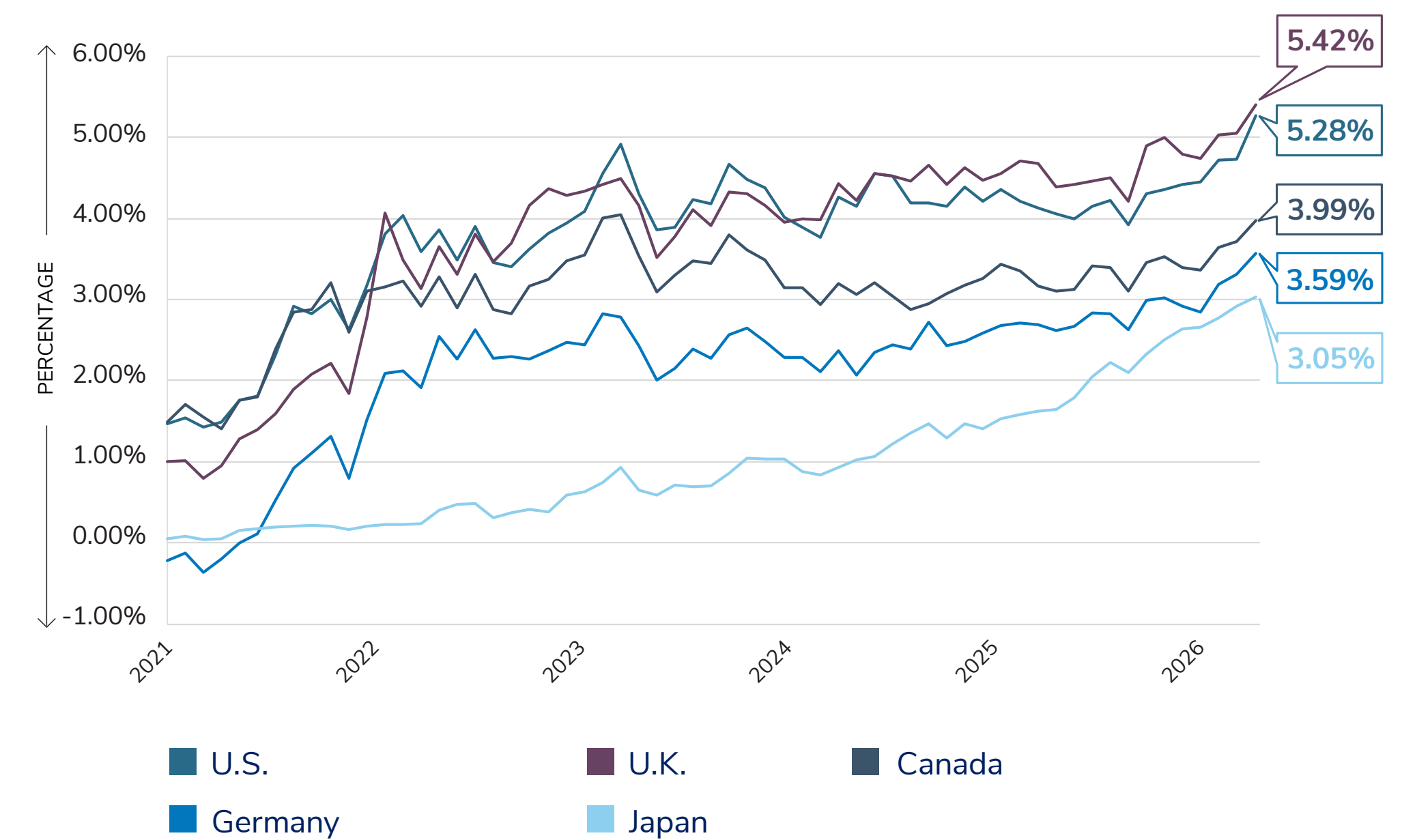


Chart 7 - Sovereign bond 10-year maturity yields



Key benchmark performance

Chart 8 - Canadian dollar/U.S. dollar cross

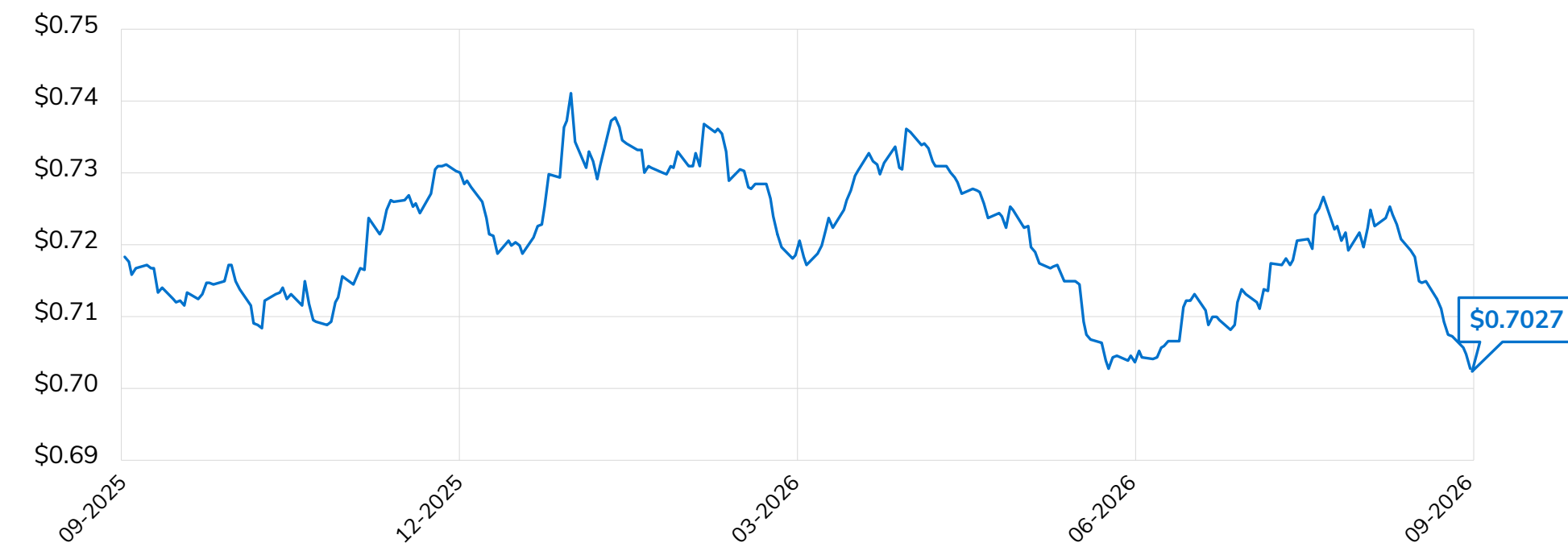


Chart 9 - Crude oil (WTI) US\$/bbl

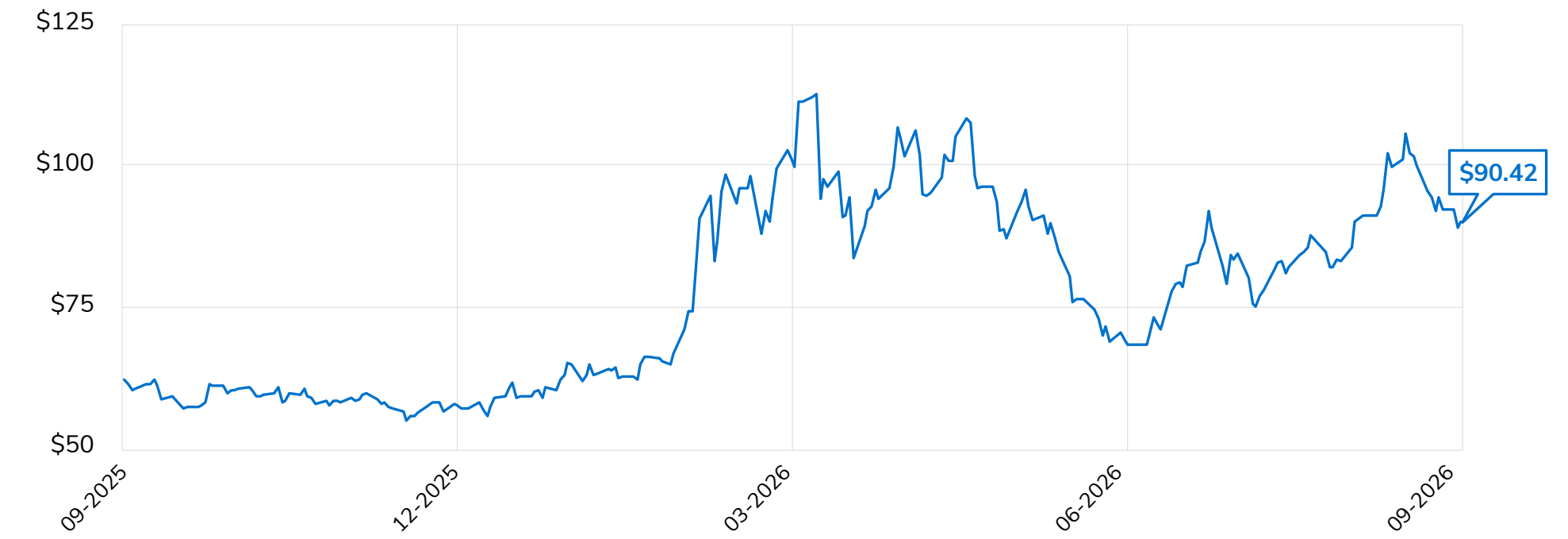


Chart 10 - Gold US\$/oz.

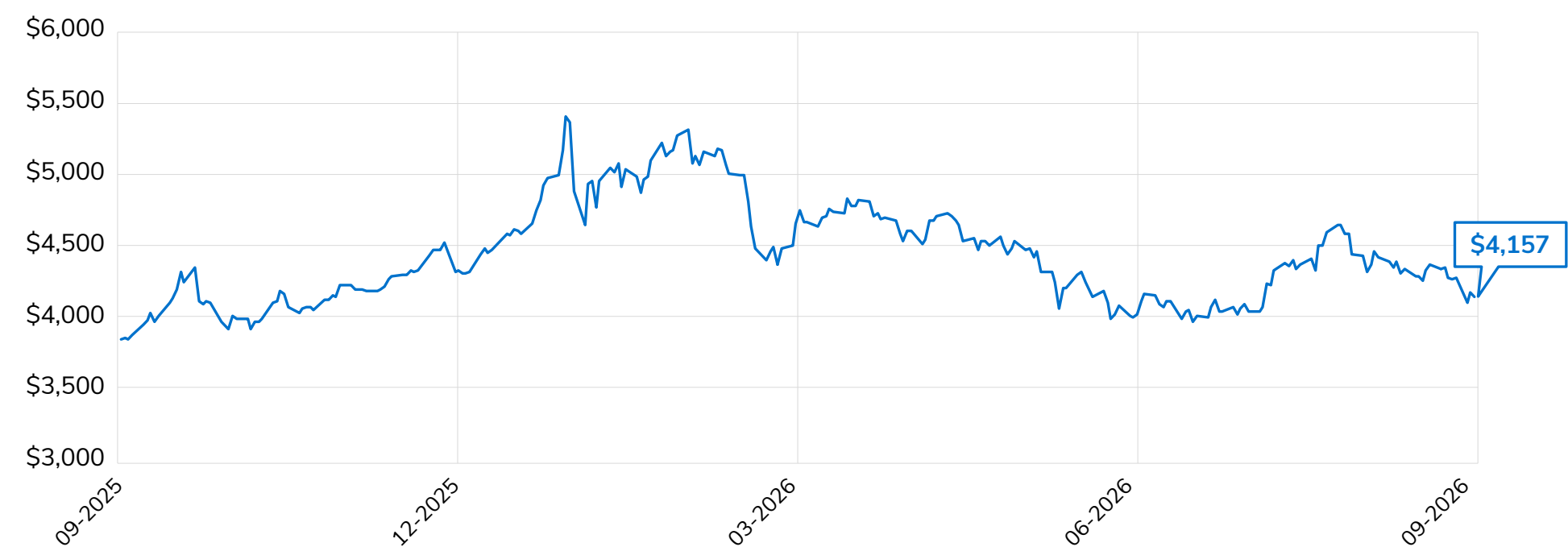
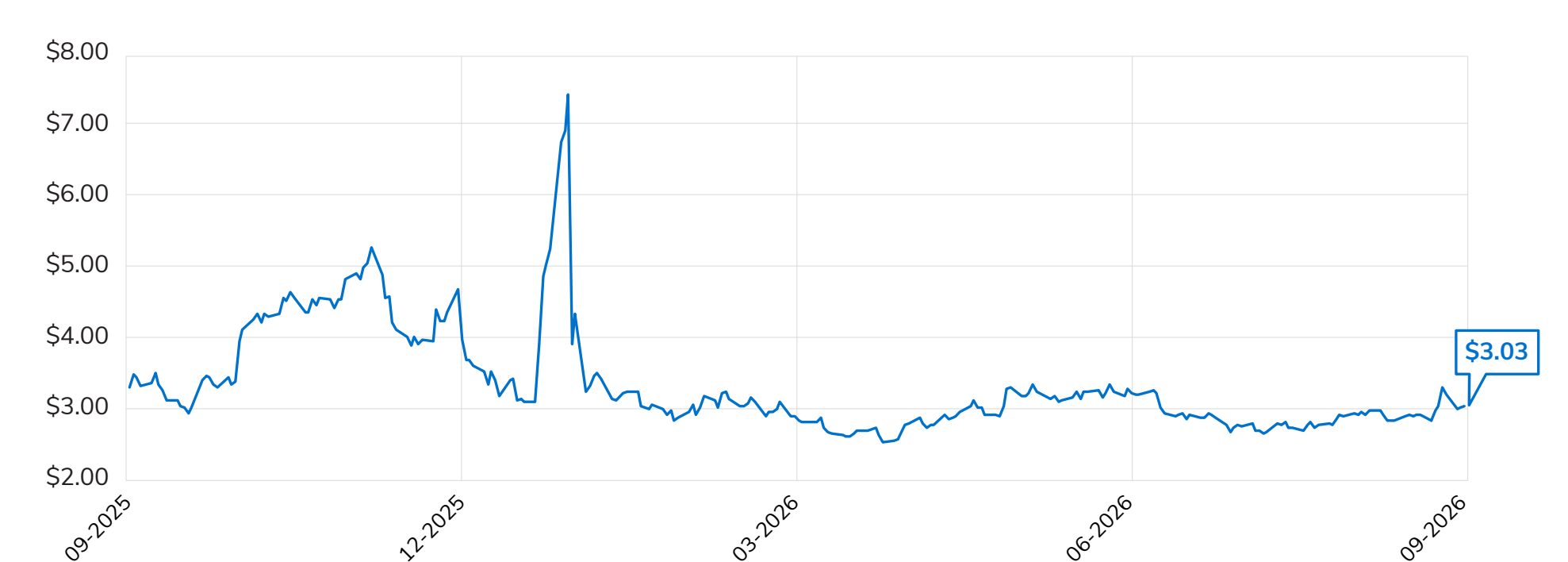


Chart 11 - Natural gas US\$/mmbtu





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Market outlook

With the recent strength and breadth of corporate earnings, the bar for success is higher from here. U.S. valuations remain near the upper end of their historical range and have come under pressure from higher yields. Continued strong earnings growth is what is suggested by analyst expectations, as well as leading indicators, and is likely to maintain the bull market. However, the magnitude of gains may be more muted through the rest of 2026 as compared to the first half.

The U.S. Federal Reserve (the Fed) and Bank of Canada (BoC) each have two decisions remaining this year. Higher energy prices and persistent inflation have shifted central banks toward a tighter policy stance. We expect an initiation of interest rate increases by the BoC

and continued rate increases by the Fed through the first half of 2027. Long-term bond yields remain the key pressure point to equity valuations. Current bond yields offer attractive income, and overall bonds are starting to offer a compelling investment case.

We continue to favour equities over fixed income for the time being, given the strong economic and earnings backdrop. The U.S. mid-terms may contribute to volatility, but the path forward will ultimately be shaped by the interaction between the economic cycle, inflation and interest rates, which we expect to persist through the remainder of 2026 and into early 2027.

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– Philip Petursson



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