

Only Winners and Losers

The start of 2026 has brought more uncertainty to the financial markets. The impact of Artificial Intelligence (AI) remains a focus while geopolitical risks have intensified.

New AI models have demonstrated exceptional coding capabilities and eroded the barriers to software development. Valuations in the software sector have suffered as a result.

AI remains very capital intensive with rising electricity and memory costs. Rising costs challenge the assumption that AI businesses can scale efficiently and question the long-term returns on capital.

The US-Israel war with Iran has upended global energy markets and raised inflation concerns. Iran continues to retaliate by disruption energy and trade flows through the Strait of Hormuz.

The start of 2026 has only brought more uncertainty to the financial markets. Canadian equity markets have outperformed their US counterparts, but performance has varied widely across sectors, industries and companies. Artificial Intelligence (AI) continues to be a driving force behind the chopiness. Those companies expected to benefit from AI (the “winners”) are being rewarded. Those with a perceived risk of being disrupted (the “losers”) are being punished. The recent US-Israel war with Iran has added another layer of uncertainty.

Software, a long-time winner, has fallen firmly into the loser camp. Many of the latest AI models – Anthropic’s Claude being the most noteworthy – have demonstrated exceptional coding capabilities. The barriers to software development are being eroded. Valuations have followed suit. The belief is that companies will be able to develop bespoke software in-house. Productivity benefits from AI also mean fewer employees using the software. This will challenge the software business two-fold: there will be fewer paying users, and their pricing power will erode. Some of this is a real threat. But many of these companies are not going to sit idle and die – and may even benefit from productivity improvements.

Yet, the economics of AI are still unresolved. The demand for capital is fierce, and hundreds of billions of dollars are still being spent. But monetization remains uncertain and AI hallucinations persist. Electricity demand is rising, and with it, electricity prices. Consumers are asking why they should bear the brunt of power-hungry AI. Memory storage has also become a constraint as AI models output more and more data. Rising costs challenge the assumption that AI businesses can scale efficiently. It also raises questions about long-term returns on the substantial capital being deployed. The geopolitical backdrop has only added further pressure.

Any positive economic momentum from 2025 has faded as geopolitical conflicts have intensified. The US-Israel war with Iran has upended global energy markets and raised inflation concerns. Iran’s greatest weapon is not its arsenal of missiles or drones. It is its ability to continue disrupting global energy markets and trade flows. Continued closure of the Strait of Hormuz and escalating attacks from both sides on energy infrastructure increases the risk of spiralling energy prices. And it is not just energy. A large amount of fertilizer transits the Strait, putting food prices at risk.

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The current environment has created a more challenging backdrop for financial markets. But periods of dislocation can create opportunities. We have capitalized on pockets of strength to realize gains and position for other opportunities.

The main question that defines financial market performance in the near-term is: “how long will the war last?” In an increasingly polarized world, it remains unclear how either side can be declared a “winner”. The US will struggle to accomplish its stated goals without boots on the ground and the risk of another “forever war”. Any pullback from the US will see Iran continue to wield authority over the Strait of Hormuz in an effort to seek reparations for the damage caused.

A near-term resolution could cause a strong rally in the financial markets. But a prolonged conflict risks causing serious damage to the global economy. Energy prices across Europe and Asia have risen significantly. The US is more sheltered, but an increase in export capacity over the past decade means more exposure to global energy prices. Canada – and particularly Western Canada – is even more isolated due to high production but limited export capacity.

Higher energy prices will permeate across all aspects of the economy. Many consumers are already challenged, and unemployment rates are rising. Inflation, already elevated by tariffs, is now being compounded by higher energy prices. The risk of dreaded stagflation – when inflation exceeds growth – is increasing if global growth does not accelerate. As is often the case, the cure for high prices is high prices. High prices will slow demand, which can ease inflationary pressures. However, this process is neither immediate nor painless.

The outlook for monetary policy is less clear as borrowing rates have increased and expectations for interest rate cuts have been pushed out. History has shown that it is hard to quell supply-driven inflation with monetary policy. Competing demands for capital may further pressure borrowing rates. AI continues to demand significant investment. But higher defense spending and capital to rebuild the Middle East and Ukraine will be required. Investors will demand more certainty and higher returns as the geopolitical overlay remains uncertain.

Rising borrowing rates and increased uncertainty have created a more challenging backdrop for financial markets. But periods of dislocation often create opportunities for those who remain patient. Our short-term fixed income positioning has helped mitigate the impact of rising rates, while allowing us to reinvest at more attractive yields. We have capitalized on pockets of equity strength to realize gains and position for opportunities elsewhere. Certain sectors, such as software, have seen meaningful repricing with more attractive valuations. Where business fundamentals remain sound and well understood, these shifts can present compelling long-term opportunities. As always, we remain focused on ensuring a favourable risk-reward balance.