RBC Global Asset Management

Market Update

Resilient economy and extraordinary earnings growth sustain equity rally despite stubborn inflation and hawkish central bank pivot

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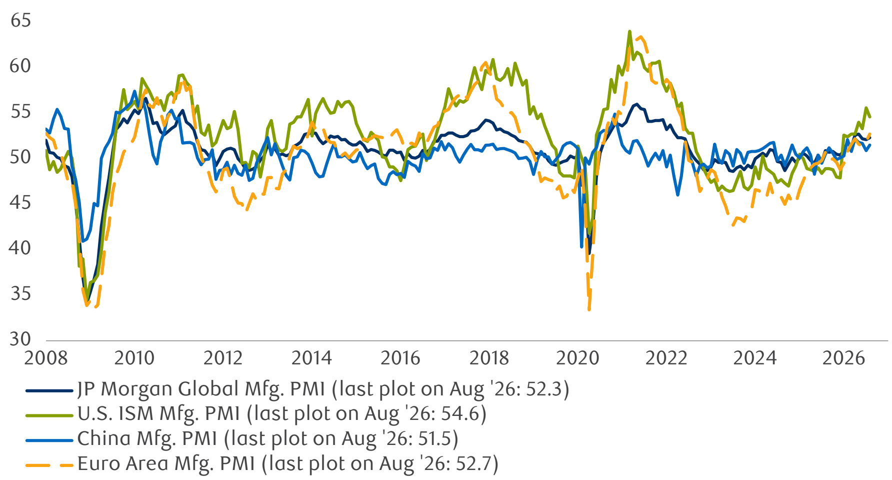
The global economy has been resilient and leading indicators of growth suggest the expansion has room to run (Exhibit 1). Activity has been supported in part by the massive AI infrastructure investment and fiscal stimulus while AI-related productivity gains are also proving helpful. On the flip side, the war in Iran and associated energy shock is lingering, and new tariffs present another headwind – although these forces, in our view, are not strong enough to topple the economy into recession. We look for a solid economic expansion over this year and next, and our global growth forecasts are slightly above the consensus.

Exhibit 1: Global purchasing managers' indices

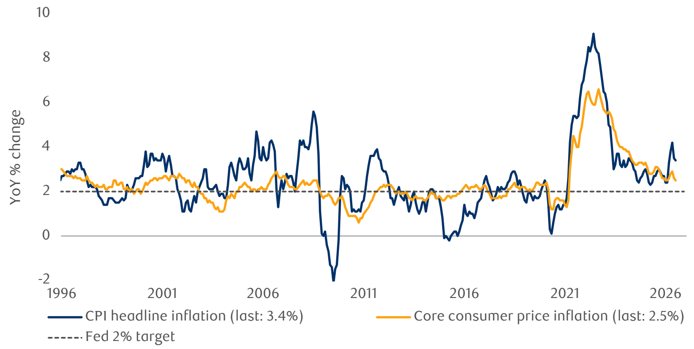


Note: As at August 31, 2026. Source: Macrobond, RBC GAM

Inflation pressures persist

On the inflation front, a combination of forces is keeping price pressures elevated. Supply chains have been disrupted by the Strait of Hormuz closure, tariffs raise the costs of goods and services, and the surge in AI demand is pushing up prices of ingredients needed for the AI build-out – and impacting consumer products as well. U.S. consumer price inflation was at 3.4% in July and remains too high relative to the 2.0% level targeted by central bankers, although we expect that price pressures will eventually moderate into 2027 as some of these upward forces on prices subside (Exhibit 2).

Exhibit 2: U.S. inflation measures

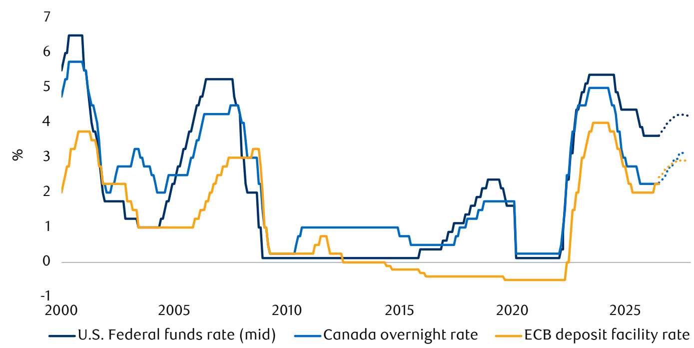


Note: As of July 31, 2026. Source: Bloomberg, RBC GAM

Central banks shift to tightening mode

Against this backdrop, central banks are pivoting away from stimulus toward more restriction, and interest rates have already begun to rise in some regions (Exhibit 3). The European Central Bank (ECB) and Bank of Japan (BOJ) each raised their respective policy rates by 25 basis points in June and indicated that more tightening could be coming. In the U.S., newly appointed Fed chair Kevin Warsh has reiterated his commitment to bring inflation back down to the 2.0% target and that, with the labour market in solid position, focus should be on addressing inflation. Investors are looking for higher rates ahead, with the futures market is pricing in two 25-basis-point hikes in the U.S. by the spring of 2027.

Exhibit 3: Central bank policy rates



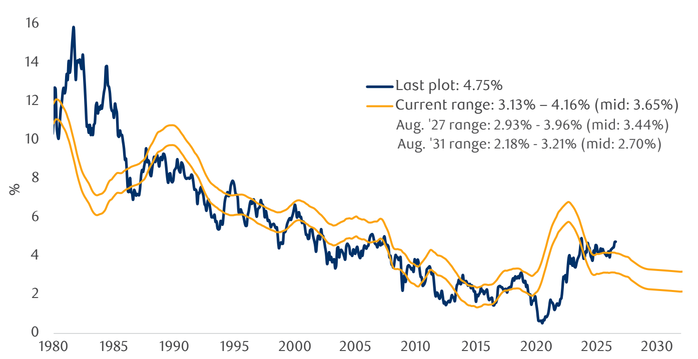
Note: Forecasts, shown as dotted line, are based on futures for the U.S. and OIS forwards for other regions. As of August 31, 2026. Source: Bloomberg, RBC GAM

Rising bond yields reduce valuation risk

Bond yields climbed in all major regions over the past quarter as investors factored in stubborn inflation, large government deficits, and unexpectedly high corporate issuance of debt by hyperscalers. The U.S. 10-year yield climbed as high as 4.75% during the quarter, up from 4.44% at the end of May, and is now situated well above our modelled estimate of equilibrium (Exhibit 4). While further concerns around U.S. fiscal health and firmer consumer prices could push bond yields higher in the near term, we note already attractive real rates, especially if inflation ultimately moderates over the medium term as we expect.

Exhibit 4: U.S. 10-year T-bond yield

Equilibrium range



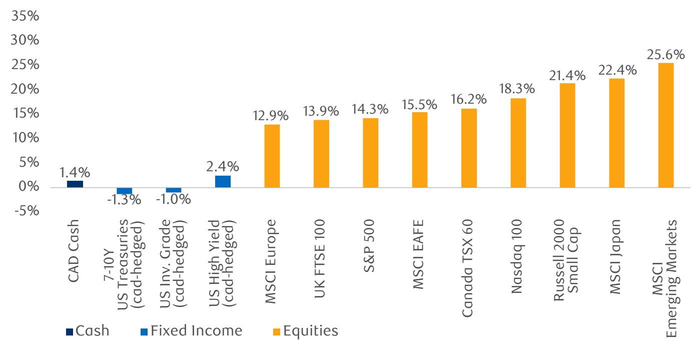
Note: As of August 31, 2026. Source: RBC GAM

Stocks make new highs despite AI volatility

In equity markets, stocks extended their gains to fresh records after a volatile summer in which certain groups of stocks experienced great volatility. While major indices appeared relatively calm, leadership shifted violently between semiconductors, hyperscaler and software companies as investors debated the winners and losers of the AI theme. Overall, though, stocks marched higher and, as of the end of August, most major indices have delivered double-digit gains year-to-date, with emerging market equities in the lead with a 26% gain so far this year (Exhibit 5). Following these strong gains, our global stock-market composite is situated 14% above fair value, reducing future return potential (Exhibit 6). This places greater dependency on further strong earnings growth to sustain the bull market particularly as higher yields could compress valuations.

Exhibit 5: 2026 year-to-date performance

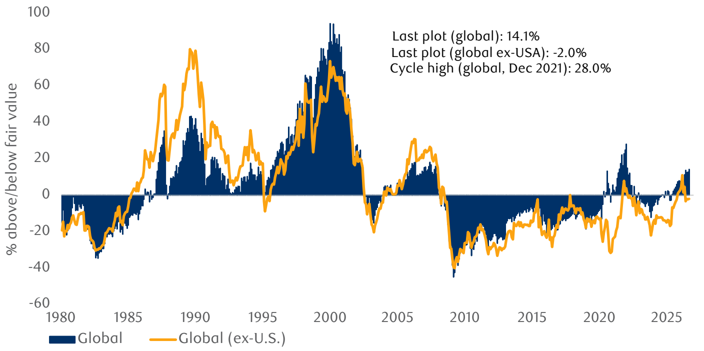
Total returns, in CAD



Note: As of August 31, 2026. Returns based on various ETFs and official indices. ETFs used are as follows: CAD Cash (CBIL), 7-10Y US Treasuries (IEF), US High Yield (HYG), U.S. Inv. Grade (LQD). Source: Bloomberg, RBC GAM

Exhibit 6: Global stock market composite

Equity market indexes relative to equilibrium



Note: As of August 31, 2026. Source: RBC GAM

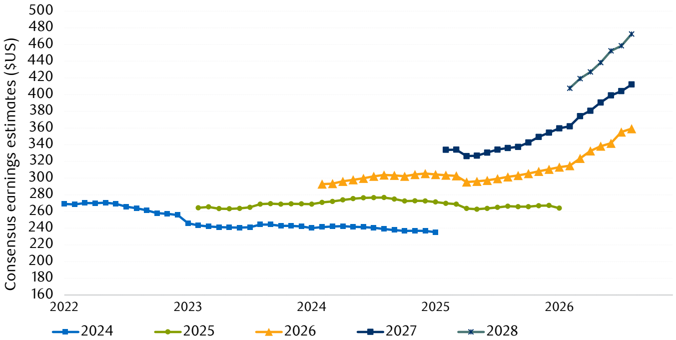
Earnings boom driven by AI spending and energy gains

Supporting high equity-market valuations is the fact that corporate profit growth has been extraordinary and much better than expected. At the beginning of the year, analysts looked for S&P 500 earnings to grow by 15% in 2026, but that figure has since swelled to 34% as companies consistently beat estimates and raised forward guidance (Exhibit 7).

Earnings have been boosted in large part by substantial increases to AI capital spending plans, improving profit margins and by surging oil prices that boosted energy companies' bottom lines (Exhibit 8). The test for the profit outlook going forward will be whether substantial AI investment, which has raised profits in the near term, translates to durable revenue from end-user demand. Early signs of enterprise AI adoption are encouraging, but the profit outlook would be vulnerable if AI demand ultimately underwhelms.

Exhibit 7: S&P 500 Index

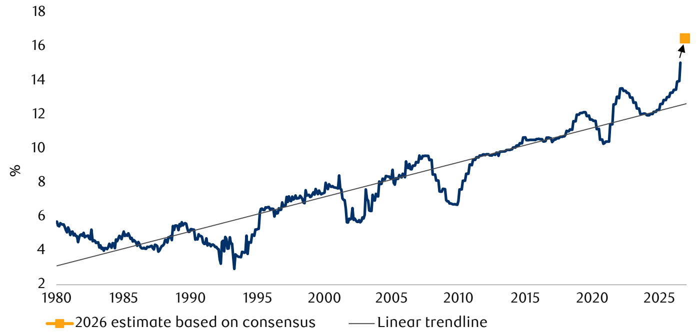
Consensus earnings estimates



Note: As of September 2, 2026. Source: Bloomberg, RBC GAM

Exhibit 8: S&P 500 Index

Net margin



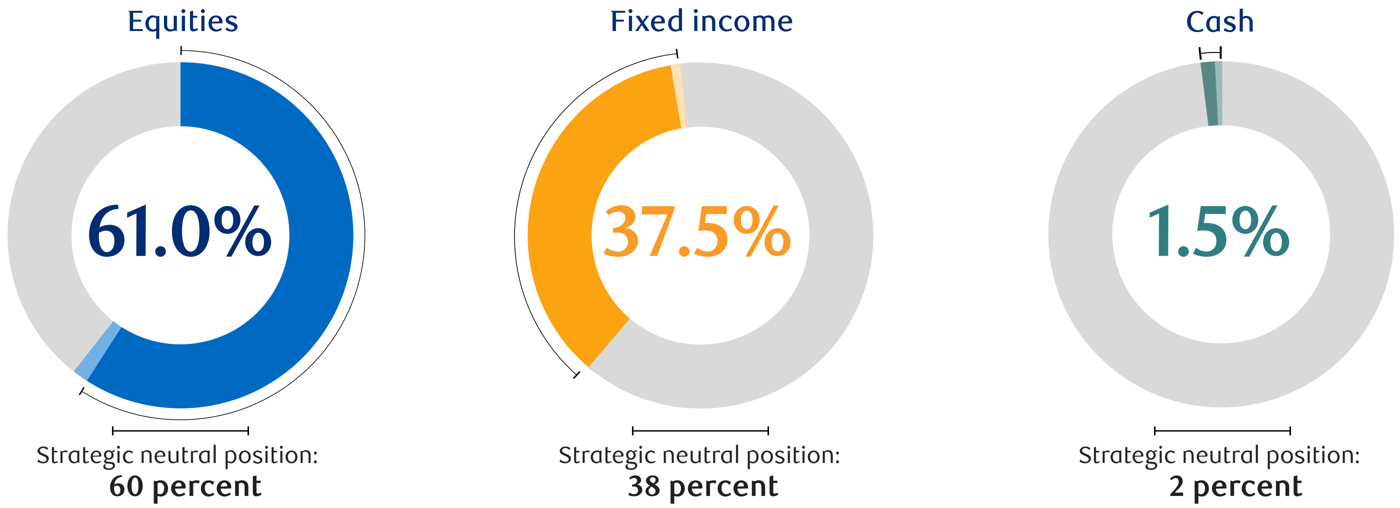
Note: As of August 2026. Source: Bloomberg, RBC GAM

Asset mix: maintaining near-neutral asset mix, with slight overweight in stocks

Our asset mix considers a variety of scenarios around our base case and balances the risks as well as the potential rewards. Our central scenario is for the economy to continue expanding at a moderate pace and for inflation to eventually ease toward central bank targets sometime next year. In this environment, we expect only little change in yields from here, unlikely to cause significant losses for government bonds. As a result, we look for low to mid-single digit gains on government fixed income, with slightly higher return potential in corporate bonds while acknowledging that historically narrow risk premiums don't support substantial risk taking in credit markets. Stocks have enjoyed powerful gains and valuations reflect heightened investor optimism about a positive outlook. We are maintaining only a slight overweight in stocks, with modest regional tilts in favour of North America and Asia, versus a slight underweight exposure to Europe and a neutral position in emerging markets. This positioning is unchanged from a quarter ago, and our current recommended asset mix for a global balanced investor is 61.0% equities (strategic: "neutral": 60%), 37.5% bonds (strategic "neutral": 38%) and 1.5% in cash (Exhibit 9).

Exhibit 9: Recommended asset mix

RBC GAM Investment Strategy Committee



Note: As of September 1, 2026. Source: RBC GAM

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