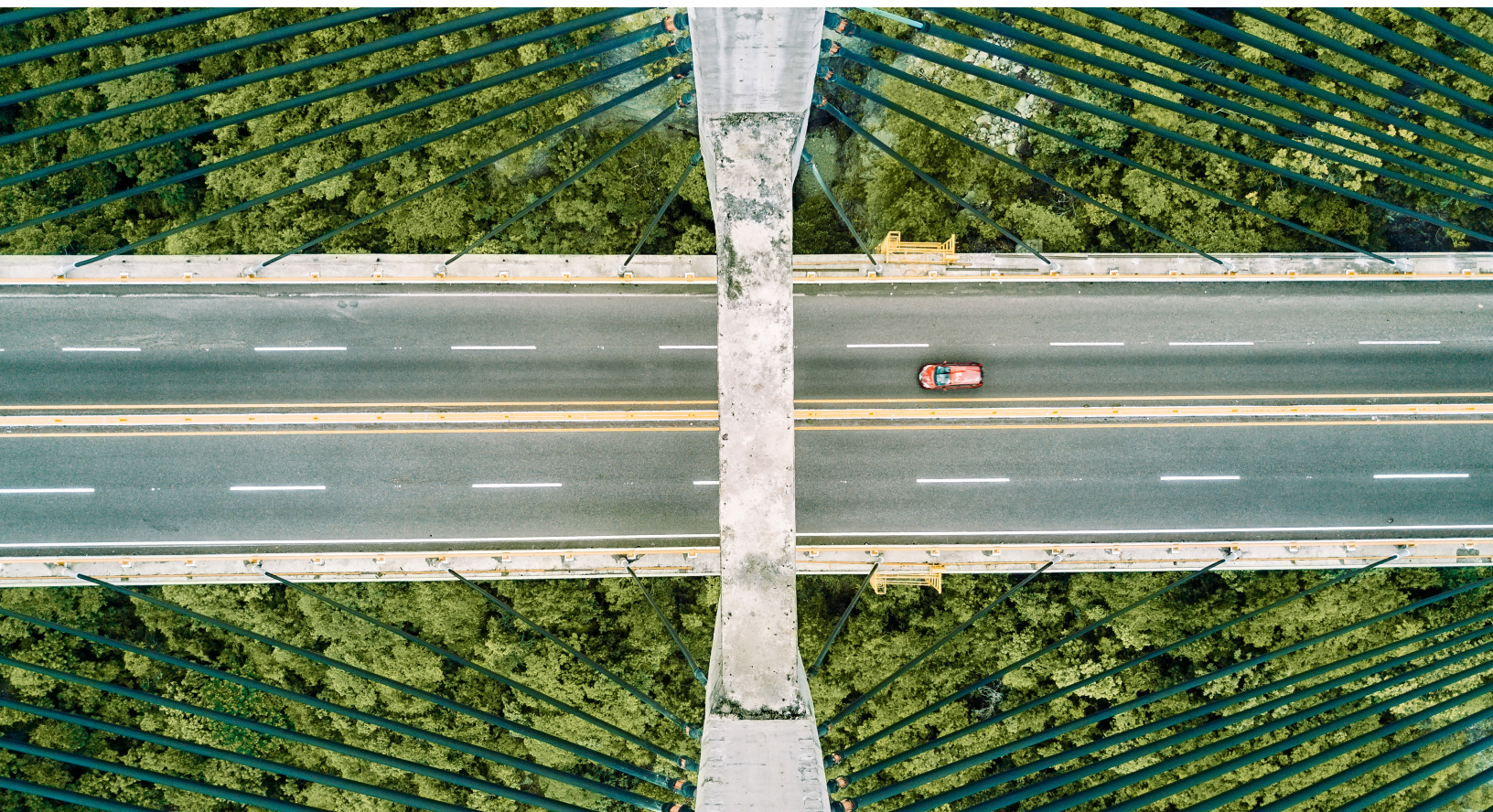


Portfolio Solutions Research Forum Commentary

October 1, 2025



Key takeaways

- While market volatility has subsided and equities have rallied, this is not viewed as an “all clear” to significantly increase equity exposure. Tight credit spreads, stretched valuations (especially in AI-related stocks), and euphoric sentiment suggest the risk-reward balance is becoming less favorable.
- The US remains a relatively strong market, but its outperformance edge is narrowing. Key risks include potential erosion of institutional stability and less pronounced fundamental outperformance compared to peers like Canada and Japan. Forward returns are expected to be lower than in the past decade.
- Democratization of private assets offers new opportunities for retail investors, but illiquidity and selection risks remain. Allocations should be modest, with a focus on rigorous due diligence and transparent communication about risks and liquidity constraints.
- Weak GDP growth and expectations for rate cuts support a constructive view on Canadian bonds. Canadian equities present selective opportunities, particularly for income-focused investors, given high dividend yields and sector diversification, but overall caution is warranted due to economic and policy uncertainties.
- Currency hedging is favored in fixed income to reduce volatility, but a wholesale approach is not recommended for equities given mixed signals on USD/CAD. Partial hedges have been implemented in select programs.

Market volatility has diminished since the spike in early April, and equities have rebounded strongly. Is this an all-clear signal to take on added equity exposure?

In our view, no. While volatility has subsided and indices have moved higher, we do not see this as an “all clear” signal to materially increase equity risk. History shows that periods of low volatility can sometimes mean investors are becoming too comfortable, rather than reflect real improvements in fundamentals.

Over the short term, earnings in certain sectors remain resilient – notably in technology – and market momentum can persist. This is among the reasons our active asset allocation stance remains modestly overweight equities.

However, there are several factors that may reduce equity risk back to neutral over the near term. We expect a further slowdown in the US economy and an inflation shock, which may reverse some Risk-On Tactical Asset Allocation model indicators. In addition, we continue to monitor valuation risks in the portfolio:

- Credit spreads are tight, suggesting limited room for error on the effectiveness of monetary easing in supporting growth.
- Valuations continue to stretch to new peaks in stocks connected to artificial intelligence.
- Sentiment is increasingly euphoric, which can sometimes be a warning sign.

This combination suggests the balance between risk and reward is becoming less favorable. So while equities can grind higher for now, a more balanced and cautious approach may be warranted in coming months.

With the current US administration challenging its own institutions, is the case for the US as an exceptional place to invest diminishing?

We believe there are several enduring factors supporting US exceptionalism, but that its edge is moderating. Much of the past decade’s outperformance came from margin expansion, valuation multiple increases, and share buybacks. Looking ahead, these drivers are unlikely to be as influential.

At the same time, key risks deserve attention:

- Institutional stability: Any erosion of Fed independence could have major consequences including higher inflation expectations, a weaker US dollar, and rising long-term bond yields. While a sudden shift is unlikely; gradual weakening is a possibility to watch.
- Narrower US fundamental outperformance: US exceptionalism has been driven by US margin expansion and valuation multiples increases. On organic fundamental drivers like sales and dividend growth, the US looks more like its peers, with markets such as Canada and Japan keeping pace.

Despite these challenges, compared with Europe, Japan, UK and several Emerging Market countries—which face their own structural political and economic challenges—the US may still represent the most reliable market in an otherwise challenging global landscape.

On balance, the US remains exceptional, but the gap with other markets is narrowing. Forward returns are likely to be lower than in the past decade and the degree of US outperformance lower.

There has been industry discussion that democratization of private assets is about sophisticated investors offloading risk onto retail investors. How do we see this?

Democratization opens doors to both opportunities and risks for retail investors.

On the opportunity side, private assets—such as private equity and real estate—can play a valuable role in a diversified portfolio. They offer unique growth prospects not typically found in public markets, and they tend to move differently from traditional stocks and bonds. As access to these investments expands from large institutions to individual investors, more people have the chance to benefit from opportunities that were once out of reach. This is particularly relevant today, as many innovative and fast-growing companies are choosing to remain private for longer, delaying or even skipping public listings.

However, there are important considerations for investors exploring private assets:

- Illiquidity is inherent: changing how you access privates does not change the underlying asset. It's important to keep allocations modest. In our Managed Solutions, allocating within 10% regulatory limits is manageable.
- Selection matters: Not all private assets are created equal. We avoid continuation vehicles or GP-led secondaries designed mainly to offload risk. Our focus is on assets that meet rigorous underwriting standards.
- Communication matters: clients must fully understand liquidity limits, redemption restrictions, and the risk of performance divergence during periods of market stress.

Looking at the big picture, private assets can enhance portfolio outcomes if sized prudently, selected carefully, and communicated transparently.

Canadian GDP contracted as tariffs slowed trade and investment weakened. How does this shape our view on Canadian assets?

Recent Canadian data reinforce a cautious stance on equities but a constructive view on fixed income.

Slower economic growth and rising expectations that the Bank of Canada will resume cutting interest rates create an environment that is supportive for domestic bonds.

The outlook for equities is less straightforward. While interest rate cuts could boost the housing market and consumer spending, the fact that cuts would be prompted by weaker-than-expected growth reduces the benefit. Canadian banks remain conservatively provisioned, signaling a muted recovery path rather than a robust rebound.

Despite these headwinds, Canadian equities do offer some compelling features. Earnings growth forecasts for Canadian companies are on par with those for the S&P 500. More notably, Canadian dividend yields are near a 15-year high relative to the US. For investors seeking income—especially as rates decline—this yield premium, combined with the tax advantages of Canadian dividends, could make high-quality, dividend-paying Canadian stocks an appealing alternative to fixed income. Furthermore, Canada's market offers exposure to cyclical sectors like Energy and Materials, providing valuable diversification beyond the technology-heavy US market.

Still, uncertainties persist. The ongoing renegotiation of US-Canada trade is weighing heavily on business confidence and investment, adding another layer of risk for Canadian companies.

Our key takeaway is that while bonds currently appear better supported, Canadian equities present selective opportunities, particularly for those focused on yield and diversification. Balancing these factors, a well-considered approach remains essential in today's environment.

What about currency hedging?

Our stance remains selective, not wholesale:

- Hedging is more effective in fixed income (reduces volatility) than in equities (often provides diversification).
- We have raised USD equity hedges to ~20% in select programs, but do not see a case for fully hedging equity exposures today, given competing factors on the outlook for USD/CAD (stretched long-term USD valuation and challenges to US institutions suggest more hedging; recent US cyclical resilience suggests less hedging).

Conclusion

This month's questions reflect client concerns around buoyant markets versus hidden risks. Our stance balances these views:

- The current environment calls for balance and flexibility, with a tilt towards caution on equities as muted volatility and strong performance drive up valuations and market vulnerability. We are constructive on select fixed income, especially in Canada.
- Diversification across asset classes and regions remains critical as market leadership broadens and global risks evolve.
- Purposeful investment in private assets, emphasizing discipline and transparency.

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Portfolio Solutions Research Forum (PSRF)

The views of our Portfolio Solutions Research Forum help guide CIBC Asset Management and our partners by providing strategic asset allocation recommendations, as well as strategic and tactical investment oversight for CIBC managed solutions

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