CIBC GLOBAL
ASSET MANAGEMENT

Equity team commentary: Energy leadership, AI repricing, and infrastructure momentum

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Key takeaways

- The S&P/TSX Composite Index rose 1.1% in July, with energy stocks outperforming strongly on firmer oil prices, robust free cash flow, and optimism around infrastructure-driven production growth, while bank stocks were largely flat after a strong first half.
- Inflation, new U.S. tariffs, Middle East geopolitical tensions, and uncertainty around future rate moves all contributed to market caution. Both the U.S. Federal Reserve and the Bank of Canada held rates steady in July, but investors remain focused on inflation and policy risk.
- The market rotated away from some AI capex-linked names as concerns grew around high valuations, rising debt, weaker free cash flow, and uncertain ROI. Investors appear more willing to reward companies with a credible monetization path than companies relying on spending-led growth alone.
- More than $300 billion in prospective infrastructure-related commitments across energy, transportation, defense, and digital infrastructure could support economic growth and create opportunities for Canadian-listed companies in pipelines, utilities, engineering, construction, aerospace, and resources.

Canadian equities delivered a modest gain in July, with the S&P/TSX Composite Index up 1.1% for the month. Beneath that relatively calm headline number, leadership shifted meaningfully. Energy stocks were strong performers, helped by firmer near-term oil prices, strong free cash flow, and growing optimism around infrastructure-led production growth. In particular, oil sands issuers Suncor, Cenovus, and Canadian Natural Resources rose by roughly 20% over the month. Going forward, the combination of strong free cash flow, healthy balance sheets, and share buybacks positions the E&P sector for continued outperformance.

By contrast, Canadian bank shares were largely flat in July after a very strong first half of the year. With the sector already up more than 30% year to date, share prices paused amid stretched valuations, a slowing Canadian economy, and risks of increased credit stress in the second half of the year.

A more complicated macro backdrop

July's market action was shaped by several competing themes. Inflation remained a key focus, particularly as investors weighed the impact of AI component shortages and the latest round of U.S. tariffs. These tariffs were designed to replace the IEEPA tariffs struck down by the U.S. Supreme Court.

Although the month ended with the U.S. Fed leaving interest rates unchanged, market expectations are rising for a September rate increase as inflation remains above the central bank's target and geopolitical tensions in the Middle East continue. The breakdown of the June Memorandum of Understanding between the U.S. and Iran renewed concerns around oil supply disruption through the Strait of Hormuz, contributing to volatility in crude prices.

At the same time, investors continued to debate the sustainability and future profitability of very high spending on artificial intelligence infrastructure. As second-quarter earnings season unfolds, that debate is likely to remain central, particularly for hyperscalers and other companies making outsized capital commitments.

In Canada, the Bank of Canada also left rates unchanged in July, as widely expected. The more important takeaway was the Bank's tone, which was relatively constructive. Policymakers acknowledged ongoing risks from energy markets and geopolitics, but also pointed to resilient labour markets, improving export expectations, and healthier business investment intentions.

Earnings season: Focus on margins

Second-quarter earnings season got underway in late July, and investors are looking for confirmation that corporate fundamentals remain sound. We expect Q2 to show continued strength in corporate earnings and margin expansion, supported in part by AI-driven cost savings and product innovation, alongside continued strength in M&A activity.

Investors will also be watching companies exposed to AI-related disruption concerns, particularly in software and engineering. Businesses such as Thomson Reuters and WSP Global may have an opportunity to demonstrate that AI is enhancing their services and customer relationships rather than displacing them.

Infrastructure becomes a bigger theme

One of the more important developments in July was the continued wave of major infrastructure announcements in Canada. In total, prospective federal infrastructure-related investment commitments now exceed $300 billion, spanning energy, transportation, defence, and digital infrastructure.

Notable announcements included:

- A July 3 memorandum of understanding with Alberta regarding an additional oil pipeline to the B.C. coast, with Pembina Pipeline identified as an equity participant
- A memorandum of understanding with British Columbia to accelerate additional LNG development, as well as the Port of Vancouver Gateway Strategy, including expansions to the Roberts Bank Terminal
- A July 6 submarine procurement award to ThyssenKrupp Marine Systems, alongside related German infrastructure investment commitments in Canada
- Alberta's announcement of a 1-gigawatt natural gas generation facility to support a Meta-backed data centre

These projects are significant because they could provide a longer-term boost to Canadian economic growth, employment, and capital investment. They also create potential opportunities for a range of listed Canadian companies across pipelines, rail, utilities, engineering, construction, aerospace, and resource production, including Pembina, CNR, Capital Power, Teck, CAE, AtkinsRéalis, and the major oil sands producers CNQ, CVE, and SU.

AI enthusiasm meets valuation reality

Another major July theme was a significant rotation away from the AI capex-related complex and into defensive cyclicals. After a prolonged period of strong performance, parts of the AI trade saw profit-taking as investors became more sensitive to elevated valuations and more demanding on proof of returns.

Several concerns drove the shift, including the emergence of lower-cost Chinese alternatives for computing, increased hyperscaler reliance on debt to fund continued capex, a lack of near-term visibility on return on investment, and the ongoing erosion of free cash flow. A key cash flow inflection emerged when Alphabet's Q2 results showed negative free cash flow for the first time.

Investor pushback was also evident on the debt side. Amazon's July 7 US$25 billion bond issue was received less enthusiastically than its March issuance, with higher pricing and weaker placement coverage, at roughly half the demand seen for its earlier US$37 billion deal.

Overall, the market is becoming more selective, rewarding companies with a credible path to monetization, such as Microsoft, while being less willing to pay any price for future growth when balance sheet pressure and cash flow deterioration are becoming more visible, as in the case of Meta.

TSX index changes create opportunity

A less visible but potentially meaningful development in July was the S&P/TSX proposal to allow foreign issuers with significant Canadian relevance to become eligible for index inclusion. Under the proposed rules, foreign issuers listed on the TSX with significant Canadian assets, a meaningful history with Canadian investors, and strong trading volumes on the exchange would be eligible for inclusion, subject to a 50% weighting of free float market cap.

As a result of these changes, Canadian investors could potentially see the return of Ovintiv, formerly Encana, to the index. The changes could also allow pro forma Anglo-Teck to retain Teck's TSX 60 membership after the pending transition closes.

We believe these pending changes will benefit Canadian investors by ensuring the TSX Index is able to fully reflect the depth of issuers and trading volumes on the TSX.

Final thoughts

July was a month in which the headline move in the TSX understated the amount of change happening beneath the surface. Energy surged, banks paused, AI-linked stocks saw profit-taking, and infrastructure became a more prominent long-term theme. Meanwhile, inflation data improved enough to support markets, but not enough to remove uncertainty around rates and policy.

We believe the current environment still argues for balance. Markets continue to reward companies with strong cash flow, reasonable valuations, and visible catalysts, while becoming less forgiving toward areas where expectations have run too far ahead of fundamentals.

As second-quarter earnings continue, investors will be looking for confirmation that profit growth remains resilient, that AI can contribute meaningfully through productivity and innovation, and that M&A and infrastructure spending can continue to support select opportunities across the Canadian market.

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