Equity team commentary: Look-through mentality, earnings momentum continue to propel markets higher

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Craig Jerusalim, CFA, MBA, Senior Portfolio Manager, Head of Global GARP

Tudor Padure, CFA, Portfolio Manager, Equities

Catharine Sterritt, CFA, CPA, CMA, Lead Portfolio Manager, Opportunities Funds

Natalie Taylor, CFA, Lead Portfolio Manager, Equities

Nick With-Seidelin, CFA, Associate Portfolio Manager, Equities

Monthly highlights and key events:

1. Q1 2026 earnings season summary
2. US/Iran conflict appears to inch towards a resolution
3. Alberta pipeline announcement
4. Jet fuel shortages in Europe
5. Trump/Xi meeting
6. Various company-specific developments

Markets continued to edge higher throughout May with the S&P 500 returning 5% and the TSX delivering a ~2% total return, resulting in YTD performance for both indexes sitting in the 9-11% range. Canadian market performance lagged vs. the US during the month primarily due to higher index exposure to the energy sector, where WTI crude prices declined by ~15% as the US and Iran inch closer to a resolution.

Strong earnings results in the Q1 2026 reporting period were the main driver for impressive US equity performance. 85% of companies reported results either ahead of or in-line vs. earnings estimates, with an average beat of approximately 16%. Markets continue to defy geopolitical tension, inflation fears, and oil price shocks (although the true impact may be felt at a future date if the conflict persists longer-term). The communications sector posted the strongest results (52% average beat), primarily led by Alphabet and Meta. Energy, consumer discretionary, and materials also displayed encouraging results.

With 95% of TSX companies now having reported, Canadian equities posted more modest results relative to US counterparts, with an average 3.1% earnings beat vs. consensus. Sector specific leaders included consumer discretionary, technology, and health care. The Canadian banks posted another broadly strong quarter, with all of the "Big Six" beating earnings expectations by an average of 26% despite mixed stock reactions. The group also posted attractive growth in revenue, expansion in ROE, and stable credit metrics. However with valuations at extremely elevated levels, we are not surprised at the muted-to-negative share price reactions. With average forward P/E at 14x and forward P/B at 2x, both metrics stand 3 standard deviations above their respective 10-year averages. Additionally, discounts versus the broad TSX index and US bank peers have meaningfully narrowed throughout the year.

To frame up the current energy landscape: the Strait of Hormuz has been closed for ~90 days, ~20% of global oil supply is currently offline, there are critical shortages in various key global inputs (incl. fertilizers and LNGs), and vessel traffic in/out of Iran has declined from roughly 80 per day to a low-single-digit daily rate. Despite the apparent progress on ending the Middle East conflict, the Strategic Petroleum Reserve (SPR) continues to exhibit massive outflows, with another 9.1mm barrels being released during the week of May 18th. This is the 2nd highest release on record, only slightly below the previous high water-mark set during the week of May 11th. We remain cautiously optimistic on an eventual end to the conflict, but note upside risk to inflation (and further pressure on consumers) if SPR depletion continues at its current pace. One acute example of the impact of oil shortages is the lack of jet fuel supply in Europe. With the Strait of Hormuz historically representing 30-60% of European import volumes, this has led to concerns over widespread capacity cuts at airlines during peak summer travel season. While inventories remain strained, a shift to imports into Europe from the Americas, West Africa, and Norway have eased near-term concerns to the benefit of those exporting regions.

Continuing on the topic of energy, the Prime Minister's office announced a plan for a new 1 million barrel per day oil pipeline from Alberta to the West Coast. The plan revolves around strengthening carbon markets, building a clean/reliable electricity grid, and accelerating the movement of Alberta oil to global (particularly Asian) markets. While we view a greenfield pipeline as a broadly positive development for the Canadian economy (and energy sector), we note the continuation of the carbon tax and the Pathways Project as costs that result in a relatively less competitive Canadian energy sector versus global peers.

Keyera was a popular news topic in May. Early in the month (May 5th), the Competition Bureau formally challenged Keyera's acquisition of Plains' natural gas liquids business on the basis of reduced competition at one of Canada's critical Liquid Natural Gas (NGL) hubs. It is important to note that the competition bureau did not file an injunction. Keyera subsequently committed to proceeding with the deal, reiterated the strategic merits (incl. $100M of annual run-rate synergies), and formally closed the transaction on May 12th. We believe there is potential that both parties reach a settlement (possibly involving asset divestitures) in order to avoid the process reaching the courts.

Canadian National Railway announced a partnership with Keyera and AltaGas to advance the Alberta Corridor Export (ACE) Rail Terminal. This project is designed to strengthen Canada's energy supply chain and increase competitiveness in global energy markets. At commencement (anticipated mid-2028) the project is expected to deliver transport capacity of approximately 45,000 barrels/day of NGLs from Fort Saskatchewan to West Coast export facilities. This represents 3-4 trains per week of volume for CNR, with the potential to ramp to 3 trains/day over time.

While the meeting yielded few substantial binding agreements, the Trump/Xi summit did provide visibility on an improving relationship between the two countries. Willingness to explore reciprocal tariff reductions was the most positive takeaway (in our view), providing potential inflation relief to consumers and manufacturers. Other notable topics included Nvidia receiving US approval to sell chips to major Chinese firms and commitments from China to purchase US oil and soybeans, as well as 200 Boeing aircraft.

On AI, the S&P 500's technology sector now represents 35% of total index capex, a record high, and according to Bloomberg estimates data center capex spend is expected to increase by another ~4% year-over-year in 2027. Despite increasing expectations for higher rates as inflation fears persist (largely from oil price pressures mentioned above), AI spending continues to show nearly zero sensitivity to the risk of higher financing costs or general concerns over a bubble-type scenario. With AI also accounting for nearly half of all YTD investment grade issuance activity, the impact of any slowdown or doubts in expected growth, demand, or usefulness of AI adoption would likely have wide-spread implications for financial markets. Strong industrial production in April was supported by the data center boom, and helped propel the manufacturing sector despite input cost inflation from the Iran war. Growth from the AI infrastructure build-out is widely expected to continue and will be supported by an additional 3,000 data centers either currently under construction or planned in the US alone. The sheer magnitude of demand continues to drive both record pricing power and supply constraints. Memory is an example of critical data center components that AI can't run without. Companies like Micron and SanDisk, key players in the memory space, are both benefiting from widespread supply shortages. Shares of these companies surged by ~80% and ~50% respectively in May alone. With limited new capacity coming online and the majority of supply already locked up from key AI players, NAND and DRAM prices are expected to remain elevated in the near-term, continuing to support the AI infrastructure thesis.

Despite fears surrounding inflation, geopolitical tensions, and AI bubble concerns, Goldman Sachs' "Panic Index" which tracks market stress, hedging demand, and macro fears (among other data points) recently declined to 0.25 (matching YTD lows). This compares to a peak of about 10.0 established at the onset of the Middle East conflict. Furthermore, global equity indices remain at or near all-time highs. Investors' focus on earnings momentum and margin expansion rather than macroeconomic pressures and risks represents the primarily factor driving strong year-to-date performance in global (and particularly North American) equity markets.

About the authors

Craig Jerusalim, CFA, MBA
Senior Portfolio Manager,
Head of Global GARP

Catharine Sterritt, CFA, CPA, CMA
Lead Portfolio Manager, Opportunities Funds

Tudor Padure, CFA
Portfolio Manager, Equities

Natalie Taylor, CFA
Lead Portfolio Manager, Equities

Nick With-Seidelin, CFA
Associate Portfolio Manager, Equities

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