CIBC GLOBAL ASSET MANAGEMENT

Equity team commentary: Pockets of opportunity

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Monthly Highlights & Key Events:

1) US/Iran conflict, commentary on current energy landscape
2) Alberta referendum & BC provincial election, changing Canadian political environment
3) Pacific Link declared project of national interest
4) Inflation & rising interest rate expectations
5) Emera/Canadian Utilities merger, ATCO spin-off
6) AI trade dynamics (CoreWeave volatility, recent performance)

Equity market performance diverged in October, with the S&P 500 falling by ~1% while the TSX delivered a ~1% total return. Year-to-date performance for both indexes now sits in the 12-14% range. Canadian markets outperformed the US in the month primarily due to higher index exposure to the energy sector (17% in Canada vs. ~4% in the US) as WTI advanced by more than 15%.

Much of the recent strength in energy markets has been underpinned by the lack of progress on a resolution between the US/Iran, escalation in the conflict by the Houthis, rapidly increasing transport costs, and ongoing drawdowns in strategic oil reserves. Since the onset of the Middle East conflict, the world has largely kept itself supplied by relying on oil it had already stored. Based on data from Haver Analytics, since the conflict began global oil inventories have declined by more than 620mm barrels, which would be the largest drawdown on record (going back to 1998). Furthermore, G7 countries agreed to an emergency release of 100mm barrels of oil and diesel in early October. This combined scale of drawdown is likely to support ongoing purchasing of crude in the open market to refill strategic reserves over the next few years. We have already seen China, the largest global purchaser and importer of crude oil come back to the open market. A lack of buying activity by China in the earlier stages of the conflict was a key reason oil prices initially remained subdued. Tanker crossings in/out of the Strait of Hormuz have remained severely depressed with late August seeing just 8 tanker crossings per day. Another component of disruption in energy markets is the cost of transport. Our energy colleagues suggests it now costs more than $20/barrel to transport crude from the Strait of Hormuz to Asia, up ~11x y/y. Additionally, crude carrier fleet capacity expansion is not expected until 2028/2029, and more than 20% of the existing crude carrier fleet is controlled by sanctioned countries (Iran, Russia, Venezuela, etc.). The most reliable bypass for crude transportation right now is Saudi Arabia's East-West pipeline. Despite efforts to increase capacity, reliance on this pipeline essentially trades Strait of Hormuz risk for Red Sea risk,

with the Houthis becoming far more engaged in the conflict over the last 4-6 weeks. The situation remains highly fluid with a resolution possible at any point in time. However, the key risk in our view is the fact that strategic oil reserves are a buffer that can only be drawn down once. The combination of a prolonged conflict, increased pressure on key bypass routes (i.e. the Bab al-Mandeb Strait) and the lack of the ability to once again rely on existing oil reserves results in material risk of crude prices remaining elevated. As a result, we view the current environment as highly supportive for energy-focused equities, with higher for longer "excess" free cash flow generation enabling higher buybacks, debt reduction, and funding for production expansion projects.

Continuing on the topic of a supportive energy landscape, results of the recent Alberta referendum vote and BC provincial election are both positive data points. Albertans overwhelmingly rejected initiating a process towards separation from Canada, with 75% voting to remain. While this has limited immediate financial impact for energy producers, it eliminates a significant source of political uncertainty for energy investment and supports ongoing cooperation between the Federal government and Alberta provincial government. The BC provincial election was also highly significant, with Lorne Doerksen's conservatives unseating the NDP after 9-years in power. The BC conservative platform aims to double LNG production by 2032 and triple it by 2035. The conservative party also fully supports the proposed Pacific Link pipeline (~1 million bbl/day) from Alberta to the BC coast, potentially unlocking a key first step towards meaningful crude production growth. The BC election leaves Canada with a power balance that now clearly leans conservative, with 7 of 10 provinces now controlled by conservative or conservative-aligned governments. While beneficial to the energy sector, we also view this sweeping change as highly constructive for critical growth drivers of Canada's economy, including nation building projects, defense spending, and associated infrastructure investments. We also view the rejection of Alberta separation as directionally positive for trade negotiations with the US, as it removes a key point of leverage from the Trump administration.

Another positive signpost for Canada's energy sector was the Pacific Link pipeline being listed as a project of national interest under the Building Canada Act. This critical expansion in energy infrastructure is targeted to move ~1mm bbl/day of Canadian oil from Alberta to coastal BC, providing enhanced access to Asian markets. At a time when Canadian crude oil is fetching near-record premiums in markets like South Korea and China but trading at the widest discount to WTI since 2018, increasing egress capacity becomes even more critical. The new pipeline will be jointly owned by the Federal and Alberta provincial governments, with indigenous communities to be offered a minimum 10% stake. The designation as a project of national interest now allows the pipeline to move forward under a streamlined review process, ideally accelerating the timeline to ultimately reach the construction phase.

Concerns surrounding persistent inflation continue to reverberate through markets, driving yields higher and underpinning increasing expectations for additional rate hikes in 2027. While the September headline CPI reading of +3.7% was ahead of expectations, it was primarily led by rising energy costs which were initially expected to be transitory by both investors and the Fed. However with the Iranian conflict being more protracted with significant ongoing impacts on transportation and refining infrastructure, the October core reading of +2.6% included data points that indicate a more enduring inflationary environment. Diesel continues to be the primary culprit of rising core inflation, with prices reaching ~$6.35/gallon as of late October. This is the 2nd highest level on record (previous high set in September 2026), with data going back to 1994 (monthly basis). The key issue is that diesel costs are embedded throughout the supply chain of nearly every physical good, influencing freight, rail, manufacturing, and construction expenses. One example in the September CPI report was trucking costs, which rose more than 15% y/y as fuel surcharges began taking effect. Diesel also plays a critical role in agriculture, where higher input costs directly influence prices for necessity-based consumer goods, particularly food. This is the type of inflationary pressure that cannot be explained away as transitory. Rising yields in the US are already signalling expectations for rate hikes, with 5-and-10-year yields both rising by ~150bps since the onset of the conflict. The potential for relief in prices of refined

products is also limited, in our view. China, Russia, and the Middle East region have lost ~45% of refined supply vs. pre-war. On a global basis, these 3 regions represent 35-40% of total refined product supply. Processing volumes out of Russia recently hit a 20-year low, as the ongoing conflict puts downward pressure on capacity and supply. As a result, crack spreads hit ~$50/barrel recently, more than double the long-term average. This, along with significant constraints in refining capacity, have been the key drivers of unrelenting pricing pressure in diesel. As evidence of this trend, in late October the BoC raised its overnight rate to 2.5%, citing rising inflation expectations and accelerating producer prices. The BoC also flagged greater passthroughs of increasing transportation costs, consistent with data in the September CPI report from the US.

October saw the largest M&A deal in Canadian history, with the Emera and Canadian Utilities merger of equals creating an entity with a proforma enterprise value of $72B. The combined entity will be a top-20 North American regulated utility, have a $45B rate base, and serve ~6M customers across Canada, the US, and Australia. Strategic rationale for the deal includes increased scale, geographic diversification, and exposure to Florida and Alberta, two of the fastest growth jurisdictions in North America. Despite much of the focus being placed on Emera and Canadian Utilities, an underappreciated component of the deal is the spin-off of ATCO's non-utility business into a new publicly traded entity. The "new" ATCO possesses numerous compelling catalysts for long-term growth, in our opinion. First, the simplification of the corporate structure allows investors to focus on ATCO's operating assets, as the company's prior valuation was dominated by its ~53% economic interest in Canadian Utilities and the holding company discount debate. Secondly, the company's financial profile is highly attractive, with $700M in cash/equivalents and zero corporate debt (post spin-off). Lastly, ATCO's modular housing and structures business provides appealing exposure to key "Canada Strong" themes, including defense spending, mining projects, energy production growth, new pipeline construction, affordable housing, and other nation building/major infrastructure projects. Numerous large-scale defense contracts in Canada are expected to be announced in early 2027, most of which are focused in remote Northern regions where housing for labour is essentially non-existent. This includes the Grays Bay Road & Port project in Nunavut, which incorporates a 230-kilometre all-season road, a deepwater port, a 6,000 foot airstrip, and associated support facilities. In anticipation of growing industry demand, ATCO recently expanded manufacturing capacity at their Grimsby facility, and also has the ability to increase production rates at their Calgary plant. As a key domestic manufacturer and provider of modular structures, we view ATCO as being very well-positioned to capture growth from long-term, mission-critical investment projects in Canada.

A report from Apollo's chief economist and turmoil in CoreWeave shares sent AI stocks into a tailspin in late October. Throughout the month, the Philadelphia semiconductor index fell by more than 15%, with companies like Intel and SanDisk declining by 45% and 34%, respectively. While not in the SOX index, CoreWeave shares also declined by upwards of 37% in October as concerns over the company's capital structure began to mount. With roughly $50B in reported debt obligations, credit investors began questioning whether potential revenues would be enough to cover higher financing costs and fund continued growth. This is in addition to existing concerns around circular financing and contagion risk in financial markets. Torsten Slok, Apollo's chief economist, wrote that despite massive upfront investment, AI has delivered zero financial payoff to corporate America outside of the technology sector. Revenue/worker is rising for the Mag7, but for the remaining 493 stocks in the S&P 500, this metric is flat, implying limited signs of productivity growth and other benefits from AI. This puts into question not only the ultimate level of demand for tokens, but also the pricing power of LLMs which is a key driver of reaching profitability, particularly with enterprise clients who represent large multi-year contracts. The sheer magnitude of total AI related financing activity, which now exceeds the fiscal deficit of major global economies like Germany, France, Japan, the UK, and Canada is another factor to consider. This year, cloud and data center firms alone have raised almost $370B, more than 6x last year's total. While the viability of the AI buildout is one question, the ultimate availability of capital may prove to be the near-term gating factor to the AI growth capex thematic.

Persistent geopolitical tensions, declining global oil inventories, and constrained refining capacity continue to support a constructive outlook for energy markets. A more favourable Canadian political backdrop and progress on key infrastructure projects adds to the case for select domestic opportunities. At the same time, inflationary pressures appear increasingly broad-based, with diesel, freight, rail, and other supply-chain sensitive inputs reinforcing the risk of higher yields and tighter monetary conditions as we head into 2027. Against this backdrop, we continue to favour businesses with strong pricing power, balance sheet stability, and exposure to core domestic secular themes including nation building projects, defense spending, and large-scale infrastructure investment. As AI financing conditions tighten, we believe the availability and cost of capital may become just as important as end-demand in determining winners and losers within the AI ecosystem. Overall, the current environment remains one where selectivity, discipline, and a focus on fundamental durability are increasingly important.

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