

Stocks rise on easing Mideast tension and an AI rally.



- Global equities, as measured by the MSCI ACWI Index, posted notable gains in the second quarter of 2026, supported by optimism regarding an agreement to end the hostilities in the Middle East, as well as a rally in the technology sector, particularly artificial intelligence (AI)-related companies. Emerging markets significantly outperformed developed markets.
- Global fixed-income assets, as represented by the Bloomberg Global Aggregate Bond Index, ticked up 0.9% (in U.S. dollars) for the quarter. U.S. Treasury yields moved higher for all maturities, with the exception of one-month T-bills. (Bond prices move inversely to yields.)
- We remain constructive overall on the global economy and risk assets, but we are more selective. Capital markets are entering a more complicated reflationary phase.

SEI's Canadian view

There is widespread agreement that the Canadian economy has struggled in recent years and quarters—the most recent string of quarterly gross domestic product (GDP) data confirmed it. However, those reports, especially the first quarter of 2026, were not quite as bad as headlines suggested. Business investment remained weak (outside of inventory additions), but consumers proved resilient and manufacturing continued to show positive momentum. While net exports detracted from GDP, this was due to strong imports rather than a sudden decline in trade activity. Finally, a modest population decline across both quarters contributed to the weak GDP prints, while per-capita growth remained positive—an encouraging sign that argues against the economy having fallen (or falling) into recession.

Although services sentiment turned down in June, survey respondents in other industries indicated that business activity has continued to pick up, especially in goods-producing areas of the economy. Low levels of business investment have been a challenge for the Canadian economy for several years. Encouragingly, the Bank of Canada's (BOC) most recent Business Outlook Survey (BOS), conducted in May 2026, found that the number of businesses planning to increase investment has continued to pick up and is now running well above its long-term average.

The BOS also found that respondents had an increasingly favourable outlook for exports. As we've noted previously, growing exports can help a country reduce domestic debt levels over time, which is particularly relevant to Canada right now. The BOS was conducted in May, when the Strait of Hormuz situation was much cloudier and energy prices were much higher, so we won't be surprised to see some volatility in these areas in future BOS surveys. That said, these indicators coincide with a notable global upturn in manufacturing activity and outlooks, so this does not appear to be a narrow, energy-only story. Furthermore, the commodity shortages caused by the Strait of Hormuz closure will require replenishment of above-ground supplies. As a result, we do not expect sharply lower energy prices (which have rebounded recently on renewed frictions between Iran and the U.S.) to undermine these dynamics significantly.

The Canadian dollar has been under pressure in recent years due to the low-growth, relatively low-interest rate domestic environment compared to the rest of the world. While most currencies have weakened against the U.S. dollar recently, the loonie has been weakening against a broad range of other currencies as well. This reduces import purchasing power and the spending power of Canadian tourists, but there are some beneficial trade-offs when it comes to trade. A weaker CAD against a backdrop of improving export prospects should be a powerful combination in support of both domestic growth and income.

Other considerations that support our optimistic outlook for Canada include relatively tame core inflation measures that are likely to remain within the BOC's desired range of one-to-three percent, a lower risk of tightening monetary policy as a result (compared to economies where inflation is running persistently above central bank targets and threatening to rise further), and a solid pipeline of national government expenditures focused on infrastructure, military investment, and greater energy and trade resilience.

The dynamics we've outlined put us in agreement with numerous other forecasters who are projecting a stronger economic environment in Canada in the next 18 months. Of course, a stronger economy is not guaranteed. Risks to our outlook include negative surprises on trade, inflation, interest rates, the AI buildout, and geopolitics. Among those, the status of the Canada-United States-Mexico Agreement (CUSMA) is a clear and present risk. The U.S. recently denied Canada's formal request for a 16-year renewal, which triggers a series of annual reviews and potential annual renegotiations until the agreement sunsets in 2036. This essentially kicks the can down the road with an overall effective U.S. tariff rate in the single digits—not ideal for Canada (or Mexico), but far from a worst-case outcome. That doesn't rule out future trade frictions with a sometimes-mercurial U.S. administration, and it's important to remember that CUSMA's Article 34.6 allows any of the three countries to withdraw unilaterally six months after providing written notice. But for now, CUSMA looks set to continue in something like its current form for the next decade or so which, though imperfect, provides at least a measure of stability on the trade front.

As we like to remind investors, financial market behavior doesn't neatly follow economic cycles—something that Canadian markets' solid performance over recent years confirms. However, an improved domestic growth environment (and a strong external-growth environment) should lend further support to corporate performance within Canada, possibly with a lower degree of bond market volatility than in a number of other countries. A diversified global portfolio should benefit (albeit with periodic volatility) from exposure to the global AI buildout, as well as older-economy sectors that stand to benefit from it, industries that may benefit from eventual AI-driven productivity enhancements, undervalued areas that stand apart from the AI-investment wave, and, where relevant, exporters and non-currency-hedged positions that should benefit from a weaker loonie.

SEI's global view

We remain constructive overall on the global economy and risk assets, but we are more selective. Capital markets are entering a more complicated reflationary phase. The market cycle is becoming more inflation-sensitive, more rate-volatility-sensitive, and more dependent on physical bottlenecks than on pure financial liquidity. The correct framing is not recession versus expansion; it is whether growth remains strong enough to support earnings without forcing real yields, term premia, and the U.S. dollar high enough to compress valuations.

U.S. economic growth remains resilient, but that is a double-edged sword. Manufacturing activity, labor-market momentum, macro surprise indicators, and earnings revisions do not point to an imminent recession. However, stronger growth also reduce the case for Federal Reserve (Fed) monetary policy easing and keeps the discount-rate risk alive for long-duration assets.

Inflation risk is now driven by supply-side constraints and strong demand. Oil, tariffs, electricity demand, AI infrastructure, semiconductor constraints, and persistent cost increases for services can keep inflation sticky on their own. Meanwhile, reaccelerating growth without realized productivity gains would add demand-pull pressure. Private demand running above potential real growth makes a clean return to 2% inflation difficult without either productivity gains or tighter policy. Longer-term inflation expectations remain reasonably anchored, which argues against an aggressive hiking cycle. But resilient growth, renewed inflation pressure, market pricing, and the nominal-demand backdrop are consistent with one hike followed by a pause, moving policy from modestly accommodative to closer to neutral.

Equity earnings are still a source of support. Forward earnings growth and revisions remain positive, and earnings breadth is healthier than return concentration suggests, particularly in the U.S., Japan, and across the global manufacturing and AI supply-chain cycle. Valuation discipline matters more now. The U.S. and parts of Asia look expensive, while Europe, the U.K., and selected value-oriented segments appear more reasonably priced. Markets can continue to work, but the margin of safety is thinner. Investment opportunities are broadening beyond mega-cap growth stocks. AI remains an important theme; however, the next phase increasingly depends on chips, power, grids, cooling, data centres, energy, materials, and industrial capacity. The beneficiaries may shift from software narratives toward infrastructure and old-economy enablers. Active management remains a key call this year with positive exposures to global value, quality, and momentum factors, with value as the primary emphasis. We favour earnings-supported equities over non-earners, while avoiding excessive reliance on long-duration (rate-sensitive) growth. Emerging-market equities remain interesting given valuations and leverage to economic growth.

Within the fixed-income universe, bonds are less reliable as a hedge. Elevated stock-bond correlations, higher inflation volatility, and rising term premia mean Treasuries are likely to trade more like risk assets than they have in recent cycles. We believe inflation-linked exposure is more attractive than nominal bonds as breakeven rates are still underpricing persistent inflation pressure.

Economic backdrop

Global equities, as measured by the MSCI ACWI Index, posted notable gains in the second quarter of 2026, supported by optimism regarding an agreement to end the hostilities in the Middle East, as well as a rally in the technology sector, particularly artificial intelligence (AI)-related companies. Emerging markets significantly outperformed developed markets for the quarter.

The Far East and Asia were the top performers among emerging markets over the quarter, as both regions benefited from significant market rallies in Korea and Taiwan. Conversely, Chinese stocks listed on the Hong Kong Stock Exchange were the most notable market laggards, while Latin America also lost ground due to a downturn in Brazil. The Gulf Cooperation Council (GCC) countries finished the quarter in modestly positive territory, but underperformed due to weakness in Saudi Arabia. North America was the top-performing developed market in the second quarter due to strength in the U.S. The Euro region benefited from market upturns in the Netherlands and Austria, while both the Far East and Pacific regions were bolstered by strength in Japan and Singapore. The Pacific ex Japan market posted a gain for the quarter, but was the primary market laggard due to a decline in Hong Kong.

Global fixed-income assets, as measured by the Bloomberg Global Aggregate Bond Index, ticked up 0.9% (in U.S. dollars) for the quarter. High-yield bonds led the U.S. fixed-income market, followed by investment-grade corporate bonds, U.S. mortgage-backed securities (MBS), and U.S. Treasury securities. Treasury yields moved higher for all maturities, with the exception of one-month T-bills. (Bond prices move inversely to yields.) Yields on 2-, 3-, 5-, and 10-year Treasury notes rose 0.35%, 0.34%, 0.27%, and 0.14%, ending the quarter at 4.14%, 4.15%, 4.19%, and 4.44%, respectively. The 10-year to 3-month yield curve narrowed by 6 basis points (0.06%) to +0.57% as of the end of the quarter.

Global commodity prices, as represented by the Bloomberg Commodity Index, declined 8.1% in the second quarter. Oil prices fell sharply on hopes for a resolution of the blockade of the Strait of Hormuz, a major shipping channel between the Persian Gulf and the Gulf of Oman in the Middle East, with West Texas Intermediate (WTI) and Brent crude tumbling 31.4% and 29.8%, respectively, during the quarter. The gold price fell 13.7% for the quarter amid rising U.S. Treasury yields and a strengthening U.S. dollar. (The gold price tends to move inversely to the dollar.) Despite a pullback in June following a sharp rally in May, the New York Mercantile Exchange (NYMEX) natural gas price still ended the quarter with a 13.6% gain as warmer weather forecasts bolstered expectations for stronger summer cooling demand. The wheat price decreased 4.4% during the quarter amid anticipation that improving weather in the U.S. could lead to increases in crop yields and overall supply.

The U.S.-Israel-Iran war dominated the geopolitical news throughout the quarter. The ceasefire appeared to be in jeopardy numerous times during the period, with both the U.S. and Iran accusing the other of violating the truce. Iran launched missile and drone attacks on U.S. warships and other targets in the Gulf region in May, triggering U.S. strikes on Iranian military sites. The United Arab Emirates intercepted several Iranian missiles and drones as Iran sought to retaliate against neighbouring countries allying with the U.S. and Israel. Nonetheless, U.S. officials signaled that a peace deal was possible even amid continued military strikes launched by both sides.

Toward the end of the quarter, the U.S. and Iran signed a memorandum of understanding (MOU), which moved the Mideast conflict from active escalation to conditional diplomacy. President Donald Trump signed the preliminary agreement on June 17, setting a 60-day negotiating window intended to end hostilities, reopen the Strait of Hormuz, and address Iran's nuclear program. The framework provides immediate oil-sanctions relief for Iran and calls for the U.S. to ease its naval blockade, while Tehran agreed to restore commercial shipping through the strait. However, U.S. officials stressed that the MOU is not a final deal, and Trump indicated that military action could resume if Iran fails to comply. On June 25, the Gulf Cooperation Council (GCC) welcomed the agreement and backed U.S. objectives to prevent Iran from acquiring a nuclear weapon, address Iran's ballistic missiles, and preserve free and unrestricted navigation through the Strait of Hormuz. However, Iranian authorities reportedly warned vessels transiting the strait without identification signals or Iranian permission, leading at least three oil tankers and two other ships to reverse course. The episode highlighted the gap between the diplomatic framework and conditions on the water. The MOU has reduced near-term escalation risk, but freedom of navigation through the Strait remains contested.

Trump and President Xi Jinping of China met in Beijing in mid-May to discuss, among other topics, Xi's intentions regarding possible military action against Taiwan to force reunification with China, and the war in the Middle East. Xi cautioned Trump that mismanagement of the Taiwan situation could result in an "extremely dangerous situation." Trump and Xi found some

common ground regarding the Mideast conflict, agreeing that the Strait of Hormuz should be reopened and that Iran should not be allowed to produce a nuclear weapon.

Elsewhere, on June 22, Keir Starmer announced his resignation as both U.K. prime minister and Labour Party leader. It appeared that significant Labour Party losses in local elections had eroded his authority and triggered calls for him to step down. Starmer acknowledged internal political pressure and accepted that he was no longer best placed to lead, but said that he would remain in office until the Labour Party chooses a successor to ensure an orderly transition.

Economic data (unless otherwise noted, data sourced to Bloomberg)

According to Statistics Canada, consumer prices (as measured by the change in the Consumer Price Index (CPI)) increased 1.0% in May. Year-over-year consumer prices were up 3.2% as higher gasoline costs were the primary driver of broad-based higher prices. Producer prices continued to show robust increases in May, as the Industrial Product Price Index (IPPI) rose 1.2%, while the Raw Materials Price Index (RMPI) gained 0.7%. Year-over-year prices increased 13.6% and 33.4%, respectively, for the IPPI and RMPI. Input prices for petroleum products have driven much of the recent price increases, while prices for food and industrial metals have also contributed to higher cost pressures. The Canadian labour market was nearly unchanged in June, adding a mere 18,000 jobs, while the unemployment rate ticked down 0.1% to 6.5%.

The U.S. Department of Labor reported that the consumer-price index (CPI) increased 0.5% in May, edging down from the 0.6% rise in April and meeting expectations. Rising energy prices have continued to fuel inflation, with prices for fuel oil and gasoline posting corresponding gains of 7.0% and 6.7% for the month. The CPI advanced 4.2% year-over-year in May, up from the 3.8% increase in April and in line with expectations. Fuel oil and gasoline prices surged 58.9% and 40.6%, respectively, over the previous 12-month period. Core inflation, as measured by the CPI for all items less food and energy, rose 2.9% year-over-year in May, an uptick from the 2.8% increase in April and in line with expectations. Costs for apparel and transportation services rose 4.8% and 4.1%, respectively, over the previous 12-month period. Conversely, prices for used cars and trucks and medical care commodities declined by corresponding margins of 2.0% and 1.8% year-over-year. According to the third estimate from the Department of Commerce, U.S. gross domestic product (GDP) grew at an annual rate of 2.1% for the first quarter of 2026, exceeding expectations and up from the previous estimate of 1.6% and the 0.5% rise in the fourth quarter of 2025. The increase in GDP for the first quarter was attributable to growth in investment, exports, government spending, and consumer spending, while the upward revision from the second estimate primarily reflected a downward revision to imports, which are a subtraction in the calculation of GDP.

According to the Office for National Statistics (ONS), inflation in the U.K., as measured by the CPI, edged up 0.2% in May, down sharply from the 0.7% increase in April. Costs for furniture and household goods, and restaurants and hotels rose 0.8% and 0.6%, respectively, for the month. Conversely, alcohol and tobacco prices declined 0.3%, while costs for food and alcoholic beverages, and housing and household services dipped 0.1%. The CPI advanced at an annual rate of 2.8% in May, marching the increase in April. Transportation, education, and restaurants and hotels posted the largest price gains for the period. The ONS also announced that U.K. GDP edged down 0.1% in April (the most recent reporting period), declining from the 0.3% growth rate in March. Output in the services sector dipped 0.2% in April, while construction sector ticked up 0.1% and production was flat. GDP increased 0.6% for the three-month period ending April 30, 2026, up marginally from the 0.5% growth rate for the first three months of the year. Output in the construction and services sectors increased 1.6% and 0.8%, respectively, for the three-month period. In contrast, production output edged down 0.1% for the period.

Eurostat pegged inflation for the eurozone at 2.8% for the 12-month period ending in June, down from the 3.2% annual increase in May. Energy prices surged 10.9% year-over-year in June due to the ongoing blockade in the Strait of Hormuz, affecting a significant amount of global oil capacity, and costs for unprocessed food rose 4.2% compared to the same period in 2025. The economic contraction for the first quarter was attributable largely to a 12.1% GDP decline in Ireland, while GDP for Lithuania and Sweden dipped 0.3% and 0.2%, respectively. The economies of Iceland, Denmark, Estonia, and Malta were the strongest performers for the first quarter, expanding by corresponding margins of 3.7%, 1.9%, 1.1%, and 1.1%.

Index data (2Q 2026 in CAD)

- The S&P/TSX Composite Index gained 6.96%.
- The FTSE Canada Universe Bond Index rose 2.01%.
- The S&P 500 Index, which measures the performance of U.S. equities, climbed 17.12%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, gained 16.84%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 2.03% (currency hedged) and 4.16% (unhedged).
- The Chicago Board Options Exchange Volatility Index (VIX)—which tracks implied volatility in the S&P 500 Index and is often referred to as the “fear index”—ended June at 16.45 as volatility decreased throughout the quarter as warring parties in the Middel East dialed back hostilities in favour of a tentative cease fire and negotiations.
- The WTI Cushing crude oil price—a key indicator of movements in the oil market—decreased from US\$101.38 to US\$69.50 a barrel during the quarter. The oil price returned to near pre-war levels as some tankers began to trickle out of the Strait of Hormuz following the signing of a memorandum of understanding between the U.S. and Iran.

Glossary and index definitions

For financial term and index definitions, please see: <https://www.sei.com/ent/imu-communications-financial-glossary>

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