

Market Pulse



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TSX pulls back amid higher yields, trade uncertainty

Canadian equities gave back some ground after a strong run earlier in the year, as the S&P/TSX Composite declined approximately 2.9% on a price-return basis. The Canadian economy, however, held up reasonably well. Real GDP grew at a 3.3% annualized pace in Q2 after a weak start to the year, with support from consumption, housing, exports and business investment. Even so, there's still excess supply in the economy, and uncertainty around Canada-U.S. trade continues to hang over the outlook.

Against that backdrop, the Bank of Canada (BoC) held its overnight rate at 2.25% on September 2. Headline inflation was running near 3%, largely because of higher gasoline prices, while inflation excluding gasoline was 2.2%, and core measures remained close to 2%. For the BoC, the challenge is weighing a softer domestic backdrop against the risk that energy prices and trade-related costs keep inflation from settling comfortably at target.

U.S. equities were mixed as investors weighed competing forces. The S&P 500 Index slipped 0.45%, while the Nasdaq Composite Index finished the month up 1.86%. Corporate fundamentals and continued enthusiasm around AI remained supportive, but rising interest rates and bond yields made the valuation backdrop more demanding.

The U.S. economy continued to show considerable strength. September business surveys pointed to faster activity, stronger employment growth and ongoing inflation pressures. That combination reinforced the view that monetary policy may need to remain restrictive for longer than markets had expected.

In response, the U.S. Federal Reserve (Fed) raised its target rate by 25 basis points to 3.75%–4.00%, its first increase since 2023. The decision marked an important change in direction and brought the inflation outlook firmly back into focus.

International developed-market equities also weakened. The MSCI EAFE Index declined approximately 3.3% in U.S.-dollar price-return terms, although it remained up approximately 8% year-to-date. The international economic picture, meanwhile, was fairly resilient. Business activity improved in the euro area, while Japan remained in expansion territory. At the same time, higher energy costs and rising interest rates created a tougher environment for consumers, companies and investors.

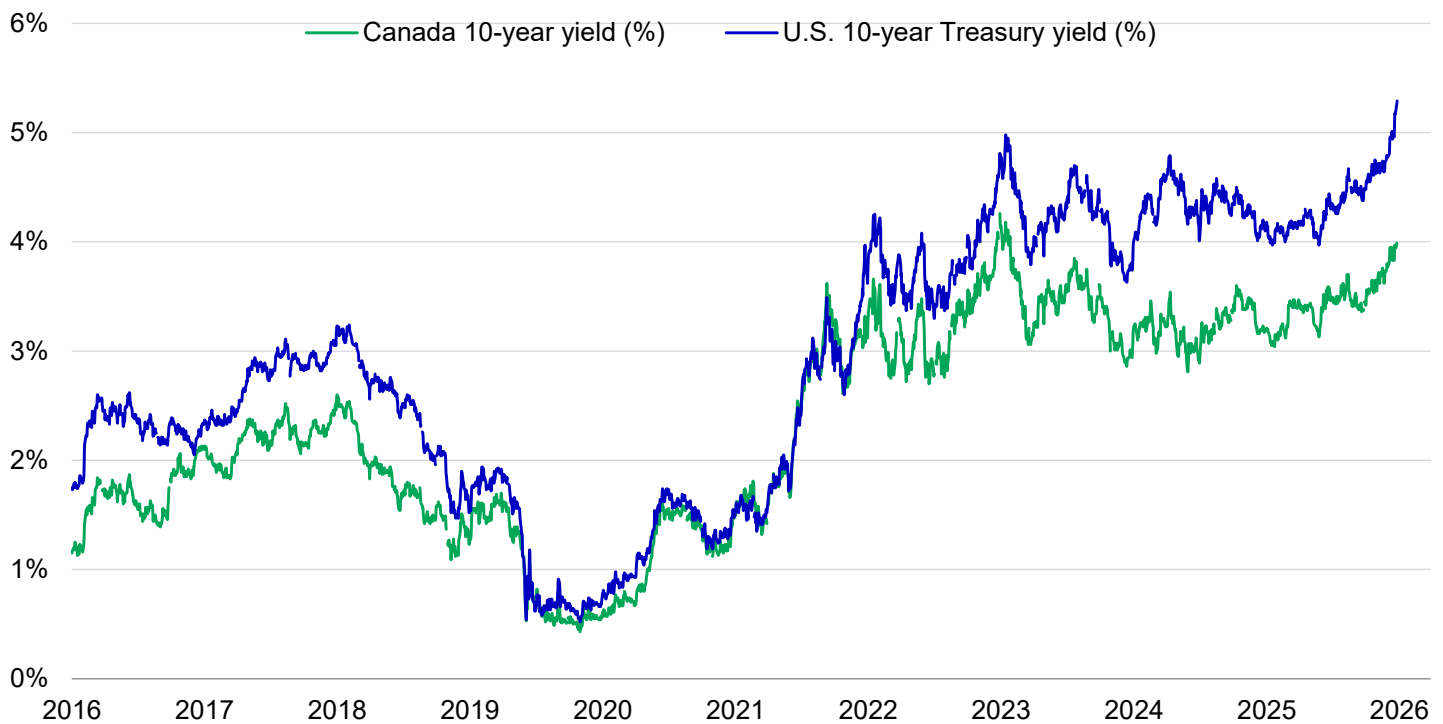
U.S. 10-year yields top 5%

Bond markets were a big part of September's story. Long-term government yields moved higher as investors responded to resilient growth, persistent inflation and the possibility that central banks will need to keep policy restrictive.

In the U.S., 5-year and 10-year Treasury yields moved above 5% following stronger-than-expected September business activity data, reaching their highest levels since 2007. Canadian government bond yields also rose as part of the broader global move higher in long-term rates.

The move was painful for bond prices, but higher yields give investors a better starting point for income and potential future returns. We think that the trade-off between better income and continued price volatility will remain important in the months ahead.

Canada and U.S. 10-year government bond yields



Source: Bank of Canada; U.S. Federal Reserve, as of September 30, 2026.

What to watch

There's no shortage of potential market catalysts as we head toward year-end. We continue to believe that economic growth can support company earnings, but if growth and inflation stay firm, interest rates may also remain higher for longer. Investors may want to consider monitoring the following themes:

- Following the Fed's September increase, we'll be watching to see whether this was a one-time adjustment or the start of another phase of tightening. Similarly, for the Bank of Canada, investors will be monitoring economic conditions and inflation developments to assess the potential path of future interest rate decisions.
- The U.S. midterm elections take centre stage on November 3. We'll be paying attention to what it could mean for fiscal priorities, trade and regulatory policy, and the administration's ability to advance its agenda. Election-related headlines can create short-term volatility, but we don't believe portfolios should be positioned around a single political outcome.
- Corporate earnings will be another important test. With bond yields elevated, investors may be less willing to pay high valuations in the absence of clear earnings results. We'll be looking to see whether earnings growth broadens beyond the largest technology companies, and whether the significant spending on AI, data centres, semiconductors and power infrastructure begins to translate into stronger revenue and productivity.
- We're also watching what's driving long-term bond yields. Central-bank policy matters, but it's not the whole story. Heavy government borrowing, rising corporate issuance, global demand for duration, energy prices, and fiscal and political uncertainty can all influence yields. If these forces keep term premiums elevated, longer-term rates may remain high even if central banks eventually pause.

- For Canadian investors, trade policy and energy prices deserve particular attention. New trade measures could affect exports, business investment, supply chains and consumer prices. At the same time, sustained strength in energy prices could support parts of the Canadian equity market while adding pressure to inflation, household budgets and corporate margins.

Bottom line: This remains an environment where balance matters. Higher bond yields have improved the income available from fixed income, but rate volatility may stay elevated. Equity fundamentals remain reasonably supportive, but valuations and market concentration leave less room for disappointment. In this environment, investors may wish to review whether their portfolios remain appropriately diversified across asset classes, regions and investment styles, having regard to their individual objectives, time horizon and risk tolerance..

Monthly lookahead

October 4	Canada September employment, U. of Michigan consumer sentiment
October 14	U.S. September CPI, Canada August building permits
October 15	U.S. September retail sales, Philadelphia Fed Index, Canada August wholesale trade
October 19	Canada September CPI
October 20	U.S. September housing starts and building permits, pending home sales
October 23	Canada August retail sales
October 28	Bank of Canada rate decision, U.S. FOMC rate decision
October 30	Canada August GDP

Important disclosure

The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States.

The S&P/TSX Composite Index is the benchmark Canadian index that tracks the performance of companies listed on the Toronto Stock Exchange (TSX).

It is not possible to invest directly in an index. Past performance does not guarantee future results.

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