

## 2026: Constructive Backdrop & Clear Watchpoints

*Happy New Year!*

The backdrop for equities remains positive heading into 2026. After April's tariff-related volatility, markets rallied strongly, then shifted into a choppy year end phase while remaining within an overall bull market. Early December reflected an attempt to reassert upward momentum after November's reassessment of several dominant themes, including artificial intelligence leadership, the gold trade, expectations for the pace of rate cuts, and the broader developed market soft-landing narrative.

While these pauses can feel frustrating, they are a healthy feature of bull market cycles. They help unwind crowded positioning, allow capital to rotate, and create room for new opportunities to emerge. Markets advanced steadily for nearly six months after the April rebound, so a period of digestion was expected. November served that role, and December saw renewed efforts to rebuild momentum, though lighter year end volumes made sustained follow through harder to achieve.

The result was uneven progress rather than a clean trend. Volatility declined meaningfully from November's elevated levels, signaling reduced stress, but price action remained range bound. Markets tested higher levels at times, yet lacked the consistent traction that typically signals trend authority.

Despite this consolidation, the broader bull market remains intact. The U.S. economy continues to operate within a supportive macroeconomic backdrop. The Federal Reserve remains mid-cycle in its rate-cutting process, providing an important tailwind for risk assets. Labour market conditions, while no longer as tight as in prior years, remain resilient. The U.S. unemployment rate sits near 4 percent, and December employment data continued to show steady job creation, reinforcing the view that economic momentum is moderating rather than deteriorating. Inflation has also stabilized, reducing pressure on monetary policy and helping anchor longer-term expectations.

Taken together, recent market behaviour is best viewed not as a reversal, but as a pause within a larger upward trend. Periods of consolidation often strengthen market structure, particularly when they occur alongside declining volatility and stable economic data

### How We Read the Environment

As we move into 2026, equity markets remain supported, but increasingly shaped by forces beneath the surface. While stock prices and valuations tend to dominate headlines, many of the outcomes investors experience in equities are driven by shifts in risk appetite and liquidity elsewhere in the system.

For that reason, our equity strategy is not built on forecasting stocks in isolation. We focus on financial conditions and investor behaviour across

markets. Interest rates, liquidity, and funding dynamics often provide early insight into whether volatility reflects a normal adjustment or a more meaningful change in risk.

Stock valuations, something we hear about often in the media, are best understood as a reflection of this environment rather than as a primary driver of returns. When credit is readily available and interest rates are low, investors are willing to pay higher prices for future earnings. When those conditions tighten, valuations tend to adjust after the fact. This is why we view fixed income not as a separate consideration, but as a critical lens for understanding equity behaviour, and we think our clients should too.

### **What We Are Watching in Credit**

As mentioned, the bond market can provide a wealth of insight, and this year is no different. Entering 2026, the credit markets remain supported by technical factors. Many institutional investors are still positioned cautiously, with significant capital not yet fully invested. As a result, periods of weakness are generally being met with incremental buying rather than selling. While much of the “buy-the-dip” narrative focuses on retail investor activity, institutional investors are playing a significant role in supporting this dynamic today.

This backdrop reduces the likelihood of a sharp, sustained market decline for the foreseeable future. The more credible risk will come after repeated bouts of volatility close together, which could alter investor behaviour. We remain focused on monitoring for that type of sequence, as it is often behavioural shifts, not headlines, that change market regimes.

### **Rate Moves Have Been the Main Driver**

In bond markets, it helps to separate the two main sources of volatility: interest rate moves versus a real deterioration in credit quality. Recently, most of the movement has been driven by interest rates, not by a broad rise in default risk. When rates move, the market reprices the value of future cash flows. This can move both stocks and credit-sensitive assets even when company fundamentals have not changed. In other words, rate-driven volatility can create meaningful price swings without necessarily signaling deeper stress in the system.

### **Secondary Watchpoints**

In the U.S., a meaningful share of recent bond market activity has been tied to the AI investment cycle. A small group of issuers has accounted for a large portion of new borrowing, which means credit benchmarks are more sensitive to how that group trades. If investors become less willing to provide funding, or if borrowing costs rise, stress is likely to appear there first. When that happens, financial conditions can tighten and equities often feel the impact soon after. The earliest signals are usually subtle: weaker relative performance and widening gaps between similar issuers or securities, well before broader, headline credit measures move.

In Canada, the long end has been held in place by a technical imbalance: steady institutional demand and limited supply. That can keep pricing tight for longer than expected. The risk is a sudden change in that bid. If buyers step back or supply returns, long-term yields can jump quickly, tightening conditions and forcing a fast revaluation of risk assets.

### **How This Informs Our Positioning**

Stepping back, equities remain well supported, but the drivers of future returns are rooted in risk appetite and liquidity conditions rather than in simple measures in isolation like valuations or short-term narratives. Volatility on its own is not a problem. The distinction is between volatility that reflects normal adjustment and volatility that begins to change investor behaviour.

Our focus remains disciplined execution: participating when conditions support taking risk, and reducing exposure when behaviour and financial conditions begin to shift in ways that have historically preceded more durable drawdowns.

*We look forward to the year ahead and working closely with you! As always, please reach out to our team anytime with questions!*

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