2026 Q1 Economic and Market Commentary

Executive Summary

- The first quarter of 2026 (Q1) continued many of the trends that defined 2025, but uncertainty increased in March as the conflict with Iran raised concerns about energy prices, inflation and economic growth.
- Global stock markets ended the quarter slightly down, as strong corporate earnings were offset by rising energy prices and long-term interest rates, as well as ongoing geopolitical risks. Canadian stocks edged slightly positive, helped by rising commodity prices.
- Bonds were up slightly in the quarter. Demand for safer investments pushed bond prices up, but concerns about inflation limited those gains.
- The Canadian economy grew slowly in Q1, with early estimates pointing to continued sluggish expansion. Labour market conditions remained stable, with unemployment roughly flat for the quarter.
- Inflation (the rate at which prices rise over time) remained above the Bank of Canada's 2% target, making further interest rate cuts in the near term unlikely.
- Looking ahead, markets continue to balance resilient corporate performance against uncertainty in trade policy, interest rates, and global political developments.

Economic Highlights

Economic activity in Canada continued its pattern of slow growth into early 2026. Consumers remain cautious, and uncertainty around US tariffs and the renegotiation of the Canada-US-Mexico free trade agreement (CUSMA) continues to hold back business investment and hiring.

Canadian exporters are continuing efforts to reduce their reliance on the US market, although progress remains gradual. Commodity exports, particularly precious metals, continue to provide support, but the economy remains heavily exposed to US demand and policy decisions.

Consumer spending in Canada remains flat, with buyers cautious about the economic uncertainty and still-high prices. This caution is showing up in residential real estate as

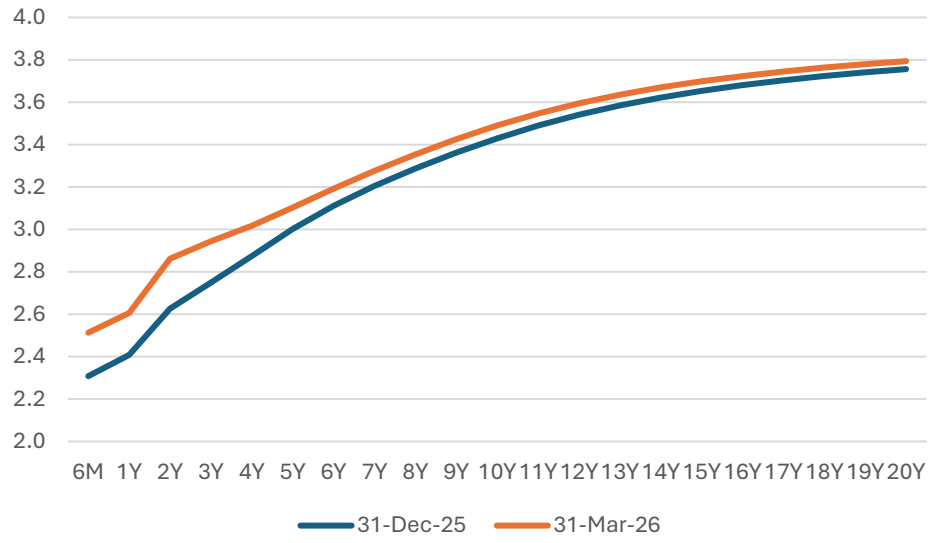
well. Surveys suggest that Canadians continue to favour domestically produced goods where possible.

The weak economy has taken a toll on the job market. Job growth has slowed, and with more people looking for work, the unemployment rate has moved into the 6.5% – 7% range, above pre-pandemic levels.

Conflict in the Middle East has reversed some of the improvement in inflation that we saw in 2025. Last year, the prices of goods fell while the cost of services (like housing) remained stubbornly high. In Q1 2026, the pattern flipped: services costs have eased somewhat, but goods prices are rising again – partly because conflict-related disruptions have pushed energy prices higher. Given this reversal and continued uncertainty about how long energy prices will stay elevated, it unlikely that the Bank of Canada will cut rates further in the near term.

A note on interest rates and bonds: When interest rates rise, existing bond prices fall (and vice versa) – because newer bonds issued at higher rates become more attractive by comparison. Figure 1 shows the interest rates on Government of Canada bonds across different time horizons (called maturities). Rates rose modestly across the board in Q1, which put downward pressure on bond prices and limited returns.

Figure 1. Government of Canada Yield Curve, Dec. 31, 2025 to Mar. 31, 2026 (%)



Source: Bloomberg

Longer-term interest rates remain elevated, reflecting investors' concerns about government borrowing, inflation and global bond market conditions. These higher long-term rates continue to affect borrowing costs across the economy, including mortgages and business investment.

The key driver of rising energy prices in Q1 has been the escalation of conflict in the Middle East, which disrupted oil supply and shipping routes, particularly through the Strait of Hormuz. Higher oil and gas prices increase transportation and logistics costs and feed directly into the price of many goods and services.

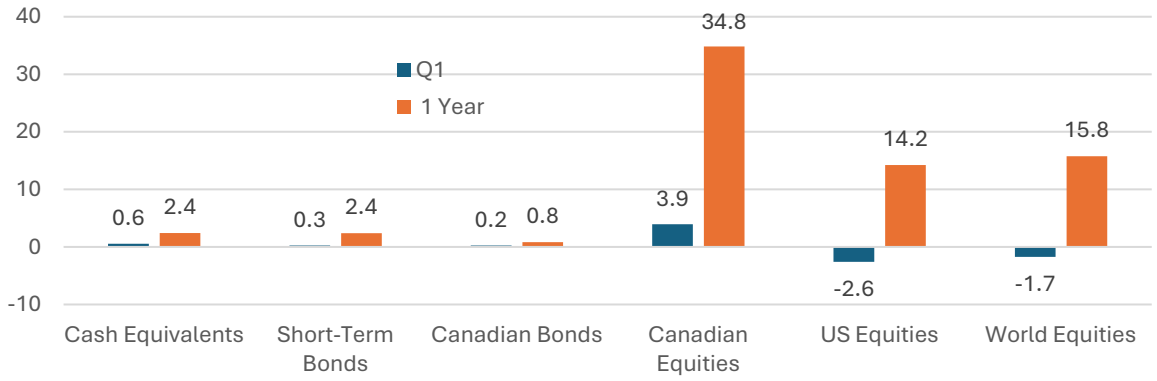
In addition, energy and petrochemical products are critical inputs in the production of fertilizers, industrial materials and everyday consumer products from plastics to pharmaceuticals – so the effects are broad. These pressures may take time to show up in consumer prices but represent a clear upside risk to inflation over the coming quarters.

This dynamic raises the possibility of stagflation – a situation where higher costs push prices up at the same time that growth slows down, creating a difficult combination for both households and policymakers. The longer the Middle East conflict persists, the greater this risk becomes.

Market Highlights

Reflecting the rising risks of inflation or stagflation, financial markets finished Q1 close to flat.

Figure 2. Returns from Key Asset Classes (%, in Canadian dollars) as at March 31, 2026



Source: eVestment

Stocks (Equities): After solid gains in 2025, stock market returns slowed or reversed in Q1.

Technology and AI-related companies remain important drivers of earnings expectations, with financial, industrial, and resource sectors also contributed positively

That said, stock valuations – particularly in the United States – remain high by historical standards, suggesting that while further gains are possible, markets may be more sensitive to changes in interest rates and earnings expectations.

Canadian equities benefitted from strength in energy prices, which helped offset a partial reversal in gold and silver prices as some investors locked in earlier gains. Overall, Canadian equities came out slightly positive in Q1.

Bonds: Short-term bonds held up relatively well, supported by lower central bank rates and relatively attractive yields. Longer-term bonds continue to face pressure from concerns about government borrowing and inflation, despite offering higher yields than short-term bonds.

Corporate bonds (debt issued by companies rather than governments) remained relatively stable. Corporate balance sheets appear broadly healthy, keeping the extra interest or “spread” that corporate bonds pay over government bonds relatively narrow. However, spreads could widen (meaning corporate bonds would become relatively cheaper) in the event of slower growth or heightened market stress.

Outlook and Conclusion

The outlook for 2026 remains uncertain, with several forces pulling in different directions.

On the positive side, Canada and other major economies continue to grow, however slowly. Consumer spending, while cautious, has held up. Stocks could continue to do well if corporate profit growth remains strong. Expectations that artificial intelligence will support productivity and long-term growth also continue to support market confidence. Notably, stock markets in Q1 showed a tendency to rally on good news, suggesting that investors remain broadly optimistic.

At the same time, elevated energy prices could keep inflation higher for longer and weigh on economic growth. Trade uncertainty remains high, particularly as CUSMA renegotiations begin and US tariffs continue to affect key Canadian sectors, including forestry, steel and aluminum.

For bond markets, the path forward will depend heavily on inflation. If energy prices stabilize and inflation eases, bonds could perform well. But if inflation stays elevated or concerns about government borrowing grow, bond prices could come under pressure.

As always, Encasa remains committed to helping investors align their portfolios with their objectives, time horizons and willingness and ability to bear risk. If you have questions about your portfolio or the Encasa Funds, please contact your Encasa advisor.

Encasa Fund Results (%, as at March 31, 2026)[1]

	QTD	1 Year	3 Years	5 Years	10 Years	Since Inception[2]
Encasa Canadian Short-Term Bond Fund	0.2	1.9	3.8	1.4	1.5	2.5
FTSE Canada Short Term Overall Bond Index	0.3	2.4	4.3	2.0	2.0	3.1
Encasa Canadian Bond Fund	-0.1	0.3	3.0	0.1	1.1	3.2
FTSE Canada Short Term Overall Bond Index	0.2	0.8	3.5	0.7	1.8	3.8
Encasa Equity Fund	4.1	29.0	22.9	13.2	11.3	9.2
Encasa Equity Fund Benchmark[3]	0.3	22.2	19.5	13.9	12.3	10.5

Encasa Canadian Short-Term Bond Fund

The Short-Term Bond Fund delivered a return of 0.2% for the quarter, bringing the 1-year return to 1.9%. For comparison, the Fund's benchmark, which doesn't include fees or expenses, delivered a return of 0.3% for the quarter and 2.4% for the year.

In Q1, the Fund held more Corporate and Provincial bonds and fewer Federal bonds compared to the benchmark. At the end of the quarter, the portfolio's overall interest rate sensitivity was slightly greater than the benchmark's.

As at March 31, the Fund's yield to maturity (expected return if bonds are held to maturity) was 3.3%, compared to 3.2% for the benchmark.

Reflecting Encasa's commitment to Responsible Investment, 28.3% of the Fund's portfolio was invested in Sustainable Labelled bonds (bonds that help fund environmentally or socially beneficial projects), compared to 4.2% for the benchmark. The Fund also had a lower carbon intensity, with carbon emissions relative to company revenues 83% lower than the benchmark[4].

Encasa Canadian Bond Fund

The Canadian Bond Fund declined 0.1% in the quarter, bringing its one-year return to 0.3% after fees. The Fund's benchmark, which doesn't include fees, returned 0.2% for the quarter and 0.8% over the past 12 months.

During the quarter, the Fund invested more in Corporate and less in Federal bonds compared to the benchmark, with Provincial bonds roughly in line with the benchmark. The fund increased its interest rate sensitivity slightly during the quarter, expecting a

reversal in the rise in interest rates. At the end of the quarter, the Fund's yield to maturity was 3.9%, compared to 3.7% for the benchmark.

Consistent with Encasa's commitment to Responsible Investment, 35.0% of the Fund's portfolio was invested in Sustainable Labelled bonds, compared to 4.4% for the benchmark. The Fund's carbon intensity was 54% less than the benchmark's[5].

Encasa Equity Fund

The Equity Fund rose by 4.1% in Q1, bringing its return for the one-year period to 29.0% after fees. The Fund's benchmark, which doesn't include fees, returned 0.3% for the quarter and 22.2% for the year.

The Fund's geographic mix (how investments are spread across different countries) remained close to the benchmark's over the quarter. Stock selection added value in the quarter. The portfolio's focus on high-momentum companies (those with strong recent performance) was a positive factor once again. Exposure to commodity related companies was a mixed picture; for example, holding the shares of energy companies that pass Encasa's Responsible Investment screens contributed positively, but the gold stocks that had contributed strongly in 2025 were down slightly in Q1.

At the end of Q1, the Fund had slightly more exposure to Canada and the US than its benchmark, and a smaller share invested in markets outside North America. The Fund continues to focus on companies with strong fundamentals and growth potential.

Consistent with Encasa's commitment to Responsible Investment, the Fund continues to avoid companies with controversial business practices or industries. The Fund's carbon intensity (measured as carbon emissions relative to revenues of reporting companies in the portfolio), was 55% less than the benchmark[6].

Concluding Note

2025 showed that markets can deliver solid returns even during periods of major disruptions and risks. As 2026 begins, uncertainty remains, including the possibility of further changes to US trade policy, the need to renegotiate CUSMA, ongoing geopolitical tensions and market valuations that already reflect optimistic expectations for corporate earnings and AI-driven growth.

As always, volatility is possible – and as always, the best way to manage that risk is to ensure that your portfolio is well matched with your goals, time horizon, and comfort with market fluctuations.

If you have questions or concerns, please contact your Encasa advisor.

Endnotes

1. Rates of return assume reinvestment of all distributions, after deduction of fees. Returns are annualized for periods of greater than one year.
2. Inception date Jan. 1, 2003.
3. Prior to July 1, 2020, the benchmark for the Encasa Equity Fund was 70% S&P/TSX Composite Index and 30% MSCI World Ex-Canada Index.
4. Based on portfolio's estimated weighted average carbon intensity of 21.9 tCO_2/$M revenue for reporting issuers, compared to 132.0 for benchmark.
5. Based on portfolio's estimated weighted average carbon intensity of 114.8 tCO_2/$M revenue for reporting issuers, compared to 242.4 for benchmark.
6. Based on portfolio's estimated weighted average carbon intensity of 47.7 tCO_2/$M revenue for reporting issuers, compared to 105.2 for benchmark.

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