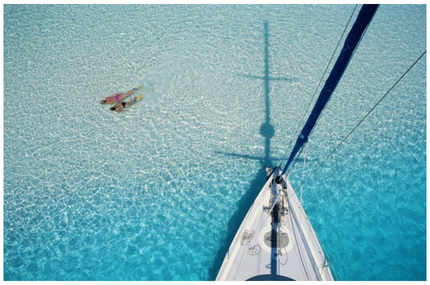
Price Private Wealth
Of RBC Dominion Securities
Investment Quarterly

Wealth Management
Dominion Securities

July 2026: Issue 28



Climbing The Wall of Worry

Financial markets need the reopening of the Strait of Hormuz. This would permit inflation to subside, keep bond yields in check, head off a renewed central bank tightening cycle, and improve the prospects for corporate earnings.

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Market Overview

Major global stock markets have regained most of the ground lost in the February-March plunge triggered by the start of the Iran conflict and the closing of the Strait of Hormuz. The S&P 500, Canada's S&P/TSX, Japan's TOPIX, and the Shanghai Composite Have all now posted new highs. The MSCI Europe is very close to hitting higher ground while the MSCI UK is a notable laggard.

The Taiwan and South Korea stock markets have left everyone else in the dust, surging by 40% and 70%, respectively, in just eight weeks. Chip making, driven by worldwide AI demand, has powered those to big winners and has also accounted for why the S&P 500 has opened up a sizeable gap over other developed markets.

The S&P's standout performance is due to a big upward revision in estimated earnings from a fairly narrow selection of very large-cap tech and tech-related stocks. However, the broader U.S. economy looks to be gaining steam as well. 81% of the companies surveyed by the Business Roundtable expect their sales to increase in the coming six months, up from 74% in the prior quarter. This corresponds with a notable increase in the percentage of surveyed companies planning to increase capital spending and to hire more workers.

This rising U.S. business optimism, combined with improving productivity, low unemployment, and strong GDP growth, suggests that the U.S. economy is not holding its breath waiting for the Strait of Hormuz to reopen.

However, the trajectories of all economies, to one degree or another, depend on when the Strait resumes the normal flow of traffic. Restoring the free flow of shipping would act to lower oil and natural gas prices and remove or reduce the threat of outright shortages of not just oil and gas, but also fertilizers and important industrial chemicals. The longer it takes to open and clear the Strait, the greater the risk of inflation rising further and entrenching itself in the broader economy.

hike Fed tightening cycle would be unlikely to push the U.S. economy into recession or seriously derail the prospects for worthwhile earnings gains this year. That said, a correction of some degree can't be ruled out for the back half of 2026, perhaps in response to Hormuz complications, or to an upside breakout in bond yields, or to the sheer weight of AI expectations.

The outlook for the U.S. market will continue to be dominated by the Artificial Intelligence juggernaut. The unprecedented spending on the part of the mega-cap hyperscalers is undeniable. While few businesses can so far point to any sustainable return on investment from these expenditures, that won't stop or slow the spending because of what most businesses perceive as the unacceptably high cost of being left behind. But at some point, returns will be needed to justify the AI expense.

Meanwhile, at the halfway point of 2026, global bond markets are lagging the already low expectations we held at the start of the year. Not only have many major global bonds failed to earn their coupons, but rising bond yields also have pressured prices lower to such a degree that declines have more than offset coupons earned, putting total return performance modestly in the red year to date.

While the Middle East conflict is no small issue, we see it as just another tree in a forest of reasons that has pressured global yields higher not just this year, but for many years running at this point. Nearly all developed market 30-year government bond yields are at or near 20-yeear highs. We think markets are pricing a bigger confluence of factors as driving this trend, and these factors largely point in the same direction – higher yields still.

The technology hyperscalers are issuing massive amounts of debt and equity to raise funds for the ongoing AI buildout, and governments continue to issue massive amounts of debt to fund ongoing deficits, with rising defense costs likely to compound these deficits. The demand for capital is increasingly overwhelming the supply of capital, as savings rates decline and aging population pivot from saving money to spending it.

Where might it end? We would concede that we don't have a high-conviction view on that front. But the answer is likely some degree of *higher*.

Canada

Volatility gripped the S&P/TSX Composite during H1 2026, with the index experiencing a temporary pullback following the onset of the conflict in Iran. However, it took fewer than 30 days to recover the 9% drawdown, and then the index continued marching higher to all-time highs in early June. Looking ahead, the Canadian market continues to face lingering volatility risks stemming from perceived AI-driven disruption, Middle East tensions, and the ongoing tariff uncertainty as USMCA renegotiations play out.

Meanwhile, recent macroeconomic data has painted a mixed picture of the Canadian economy. In Q1, GDP contracted by 0.1% on an annualized basis, significantly below the 1.5% growth expectation. This was the second straight quarter of negative growth, which satisfies the technical definition of a recession, and economic output has contracted for three of the past four quarters.

Market pricing implies one rate hike from the Bank of Canada this year. However, uncertainty continues to weight on the nation's economy. We think the BoC is most likely to remain on hold until at least the end of the year.

United Kingdom

The UK is facing some specific headwinds, such as the change in Prime Minister, with Andy Burnham being the most likely replacement. Burnham is perceived as being less market-friendly, as he has expressed support for nationalizing utilities and introducing asset-based taxes. His policies seem likely to result in more government borrowing, in our opinion.

The debate over who will be the next Prime Minister masks an even greater uncertainty over who will win the next election, due in 2029, as the two traditional Labour and Conservative parties, which split 57% of the vote in 2024, only amass 37% in total in recent polls.

It's difficult to see the UK fully emerging from the gloom of political uncertainty over the coming months. However, when global equity market conditions seem stretched in the areas Britain is not exposed to, such as Information Technology and AI stocks specifically, we believe there is potential for outperformance as has been the case during such periods in previous years.

The UK is facing an energy price shock when softer consumer demand and a less tight labour market, in our view, are reducing the risk of higher prices feeding through into broader wage pressures as was the concern three years ago. Our base case is one rate hike from the BoE this year, as inflation returns to the BoE's 2% target, accompanied by modest second-round wage pressures and weak growth. We note that longer-dated market inflation expectations currently remain well anchored, with markets treating the energy shock as largely transitory, limiting the risk of persistent second-round effects

Currencies

U.S. dollar: Resilience amid Middle East conflict

While April's ceasefire announcement temporarily pressured the dollar by reducing demand for its perceived safety, the greenback stabilized somewhat in Q2 on resilient U.S. economic data and anticipation of an interest rate hike from the Federal Reserve (as opposed to earlier expectations of a cut). A potential U.S.-Iran peace deal presents downside risk, but higher Treasury yields could keep the dollar supported in H2 2026.

Canadian dollar: Technical recession

Canada has entered a technical recession following two consecutive quarters of negative growth. With economic momentum slowing, the Bank of Canada is likely to remain on hold, while rising U.S. Treasury yields continue to support the greenback. This could push USD/CAD above 1.40 through H2 2026, with additional pressure on the loonie anticipated around July's review of the USMCA trade agreement.

British pound: Consolidating around 1.35 USD

The pound is consolidating around 1.35 against the dollar as competing forces offset each other. Political uncertainty surrounding leadership presents a headwind, but anticipated Bank of England rate hikes provide support. We expect GBP/USD to remain range-bound between 1.32 and 1.37 through H2 2026, with the outcome dependent on the relative weight of political developments versus monetary policy expectations.

Commodities

Gold

The price of gold rose modestly through the first half of the year, even while contending with significant volatility, as the risk of rising inflation (and therefore, potentially higher interest rates) weighed on investor sentiment. RBC Capital Markets is still constructive on higher gold prices beyond the short term as central banks remain consistent buyers, and forecasts a 2026 average price of $4,564/oz.

Copper

Copper prices have trended higher through the first half of the year as mine supply has remained constrained and Chinese demand has been strong. Furthermore, sulfur shortages in the Middle East as well as lower copper grades and adverse weather conditions in Chile are likely to keep prices elevated in the near term. RBC Capital Markets is forecasting 2026 and 2027 prices of US$5.83/lb. and US$6.00/lb., respectively.

Oil

Discussions between Iran and the U.S. have consistently given false signals about a resolution to the conflict impacting the Strait of Hormuz. With Iran's uranium enrichment capabilities and stockpiles remaining a focus for the U.S., many in the shipping industry believe an Iranian military defeat is likely the prerequisite for a full recovery of maritime traffic. RBC Capital Markets is forecasting WTI to average at US$83.63/bbl for 2026, before dropping to US$76.72/bbl in 2027.

The Unstoppables

Diversification in today's market is increasingly non-existent. These themes should provide portfolios with differentiated investable opportunities capable of delivering long-term compounding of sales, earnings, and share prices for decades.

The current market environment creates the illusion of diversification across indexes that increasingly share the same underlying AI-related risk factors. Real diversification in investor portfolios today means genuine separation from that exposure. Some investment opportunities are built on structural forces powerful enough to transcend the noise of today's investment environment. Here, we highlight two megatrends that we believe will emerge as defining forces for the coming decades. Both of these are driven by demand imperatives that show no signs of abating. For at least the next two or three decades, we believe they are likely to provide a reliable, exploitable tailwind for portfolios. These are "The Unstoppables:"

Advanced Medical Technology

Roy Amara, an American scientist and futurist, observed what came to be know as Amara's Law: we tend to overestimate a technology's impact when it first arrives on the scene, but underestimate what it actually delivers a decade or so later. The medical sector illustrates the different facets of Amara's Law.

The CRISPR gene-editing technology was heralded as a potential cure for genetic diseases when it emerged in the early 2000s, winning its developers a Nobel Prize, before disappointing as costs ran into the millions per patient and progress stalled. After more than a decade, the first approved CRISPR-based therapy for humans arrived in 2023 for sickle cell disease, though it remains beyond the financial reach of most patients for now. CRISPR-based technologies are also providing new therapeutic avenues for beta thalassemia and there is early promise from a small trial that has showed a dramatic slowing in the progression of Huntington's disease, regarded as incurable. Also of note, following the injection of CRISPR-modified pancreatic cells into an individual suffering from Type 1 diabetes, the patient's pancreas produced normal insulin for more than a year without rejection.

Health Care, and particularly Biotech and Pharmaceuticals, could enter the AI winners basket over the next 1-2 years. RBC Capital Markets estimates that AI could unlock ~$90 billion in cost savings across U.S. pharmaceutical companies over the next five years. The opportunity spans the value chain: AI-driven drug discovery can collapse pre-clinical timelines by 30-40% and reduce failure rates, clinical trial optimization through patient identification and adaptive designs could cut development costs 20-30%, and manufacturing/supply chain efficiencies via predictive maintenance and demand forecasting offer margin expansion of 200-300 basis points.

Early movers in the pharmaceutical industry are already demonstrating proof-of-concept with AI designed molecules entering clinical development 2-3 years faster than traditional approaches, while AI-enabled trial recruitment has accelerated enrollment 40%-plus in recent studies.

Meanwhile, the global population of people 65 years and older will approach 1.6 billion by 2050, according to the UN. Given thee onerous costs and the fact that up to 20% of life is spent battling chronic diseases in later years, this surging wave of retires has an increasing appetite for therapies and products promising to lengthen healthspan (i.e., the number of years a person lives in good health).

Early disappointment has not always been the end of the story. Medical advancements tend to retain their momentum, and with AI accelerating progress across several fields simultaneously, we believe the long-term potential of today's technologies is likely to surprise on the upside.

Defense Tech

Higher defense spending should persist for years largely due to the ongoing transition from a U.S.-led Western unipolar order to what is often described as a multipolar or polycentric world order. Sole U.S. dominance of global affairs, which had characterized much of the post-Cold War period, is morphing into a new framework where regional alliances have significant influence over global affairs.

The tension between the unipolar and multipolar frameworks could play out for many years or even a couple of decades. The transition is already proving to be turbulent and disorderly. The Russia-Ukraine war; the U.S. special forces raid in Venezuela' the U.S./Israel war in Iran; and the Trump administration's attempt to assert more control over global energy flows and shipping lanes are among the initial dominoes to fall.

Amid this transition, major, middling, and some smaller military powers seem committed to robust weapons spending and, in many cases, expanding their armed forces. The U.S. is calling upon Europe, Canada, Japan, and South Korea to shoulder more of the defense burden. Even Germany and Japan are pushing against foundational post-World War II agreements that limit re-militarization.

For starters, the U.S. and European NATO countries seek to rebuild stockpiles of existing weapons systems due to significant depletions during the wars in Ukraine and Iran. A study published by the Washington D.C.-based Center for Strategic and International Studies think tank in May 2026 estimates that it could take years to replenish U.S. stockpiles; Pentagon leadership has acknowledged this. It follows that U.S. resupplies to Europe, Japan, and South Korea could take even longer, in our view.

Additionally, and importantly, major military powers and some others are prioritizing the development of advanced precision weapons systems, drones, and autonomous vehicles, which we think will be in high demand in the future.

Long-Lasting Diversification

There's plenty we don't know about how the world's economy is going to play out over the next 30 years. But there are several aspects where we can identify demand imperatives likely to be in play for at least the next few decades driven by: unavoidable demographics, the fruits of advances in biology and life sciences, and the inevitable global geopolitical frictions arising from the fracturing of the unipolar world into a multipolar one that is very much in flux.

Identifying reliable long-term sources of demand growth should point the way toward investable sectors and industries that provide the prospect of long-term compounding of sales, earnings, and share prices, while providing investors with real sources of diversification in today's concentrated markets.