

Markets Made Simple

Chan and Brown Wealth Management



Wealth Management
Dominion Securities

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EROSION

Verið velkomin til Íslands! Countless waterfalls, the largest glaciers I have ever seen, picture-perfect coastlines, rolling green hills with freely roaming horses that looked like they had wandered out of a storybook. It was the closest to heaven (since an emergency appendectomy on a Texas trip), that I've ever been.

My dad and I were in Iceland, a few hundred kilometers from the Arctic Circle and only 300 km from the US annexation target of Greenland, in the middle of a 10-day road trip that would take us over 1,300 kilometers around the perimeter of the island. We had already walked through lava tubes, hiked over bubbling earth and I had taken so many photos my phone was flashing "iCloud Storage Full".

The land of ice and fire, Iceland is a place of extremes. Over millions of years, glaciers and volcanoes have shaped the unique landscape to a physical representation of that famous line "when hell freezes over" that many men have heard after trying to convince their wives about the benefits of getting a Harley Davidson motorcycle or buying a set of new golf clubs. In the summer the sun barely sets, and in the winter, it barely rises. Outside of a few main towns near the airport, civilization quickly fades. As you drive, the towns get smaller, the distances grow longer, and eventually it's just you, the open road, and some of the most breathtaking views on earth.

As we get older, we start to realize something important: small things don't stay small. An extra dessert here, a second glass of wine there, skipping a workout or two, it all adds up. One day your clothes feel a little tighter and you blame the dryer. A few months later, you suddenly realize what a comfortable fashion statement sweatpants make.

Cars follow the same principle, as I found out on our visit to the rental car agency in Iceland. At the counter, the attendant smiled and said, "I'm going to upgrade your vehicle today." Naturally, I assumed it was my undeniable charm working on the cute girl at the front desk.

That illusion lasted about two minutes until we got to the car. It was something like a Dacia made in Romania and looked like it had been put together from an Ikea furniture assembly manual by political prisoners in a gulag. If this was an 'upgrade,' I think the standard vehicle must have been the Flintstones car.

The journey to get into the country hadn't helped. A delayed red-eye flight followed by a two-hour wait at the rental counter (they probably misplaced one of those little Allen wrenches as they worked to put our car together), had left us exhausted, behind schedule, and in no mood to negotiate for a real car.

As we lurched out of the lot, my dad took one turn, paused, and said, "This car handles even worse than it looks..." Yikes!!!

This 'upgrade' was about to give us a masterclass in what happens when small problems are ignored for too long.

The Silent Killer

Since COVID we've all experienced inflation. Some related to prices and others around our waistlines. A few years ago, my brother and I were having lunch at an Indian restaurant in Chilliwack. At the order counter was a photo of their combo plates and we both ordered one. When the food came a dish was missing and I asked the server if it was coming separately.

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She looked at me...shook her head 'No' and said... "Inflation."

Like our pants, inflation is causing us to "stretch" our savings farther and farther.

Since 2005 inflation has averaged 2.2% per year. It doesn't sound like much until you realize that the rolls of cash wrapped up in your dresser drawer hidden under your socks for a "rainy day" fund, quietly lost over 60% of its purchasing power over the last two decades and may not even be enough to cover for a light drizzle.

For most of our lives, inflation stayed low enough to ignore. But in 2022, for the first time since the days of disco and bell bottoms, it surged toward double digits. Suddenly, dinner conversations changed from real estate and the Canucks (fans still had hope that year) to grocery bills that felt like they were priced by luxury brands with Whole Foods being renamed Whole Paycheque.

Prices weren't just creeping up, they Artemis II rocketed up. Groceries, gas, and dining out, everything became more expensive. Our wallets rang with the 1960 Ronnie Dove Song "That Empty Feeling".

Central banks realized that inflation, like Cousin Eddie from the Chevy Chase Vacation movies, was overstaying its welcome. To deal with it, central banks reacted by raising rates and reducing the money supply to cool down an overheated economy. As those changes worked their way through the system, prices came back under control.

Time went on, and inflation slipped from the headlines and from our attention.

When inflation is high it is top of mind. When it is low we forget it exists, but it doesn't go away. Inflation doesn't need to spike to do damage...it just needs time to erode our savings like the ocean tide erodes a shoreline cliff. One day you have ocean front property, the next day it's a boathouse.

Back in Iceland, time was not on our side. We were halfway through the trip when my dad, who was tired of driving, offered me the wheel. There was just one small issue...the car was standard, and I never learned to drive stick!

What followed could best be described as mechanical aggravated assault. We pulled into an empty parking lot, switched seats, and for the next two minutes the car was jerking and lurching like a ride at the PNE, making noises that sounded like fingernails on a chalk board (do they exist anymore?) and made your skin crawl like a Stephen King novel. Then followed the smell, a strong, unmistakable burning like the soul of the car was leaving its body for a bad place.

My dad got back behind the wheel and as we returned to the road, he said, "Son, you are amazing... you trashed the clutch on our car in two minutes AND on your first try." I guess that was impressive in its own way...our already questionable 'upgrade' had now been "promoted" ...to fragile.

Inflation

Modest inflation doesn't feel dangerous because it doesn't hit all at once. It slowly chips away and erodes a little each year of your buying power. By the time you notice it, the damage is already done. Remember when McDonalds used to advertise a hamburger, fries and a drink for \$1 with change back?!? The only thing you can now buy at McDonalds for a \$1 is a small coffee... but only if you are a senior. At least the "smiles" are still free. At this point, I would gladly trade a small McDonalds coffee for our rental car.

Now the car entered what I can only describe as its pre-retirement phase, everything takes more effort, motivation level is that of a sloth on a sunny day and mobility has reached the agility of a beached starfish. Every gear change was a negotiation, accelerating required patience and stopping was to be avoided at all costs because starting again may require divine intervention. A warning light flashed on the dashboard, a large triangle with an exclamation mark, accompanied by the words : **Vélarljós** and **Hætta** which we didn't know at the time meant "Engine Light" and "Danger/Stop" in Icelandic.

The car began making new noises. Not better noises, just... new ones, sounding like a baby zebra squealing as it is being devoured by hyenas. We, like the zebra, were on borrowed time.

The Middle East

On the other side of the world, tensions escalated sharply as the US and Israel launched attacks on Iran targeting nuclear and missile infrastructure at the start of 2026. As the conflict intensified, Iran responded by closing the Strait of Hormuz, one of the most critical oil routes on the planet, responsible for roughly 20% of the global supply.

The result? Surging worldwide energy prices and locally here in BC, gas stations started offering payment plans for a fill up as prices jumped from \$1.30/litre to over \$2.10/litre. Employers now consider the option to work from home equivalent to a 10% raise. As the cost of energy percolate through the economy impacting everything from travel to food prices, the topic of rising inflation is once again at the forefront of conversations.

Wars, Oil and the Market

I love history, it’s full of lessons, adventures, and stories, and it often provides the best roadmap for the future. As Mark Twain put it, “History doesn’t repeat itself, but it often rhymes.”

Looking at past conflicts between countries and the impacts on markets, equities tend to react negatively in the short-term, but the effects quickly fade. Across 41 major “acts of war” since 1940, the S&P 500 has declined by an average of about 3% before recovering within a matter of weeks. In other words, although markets may panic briefly, they don’t tend to stay scared for long.

The bigger implication for markets today is high oil prices. With 2/3rds of our economy dependant on consumer spending, rising energy prices start to act like a tax, leaving less in people’s pockets. When consumers pull back, the risk of a recession begins to rise. These slowdown fears have already weighed on markets with Canadian and US equities pulling back by 10% or more from their 2026 peaks.

	S&P 500 Peak to Trough	US 10-year yield change (bps) from S&P 500 peak to trough	Gold change from S&P 500 peak to trough	DXY change from S&P 500 peak to trough	Crude oil (WTI) change from S&P 500 peak to trough	Trading days of S&P 500 decline	Trading days to S&P 500 recovery
Acts of War (median of all 41 events)	-3.0%	0	1.5%	0.3%	0.7%	5	12
U.S. Aggressor (median of 13 events)	-1.4%	9	-1.0%	0.5%	0.3%	5	11
U.S. Target (median of 6 events)	-5.2%	-6	1.1%	-1.9%	0.8%	10	12
Assassinations (median of 2 events)	-0.6%	0	n/a	n/a	n/a	2	2
External (median of 11 events)	-5.4%	17	3.3%	0.5%	2.5%	13	18
Terrorism (median of 9 events)	-3.0%	-4	3.4%	-0.2%	-3.9%	5	12

Protecting the Portfolio

We continue to follow a disciplined approach owning assets that offer strong long-term returns while focusing on downside protection during periods of volatility and market drawdowns.

In the beginning of 2026, before market volatility spiked, we positioned the portfolios to insulate against some of the biggest risks facing investors. We took profits in several areas and rebalanced toward more defensive investments with stronger valuations and better long-term upside.

Some of the changes included trimming our gold equity exposure after a gain of over 175% in 2025, reducing preferred share holdings that had risen nearly 50% since 2024, and exiting Canadian Financials following gains of over 40% last year. We also sold a note linked to the performance of the six major Canadian banks, which had appreciated more than 90% over the three years that we held it.

With valuations elevated in these areas, we redeployed capital into more attractively priced opportunities like industrial companies such as CP Rail and Cargojet, US small and mid-cap equities, and defensive positions like Northland Power.

This approach is consistent with our actions in early 2025 where we also shifted away from areas of heightened risk, resulting in less impact on our client's funds during the market sell-off following 'Liberation Day'. We were able to benefit from the subsequent market recovery and went on to deliver strong results for the remainder of the year.

Similar to the theme of Rocky Movies, hero defeated, reflect on need to change, comes back and wins, we have seen the pattern in the today's volatility back in 2022, 2023, and 2025. In each case, our approach helped preserve capital during periods of stress and position ourselves to come back and to take advantage of opportunities that often emerge during periods of uncertainty and earn a strong return for our clients, defeating the Apollo Creed of 2022, Clubber Lang of 2023 and Ivan Drago of 2025. Side note, Dennis' favourite music of these movies is from Rocky IV with workout inspiring songs such as "Hearts on Fire" and "Burning Heart". He calls it oldie sweating to the oldies.

The Cost of Safety

With increasing market volatility, investors have started eyeing GIC's like Garfield the cat eyes lasagna (...nature's most perfect food and why sweatpants were invented...).

The best GIC rates today are around 3%. When you consider that Canada's long-term inflation rate has also averaged around 3%¹, your investment is stuck in a zero-sum game, in the best-case scenario. Add taxes into the mix, and things get even bleaker. In British Columbia the top marginal tax rate is 53.5% and even an average income earner is looking at losing between 25-30% of their earnings to tax. That means investors in GIC are looking at a way smaller slice of lasagna than they thought they were going to get.

Record government deficits and spending with no plans to rein them in have increased the risks of higher inflation in the future and lessen their ability to mitigate the impact on consumers. There are real costs to seeking 'stability' in volatile markets and how inflation is eroding our savings ability to meet our financial goals, like how the Icelandic roads were eroding our rental car's ability to get my dad and I to our destination goal.

You know when you think things can't get any worse and then the Universe laughs and shows you differently? We found one of our tires leaking air on Day 6 of our trip. Apparently, there are no boy scouts in Iceland so the motto of being "always prepared" was lost on rental car companies. There was no spare tire. We were now driving through increasingly remote areas, towns that were hours apart, often consisting of a gas station, a small store, some sheep and not much else. We could ask the sheep for help, but they are baaaaad at fixing flats.

Our solution was simple, fill the tire with air and hope it lasted long enough to get us to the next stop. Repeat as necessary, basically doing the reverse of bailing out a leaky raft in shark infested waters before it sinks.

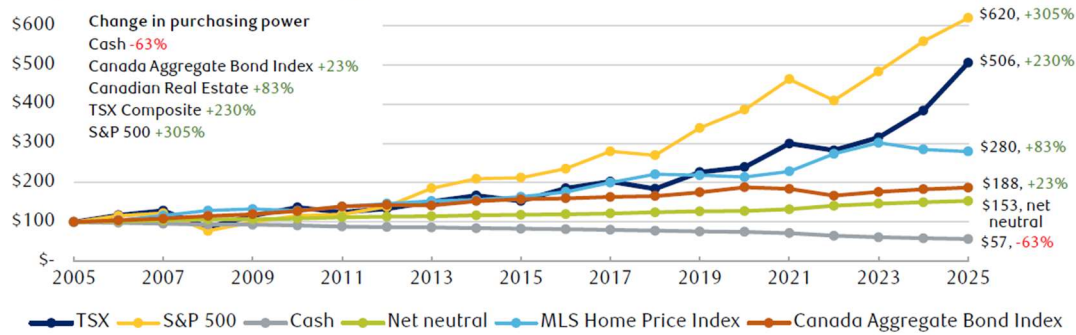
At this point, our road trip had turned into a strategic operation. We timed stoplights to avoid coming to a complete stop and stop signs in general became more of a suggestion. We mapped out gas stations like oasis lifelines in a desert and as our traffic violations piled up, our final challenge approached: driving through Reykjavik, where 60% of Iceland's population lives. Traffic. Intersections. Stoplights. Roundabouts. Everything our car was no longer equipped to handle. It felt less like a drive and more like playing Mario Kart...Woohoo! Let's-a-go! Waah haa haa!

Protecting Against Inflation

Since 2005 cash lost 63% of its purchasing power. Cash is not the answer to inflation erosion. The chart on the next page shows the different asset classes and their returns from 2005 to 2025 after inflation. If you made 5% one year but inflation was at 4%, your real return after inflation is 1%, which is roughly enough to buy a McDonald's coffee.

¹Long-Term Inflation in Canada: <https://tradingeconomics.com/canada/inflation-cpi#:~:text=Inflation%20Rate%20in%20Canada%20averaged,percent%20in%20June%20of%201921>

Sitting on cash can shrink purchasing power



Source - RBC Wealth Management, FactSet, Canadian Real Estate Association

There are a number of different options to address inflation: bonds, stocks or real estate.

Bonds: Over the past twenty years, bonds have generated a total return of about 23% after inflation, or less than 1% annually. About as appealing as paying Elias Petterson \$10 million to generate less than 20 goals a year, same as teammate Linus Karlsson who earns \$2.25 million a year.

Canadian Real Estate: Slightly better. Over the same period, real estate delivered an 83% real return, or roughly 2.3% annually after inflation. Of course, this does not include the cost of property taxes, maintenance and upkeep or the potential to be under 6 feet of water if you are in Chilliwack.

And the clear winner...Stocks: \$100 invested in the Canadian stock market would have grown to about \$506 over 20 years for a real return of roughly 230%. In the US, that same \$100 would have grown to around \$620, or over 300% after inflation. 20 years may seem like a long-time, but that’s the length of the average retirement².

From 2005, we have lived through a wide range of economic shocks: the worst financial crisis and US housing crash since the Great Depression in 2009, the Eurozone debt crisis that nearly destabilized Spain, Portugal, Italy, and Greece, China’s stock market falling over 40% in 2015, Brexit, COVID, the inflation and rate-hike cycle that followed in 2022, the Russia-Ukraine war, the US banking crisis, and more recently, renewed global trade tensions and geopolitical uncertainty and the 6 week long (so far) war in Iran also called “a short term deal” by the US president. Cash and GICs may feel safe in the short term, but over time, the erosion of purchasing power becomes impossible to ignore.

Why have stocks historically been such a strong hedge against inflation? Unlike bonds, which pay fixed coupons over their term, stocks represent ownership in businesses that increase prices and sales, leading to higher revenues and earnings over time. For example, a 30-year bond yielding 5% will pay the same \$5 every year on a \$100 investment for three decades, regardless of what inflation and prices do in the meantime. That said, we do own fixed income strategies have a floating rate and adjust the rate they pay to inflation providing the same real coupon rate of return over time.

Inflation like sitting under a coconut tree, doesn’t need to be dramatic to be dangerous, it just needs time. As my dad and I began the final stretch back to the airport, we weren’t entirely sure we had enough of it on our side. Each red light wasn’t just an inconvenience; it was a risk. Every time we had to come to a complete stop, there was a very real chance that it would be final one. And if it did... we weren’t exactly in a position to push it through city traffic, more accurately...”I” wasn’t in a position to push as my dad decided he would be the one to steer since I was young and healthy.

Our plan: Leave early with minimal traffic, pick a route with the fewest stops and pre-map every gas station to refill our tire that was losing air faster than my hope of ever seeing the rental kiosk again. It felt less like a drive to the airport and more like we were in a survival documentary. I can hear David Attenborough’s (narrator for series such as March of the Penguins) voice speaking: “See the father and son...Canadians...lost in the wilds of a harsh unfamiliar land, striving to find their way home...as around each corner, lurk unsuspecting Icelanders readying to cross the street unaware that these funny looking foreign intruders...can...not...stop...”

² Scotiabank - <https://www.scotiabank.com/ca/en/personal/advice-plus/features/posts.retirement-planning-101.html>

My dad and I exchanged a final look like Sam and Frodo headed for Mount Doom from Lord of the Rings and got in the car for the final stretch. He turned the key. The car hesitated, then a long pause. It shuddered to life! Not smooth, not quiet, not without the odd rattle and spark...but it was...ALIVE.

It was a silent trip. As we made our way toward the city, every sound felt amplified. The engine was louder. The gear shifts were rougher. The warning light flashing **Hætta!**, **Hætta!**, **Hætta!**, glowing brighter like an overheating furnace with each mile. Every intersection felt like a coin toss, every grinding gear change leaving metal shavings in the road. At one point, the car made a noise like Sauron's roar when the one ring was destroyed. We didn't care as long as the car kept moving.

Finally, the airport was in sight. We rolled in slowly, and my dad put it in park and for a moment, neither of us moved, we just sat there with the music of 2001 Space Odyssey playing in our heads sending us to our final destination.

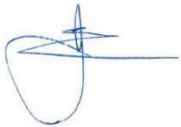
When erosion sets in, small things accumulate. It could be breakdowns in a poorly built rental car, health concerns that are not addressed or money in savings account slowing losing buying power until one day, they become critical and have important consequences. A frog slowly boiling in water is comfortable until it is too late to jump out. So are investments that don't keep up with inflation. They provide the comfort that every time you look at a statement, it is never less than the last time you looked at it, but the invisible killer is the loss of purchasing power that compounds year after year. Protecting that requires thinking beyond what feels safe today and focusing on what holds up over decades.

In 2023, investors could lock in rates around 5% while the economy was dealing with high inflation, rising interest rates, and recession fears. Fast forward just a few years, and those same investors are now looking at a market where the S&P/TSX is up roughly 80%, while the S&P 500 and MSCI EAFE have gained around 60%. The 5% that looked so attractive was the worst performing investment during that period.

It's a good reminder that what feels safe in the moment doesn't always lead to the best long-term outcome. It's the end goal that matters.

We grabbed our bags, walked inside and handed over the keys. The attendant got in, turned the ignition, and glanced at the dashboard. Then he looked up and said, "Great, thanks for bringing it back... this isn't even one of our cars. We borrowed it."

-Kind regards,



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