

# Wealth Management & Capital Markets Perspective



Wealth Management  
Dominion Securities

For the clients of Grimes Handscomb Asset Management of RBC Dominion Securities | Fall 2025

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## Threading the needle

By Jim Allworth

- There is room for equity markets to advance further if investors can remain confident in 2026 projected earnings.
- The above-average S&P 500 earnings gain currently estimated for 2026 will be difficult to achieve in the “slow growth” environment portrayed in consensus GDP forecasts. However, recent, more buoyant data may provoke upward revisions to those GDP estimates, boosting confidence in the earnings outlook.
- Solid employment conditions and no major setback on the AI front are necessary accompaniments to a bullish equity market outlook.
- We look for more new highs albeit at a slower pace with occasional pullbacks/consolidations. We would use today’s elevated valuations to trim equity exposure back to long-term targeted levels.

Last month, we contended that global equity markets would extend their powerful advances that began at the deep “liberation day” market trough set in early Q2. But it would be at a slower pace than the rocket ride from the April lows to early September. As it turned out, several markets, rather than slow down after Labour Day, accelerated. The S&P 500 tacked on another 4% in just 15 trading days. Canada’s S&P/TSX Composite and Japan’s blue-chip TOPIX, both of which have comparatively little representation in the mega-cap AI space, were up by an even stronger 5.9% and 4.5%, respectively.

The peak set over the past few weeks took the S&P 500 to within 6.5% of RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina’s projected target of 7150, which she expects will be reached sometime in the second half of 2026. Just a month earlier, when the S&P 500 was sitting at 6300, the return to that 7150 target was twice that, at about 13%.

What happened over the month of September? Consensus estimates for 2026 S&P 500 earnings per share were mostly unchanged (\$305 vs. \$303), while the (widely expected) rate cut from the U.S. Federal Reserve arrived, marking an end to the central bank’s eight-month pause.

Calvasina’s 7150 target for 2026 assumes two further 25 basis point cuts this year and four more next year. It also factors in inflation coming in at 3% for 2025 and falling to 2.4% by year-end 2026. The same forecasting model, which incorporates the inputs laid out above to generate the 7150 target for next year, could give us even higher

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prospective returns (7460) if the fed funds rate is assumed to move even lower—six cuts next year to 2.5%—and inflation were to sag to 2%.

### Confidence in 2026 is essential

Our view has been (and still is) that as long as investors can be confident another solid earnings gain will be delivered in 2026, the current uptrends for the S&P 500 and for most major equity markets have further to run—occasional pullbacks and consolidations notwithstanding.

Current consensus earnings estimates of \$270 for this year (up 9% y/y) and \$305 for 2026 (up 13% y/y) offer just such a constructive backdrop.

In recent weeks, the majority of earnings estimate revisions for large-cap stocks has been upward. Business confidence has also recently reversed course and moved higher, both for CEOs of large companies and those of small and mid-sized businesses. The very recent revision higher for Q2 U.S. GDP due to stronger-than-previously-reported consumer spending and business investment underscores this improvement in outlook.

### Fed cuts act with a lag

In one sense, this is right on schedule. Monetary policy changes are thought to act on the economy with a six- to 12-month lag. Most market watchers spent the first eight months of this year focused solely on the fact the Fed had not cut the funds rate since last December and on the prospects for when it would resume cutting and by how much. That cut (of 25 basis points) arrived at the Fed's September meeting.

Predictably, the Street's attention has now shifted to prospects for the next cut. Meanwhile, the 100 basis points of rate cuts put in place in Q4 2024 have been working their way into the economy and are now starting to show up in better-than-expected consumer and business spending.

By the same token, the latest Fed rate cut and the further ones we expect this year and next are unlikely to show up as better economic activity much before the second half of 2026. But over the intervening period, Street expectations for moderate economic growth and some further receding of inflation would leave the path open to additional Fed easing and, importantly, would be consistent with some year-over-year earnings gains in 2026.

### History warms to faster GDP growth

The icing on the cake, should it occur, would be a lift in the consensus estimates for U.S. GDP growth to a level firmly in the 2% to 3% range. Today's GDP growth estimates sit at 1.7% for 2025 and 1.8% for 2026. The historical record reveals that a GDP growth rate between 1% and 2% has been associated, on average, with subpar equity market performance. Measured from 1947, such "slow growth" years experienced negative S&P 500 price performance 60% of the time and an average return of -3.4%.

Move that GDP growth rate up to between 2% and 3% and the sun shines much more brightly—in such years the S&P 500 has produced positive returns 71% of the time and an average gain of 7.7%.

It's not out of the question to imagine that the recent upward revision to Q2 GDP growth (to 3.8% from 3.3%) and the energetic pickup in Q3 capital goods orders could provoke some more optimistic expectations among forecasters for next year's GDP prospects, perhaps bumping them up into that 2%–3% range, in the process providing a solid historical rationale for further S&P 500 Index gains in 2026.

### Today's narrative needs staying power

Meanwhile, investors are left threading the needle. We think consensus estimates for S&P 500 earnings growth—up 13% to \$305 for next year—look optimistic for an economy projected to grow, as things stand today, at just 1.8%. And from our vantage point, even were growth to pick up into a higher bracket, important elements of today's positive backdrop would need to remain in gear:

- The employment picture needs to remain solid. So far, unemployment claims and the unemployment rate have been quiet, not surging higher in a way that would put pressure on consumer spending and threaten recession.
- The AI landscape needs to avoid any major setback. In particular, the pace of AI-related capital spending has to remain positive and the earnings outlook for the major providers buoyant. These are tall orders, as we see it, given the dollar amounts in question and the fact that very few corporate adopters of AI have reported any meaningful earnings gains from doing so.

### Things can continue to go right from here

We do expect more new highs in the coming quarters—but the projected earnings gains for 2026 and beyond may require somewhat more optimistic operating and economic growth assumptions than currently prevail to make today's elevated valuation metrics sustainable. That leaves us inclined to think cautiously about portfolio positioning.

A great deal rides on the AI outlook. The relative handful of mega-cap growth stocks driven by the AI story has accounted for much of the earnings growth and value added (i.e., price-to-earnings [P/E] expansion) to the S&P 500 in recent years. But even the P/E ratio for the rest of the index, while not at the rarified levels of the leaders, is nonetheless well above its long-term average.

In our view, this is a time to be committed but not overcommitted to equities. Using today's elevated prices to trim equity exposure back to long-term targeted levels seems an appropriate response. Developing a plan for how to transition to a more defensive posture, if and when called for, sounds to us like time well spent.

# U.S. Recession Scorecard: Stuck...with reduced visibility

By Jim Allworth

The scorecard indicators remain mixed, including a shift in the yield curve indicator. The government shutdown has limited employment data, confirming a cautious investment approach is needed, as ongoing policy and trade shifts affect the economy.

Once again, the U.S. Recession Scorecard remains at an indecisive setting, as it has for several quarters running. However, there is one change of note: the yield curve indicator has shifted back to neutral Yellow from recessionary Red. Meanwhile, the government shutdown has already removed current employment data—unemployment claims and the unemployment rate—from view, and that potentially means there won't be a “clean” read from any of our indicators (except the yield curve and ISM) perhaps into next year.

In our view, the mixed state of the scorecard indicators argues for a watchful portfolio investment approach, particularly in a world where policy is very much in flux and the effects of ongoing trade shifts are still not yet visible.

## Yield curve

**Shifting to Neutral.** Short-term Treasury yields—in this case, the market yield on the 1-year T-bill—fell below the 10-year yield back in December 2024, reverting the yield curve to its normal shape in the process. Despite that, we left this indicator in the recessionary Red column for the past nine months because typically in past cycles, when such a crossing point has occurred—usually in response to the start of Fed rate cutting—the recession arrives anyway.

However, in this instance, the Fed cut three times in Q4 of last year. Changes in monetary policy are thought to act with a lag of six to 12 months, so we are now in the window when the effect of those rate cuts should be showing up as some visible improvement in the economic backdrop. Better-than-expected consumer spending in the summer and strengthening new orders for capital goods by business suggest that may be happening.

We are shifting this indicator into the neutral Yellow column.

## Fed funds rate versus nominal GDP growth

**Reaffirmed at Red.** Before every recession, the federal funds rate has managed to climb higher than the annualised run rate of nominal GDP (that is, GDP not adjusted for inflation). That occurred briefly in the summer of last year, just before the Fed began cutting rates. Flagging GDP growth has once again put that condition in place, reaffirming its reading at recessionary Red.

## Weekly unemployment claims

**Unchanged at Yellow.** It was quiet before the shutdown, as it has been for quite some time.

## Unemployment rate

**Unchanged at Yellow.** It was quiet before the shutdown, as it has been for quite some time.

## ISM New Orders minus Inventories

**Tariff distortion clouds the picture.** This is another indicator that should not be directly affected by the shutdown. However, it currently remains trendless. We've also left this at Yellow.

## Conference Board Leading Economic Index

**The long slide continues.** The LEI, down again in August, has now declined in 40 of the past 44 months. It has never reached these levels in the past without a recession arriving. It remains firmly in the Red column.

## Free cash flow of non-financial businesses

**Last Green standing.** This measure of the capability of non-financial businesses in aggregate to self-fund capital expansion has always declined as a percentage of GDP before or just after a recession got underway. While it has not done so yet after the Q2 data release in September, this data is reported with a long, three-month lag. The next release, hopefully, is in December.

## U.S. Recession Scorecard

Indicator	Status		
	Expansionary	Neutral / Cautionary	Recessionary
Yield curve (10-year to 1-year Treasuries)		✓	
Federal funds rate vs. nominal GDP growth			✓
Unemployment claims		✓	
Unemployment rate		✓	
ISM New Order minus Inventories		✓	
Conference Board Leading Economic Index			✓
Non-financial corporate cash flows	✓		

Source - RBC Wealth Management

## Administrative corner

### Gift of Securities

If you are planning on making a gift of securities to a registered charity from your non-registered investment account before the end of the year, please contact our office and we can assist with security selection. The deadline for in-kind donations is Friday, December 12th, 2025, to ensure the transfer is completed and received by the charity before year-end.

### Website Redesign

We are excited to announce the launch of our newly re-designed website: [www.grimeshandscomb.com](http://www.grimeshandscomb.com)

This update offers a more modern, user-friendly experience, with improved navigation and a fresh look. We encourage you to explore the updated platform, especially our enhanced "Insights" section, where you can find our latest expert analysis, market information, and thought leadership content.

## Congratulations Aurelia!

We are pleased to announce that Aurelia Pompili was recently selected for the RBC Quarterly Performance Award! This award celebrates employees who go above and beyond their required duties to provide exceptional client service and outstanding support to our team and firm.

We would like to acknowledge Aurelia's contribution and sincerely thank her for all her hard work. Our clients trust us with some of their most important decisions, and that trust is built and maintained through the dedication of employees like Aurelia who, with our entire team, work together to help our clients succeed.



## Benchmarks

Equity market 12-month trailing return (for month ending September 30, 2025)

S&P/TSX composite total return index 28.6%

S&P 500 total return (C\$) 21.0%

S&P 500 total return (US\$) 17.6%

DJIA total return (C\$) 14.8%

DJIA total return (US\$) 11.5%

Nasdaq composite price return (C\$) 28.2%

Nasdaq composite price return (US\$) 24.6%

RBC CM Canadian bond market indices 12-month trailing return (for month ending September 30, 2025)

Short-term index 4.2%

Intermediate-term 4.0%

Three-month T-Bill (C\$) 3.3%

Three-month T-Bill (US\$) 4.6%



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