

THE ARCHITECTURE OF OPPORTUNITY IN FRAGILITY

2025-2026 Global Economic and Market Outlook
Provided by the Institutional Portfolio Management Team

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AT A GLANCE

▶ **The global economy remains intact, but increasingly fragile by design.**

Growth is being sustained through fiscal support, capital-intensive investment, and technological optimism, extending the cycle while reducing tolerance for policy errors and valuation disappointment.

▶ **Canada is executing through volatility.**

Improved cost discipline, rising energy volumes, expanded export capacity, and a resilient financial system have reduced sensitivity to commodity price swings, positioning Canada as a source of stability rather than cyclical volatility.

▶ **Fixed income has reasserted its role.**

With yields meaningful and equity volatility elevated, fixed income plays a central role in income replacement, drawdown control, and opportunistic return generation through active credit.

▶ **The cycle is defined by dispersion, not direction.**

A pronounced K-shaped bifurcation is emerging. Broad participation has given way to outcomes driven by balance-sheet strength, capital discipline, and earnings durability.

▶ **Global growth is fragmenting.**

Japan's structural reforms, Europe's sector-level opportunities, and China's export-led pivot are creating differentiated regional dynamics, with currency and policy divergence becoming more consequential for markets.

▶ **Alternatives strengthen portfolio architecture.**

Private income, private growth, private real assets, and absolute return strategies broaden return sources, enhance resilience, and reduce reliance on public-market beta in a fragmented global system.

▶ **The US remains robust—but vulnerable to capital-cycle risk.**

AI investment is powering growth at the top of the economy, but rapid depreciation and narrow investment concentration raise the risk of a future retrenchment if monetization fails to scale.

▶ **Markets are shifting from breadth to selectivity.**

Equity returns are increasingly driven by earnings quality and capital efficiency rather than valuation expansion. Leadership is rotating, favouring active management over passive concentration.

▶ **The investment challenge is architectural, not predictive.**

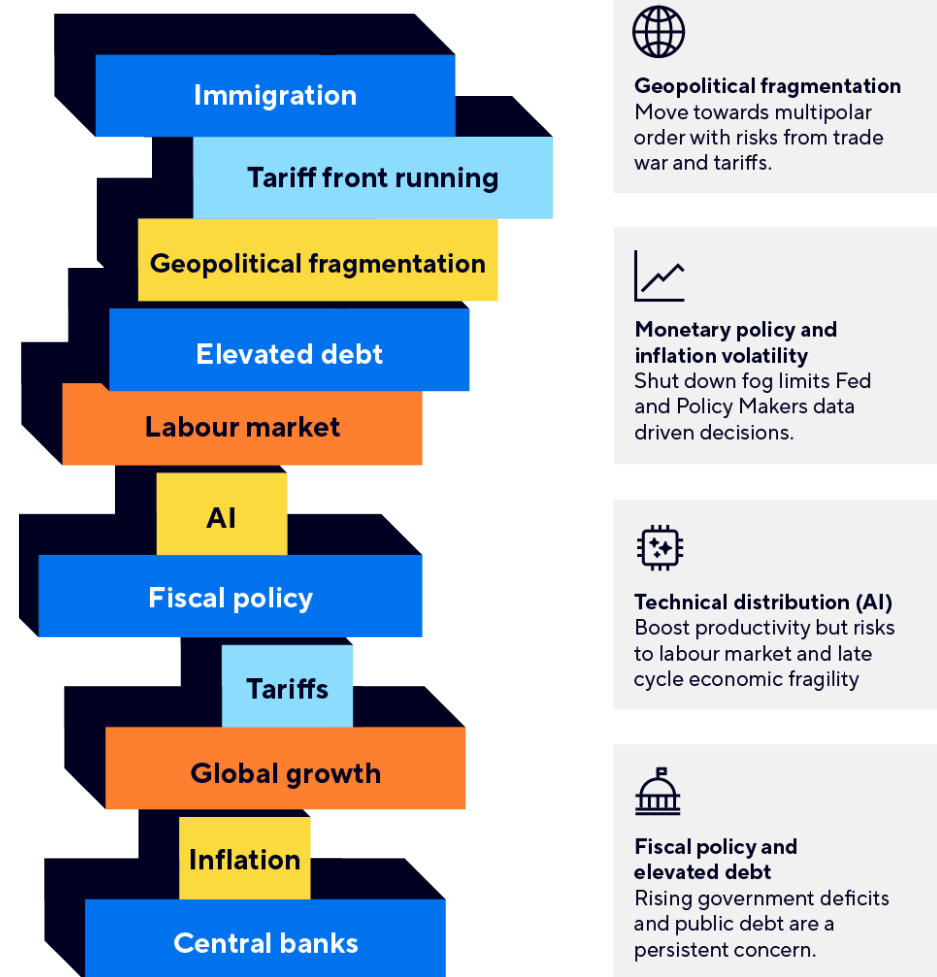
Success in the next phase of the cycle will depend less on forecasting precision and more on disciplined portfolio construction—balancing growth opportunities with resilience against volatility.

THE “JENGA ECONOMY”

As we turn the page on an eventful 2025 and look toward the strategic horizon of 2026, the global financial system presents a landscape defined less by uncertainty and more by structural instability. On the surface, economic conditions appear resilient: equity markets sit near record highs, technology valuations remain elevated, and North American growth has once again defied recessionary outcomes. Yet beneath this apparent strength, the foundations of the system are being re-engineered in real time through a pronounced K-shaped bifurcation.

The current environment resembles a Jenga tower in the late stages of the game. Core supporting blocks—fiscal discipline, free trade, and monetary stability—are being removed from the base and stacked atop the structure in the form of deficit-financed stimulus, protectionist industrial policy, and speculative capital expenditures. The tower continues to rise, reaching new valuation heights, but its integrity increasingly depends on a delicate balance of opposing forces.

For investors, the era in which “a rising tide lifts all boats” has clearly passed. The next phase of the cycle will be defined by dispersion, selectivity, and resilience, requiring a portfolio architecture capable of absorbing the inevitable shocks of a “Jenga economy.”



Source: ATB Investment Management

THE PARADOX OF AMERICAN ROBUSTNESS

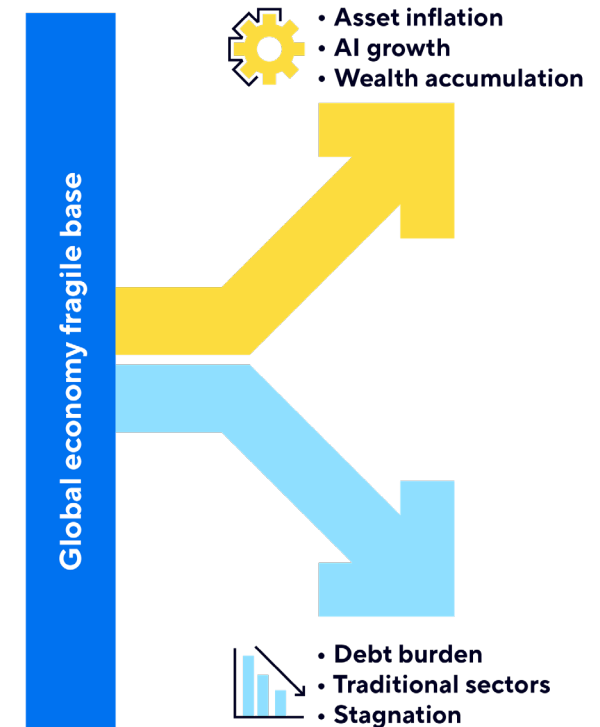
The US economy enters 2026 as a paradox—simultaneously robust and vulnerable. Headline GDP growth remains positive, supported by fiscal stimulus and elevated corporate investment. However, the quality and sustainability of that growth warrant closer scrutiny. Much of the current expansion is being financed through borrowing and forward-dated optimism, obscuring underlying structural weaknesses and a widening gap in household and corporate outcomes.

At the centre of this dynamic is the Artificial Intelligence infrastructure build-out. AI is the engine of the “upper K” — a secular transformation comparable to the railroad expansion of the 19th century. The hyperscale platforms (Amazon, Google, Meta, Microsoft, and Oracle) are collectively engaged in a capital-expenditure arms race, with approximately \$2 trillion of AI-related investment expected by 2030. While this boom has been massive in magnitude, it has also been narrow in scope. Capital spending in sectors outside of the AI buildout has been flat or declining.

The scale, speed, and capital intensity of this investment cycle introduce risks that markets may be underappreciating. Unlike traditional infrastructure with multi-decade useful lives, AI hardware depreciates rapidly. GPUs, networking equipment, and thermally stressed server infrastructure face obsolescence within three to five years, creating a recurring depreciation burden that, in aggregate, now rivals or exceeds industry-wide profits.

Equity valuations implicitly assume exponential monetization that has yet to materialize. Should AI-driven revenues fail to scale quickly enough to offset this depreciation cycle, the US economy risks a classic capital-cycle reversal—where investment retrenches sharply, with negative spillovers to employment, profits, and aggregate demand. While early signs of margin pressure may emerge in 2026, this risk is counterbalanced by the possibility of further AI breakthroughs and renewed investor optimism.

The K-shaped divergence



Source: ATB Investment Management

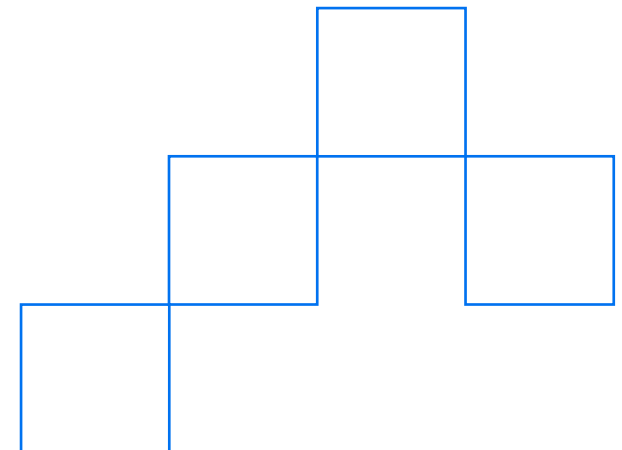
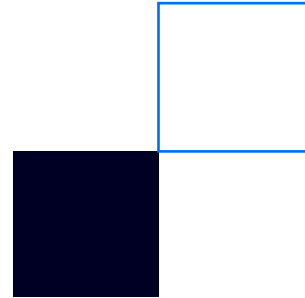
Labour, fiscal policy, and the Federal Reserve

The US labour market has remained resilient, supported by offsetting declines in both labour supply and demand. However, forward-looking labour indicators have softened steadily, and history suggests that once deterioration begins, it often accelerates quickly.

The fiscal landscape was notably altered by the passage of the One Big Beautiful Bill Act (OBBBA) in July 2025. The legislation functions as a targeted liquidity injection—effectively legislating wage increases through tax exemptions on tips and overtime, while simultaneously stimulating business investment via depreciation incentives. These measures support near-term growth and partially offset the inflationary effects of tariffs, but at a substantial fiscal cost.

Projected to add \$3 trillion to federal deficits over the next decade, this legislation borrows growth from the future to sustain the present. In our Jenga analogy, it adds weight to the top of the structure while hollowing out the base—further constraining future policy flexibility.

This leaves the Federal Reserve navigating an increasingly narrow path. Political pressure to reduce rates remains elevated, even as inflation persists above target. The transition to a new Fed Chair in 2026 introduces additional uncertainty. While internal FOMC internal divisions are likely to persist, the directional bias for short-term rates appears lower, albeit with a shallower and more cautious easing cycle than markets may expect.



The US consumer: A study in divergence

The US consumer in 2025 is not a monolith; they are the embodiment of the K-shaped economy. As of late 2025, the top 10% of income earners account for a record 50% of all US consumer spending. This cohort is supported by a powerful wealth effect: the top 1% now holds roughly 31% of total household net worth, while the bottom 50% holds just 2.5%¹.

Looking into 2026, consumption is likely to continue, but its reliance on high-net-worth households makes the economy more sensitive to equity market volatility. Two factors will be decisive:

1. Monetary Easing

Lower policy rates must ease borrowing costs for the middle class before their “pragmatic” moderation turns into a full retrenchment.

2. Asset Price Stability

As long as asset prices remain elevated, the “upper K” can sustain aggregate demand. However, should the AI-led valuation peak, the primary engine of US consumption would be at risk.

¹ATB Investment Management

CANADA'S PIVOT: OPPORTUNITY THROUGH EXECUTION

Canada enters 2026 in the midst of a structural reset. GDP growth is expected to improve to 1.4%–1.9%, supported by stabilizing business conditions and a labour market that is gradually recalibrating. Unemployment is forecast to trend toward 6.6%, while inflation remains anchored near target.

The Bank of Canada has adopted a deliberate “rate-hold” stance, maintaining its policy rate at 2.25% as it balances external trade shocks against domestic price stability. This monetary steadiness, paired with targeted fiscal support, reflects a broader shift from passive vulnerability to active execution.

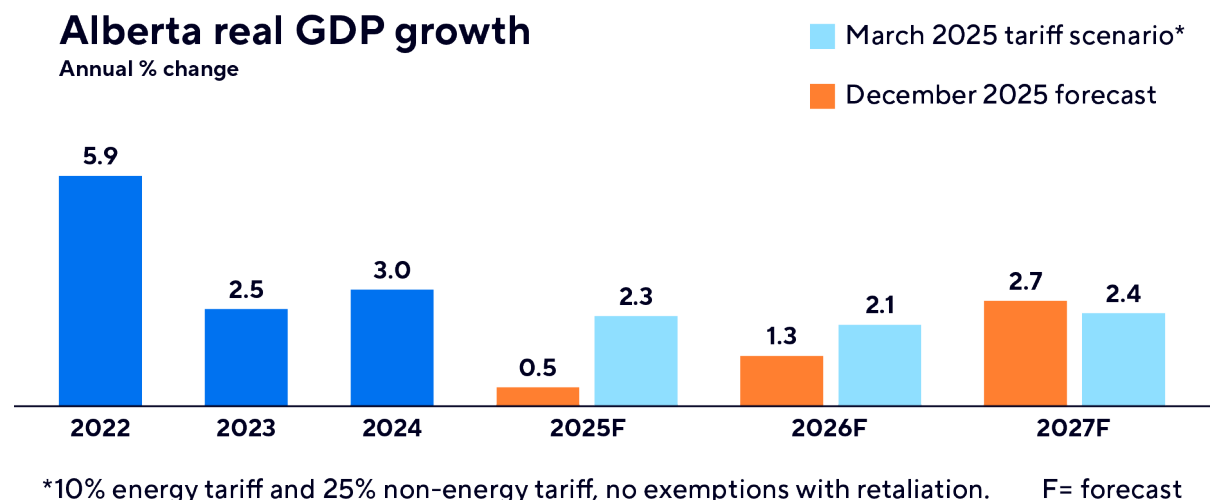
Nowhere is this more evident than in the energy sector. The final quarter of 2025 delivered a reality check as WTI crude fell below \$60/bbl amid OPEC+ oversupply. In prior cycles, such a move would have materially undermined the Canadian outlook. This time, the adjustment is being absorbed more effectively. As ATB Financial Chief Economist Mark Parsons noted in his recent Alberta Economic Outlook, the sector's

relentless focus on cost discipline has structurally increased resilience. Despite weaker prices, Alberta's real GDP is forecast to grow 2.1% in 2026, outpacing the national average.

Growth is increasingly driven by volume rather than price. The recent federal-provincial Memorandum of Understanding signalling a commitment to a new Asian-bound pipeline, alongside increased TMX capacity, provides the long-term structural framework to reduce Canada's historical

“captive market” discount. While a sub-\$60 oil environment pressures cash flows, it has not derailed the broader economic pivot.

This resilience extends to the financial system. Canadian banks reported 15% aggregate revenue growth in 2025, remain well capitalized, and benefit from regulatory changes—most notably extended amortizations—that effectively place a stabilizing floor under housing demand and bank balance sheets.



Source: 24/7 article, Mark Parsons, Chief Economist, ATB

A FRAGMENTED GLOBAL BACKDROP

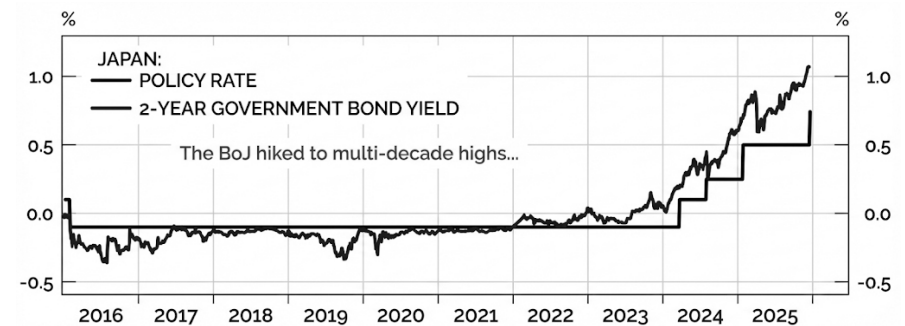
Globally, post-pandemic synchronization has fractured. Europe enters 2026 in a state of managed stagnation, with growth near 1.1% amid tariff frictions. Germany stands out as a fiscal exception, retaining capacity to stimulate given its comparatively strong balance sheet.

Japan is emerging as a key area of interest. Under “Sanaenomics,” corporate governance reforms are unlocking capital investment and wage growth, while the Bank of Japan’s gradual rate normalization signals a decisive break from deflation. A strengthening yen and rising rates raise the risk of an unwind in the yen carry trade, which could siphon liquidity from global risk assets and act as a headwind to US markets.

China continues to pivot toward export-led manufacturing growth to offset domestic property weakness—a strategy that is globally disinflationary but increases geopolitical and trade friction with Western economies.

The January 2 removal of Venezuelan President Nicolas Maduro by US forces serves as a definitive reassertion of the Monroe Doctrine and the “Trump Corollary,” signalling a forceful effort to expunge Russian and Chinese influence from strategic assets in the Americas. This shift is expected to catalyze long-term economic liberalization in Venezuela while emboldening the US to escalate pressure on other foreign rivals, notably Cuba and Iran.

Entering 2026, global growth remains intact but increasingly policy-dependent, capital-intensive, and unevenly distributed. Fiscal support and technological investment continue to extend the cycle, while higher leverage and declining margins reduce tolerance for policy missteps. This environment favours precision in portfolio construction over broad macro conviction.

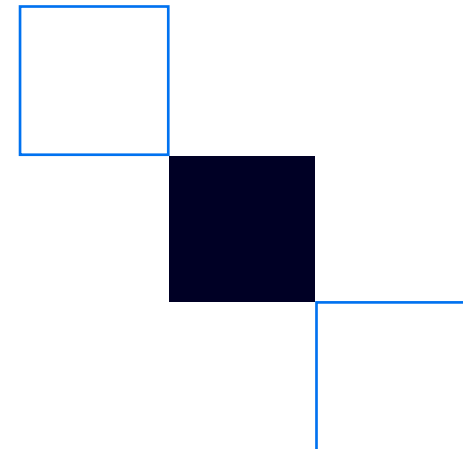
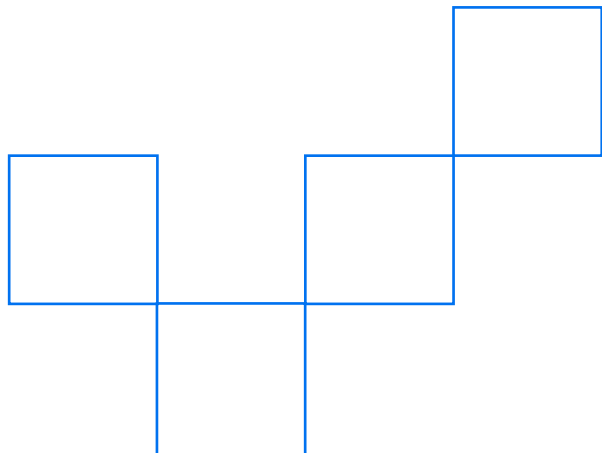


Source: BCA & Bank of Japan, Macrobond

MARKET OUTLOOK: FROM BREADTH TO SELECTIVITY

As we move into 2026, the dominant market feature is no longer directionality but dispersion. Elevated fiscal support, fragmented global growth, and capital-intensive investment cycles are creating markedly different outcomes across sectors, regions, and business models. Market leadership is becoming less durable, and valuation tolerance is narrowing as capital costs normalize and depreciation burdens rise.

In this environment, returns are increasingly driven by how growth is financed and monetized, rather than by growth narratives alone. For portfolio construction, this represents a structural shift. Passive exposure—particularly in markets with extreme concentration—now embeds unintended risks tied to capital intensity, earnings fragility, and policy dependence. The opportunity set remains broad, but it is uneven, requiring portfolios to be intentionally diversified across distinct return drivers and actively managed to adapt as leadership rotates.

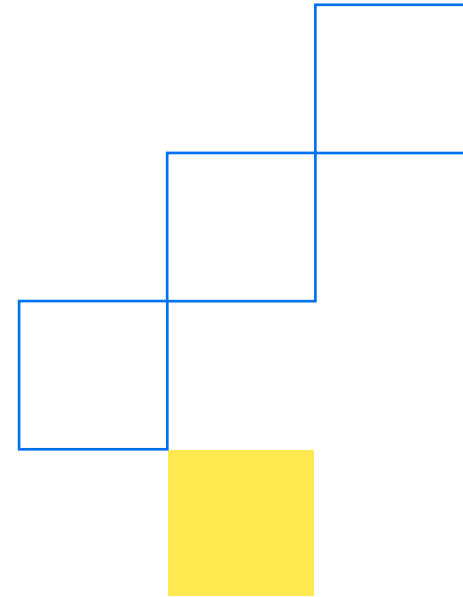


EQUITIES: DISPERSION AS A STRUCTURAL FEATURE

Equity markets in 2025 rewarded scale, narrative dominance, and capital deployment. Entering 2026, those same forces are driving dispersion rather than broad upside. Elevated starting valuations compress forward return potential, while differences in capital intensity and balance-sheet structure are increasingly reflected in earnings outcomes. Companies with durable pricing power, moderate reinvestment needs, and strong free-cash-flow conversion are positioned to compound, while those dependent on continual reinvestment face rising execution risk.

Crucially, we view this dispersion as a persistent feature rather than a temporary dislocation. The AI investment cycle, fiscal reindustrialization, and geopolitical fragmentation all favour differentiated outcomes across industries and regions. Earnings revisions are becoming more volatile, and markets are less forgiving of disappointment. As a result, equity risk is becoming more idiosyncratic than cyclical, reinforcing the importance of active management and security selection.

From a portfolio perspective, equities should be viewed less as a homogeneous growth engine and more as a collection of differentiated cash-flow streams. Managing exposure to valuation extremes and capital-intensive business models becomes a form of risk control, not market timing.



US EQUITIES: VALUATION ASYMMETRY AND ROTATION BENEATH THE SURFACE

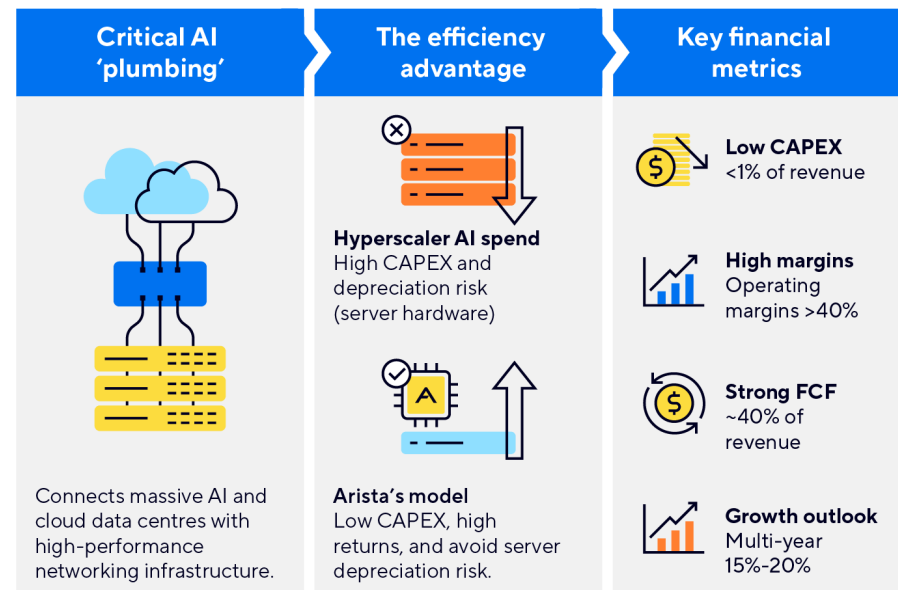
The US equity market remains structurally advantaged, supported by fiscal flexibility, deep capital markets, and technological leadership. However, leadership concentration has reached levels where valuation asymmetry becomes a central risk. At elevated multiples, even modest earnings shortfalls can result in disproportionate drawdowns, particularly when depreciation from large capital programs begins to pressure margins.

Rather than a regime shift away from US equities, we expect a rotation within leadership. As AI-related capital expenditures flow through financial statements, investors are increasingly differentiating between companies that fund the infrastructure and those that benefit from it. This creates opportunities in sectors that capture productivity gains without bearing the full capital burden, including industrials tied to infrastructure and reshoring, financials benefiting from nominal growth and stable credit conditions, and healthcare businesses with resilient demand and innovation-driven growth.

The early phase of the AI infrastructure build-out is evolving to a focus on monetization, efficiency, and enablement. Our preference is for capital-efficient enablers such as Arista Networks. They illustrate this transition by providing high-performance networking that connects massive AI clusters without requiring heavy balance-sheet investment. As such, Arista participates in secular growth while avoiding the depreciation risk embedded in server ownership. For portfolios, this distinction matters: participation in AI does not require assuming the full capital-cycle risk of the hyperscalers.

From a construction standpoint, managing US equity exposure increasingly involves what not to own as much as what to own. Avoiding excessive exposure to capital-intensive, richly valued segments can reduce downside asymmetry while preserving participation in innovation-led growth.

Arista Networks (ANET): Capital-efficient AI enabler



Arista participates in secular AI growth through essential connectivity, without bearing the heavy capital-cycle risk of server hardware.

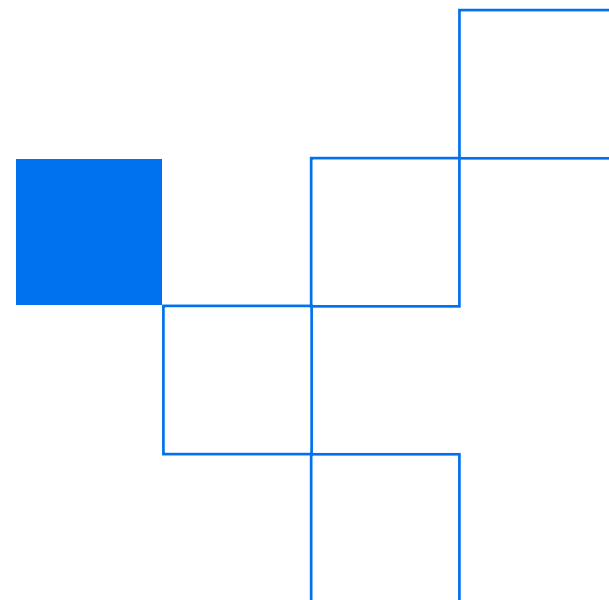
Source: ATB Investment Management

CANADA: INCOME, STABILITY, AND PORTFOLIO ANCHORING

Canadian equities continue to serve a distinct function within diversified portfolios. Relative to the US, Canada offers lower valuation volatility, higher income orientation, and greater exposure to traditional balance-sheet-driven businesses. The banking sector remains central, not as a source of outsized growth, but as a stabilizing income anchor supported by conservative underwriting, diversified revenue streams, and regulatory frameworks that reduce tail risk.

In a late-cycle environment characterized by fiscal expansion and geopolitical uncertainty, this stability becomes increasingly valuable. Canadian banks provide a counterweight to US equity concentration and capital-intensity risk, helping smooth portfolio outcomes during periods of heightened volatility. Their role is less about market leadership and more about return consistency.

Complementing this exposure is the renewed role of real assets, particularly physical gold. As central banks accumulate reserves and global policy frameworks fragment, gold's function as a hedge against currency debasement and systemic risk has strengthened. Unlike mining equities, physical bullion provides this protection without introducing operational leverage or equity-market correlation, making it a more precise portfolio hedge in the current environment.



INTERNATIONAL AND EMERGING MARKETS: CORRELATION MANAGEMENT

International equities are increasingly valuable for correlation management rather than broad-based return generation. As North American growth becomes more fiscally driven, selective exposure to markets operating under different policy regimes helps mitigate concentration risk and currency dependence.

Japan stands out structurally, supported by corporate governance reform, improving capital allocation, and rising domestic investment. These changes enhance earnings durability, but they also introduce new dynamics as monetary policy normalizes and the yen strengthens. The potential unwinding of the yen carry trade represents a meaningful global liquidity risk, reinforcing the importance of disciplined position sizing and active oversight.

Europe remains challenged at the index level, but sector-level opportunities persist where structural demand is less cyclical. Defence, aerospace, and select industrial exporters benefit from elevated security spending and supply-chain reconfiguration, offering differentiated return streams when accessed selectively.

Emerging Markets (EM) play a distinct role as volatility dampeners when implemented thoughtfully. Many EM economies entered this phase of the cycle with lower public debt, tighter monetary policy, and less reliance on late-cycle fiscal stimulus. As a result, selective EM exposures can exhibit lower correlation to US mega-cap equities, particularly during periods of valuation compression or US dollar volatility. Rather than pursuing broad EM beta, targeted allocations to markets with improving governance and strategic positioning within global technology and manufacturing supply chains—such as Korea—can enhance portfolio resilience without materially increasing downside risk.

FIXED INCOME: INCOME REPLACEMENT AND DRAWDOWN CONTROL

Fixed income has reasserted itself as a core component of portfolio construction, not merely as ballast, but as a meaningful source of return. As central banks approach neutral policy settings, yield curves remain susceptible to bear-steepening, with long-term rates constrained by persistent deficits and rising issuance. In this context, intermediate-duration bonds offer a compelling balance of yield and interest-rate risk.

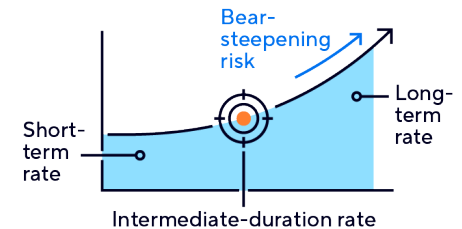
Beyond duration, fixed income now plays a critical role in income replacement. With equity returns likely to be more volatile and valuation-driven upside constrained, predictable income streams become increasingly valuable in meeting portfolio objectives. This shifts the emphasis from duration bets toward credit selection and structural income generation.

Credit markets, however, require active management. Elevated leverage and the lagged impact of higher borrowing costs increase the probability of episodic dislocation. Portfolios can benefit from specialist managers capable of deploying capital into widening spreads with a disciplined focus on downside protection. In this way, fixed income contributes not only to stability, but to opportunistic capital appreciation during periods of stress.

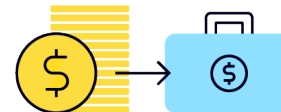
Strategic positioning

Intermediate-Duration: Compelling balance of yield and interest-rate risk.

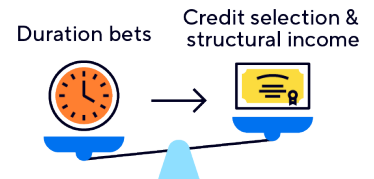
Central banks approach neutral: long term rates constrained by deficits.



Income replacement

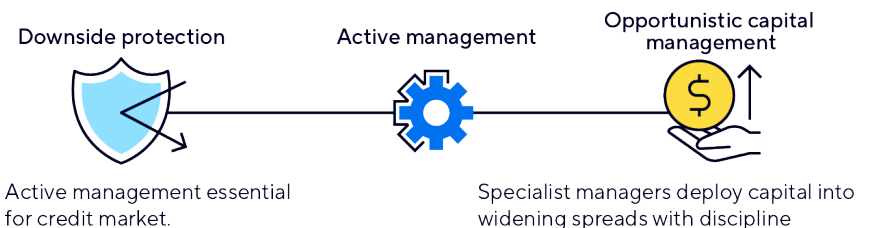


Predictable income streams valuable amidst equity volatility.



Emphasis shifts to credit selection for structural income generation.

Drawdown control



Fixed income reasserts itself as a core source of return, offering stability and opportunistic potential in portfolio construction.

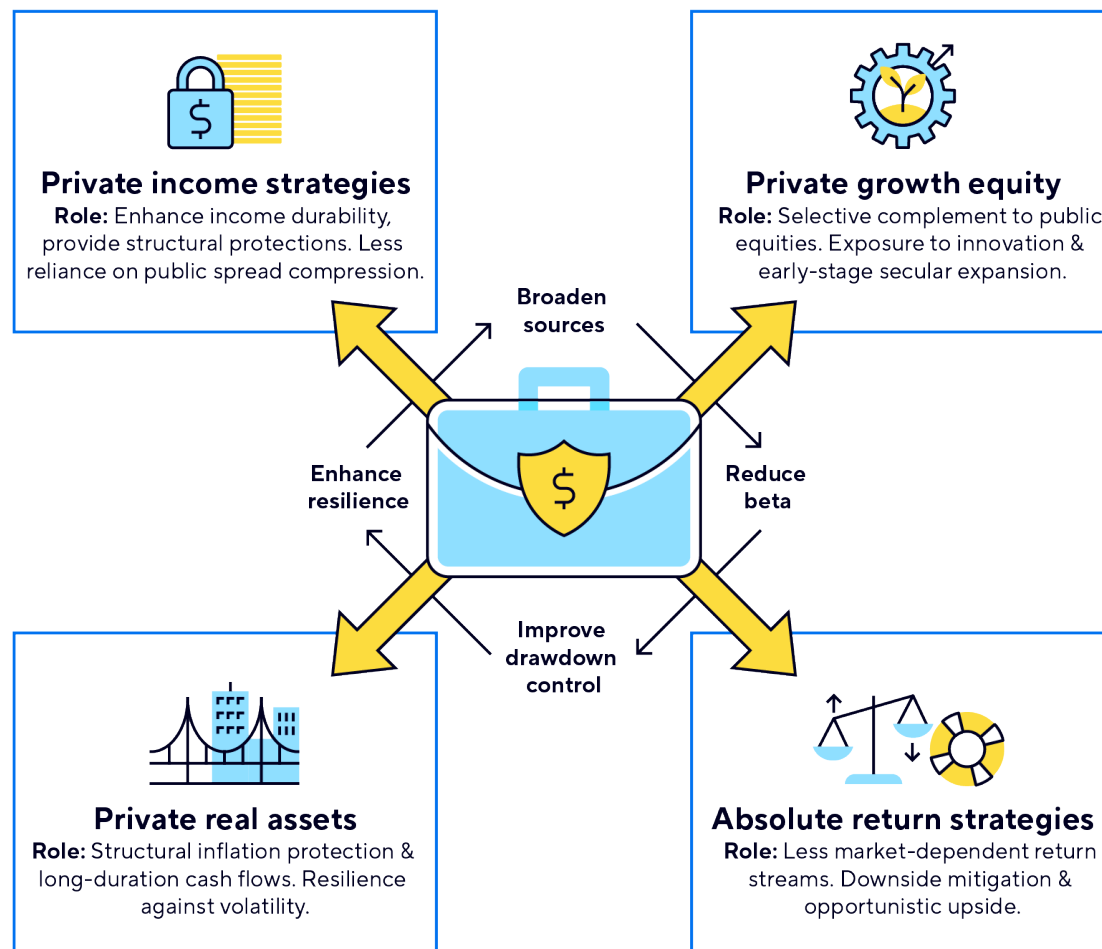
Source: ATB Investment Management

ALTERNATIVES: COMPLEMENTING PORTFOLIO DESIGN IN A FRAGMENTED CYCLE

As markets move from breadth to selectivity and public-asset volatility becomes more episodic, alternative investments play an increasingly vital role in portfolio construction. We view these not as a separate asset class, but as functional building blocks designed to address specific portfolio objectives. In the next phase of the cycle, alternatives are best evaluated through the lens of what problem they solve, rather than as sources of generalized return enhancement.

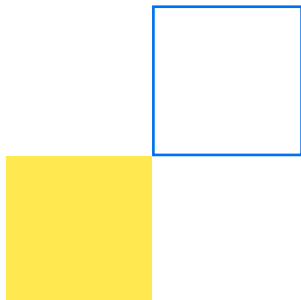
We categorize alternatives into four distinct functional roles within portfolio architecture:

- ▶ **Private income** includes strategies involving direct, mezzanine, and asset-based lending. These strategies provide a natural extension of fixed income in an environment where public credit markets are increasingly sensitive to liquidity and refinancing risk. Private credit and income-oriented private strategies offer contractual cash flows, structural protections, and insulation from daily market volatility. In a cycle defined by higher capital costs and episodic dislocation, these strategies can enhance income durability while reducing reliance on public-market spread compression.



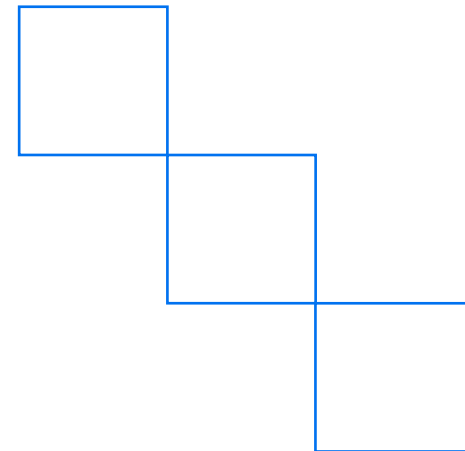
Source: ATB Investment Management

- ▶ **Private growth** strategies can include private equity, venture capital, and buyouts. These serve as a selective complement to public equities rather than a substitute. With public markets increasingly dominated by capital-intensive incumbents, private growth strategies allow exposure to innovation, productivity gains, and secular expansion earlier in the lifecycle—often with greater governance influence and less sensitivity to short-term market sentiment. However, disciplined pacing and vintage diversification remain essential, particularly as higher rates reset valuation frameworks.
- ▶ **Private real assets**, including infrastructure and real estate, offer structural inflation protection and long-duration cash flows in a world of fiscal expansion and supply constraints. These assets benefit from pricing power embedded in contractual or regulated revenue streams, providing diversification from both traditional equities and nominal bonds. Their role is not cyclical positioning, but long-term resilience against currency debasement and policy-driven volatility.



- ▶ **Absolute return strategies**, including hedge funds, regain relevance as dispersion widens and market correlations become less stable. In an environment where alpha is increasingly driven by relative value, capital structure arbitrage, and security-level differentiation, these strategies can provide return streams less dependent on market direction. When implemented thoughtfully, they offer downside mitigation and opportunistic upside during periods of market stress.

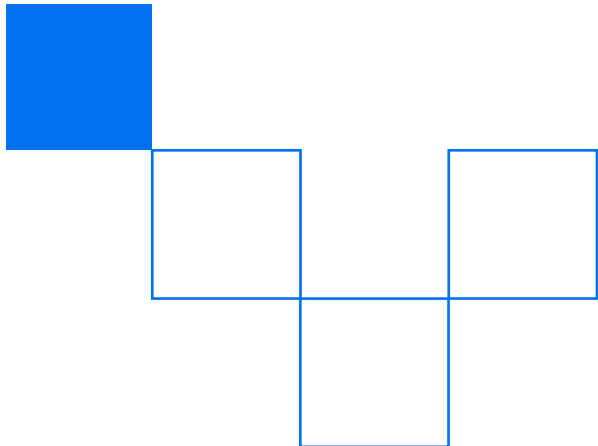
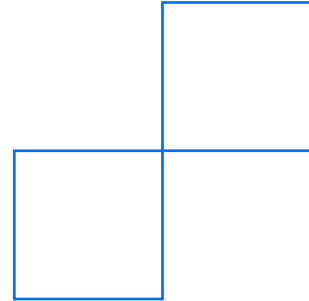
Collectively alternatives enhance portfolio resilience by broadening the sources of return and income, reducing reliance on public-market beta, and improving drawdown control. In a structurally fragile global system, their value lies not in outperforming in every environment, but in reinforcing the overall integrity of the portfolio architecture.



CONCLUSION: ARCHITECTURE OVER PREDICTION

Across asset classes, the defining investment challenge of 2026 is not forecasting precision but portfolio architecture. Markets are no longer supported by uniform liquidity or synchronized growth. Instead, outcomes depend on capital discipline, balance-sheet strength, and the ability to operate effectively within a fragmented global system.

By emphasizing earnings quality, valuation awareness, income durability, and true diversification across regions and asset classes, portfolios can remain positioned for opportunity while maintaining resilience against the inevitable volatility of a structurally fragile global order.



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