PMI

INSIGHTS

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Passing the Baton

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In the global equity relay race of 2025, the U.S. market (S&P 500) produced respectable returns of roughly 16.84% total return, but international developed and emerging markets significantly outperformed, with the MSCI ACWI ex USA returning approximately 32.45%. This was the clearest break from U.S. dominance since 2017, supported by a sharp depreciation of the U.S. dollar (DXY Index) down approximately 10% for the year and more compelling starting valuations outside the U.S.

Drivers of International Strength

Many markets began the year with materially lower multiples and higher earnings yields than the U.S., providing greater upside as risk appetite returned. At the same time, inflation moderated more quickly in several regions, enabling central banks (including the ECB, Bank of England, and Bank of Canada) to begin easing earlier than the Federal Reserve, which helped improve financial conditions and underpin earnings revisions ***(see Exhibit 1).***

Ongoing Opportunities Abroad

Despite the strong run, we continue to see value in selective international exposure as part of a diversified portfolio. Global equities outside the U.S. still trade at meaningful discounts on a forward P/E and price-to-cash-flow basis ***(see Exhibit 2)***, while consensus earnings growth expectations remain competitive with or in some cases exceed the roughly 15.6% projected for the S&P 500 (SPX) in 2026. We note that Geopolitical developments remain a risk factor and will be monitored closely as part of the broader assessment of global equity exposure.

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Exhibit 1

Name	2025 Return (%)
S&P 500 INDEX	16.84
S&P/TSX COMPOSITE INDEX	30.82
S&P/BMV IPC	35.28
BRAZIL IBOVESPA INDEX	34.25
Euro Stoxx 50 Pr	19.9
FTSE 100 INDEX	24.68
CAC 40 INDEX	13.31
DAX INDEX	21.14
IBEX 35 INDEX	52.84
NIKKEI 225	30.55
HANG SENG INDEX	35.8
MSCI ACWI xUSA	32.45

Source: Bloomberg/ PMI

Data for the period 01/06/25 to 12/30/25

Exhibit 2

Name	Forward P/E	Price to CF per Share	Fwd P/E Discount /Premium	Price to FCF Discount /Premium	Blended Earnings Growth 2026 (%)
S&P 500 INDEX	26.13	19.73			15.62%
S&P/TSX COMPOSITE INDEX	20.49	18.49	-21.60%	-6.28%	17.33%
S&P/BMV IPC	14.62	8.91	-44.04%	-54.85%	15.22%
BRAZIL IBOVESPA INDEX	9.99	6.13	-61.75%	-68.94%	26.31%
Euro Stoxx 50 Pr	18.08	11.53	-30.81%	-41.53%	9.53%
FTSE 100 INDEX	15.04	9.03	-42.43%	-54.23%	7.68%
CAC 40 INDEX	18.33	11.45	-29.84%	-41.96%	11.81%
DAX INDEX	18.67	12.22	-28.56%	-38.06%	12.80%
IBEX 35 INDEX	14.96	7.58	-42.75%	-61.59%	5.07%
NIKKEI 225	20.63	15.72	-21.05%	-20.32%	8.11%
HANG SENG INDEX	12.94	9.52	-50.50%	-51.72%	3.87%

Source: Bloomberg/ PMI

Sata as at 1-08.26

US Market Shift

By contrast, U.S. equity returns, especially in the second half of 2025, became increasingly driven by fundamentals and valuation discipline. With elevated multiples (SPX trading at a forward P/E of approximately 23x) and the Fed funds rate above the neutral nominal rate (HLW r* + 2% inflation target), signaling restrictive policy, the market favoured companies that delivered earnings beats, raised guidance, and exhibited durable free cash flow.

Looking ahead to 2026, consensus forecasts point to GDP growth around 2.1% and earnings growth near 15%, supported by moderating inflation, a resilient yet modestly cooling labor market, ongoing productivity gains from technology and AI, two anticipated Fed rate cuts, and the stimulative effects of the Big Beautiful Bill (BBB) framework (all of which remain broadly favorable for U.S. equities). That said, with the S&P 500 (SPX) at all-time highs and valuations stretched across multiple metrics, the upward path is unlikely to be smooth.

For against this backdrop of a resilient but maturing economic expansion and stretched valuations, a closer look at equity yields relative to real interest rates reveals how much “margin of safety” remains priced in. ***Exhibit 3*** compares free cash flow yields and earnings yields across major indices (adjusted for current real rates proxied by the 12-month T-bill yield minus the 1-year breakeven inflation rate).

The Dow Jones Industrial Average (INDU) currently offers the widest margin of safety with both the FCF and Earnings real rates in excess of the real risk-free rate. The SPX provides a more moderate cushion at 0.54% and 1.38% excess on FCF and Earnings yield.

Exhibit 3

Index	Free Cash Flow Yield	Earnings Yield	FCF Real Rate	Earnings Real Rate	Real Rate
INDU (Dow Jones)	4%	3.96%	1.5400%	1.50%	1.00%
SPX (S&P 500)	3%	3.84%	0.5400%	1.38%	1.00%
NDX (Nasdaq-100)	2%	3.12%	-0.4600%	0.66%	1.00%

Data as at 07/01/26

Source: Bloomberg/ PMI

By contrast Nasdaq-100 (NDX) has a negative excess -0.46% on FCF and only 0.66% buffer on the earnings yield real rates. This can be interpreted as NDX being expensive on current cash not justifying current prices due in part to the current AI capex cycle. However, on earnings yield the narrow spread suggests a smaller buffer for multiple expansion meaning that greater reliance is being placed on earnings growth with less room for earnings disappointment.

This is more in line with mid-to-late cycle expansion requiring careful navigation, with earnings execution and selective positioning likely to drive differentiated returns rather than broad upside.

Exhibit 4 highlights valuation dispersion across S&P 500 sectors (*results inverted for visual effect*) remains pronounced based on equal-weighted Z-scores of forward P/E and EPS metrics. Real Estate stands out as the most attractively valued sector (+ 2.14), with Energy (+ 0.07), Health Care (- 0.28), and Materials (- 0.42) also screening relatively inexpensive, while Industrials (- 0.88), Consumer Discretionary (- 0.96), Utilities (- 1.01), and Consumer Staples (- 1.26) sit in moderately expensive territory. By contrast, Financials (-1.38), Information Technology (- 1.61), and Communication Services (- 1.95) appear the most stretched, leaving the S&P 500 overall at - 1.29, above its long-term valuation average.

Exhibit 4

Data as of 1/14/26
Source: Bloomberg/PMI

In the current environment we continue to favour Industrials for cyclical upside and structural demand visibility and Health Care for valuation support, defensive growth, and innovation, while funding from more expensive, crowded sectors where valuation risk is elevated.

The U.S. continues to be the pillar to our investment approach, with its leadership in innovation, deep and liquid capital markets, and structurally resilient corporate earnings positioning it as the primary long-term growth engine in our portfolios.

No Longer Just a Mag 7 Story - Breadth Takes Over

While the Mag 7 stocks remain a significant driver of earnings, market leadership is no longer concentrated solely in that group. Breadth has meaningfully improved.

Exhibit 5 illustrates the steady increase in the number of non-Mag 7 companies delivering superior performance relative to the Mag 7 over the last 3 calendar years, with 2025 seeing a 262% rise in participants, equating to 123 names or roughly 25% of the SPX index.

Exhibit 5

Year	MAG7 Performance (BM7T Index)	Number of SPX Companies Outperforming MAG7	Relative %
2023	107.01%	14	–
2024	67.34%	34	143%
2025	24.90%	123	262%

Source: Bloomberg/ PMI

Exhibit 6

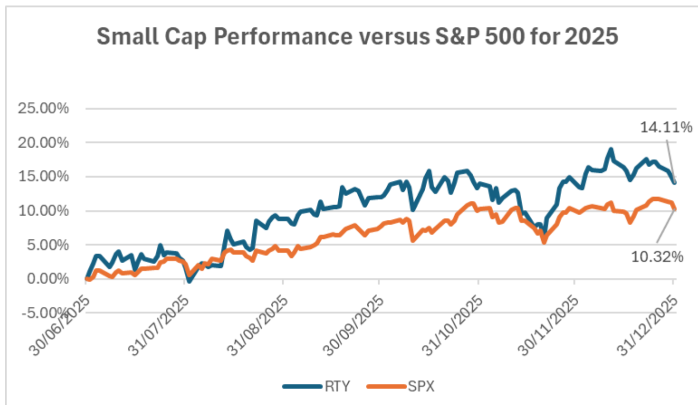
Source: Bloomberg

Technicals highlight the Mag 7 proxy (BM7T Index) is currently trading near or testing its 50-day moving average, reflecting short-term consolidation and modest near-term risk in the context of the rotation particularly given valuations that embed high expectations for continued execution i.e. "priced for perfection" ***(see Exhibit 6)***.

Extending the Baton Pass - Small Caps Join the race

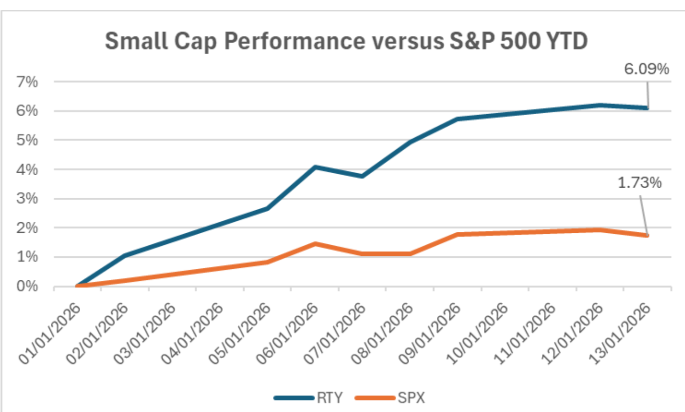
Within the U.S., this broadening extends to small caps, where the Russell 2000 (RTY Index) gained momentum in the second half of 2025 and outperformed the S&P 500 during periods of rate relief (Fed cuts) and style rotation. ***Exhibit 7*** highlights the RTY Index returned 14.11% relative to the SPX Index at 10.32% for the period 06/30/25 to 12/31/25. This outperformance (See Exhibit 8) extends on a YTD basis where the RTY Index is up 6.20% relative to the SPX Index at 1.92% (as at 1/13/26).

Exhibit 7



Data from 06/30/25 to 12/31/25
Source: Bloomberg/ PMI

Exhibit 8



Data from 01/01/26 to 13/01/26
Source: Bloomberg/ PMI

Investors are increasingly banking on further support for small caps via Fed rate cuts. As of January 13, 2026, Fed funds futures are pricing roughly two cuts over the course of 2026 ***(see Exhibit 8)***, implying a policy rate near 3.1% by year-end. This expectation is supported by the 10-year Treasury/Fed funds spread, which at 41 bps (as at 13/01/26) is well below its historical average of 115 bps (data going back to 1975), signaling that the long end is already discounting future easing. With the U.S. 10-year yield at 4.17%, the historical spread suggests a Fed funds rate around 3.0%, closely aligning with futures and reinforcing expectations of a gradually more accommodative policy environment.

Small caps (RTY Index) remain attractive with accelerating earnings growth expectations for 2026 at 59.22% relative to the SPX Index at 15.90%.

US Fixed Income: The Reliable Anchor Runner

Amid the evolving equity landscape, U.S. fixed income has reasserted itself as a critical portfolio stabilizer. The Bloomberg U.S. Aggregate (LBUSTRUU Index) delivered approximately 7% total return in 2025. Throughout the year, the U.S. Treasury yield curve displayed a classic bull steepener pattern where short-term yields fell noticeably in response to the Federal Reserve's rate cutting actions, while longer term yields proved more resilient and remained relatively anchored.

On a YTD basis, the US 10- year Treasury remains trading in a narrow trading range of 4.1% to 4.20%, suggesting that investors are largely in a "wait and see" mode assessing the evolving balance between disinflation progress, labour market dynamics, and potential policy or financial risks.

Conclusion

Market leadership is beginning to broaden meaningfully beyond the Magnificent 7, reflecting a period where the baton is passing to a wider set of sectors, styles, and asset classes. Small caps are gaining momentum on anticipated Fed easing and earnings visibility, while non-U.S. markets continue to offer compelling valuation discounts alongside competitive earnings growth. Even so, U.S. markets continue to play a central role, underpinned by leadership in innovation, resilient corporate earnings, and a supportive structural backdrop. The next phase favours thoughtful diversification, active selection of durable fundamentals, and selective exposure to attractively valued, higher-conviction opportunities both from an international and U.S. sector perspective. PMI