Q2, 2026 Investment Commentary - Market Musings

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The second quarter was another eventful period for equity markets, with all major North American indexes posting new all-time highs. In the United States it was semiconductors and other technology companies that fueled the advance while banks did the heavy lifting in Canada. The well telegraphed ceasefire with Iran proved short-lived, and it will be interesting to see what the next catalyst markets use to justify further gains. Meanwhile, the shine has come off gold and silver, reversing a significant portion of the advance that helped drive the TSX in 2025. Despite our conservative positioning, Newhaven portfolios are outperforming all relevant benchmarks this year while delivering strong dividend growth.

The S&P/TSX Composite Total Return Index (TRI) has gained 11.2% year-to-date in 2026, while the S&P 500 TRI is up 10.2%. The technology-heavy Nasdaq has performed even better, rising 19.3% after an impressive recovery from its March lows. By comparison, the Canadian Bond Universe Index has returned just 2.2% and continues to lag equity markets over the short, medium, and long-term. During the second quarter, the S&P/TSX Composite TRI gained 6.3%, the S&P 500 TRI advanced 14.4%, and the Nasdaq climbed 27.7%. *All performance figures are quoted in local currency unless otherwise indicated*.

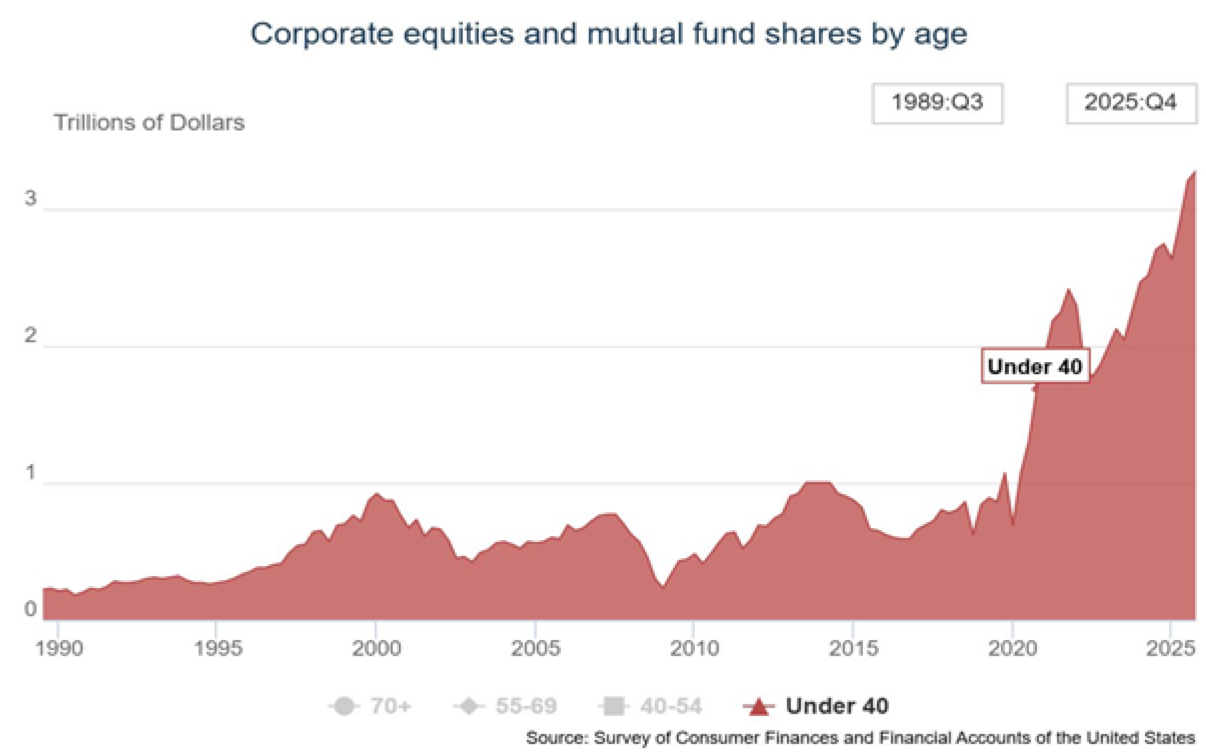
The second quarter was marked by volatile news flow and market action. The on-again, off-again conflict in the Middle East seemed to resolve itself every Monday morning, only to reignite uncertainty and volatility days later. Semiconductor stocks assumed leadership, driving US benchmark indices to new highs, taking the baton from the Magnificent Seven (Apple, Google, Amazon, Microsoft, Tesla, Meta Platforms, and Nvidia). In Canada, bank stocks accounted for most of the market's gains, reaching record valuation multiples despite the economy entering a technical recession following two consecutive quarters of negative GDP growth. New US Federal Reserve Chair Kevin Warsh surprised markets with a hawkish tone, hinting at interest rate increases after the June meeting, but even that failed to derail the rally.

The first half of 2026 ended on a surprisingly optimistic note, though history suggests the second half of the year is often more challenging. Interest rate increases are now priced in on both sides of the border, while a contentious US midterm election cycle and ongoing geopolitical tensions remain potential headwinds.

The past 30 months have been the strongest performance period of my 20-year career, despite often feeling like one of the most challenging. Returns have greatly exceeded our conservative annual objective of 6–8%, despite considerable uncertainty and volatility. It is a powerful reminder that attempting to time the market is a fool's errand. Long-term success comes from remaining invested through all environments with confidence in the quality of the businesses you own.

My colleague Rebecca and I correspond constantly, doing our best to formulate a credible view with which to shape client portfolios. One of the great advantages of doing this job in the modern age is the plethora of information at our fingertips, the corresponding drawback is the challenge of sorting through what is relevant, accurate and worthwhile. This version of the quarterly will highlight a few charts we found interesting:

Chart #1: Cumulative total investment in equities by Americans under 40 years of age



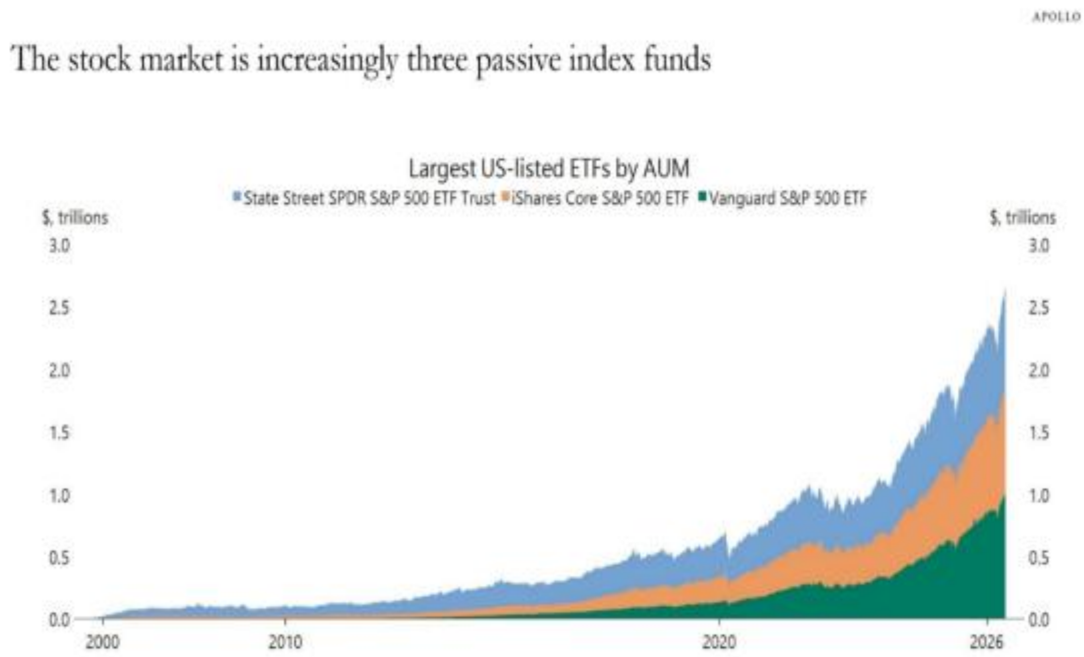
The Point: Attempting to explain the strength in the equity market

Explanation and Viewpoint: This chart stood out to us. For the three decades leading up to 2020, cumulative equity investment by Americans under 40 remained remarkably stable, ranging between roughly $500 billion and $1 trillion, despite population growth and inflation, both of which would support higher nominal investment levels. Following the pandemic, however, investment by this cohort accelerated dramatically.

In our view, several factors explain this shift. More than a decade of zero interest rate policy (ZIRP) encouraged investors to move further out the risk spectrum, while unprecedented pandemic-era liquidity, through monetary stimulus and government transfers, provided capital that needed to be invested. At the same time, younger households were increasingly priced out of home ownership as housing prices far outpaced wage growth, another consequence of the ultra-low interest rate environment of the 2010s. After witnessing the strong performance of technology stocks late in the previous decade, many younger investors shifted aggressively into equities. The repeated willingness of the Federal Reserve and other central banks to intervene during periods of market stress has reinforced a structural increase in risk appetite among this generation of investors.

Conclusion: This chart illustrates one example of capital flowing into equities from an investor cohort that historically directed a larger share of its savings elsewhere. While unusually strong participation from non-traditional investors has often been a reason for caution, it is also a logical consequence of policy decisions that have accumulated over several decades.

Chart #2: Assets under management by the largest US passive exchange traded funds since 2000



The Point: Attempting to explain the strength in equities and changes in market structure

Explanation and Viewpoint: The rise of passive investing has fundamentally reshaped financial markets. Its appeal is straightforward: lower fees and, historically, better long-term performance than the average actively managed fund. The three ETFs shown above represent only a small fraction of the thousands of indices and sub-indices now available to investors at minimal cost.

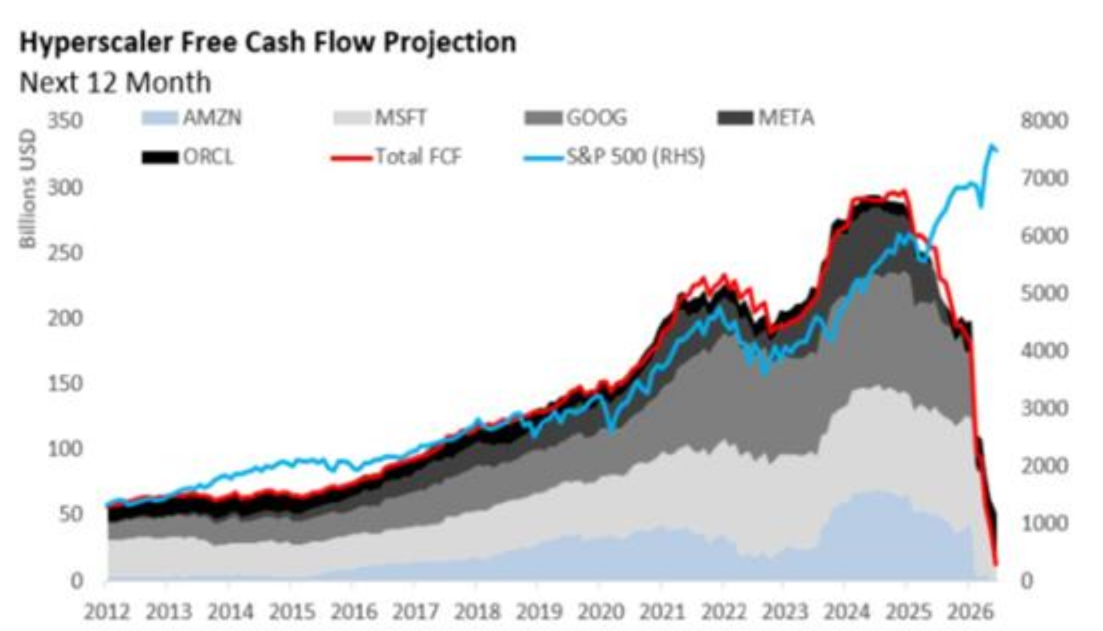
This transformation was driven by two major developments. First, advances in technology made it possible to manage index-tracking funds efficiently in real time, while derivatives and other financial instruments enabled ETF providers to create and redeem units continuously throughout the trading day, reducing costs and improving liquidity. Second, decades of academic research demonstrated that the average active manager struggled to outperform benchmark indices after fees, leading pension funds, endowments, and other institutional investors to embrace passive strategies. Retail investors followed as self-directed investing became more accessible and defined-contribution pension plans expanded.

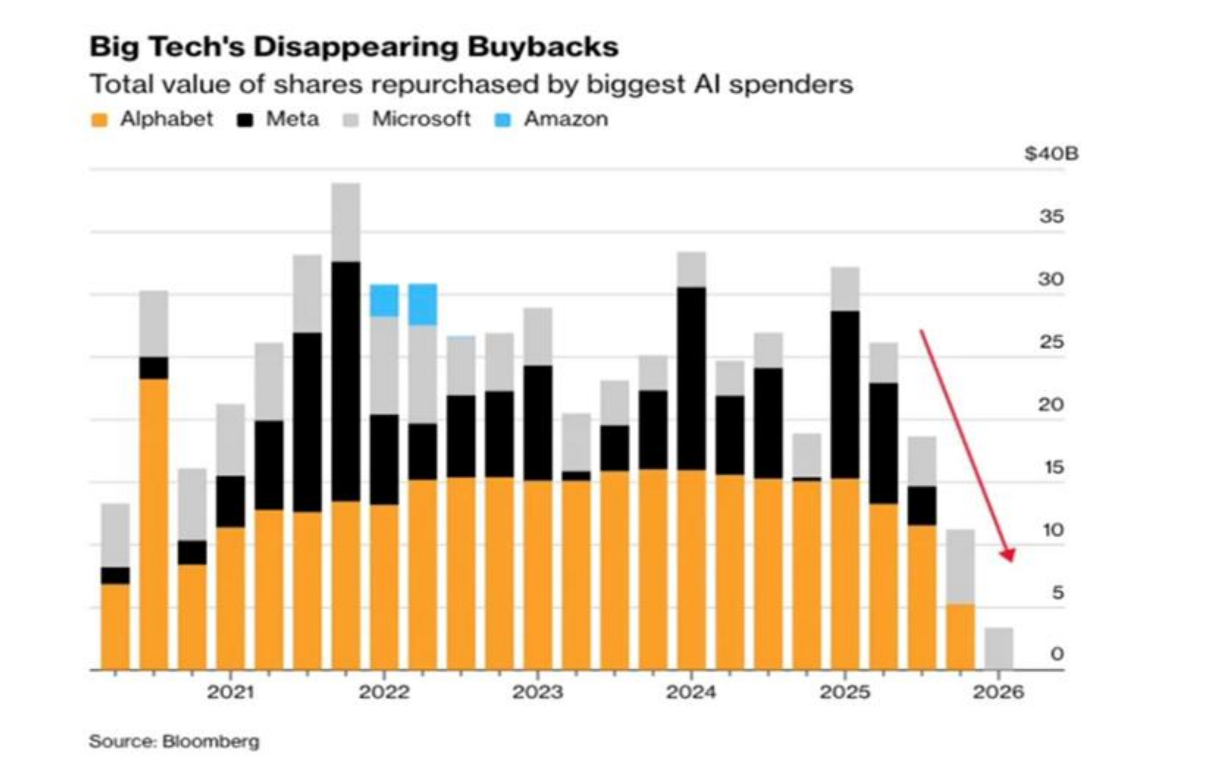
Historically, active managers found it difficult to outperform because market prices reflected the collective judgment of thousands of informed investors, resulting in relatively efficient price discovery. Passive investors benefited by effectively "free-riding" on that process without paying for active management. The tail followed the dog.

Today, however, the balance has shifted. The number of active fundamental managers has steadily declined, while passive investment flows have become large enough to influence prices independently of company fundamentals. There is no longer the same balance of active opinions shaping price discovery. Even the largest institutional investors now pay close attention to index additions, deletions, and rebalances because they trigger significant indiscriminate buying and selling. Quantitative and AI-driven strategies increasingly amplify these passive flows. In many respects, the tail is now wagging the dog. The market structure that originally supported the case for passive investing has evolved considerably and may, in some respects, have reversed.

Conclusion: The proliferation of passive investing has led to record high index concentration in a few names due to the "auto-pilot" nature of a growing share of investment dollars all buying the same investments in a self-reinforcing loop. This creates risks that did not exist previously. The modern market, with a significant passive share, has not been tested at scale by a prolonged downturn as indexed investing was still in its infancy in 2008-09. The rapid pandemic unwind of late March 2020 was a brief window into how things can look when these vehicles are abruptly shifted in reverse, as was 2022 when the Nasdaq declined more than 30%. Active investing is far less common than it once was, but it may ultimately prove advantageous when the next major downturn arrives. At Newhaven we are active investors.

Chart #3 and #4: Free cash flow profiles and share buybacks of major AI spenders (Hyperscalers)





The Point: After more than a decade a mountain of free cash flow generation by major tech companies has disappeared to fund AI capital expenditures, primarily data-centres.

Explanation and Viewpoint: One of the primary drivers of the increasing concentration of the Magnificent Seven within benchmark indices over the past decade was their extraordinary ability to generate cash. As their businesses scaled, network effects allowed revenues and profits to grow without corresponding increases in capital expenditures. These "capital-light" business models became the envy of financial analysts, with abundant free cash flow supporting share repurchases, debt repayment or cash accumulation, and even dividend growth.

That changed dramatically in 2025 as AI investment accelerated. Microsoft, Google, Amazon and Meta known as the “hyperscalers” have shifted from generating excess capital to raising it, issuing both debt and equity at an unprecedented pace to finance AI infrastructure. In just twelve months share buybacks have all but disappeared from these companies after running at ~$25 billion per quarter for the past several years.

Alphabet recently completed an $85 billion equity offering following more than $90 billion of debt issuance over the previous 12 months. Amazon just issued $14 billion in Canadian-dollar bonds, the largest corporate bond offering in Canadian history, with maturities extending to 30 years at interest rates below 5%. The scale of financing is beginning to test investor demand. As the *Wall Street Journal* recently observed, the surge in AI-related borrowing has left the investment-grade bond market struggling to absorb tens of billions of dollars in new issuance each month, with several recently issued bonds from Nvidia, SpaceX and others trading below their offering prices shortly after launch.

At the same time, previously private companies such as Anthropic and OpenAI are increasingly accessing public capital markets, with SpaceX leading the way. The market's willingness to absorb these offerings is likely to encourage even more issuance, allowing early investors to monetize their holdings while passive funds continue to purchase indexed securities regardless of valuation or underlying business quality.

Conclusion: In just 18 months, the financial profile of many of the largest US technology companies has changed dramatically. Despite this shift, passive investment flows continue to allocate capital based on index weights rather than changing fundamentals. The AI race will undoubtedly produce winners and losers, and it seems unlikely that every dollar of today's capital spending will ultimately generate attractive returns. When liquidity eventually tightens, investors will discover which business models created lasting value and which merely consumed capital. The rise of passive investing has provided indiscriminate funding for the AI trade, leaving passive investors particularly exposed if future returns fail to justify today's lofty expectations.

In summary, and at the risk of repeating ourselves, we remain very comfortable with our portfolio despite ongoing concerns about broader markets. The conflict in the Middle East has already escalated further subsequent to quarter-end, with renewed inflationary pressures among the possible consequences. At the same time, technology companies are testing investors' appetite for debt and equity as they seek to finance trillions of dollars of AI-related spending without a clearly established path to monetization.

The sheer amount of capital tied to these two themes should give investors pause after the exceptional returns of the past several years. By contrast, when we look at our own portfolio, we see a collection of high-quality businesses that we believe stand to benefit from a more balanced investment environment and a normalization of risk appetite.