



Quarterly Market Commentary

Q3 2025

The Canadian Paradox

This year has been an exceptional year in many ways—tariffs; markets; geopolitics; the volatility in the first half of the year; the lack of volatility thus far in the latter half of the year. As Canadians, we might add the exceptional performance of the S&P/TSX Composite Index ('TSX') to that list. At the close of Q3, the TSX finished up 21.4% year-to-date, handily outperforming the tech-dominated S&P 500 Index over the same period (+13.7% in USD-terms). The last time the TSX was up double-digits while outpacing the S&P 500 by nearly 8% was 2005; 1999 and 2003 were the only other two times before that.

At the turn of the calendar year, the general atmosphere within and around Canada wouldn't have convinced many to bet in favour of this relative outperformance. We entered the year on the back of President Trump's election victory; overtures were being made about Canada becoming the 51st State, and trade salvos were well underway. With Prime Minister Trudeau announcing his resignation on January 6th, political uncertainty with our closest ally—and within our own borders—was top-of-mind. Not typically conditions conducive to market outperformance.

Canada's economic numbers through the end of 2024 hadn't done much to support the idea that our market was set for a breakout either: Our GDP per capita was the worst in the G7; average household debt-to-disposable income ratios far exceeded those of the United States, forcing the Bank of Canada to cut rates much faster than their U.S. counterpart; the national unemployment rate had risen to 6.7%, compared to the U.S. at just 4.1%.

While our stock market has had an exceptional year, our economic underperformance has continued: Our real Gross Domestic Product (GDP)—the most popular measure of a country's economic strength—contracted by 1.6% in Q2. Forward real GDP is forecast to come in at only 0.5% for Q3, and 1.7% for 2025 as a whole. Our unemployment rate rose to 7.1% in August 2025, and trade negotiations with the U.S. (the country to whom we export ~77% of our goods) came to a standstill in Q3.

Against this backdrop, the TSX's outperformance in 2025 is seemingly all the more remarkable.



The Economy vs. the Stock Market

"The stock market is not the economy. The economy is not the stock market"

The above refrain comes from the famous mid-century economist and Nobel Prize laureate, Milton Friedman. If business or market news forms a part of your normal media routine, you will likely have heard various iterations of it quoted before. The frequency at which it's quoted tends to rise when stock markets perform well in the face of otherwise challenging economic conditions; that is to say, when general economic 'vibes' are low, but market momentum remains strong.

There is a natural tendency to want to draw a straight line between one's economy and the stock market. Indeed, strong economic numbers are typically associated with strong business productivity, strong employment, and high consumer confidence. The latter is particularly important in developed economies where consumer spending commonly accounts for greater than 50% of total GDP (in Canada, consumer spending accounts for ~57% of GDP; in the U.S., it accounts for ~70%). If employment is strong and the business atmosphere is favourable, it stands to reason that businesses within that country should do well, and their stock prices should respond accordingly. The opposite, then, would also be expected to hold true. Research has indeed shown that over long periods of time, a strong economy does tend to be correlated with stronger markets. That correlation, however, is not perfect, and, as Canada's current situation demonstrates, the relationship between the two is certainly not linear.

Investing in a company's stock is by its very nature a forward-looking endeavour. At the most fundamental level, one buys a stock today with the expectation that the value of that stock, or the value of the income it pays, will be worth more over the period of

investment than merely holding cash. If the stock is in a high-growth industry, an investor may be willing to pay more for a stock now with the expectation that its earnings in the future will be much higher. Similarly, if the stock pays a dividend, an investor can ascribe a value to the income stream associated with potential future dividend payments. All else being equal, if that dividend is expected to rise, the price an investor would be willing to pay for the stock today would naturally be higher than if that dividend is anticipated to remain stagnant, or worse, fall or stop all together. This rather technocratic approach is formalized by a very popular mathematical model called the dividend discount model (DDM), and is commonly used by research analysts and sophisticated investors to determine the fair market value of a stock.

Economic data by contrast are generally backward-looking: GDP numbers, employment figures, etc., are aggregations of past activity. If a country's economic conditions look brighter in the future, investors may be more prone to look through current data with the expectation the forward backdrop will support higher prices.

There are myriad other reasons why a company's stock price may not reflect the underlying economic conditions of the country within which it's based. For example, many companies sell goods and services in countries other than their own. Revenue can therefore be more dependent on the economic conditions of the countries within which they sell. Certain industries can also differ in their sensitivity to the underlying economy. Cyclical industries, like the energy and consumer discretionary sectors, benefit from economic momentum, whereas non-cyclical industries, such as health care and consumer staples, are comparably apathetic to changing conditions. (No matter the state of things, people still need food, toothpaste, and medicine.)

Interest rates can be another important influence. Lower interest rates can mean lower cost-of-capital for corporations and higher discretionary capital for consumers. The former means less money is needed to cover interest on a company's debt, leaving more capital available to fund growth. Higher discretionary capital can result in people spending more on non-essential goods and services, such as travel, eating out, or home renovations. Interest rates can also influence asset-allocation decisions—as interest rates fall, GIC and bond yields tend to fall, making fixed income investments less attractive and equities more attractive (particularly dividend-paying securities).

One factor that is harder to quantify but impossible to ignore is momentum. No matter what the dividend discount model says the fair market value of a stock should be, when investor sentiment is strong, stock prices can trade at values much higher than underlying fundamentals would suggest.

When the above factors are extended beyond a single company to the broader market, it's easy to see how stock markets can become dislocated from the underlying economy. Beyond the Canadian Paradox described above, the U.S. S&P 500 Index may be another, potentially less obvious example of such a dislocation. One much-talked-about quantification of this is the current ratio of the total market capitalization of the S&P 500 compared to total U.S. GDP. This ratio is known as the 'Buffet Indicator' (after Warren Buffet; one of the most successful investors of all time). Buffet used this ratio as an indicator of the valuation of the stock market relative to economic activity. A ratio of 75-90% was deemed reasonable, while anything over 120% was considered overvalued. At the time of writing (October 8, 2025), the Buffet Indicator currently sits above 200%; an all-time high.

In the case of Canada's market, while many of the above factors have undoubtedly played

a part in the outperformance of the TSX relative to the economic backdrop, the single most significant factor is more idiosyncratic: Momentum in the price of gold. Gold has risen from approximately \$2,658 USD per ounce at the start of the year to greater than \$4000 USD at the time of writing. A significant driver of this ascent has been global Central Banks prioritizing the purchase of gold over the U.S. Dollar (USD), particularly in the developing world. In the face of the Trump administration's confrontational approach to trade and foreign policy, an aggressive fiscal agenda, and uncertainty related to the potential inflationary impact of tariffs, the status of the USD as a reserve currency has faced pressure in 2025, making gold an attractive (and apolitical) alternative. Four of the five top-performing stocks in the TSX are gold companies, all of which have produced total year-to-date returns in excess of 65% to the end of Q3. Financials and Utilities have also been strong performers, benefiting from falling interest rates and, in the case of utilities, continued anticipation of an artificial intelligence-driven boom in power demand.

Q3 Market Update

Equities continued their rally in the third quarter with Canadian and U.S. markets reaching new record highs. Enthusiasm around Artificial Intelligence (AI) endured on the back of outsized capital spending from mega-cap tech companies. Adding fuel to the fire, the U.S. Federal Reserve (the Fed) cut interest rates on September 17th by 0.25%, the first such cut since December 2024. Federal Reserve Chair, Jerome Powell, cited early signs of a weakening labour market as the primary reason for the cut; a notable shift in focus away from inflation, which remains elevated relative to the Fed's 2% target. Pressure on the Fed to lower rates ramped up through the quarter with the appointment of Stephen Miran (former Chair of President Trump's Council of Economic Advisers), and continued efforts to fire embattled Federal

Reserve Governor, Lisa Cook. The S&P 500 Index finished the quarter up 13.7% year-to-date, while the tech-heavy Nasdaq Composite Index closed up 17.3% over the same period. Meanwhile, the Dow Jones Industrial Average finished the quarter up 9% on the year.

The Information Technology sector continued to dominate S&P 500 returns during the third quarter, finishing up 11.7%. Nine stocks—the Magnificent Seven plus Taiwan Semiconductor Manufacturing and Broadcom—now have market capitalizations exceeding \$1 trillion. Nvidia became the first \$4 trillion company during Q3. Excluding Taiwan Semiconductors, which is foreign-listed, these stocks now make up >35% of the total market capitalization of the S&P 500 Index. The equal-weight S&P 500 index is up only 6% year-to-date, compared to 13.7% for the traditional market capitalization-weighted index, demonstrating the effect of the 'Mag-7-plus-Two' on year-to-date performance. Collectively, these stocks are up an astounding ~40% year to date.

Closer to home, the S&P/TSX Composite Index rose above 30,000 for the first time in Q3. Performance has largely been fueled by a surge in gold prices, with the Materials sector (which includes gold miners) finishing up approximately 79% year-to-date. The Canadian stock market has also benefited from strong performances in the Financials (up 22.5% year-to-date), Utilities (up 17.5% year-to-date) and Information Technology sectors (up 19.68% year-to-date; consisting primarily of Shopify). Despite outpacing the S&P 500 so far this year, valuations remain relatively fair, with the S&P/TSX Composite Index trading at an aggregate price-to-earnings (P/E) ratio of approximately 18x, compared to approximately 22x for the S&P 500.

Positive momentum continued in international equity markets, albeit at a slower pace than Q2. International equities, as measured by the MSCI EAFE Index, finished the quarter up 11% year-to-date (+22% in CAD-terms). Emerging

Market equities had another strong quarter, up approximately 12% in Q3, as measured by the MSCI Emerging Markets Index (in CAD-terms). A weaker USD has helped propel international equities, although the gap to the U.S. market has narrowed since the first quarter. The MSCI EAFE Index ended the quarter at an aggregate P/E of ~16.5x.

Global interest rates continue to move broadly lower, with a number of major central banks cutting rates during the third quarter. Both the Bank of Canada and the U.S. Federal Reserve cut rates on September 17th by 0.25%. Canada's benchmark rate now sits at 2.50%, while the upper bound the Fed's benchmark range sits at 4.25%. Bonds have delivered positive returns so far in 2025, with the Bloomberg U.S. Aggregate Bond Index up 6.1%, the FTSE Canada Universe Bond Index up 3.0%, and the Bloomberg Global Aggregate Bond Index up 7.9% year-to-date.

Heading into Q4, investors are attempting to balance optimism for the continued bull market with caution around valuations. With the U.S. Government shut down, ongoing inflationary pressures, and ever-present tariff clouds still looming overhead, our team remains strategic in our equity allocations. We have trimmed top performers in several areas, and continue to monitor underlying risk exposure as it relates to the AI trade, particularly given elevated valuations, concentration in the big tech names, and a fractious and uncertain geopolitical backdrop.

Year-to-Date Returns (local currencies):

S&P 500: 13.7%

Nasdaq: 17.3%

S&P/TSX Composite Index: 21.4%

Euro Stoxx 50: 13.0%

Japan Nikkei 225: 12.6%

Shanghai Stock Exchange (SSE)

Composite: 15.8%

Data: FactSet as of September 30th 2025; price returns.



Team Update

Beginning on **November 1st**, our team name will be updated to **Griffiths Underdahl Wealth Management**. This is reflective of Joshua Borger's official retirement on October 31st.

We would like to take this opportunity to thank you for your business and continued trust in our team. We look forward to continuing to work with you and your family as we help navigate your financial journey with deep knowledge, diverse experience, and commitment on your side. If you have any questions or issues you would like to discuss, we would be happy to receive your call.

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