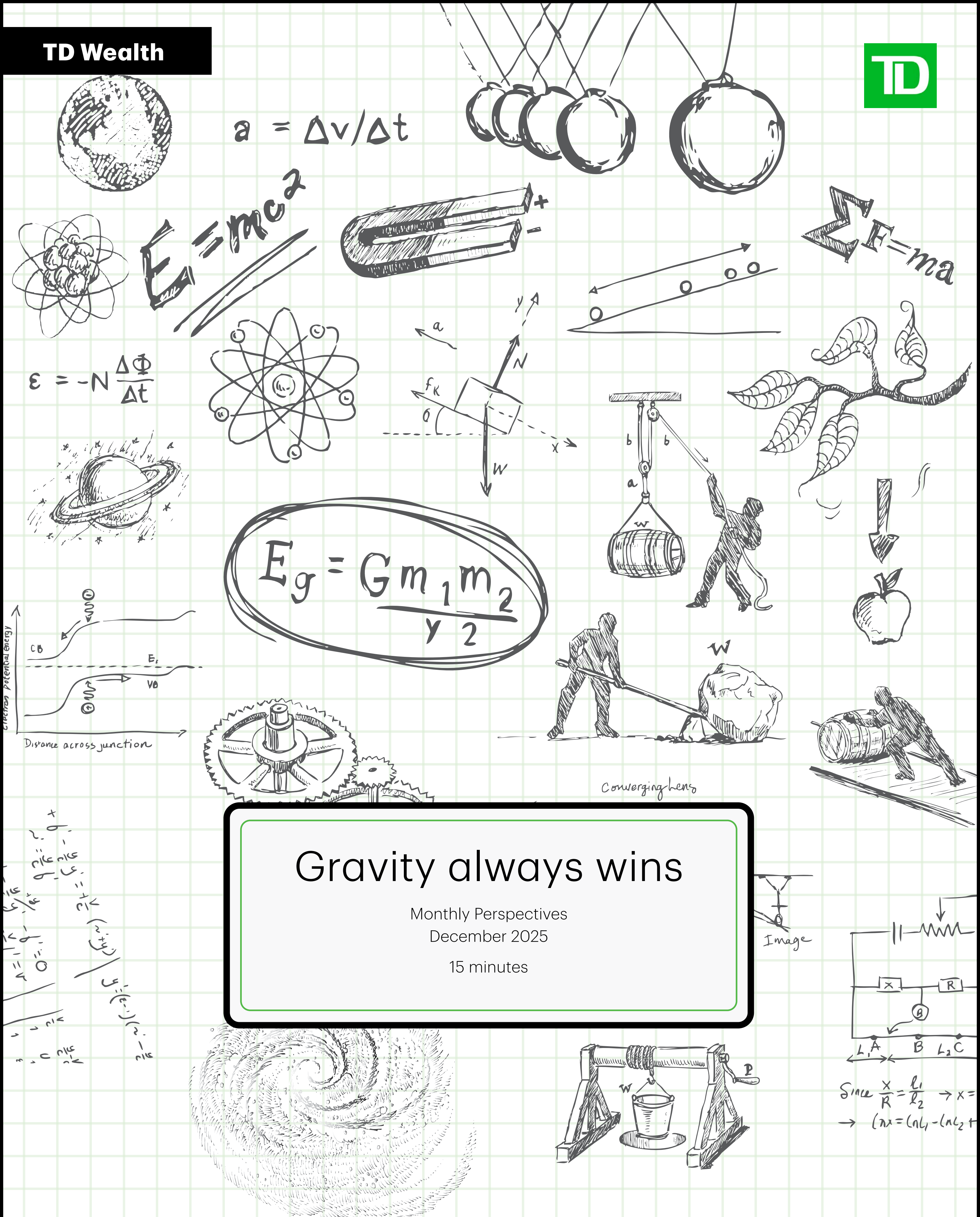
TD Wealth



Gravity always wins

Monthly Perspectives
December 2025

15 minutes

Gravity always wins

The real story isn't a market correction — it's the unwinding of the most speculative and crowded trades in years.

By Brad Simpson, Chief Wealth Strategist, and Kevin Yulianto, Portfolio Manager | TD Wealth

For all the noise about a market correction, the reality is far less dramatic: we haven't had one. What we have had instead is an unwinding of concentrated long positions on names that are popular among retail investors and have much smaller implications for diversified investors. Bitcoin, triple-levered products, "retail favourites" and the outer edge of speculative tech have been hit hard, while the centre of financial markets — major equity indices, credit and rates — has stayed almost boringly stable. At the same time, the market has been living inside a narrative about AI and transformational technology — an era of extraordinary promise that, if history is a guide, tends to invite extraordinary excess. Every technological revolution follows this arc: the story becomes bigger and bigger, leading speculators to price inevitability rather than probability. These periods never end because the technology fails; they end because the narrative becomes too perfect, too linear, too widely believed, too easy.

This isn't the kind of correction that comes from tightening liquidity, a deterioration in corporate earnings or a breakdown in macro fundamentals. It's the slow deflation of the most crowded, most fragile retail trades built up over the past year — trades that relied on momentum, leverage and a belief that, in this new era, the returns on speculative assets could be the equivalent of a consistent paycheque. The unwind has been sharp, but it's happening in the same corners where the excess was concentrated.

As we wrote in our recent PSQ, Artificial Intelligence. The Last Temptation: "Financial markets rest on two stabilizers — liquidity and earnings power — that have not yet broken. Until these two dry up, calling the exact peak may remain more psychological than empirical." That's where this "correction" sits today. Not as a broad market unwind, but as the first cracks in a set of retail-driven trades built on the assumption that AI, crypto and related tech would make the path forward frictionless. The real correction isn't in earnings or economic data — it's in sentiment, leverage and the belief that a great story can outrun gravity. As Sir Isaac Newton himself discovered during the South Sea Bubble, when it comes to the age-old struggle between gravity and speculation, gravity always wins.

A Year-End Message

As the year draws to a close, we want to sincerely thank you for the trust you place in us. It is a privilege to work alongside our advisors and clients, and we are deeply grateful for the partnership we share. This year brought moments of enthusiasm, moments of recalibration, and plenty of reminders that markets, like life, move in cycles.

Long ago, Newton gave us a simple truth about the natural world: what rises is always subject to gravity. Markets are no different. Periods of speculation and excitement can feel weightless for a time, but gravity eventually reasserts itself, gently or otherwise. It is in that steady pull, towards discipline and fundamentals, that long-term success is most often found. This quiet force continues to guide how we think about investment strategy and managing money.

As the holidays approach, we know this season is about far more than markets and portfolios. It is about family, friendship, reflection, and rest. We hope the weeks ahead offer you moments of calm, connection, and joy.

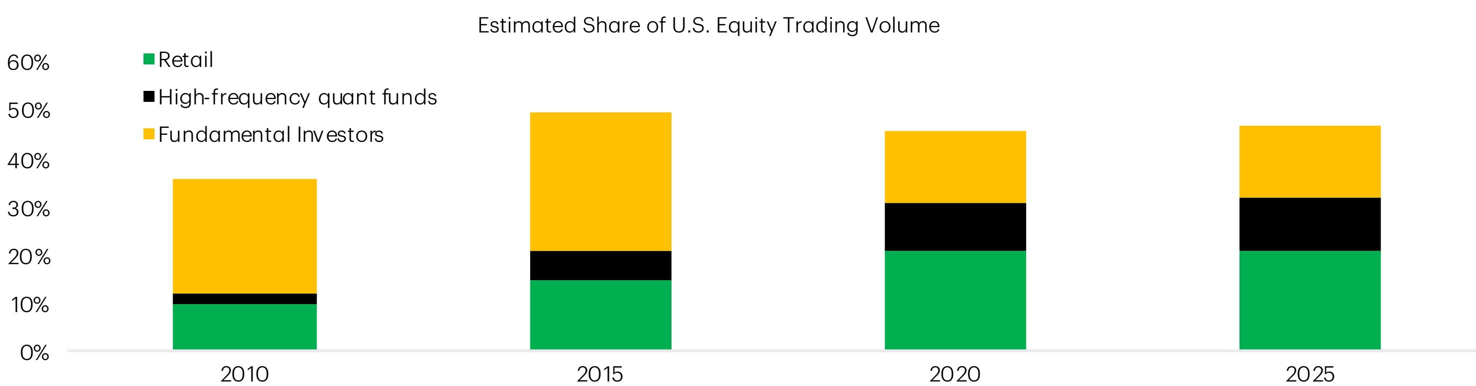
From all of us at the Wealth Investment Office, thank you again for your confidence and your continued partnership. We wish you and your loved ones a warm and wonderful holiday season, good health, and every success in the year ahead. We truly look forward to continuing our work together in the new year.

The rise in user-friendly brokerage applications has changed the nature of trading in equity markets. Retail investors and quant funds, which used to be a minnow in global equity trading, are now estimated to account for more than one-third of daily trading volume. And retail investors are punching above their weight with the use of levered ETFs, options and other derivative products. Levered ETFs have grown from only $40 billion in AUM before the pandemic to a $240-billion industry today. On the flip side, fundamental investors' share of trading volume has declined from around 30% in 2015 to 15% currently (Figure 1).

Although retail participation had been rising before 2020, this trend accelerated sharply during the pandemic as Americans — flush with government stimulus cheques and with plenty of spare time — opened brokerage accounts and started trading stocks that were in the mainstream consciousness. In January 2021, a group of retail traders triggered a short squeeze on GameStop (GME), causing major financial consequences for certain hedge funds and large losses for short sellers. At the peak, the game retailer's stock price reached $500 per share, or nearly 30 times its value a month earlier. Cryptocurrencies also soared. Around three years later in May 2024, in another round of retail trading mania, GME jumped six times. Increasingly, the stock market is looking like a casino and the line between investing and gambling is fading.

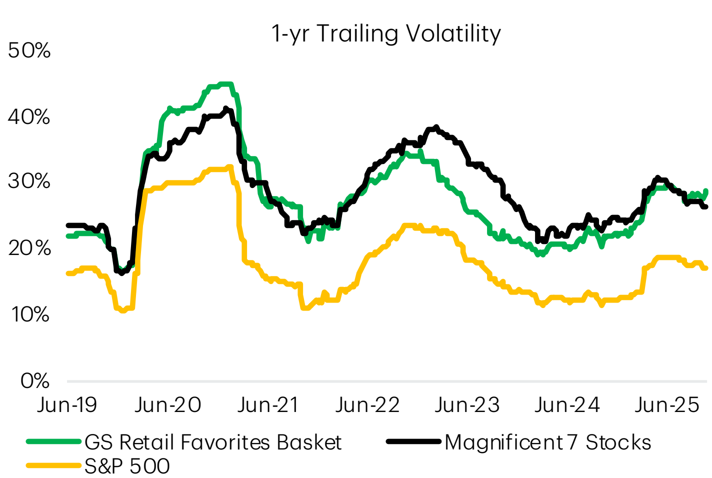
Investors would be wrong to think that this was simply a pandemic-era phenomenon. Retail investors continue to see share gains in daily trading volume, and the impact of this is increasingly affecting how institutions invest in the equity market. Retail favourite names and the Magnificent 7 stocks are exhibiting higher volatility than the rest of the index, which translates to hundreds of billions in daily value changes (Figure 2). Given the large weights of the Mag-7 in the S&P 500 (combined they represent 37% of the index) and the trend in passive investing, higher overall portfolio volatility for investors is inevitable. Perhaps now the tail is wagging the dog, with institutional investors having to chase higher mega-cap stocks that are popular among retail investors or risk underperforming the benchmark.

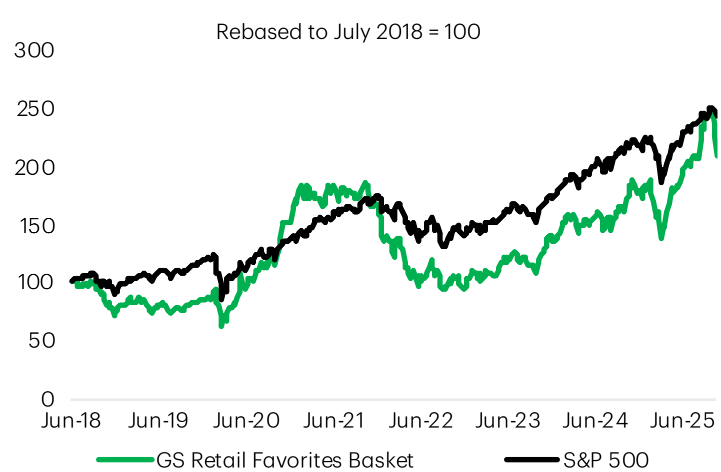
Figure 1: Retail investors, quant funds have made the market more volatile



Source: Macrobond, Empirical Research Partners, Wealth Investment Office, as of November 24, 2025

Figure 2: Meme stocks, Mag-7 way more volatile





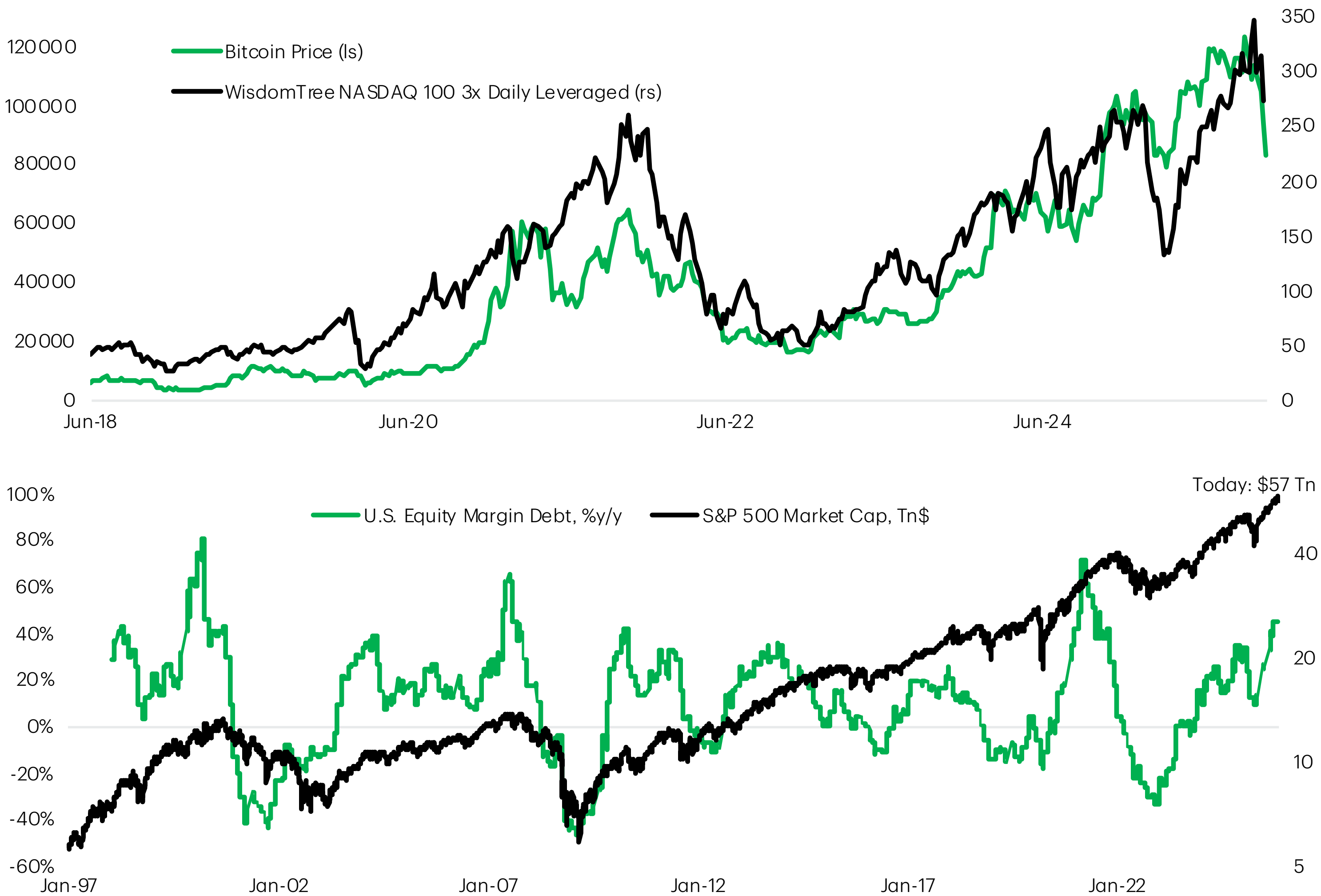
Source: Macrobond, Wealth Investment Office, as of November 24, 2025. Note: The GS retail favourites basket consists of U.S. listed equities that are most popular among retail communities measured by retail flow data.

We are seeing the line between investing and betting blur as traditional institutions also change. Intercontinental Exchange stated that it would invest as much as $2 billion in the cryptocurrency betting platform Polymarket, while CME Group is collaborating with FanDuel, an online gambling website, to offer financial contracts tied to sports, economic indicators and stock prices. This is a further democratization of online gambling, with more people now active in both betting and the stock market.

Today, there are more than 500 levered ETFs across U.S. exchanges, with focuses ranging from index-based products to single-name stocks as underlying exposure. In addition to cryptocurrencies, this offers retail traders access to potentially double-digit-percentage moves on a daily basis (Figure 3). Margin debt (use of margin in trading accounts) has also seen a meaningful jump as investors turned from "fear" in 2022 and last April to "greed" currently. An increase in equity margin debt tends to coincide with or precede the peak in the S&P 500 Index. Today, equity margin debt has jumped but remains lower than historical peaks.

The macro and liquidity backdrop over the past five years has been conducive to speculation. There are three reasons for this. First, the unemployment rate has been low, and inflation, although still higher than the central bank's target, is coming down. Second, despite quantitative tightening since 2022, global money supply has barely declined and monetary conditions remain loose. Third, another important measure of liquidity — the amount of money in the financial system that is neither in government deposit accounts nor earning interest through the central bank's reverse repo operation — remains significantly above pre-pandemic levels, which is supportive for risk assets. This measure of net liquidity spiked during the pandemic as the Federal Reserve flooded the system through quantitative easing and tightened somewhat through most of 2022.

Figure 3: Retail investors chase volatility, often on margin



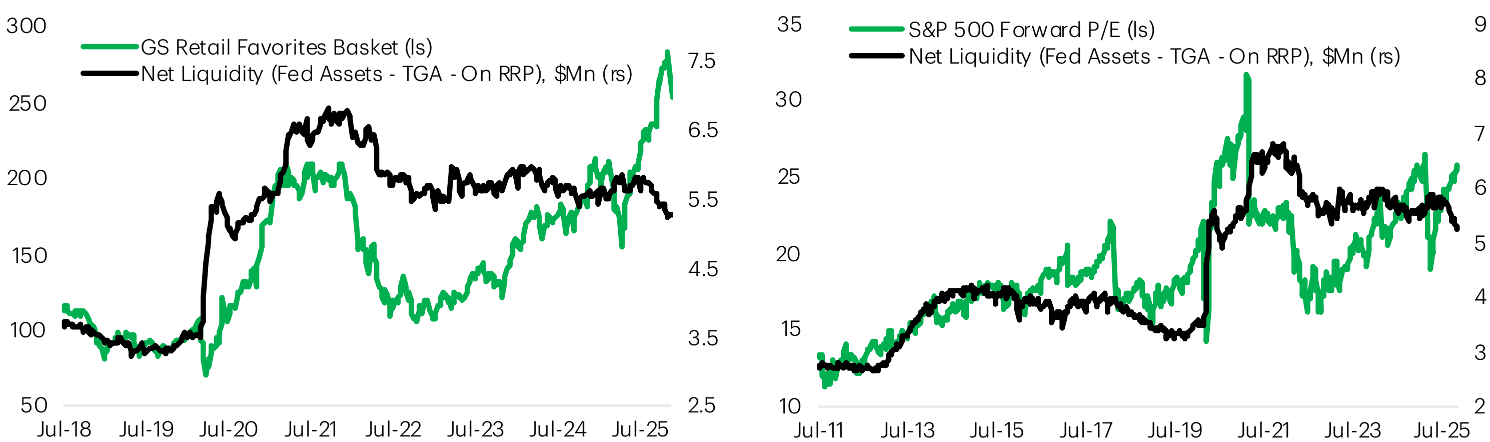
Source: Macrobond, Wealth Investment Office, as of November 24, 2025

Figure 4 shows that net liquidity is loosely correlated with the boom-bust in retail favourite names and the S&P 500 forward P/E ratio. Given that the government shutdown between October and November increased the amount of money in the Treasury General Account (TGA), net liquidity has tightened gradually since September, despite higher equity valuations. This will likely reverse as the U.S. government resumes operation and starts paying its expenses. Another potentially positive development is that the Fed will stop quantitative tightening by December 1 and banks' reserve balances remain "ample."

Increases in leverage, concentrated long positions and changing liquidity conditions all make the equity market more vulnerable to negative shocks. In November we saw higher-beta and more speculative assets tumble amid a long list of investor concerns:

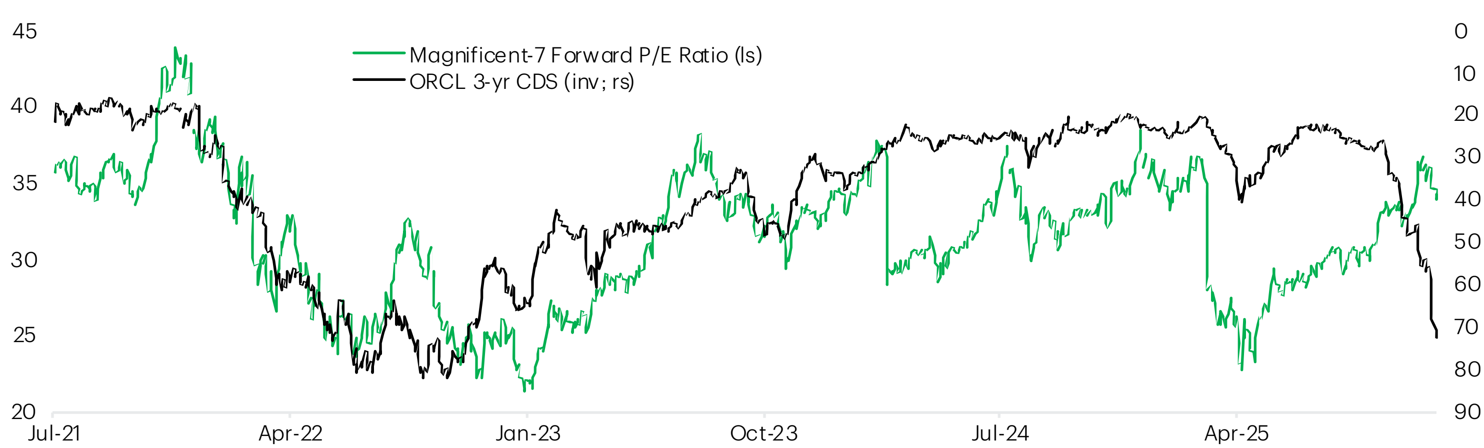
1. Scrutiny on AI ROI and circularity of AI financing. Investors are increasingly questioning whether the returns on AI investments will be justified, with a rising focus on the circularity of AI financing and the rising debt profile of select players. Oracle is one of the most discussed names, given that it may have to take on more debt to fund its AI data-centre expansion. Unlike the mega-cap tech firms, Oracle has weaker cash flow and balance-sheet profiles. On September 9, when Oracle reported a massive $300-billion order from OpenAI — increasing its backlog threefold on an annual basis — its stock price jumped 36%. As of November 21, however, the stock has erased all these gains and more amid concerns about how OpenAI will pay for it. This is also reflected in the sharp increase in the cost of hedging Oracle's bonds. Figure 5 shows that the three-year credit default swap (CDS) for Oracle is at its highest level since 2022. In other words, investors are skeptical about whether the company could deliver adequate profit on its investments. Sentiment has now swung from extreme optimism in September to deep skepticism. This counters the narrative that AI-related stocks are in a bubble.

Figure 4: Speculation has thrived on stimulus



Source: Macrobond, Wealth Investment Office, as of November 24, 2025

Figure 5: Investors growing concerned about AI ROI



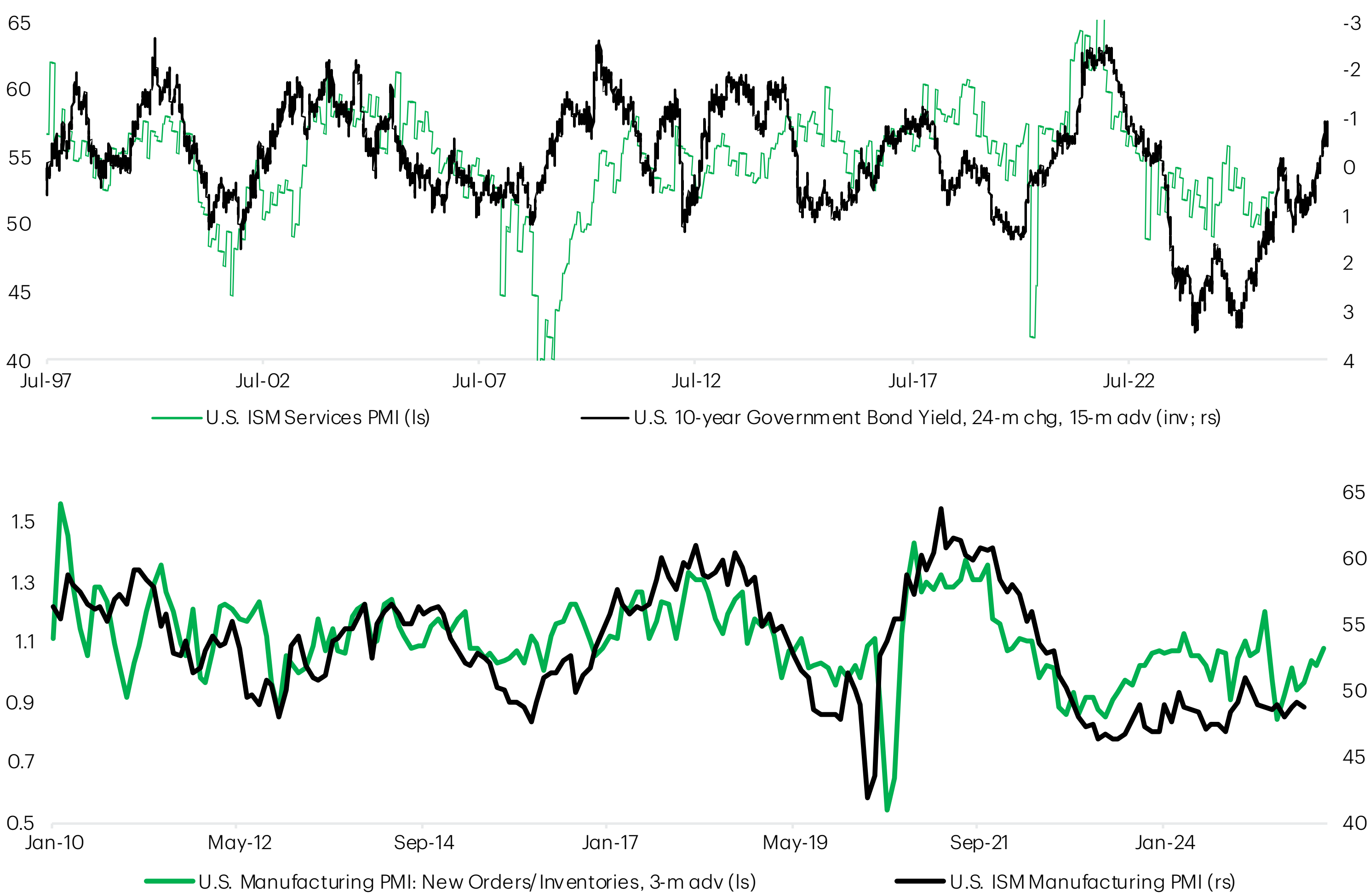
Source: Macrobond, Wealth Investment Office, as of November 24, 2025

2. More hawkish pricing for a Fed rate cut. The lack of U.S. economic data amid the government shutdown made it more difficult for investors to assess underlying strength in the U.S. economy. Commentary from U.S. companies reporting in the most recent quarter, as well as private surveys, highlight that the inflationary impact of tariffs appears manageable, with more focus on the weakening labour market and slowing consumer spending among lower- and middle-income households. However, views among regional Fed governors have diverged, with some preferring further rate cuts and others favouring a wait-and-see approach. The Philadelphia Fed's Anna Paulson said she is more worried about the labour market than inflation but stated that each rate cut raises the bar for the next.

3. Softening labour market and consumer spending. Underlying U.S. labour-market conditions continued to soften, with the bulk of job gains in non-cyclical industries. Despite the strong September U.S. jobs gain, where U.S. non-farm employment increased by 119,000, the unemployment rate rose to 4.4% — above economists' expectations of 4.3%. More concerning, employment for July and August was revised lower by 7,000 and 26,000, respectively. An increasing share of households now think that unemployment will be higher in the coming year, which historically indicates the direction of job gains in the subsequent quarter. Meanwhile, job growth likely has fallen below potential, and layoffs are increasing in many industries, as suggested by recent Challenger reports. In the most recent earnings season, we saw consumers trading down across all income groups and pulling back on discretionary spending, including eating out at fast-casual restaurants.

Amid the wall of worries, however, we also see tailwinds next year that support a potential upswing in the U.S. business cycle. First, fiscal policy will shift to net easing amid corporate and income tax cuts from the OBBBA. Second, monetary easing by the Fed should revive economic activity, especially in rate-sensitive sectors. Third, a decline in policy uncertainty should bolster foreign direct investment into the U.S. All these are tailwinds for the U.S. economy and favourable for the outlook of domestic cyclical sectors. Already, there are budding signs of a recovery in manufacturing and services (Figure 6).

Figure 6: Indicators point to accelerated business activity



Source: Macrobond, Wealth Investment Office, as of November 24, 2025

In addition, we expect AI adoption across households, enterprises and government to enter its J-curve in 2026. We have observed efforts across industries to hire talent to integrate AI into daily business activities while pulling back on junior hiring. To support this adoption, the world needs not only advanced chips but also the development of energy infrastructure to power the growing number of data centres.

This quarter, more companies mentioned the potential use of AI to boost worker productivity. Given the early stage of adoption, service-sector companies have seen greater integration of AI than those in goods-producing sectors. Sectors with higher operating margins tend to see greater benefits from integrating AI into business processes, potentially further bolstering profitability. Figure 7 shows that significantly more companies in communication services, information technology and financials mentioned AI's potential to increase productivity compared to companies in utilities, energy and materials. This likely reflects the differential impact of AI integration on labour demand across sectors.

What To Do?

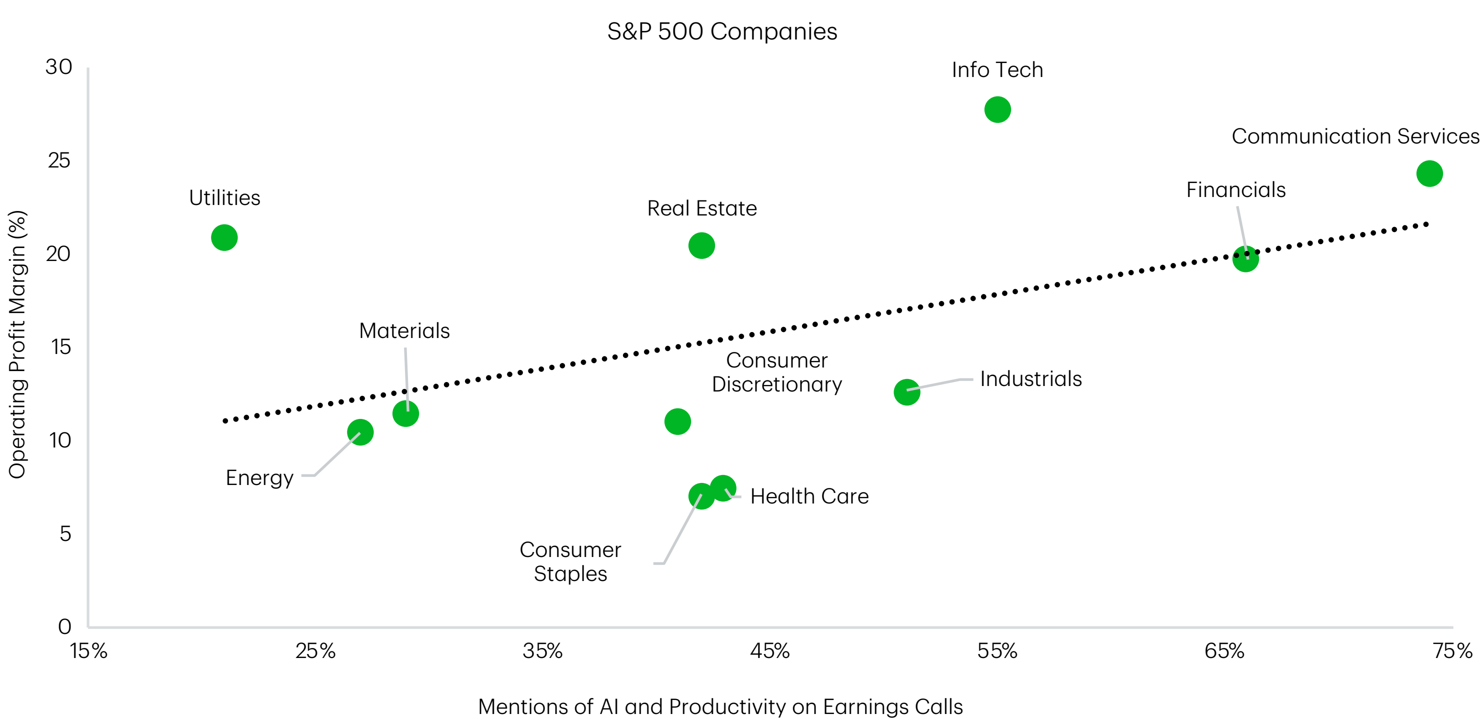
So here we are. The current correction is not an early recession signal, a break in market liquidity conditions, a credit crisis, a reversal in the AI capex cycle or a deterioration in corporate earnings. Instead, it is a behaviour-driven, positioning-heavy and options-amplified reset in the most crowded AI momentum and retail trades, with leverage.

The good news is this has not spread into the greater financial market, which is the kind of contagion that can happen when leveraged speculators caught on the wrong side of a selloff are no longer able to get rid of the niche assets they'd intended to flip, and are instead forced to sell reasonably priced assets in the mainstream.

The solution is two-fold. First, know the difference between speculating and investing. Given the uncharted territory ahead, investors should aim to increase the stability of their portfolios and reduce volatility through greater diversification into alternatives. Investing for the long term requires discipline. Rather than chasing the latest trends, we advocate for a diversified portfolio that can navigate cycles and is not reliant on timing the market. Risk management and portfolio construction are essential parts of investing that are often overlooked as fear of missing out (FOMO) and panic ebb and flow in the market.

From all of us at the Wealth Investment Office, thank you again for your confidence and your continued partnership. We wish you and your loved ones a warm and wonderful holiday season, good health, and every success in the year ahead. We truly look forward to continuing our work together in the new year.

Figure 7: High-margin businesses reap greatest rewards from AI



Source: Macrobond, Wealth Investment Office, as of November 24, 2025

Market Performance

Canadian Indices ($CA) Return	Index	(%) 1 Month	(%) 3 Months	(%) YTD	(%) 1 Year	(%) 3 Years	(%) 5 Years	(%) 10 Years	(%) 20 Years
S&P/TSX Composite (TR)	127 923	0,97	11,70	25,13	28,75	19,52	17,64	11,71	8,63
S&P/TSX Composite (PR)	30 261	0,79	11,01	22,37	25,27	15,92	14,20	8,38	5,49
S&P/TSX 60 (TR)	6 163	0,80	10,64	23,05	26,87	18,58	17,54	11,88	8,85
S&P/TSX SmallCap (TR)	2 098	2,30	21,82	39,40	38,43	21,95	18,69	10,81	5,93
S&P/TSX Preferred Share(TR)	2 411	2,24	3,29	14,36	20,01	13,82	9,73	6,25	3,61
U.S. Indices ($US) Return									
S&P 500 (TR)	15 174	2,34	8,23	17,52	21,45	22,68	17,64	14,64	11,19
S&P 500 (PR)	6 840	2,27	7,90	16,30	19,89	20,89	15,91	12,65	9,06
Dow Jones Industrial (PR)	47 563	2,51	7,78	11,80	13,89	13,26	12,41	10,41	7,88
NASDAQ Composite (PR)	23 725	4,70	12,32	22,86	31,11	29,25	16,81	16,72	12,83
Russell 2000 (TR)	13 554	1,81	12,48	12,39	14,41	11,94	11,50	9,36	8,41
U.S. Indices ($CA) Return									
S&P 500 (TR)	21 274	3,06	9,57	14,50	22,30	23,81	18,82	15,44	12,14
S&P 500 (PR)	9 590	2,99	9,24	13,31	20,72	22,00	17,07	13,43	9,99
Dow Jones Industrial (PR)	66 683	3,23	9,12	8,92	14,68	14,31	13,53	11,19	8,80
NASDAQ Composite (PR)	33 262	5,44	13,72	19,70	32,03	30,44	17,97	17,54	13,80
Russell 2000 (TR)	19 002	2,53	13,87	9,50	15,21	12,97	12,61	10,13	9,34
MSCI Indices ($US) Total Return									
World	20 859	2,02	8,12	20,21	22,53	22,25	16,12	12,37	9,33
EAFE (Europe, Australasia, Far East)	14 194	1,19	7,58	27,21	23,66	20,68	12,89	8,01	6,26
EM (Emerging Markets)	3 812	4,19	13,31	33,59	28,69	21,72	7,95	8,13	7,08
MSCI Indices ($CA) Total Return									
World	29 245	2,74	9,46	17,12	23,39	23,38	17,28	13,15	10,27
EAFE (Europe, Australasia, Far East)	19 900	1,90	8,92	23,94	24,52	21,79	14,02	8,77	7,17
EM (Emerging Markets)	5 344	4,92	14,72	30,16	29,58	22,84	9,03	8,89	7,99

Currency									
Canadian Dollar ($US/$CA)	1,40	0,65	1,11	-2,60	0,55	0,94	1,01	0,69	0,85
Regional Indices (Native Currency, PR)									
London FTSE 100 (UK)	9 717	3,92	6,40	18,89	19,82	11,06	11,74	4,33	3,06
Hang Seng (Hong Kong)	25 907	-3,53	4,57	29,15	27,51	20,83	1,45	1,36	2,98
Nikkei 225 (Japan)	52 411	16,64	27,62	31,37	34,11	23,85	17,93	10,63	6,98

Benchmark Bond Yields	3 Months	5 Yrs	10 Yrs	30 Yrs
Government of Canada Yields	2,25	2,70	3,12	3,58
US Treasury Yields	3,83	3,69	4,08	4,65

Bond Indices ($CA Hedged) Total Return	Index	1 Mo (%)	3 Mo (%)	YTD (%)	1 Yr (%)	3 Yrs (%)	5 Yrs (%)	10 Yrs (%)
FTSE TMX Canada 91-day Treasury Bill Index	483	0,25	0,74	2,46	3,12	4,26	2,80	1,90
FTSE TMX Canada Universe Bond Index	1 212	0,69	2,98	3,69	5,23	5,25	0,07	2,13
FTSE TMX Canada All Government Bond Index	1 130	0,69	3,12	3,31	4,70	4,53	-0,60	1,69
FTSE TMX Canada All Corporate Bond Index	1 510	0,70	2,54	4,86	6,88	7,39	2,01	3,36
U.S. Corporate High Yield Bond Index	320	-0,01	1,77	5,89	6,23	9,01	4,61	5,03
Global Aggregate Bond Index	268	0,62	1,63	3,36	3,38	4,45	-0,22	1,78
JPM EMBI Global Core Bond Index	588	1,78	5,05	11,22	10,38	11,48	1,44	3,09
S&P/TSX Preferred Total Return Index	2 411	2,64	3,29	14,36	19,39	13,82	9,69	6,22

Source: TD Securities Inc., Morningstar®, TR: total return, PR: price return, as of October 31, 2025.

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