



What's going on? War, Oil, AI and Returns

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15 minutes



What's going on? War, Oil, AI and Returns

Geopolitical shocks may grab headlines, but markets are increasingly driven by a deeper shift – from the weightless digital economy to the capital-intensive world of energy, infrastructure and AI.

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

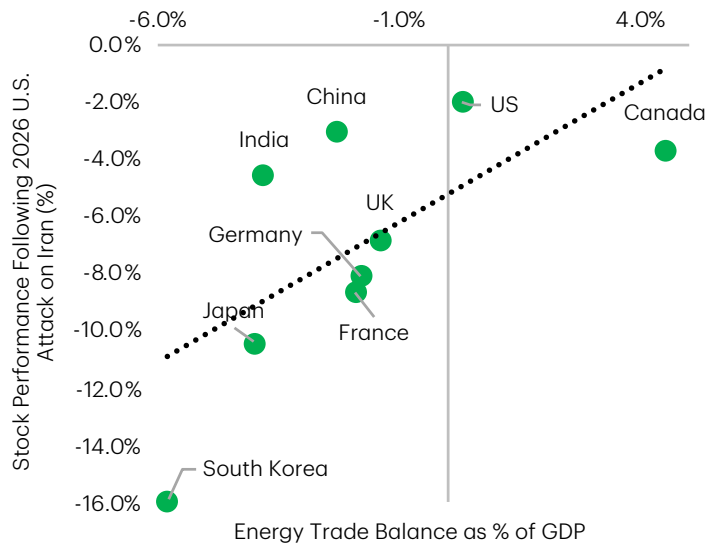
Markets entered the current geopolitical crisis in a reasonably good mood. Of course, as war broke out across the Middle East, that optimism was tested, but even after missile strikes across the Gulf and a sharp rise in oil prices, North American equity markets are only modestly lower. The contrast between the headlines and the market behaviour could hardly be more striking. Oil and natural gas prices have moved meaningfully higher as traders reassess the risk of disruption around the Strait of Hormuz. Beyond energy markets, though, the reaction has been far more restrained than the tone of the news coverage might suggest. It's safe to say the question on most investors' minds is: What's going on?

Equities have been relatively stable, and credit spreads have moved only modestly higher. Perhaps most notable, government bond yields have actually moved higher in the initial phase of the conflict amid the fear of higher oil prices leading to higher inflation – a change from the traditional flight-to-safety pattern typically associated with geopolitical crises.

The global picture is somewhat more nuanced, however. Equity markets in parts of Asia and emerging markets have corrected more noticeably, reflecting their greater sensitivity to rising energy prices and global trade disruptions. Many of these economies are significant energy importers,

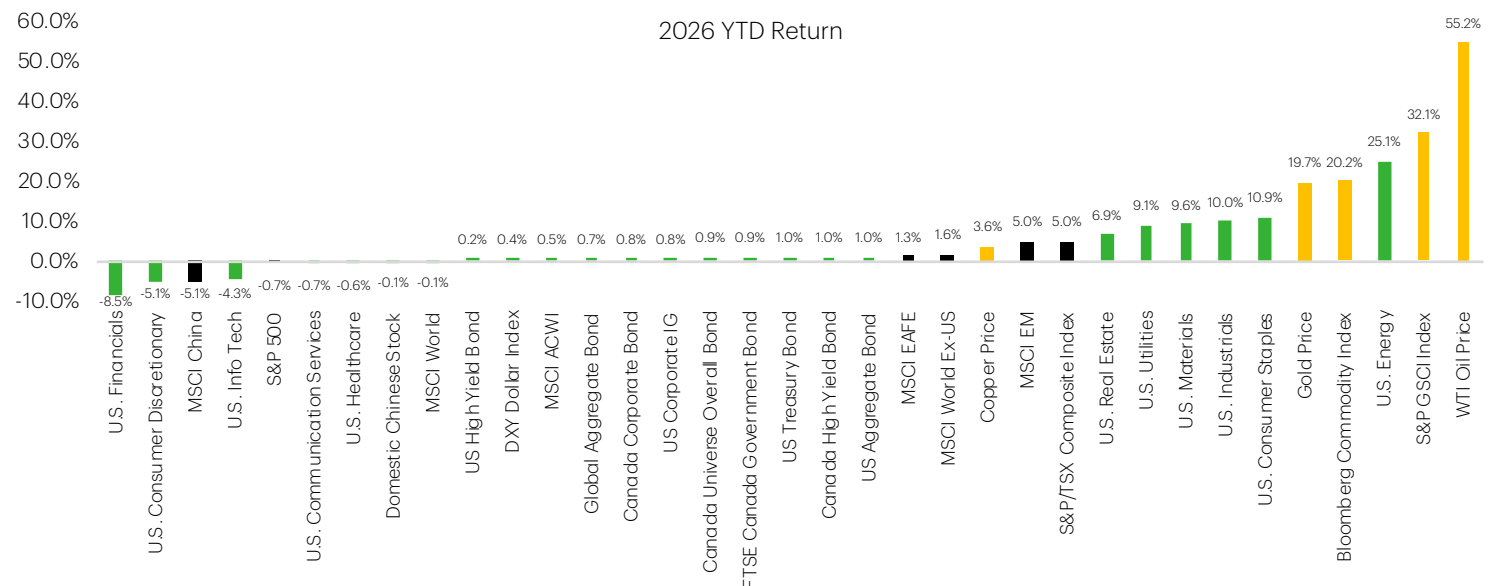
and therefore more vulnerable when oil prices rise. Figure 2 plots the performance of equity markets in various countries following the attack against their respective energy trade balance as a percentage of GDP. As you can see, there's a positive correlation between the two variables, highlighting the vulnerability of countries with large energy deficits.

Figure 2: Energy exporters have an advantage right now



Source: Macrobond, Wealth Investment Office as of March 9, 2026

Figure 1: No panic in the markets



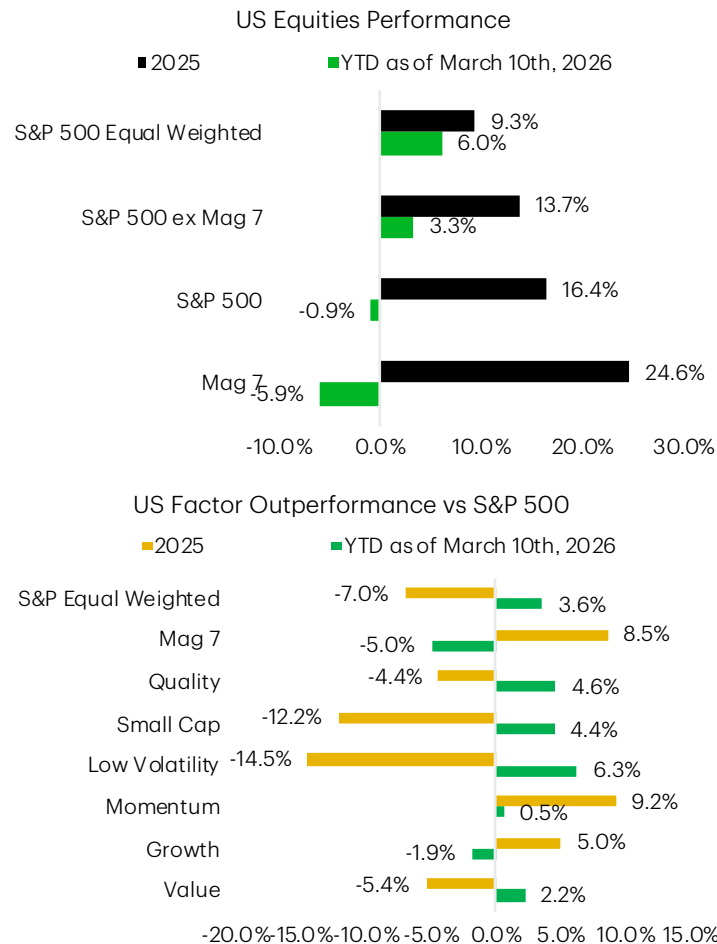
Source: Macrobond, Wealth Investment Office as of March 9, 2026.

By contrast, the United States and Canada are now net energy exporters, leaving North American economies less exposed to oil shocks than in previous decades. In fact, rising energy prices can provide a boost to Canadian GDP, although higher oil prices may also lead to higher domestic inflation. Again, this partially explains why North American equity markets have been more resilient relative to the rest of the world amid the recent surge in oil and natural gas prices.

Part of the broader explanation also lies in how markets have historically processed geopolitical events. While conflicts can create sharp moves in commodity prices — oil and natural gas most notably — they rarely derail the broader economic cycle unless they significantly disrupt global trade or energy supply for an extended period of time. Iran's response to the initial strikes suggests the conflict may evolve through what military strategists often describe as “horizontal escalation.”

Rather than confronting the United States and Israel directly in a single theatre, Iran appears to be widening the geographic and political scope of the conflict — targeting areas near U.S. bases across the Gulf and threatening infrastructure across multiple countries. Such a strategy allows a weaker power to raise the economic and political costs of confrontation without needing to match its adversaries militarily.

Figure 3: Laggards play catch-up as Mag 7 pull back



Source: Macrobond, Wealth Investment Office as of March 10, 2026.

History suggests that these dynamics can prolong geopolitical crises, but markets ultimately focus less on the initial shock of military events and more on whether those events alter the underlying economic trajectory. The war in Iran is creating volatility, but what is fundamentally driving markets right now is more fundamental, a rotation away from the digital industries that have propelled the market recently and towards the physical industries that have sustained it for generations — physical over digital, atoms over electrons.

In the short article that follows, we're going to be exploring a handful of key questions and concerns that the market is grappling with right now:

- **how the conflict in the Middle East could impact oil prices, inflation and financial markets**
- **what the latest inflation data means for the path of interest rates and central bank policy**
- **why markets have historically remained resilient through geopolitical shocks**
- **what higher oil prices could mean for equity markets, sectors and inflation expectations**
- **where we see risks emerging in credit markets and how investors should think about them**
- **how portfolios are positioned across equities, fixed income and alternatives in today's environment**
- **where we see opportunities for investors as markets navigate the current uncertainty**

At times like these — and it can't be overstated — stepping back from the headlines and focusing on underlying economic forces shaping markets is critical for investors.

Atoms: The Return of the Physical Economy

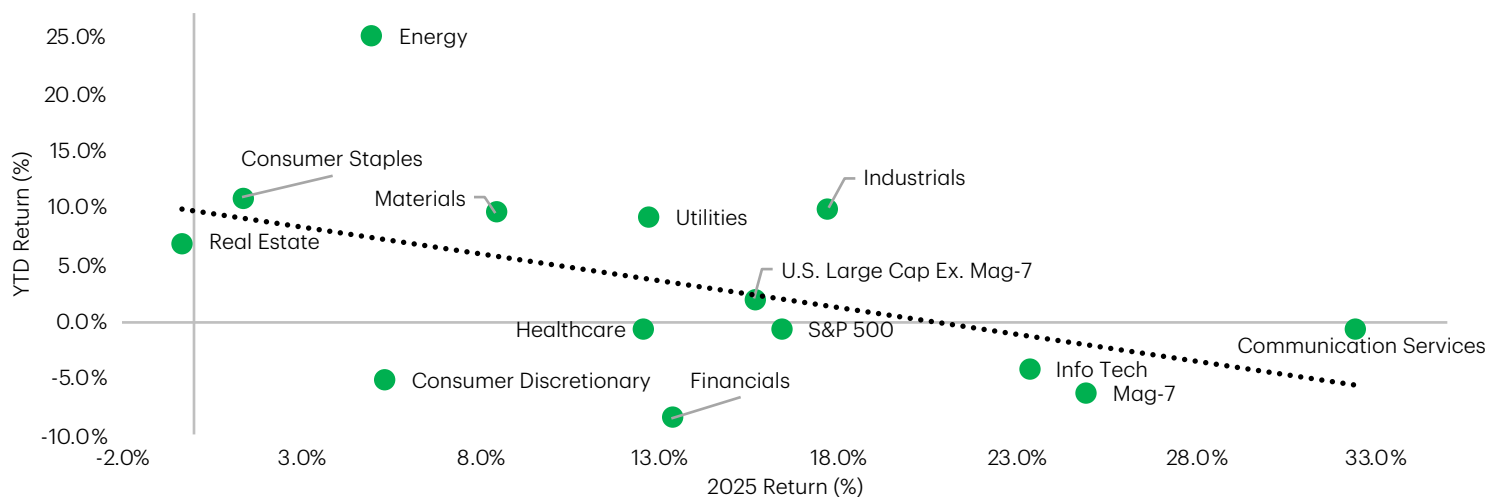
For much of the past decade, financial markets were dominated by the digital economy. Software platforms, cloud computing and businesses built around network effects drove extraordinary earnings growth and valuation expansion. The next phase of the economic cycle, however, is increasingly being driven by the physical economy. Artificial intelligence requires vast data centres and computing infrastructure. Electrification requires power generation and transmission capacity. Reshoring requires factories, logistics networks and skilled labour. In other words, the digital economy ultimately rests on a foundation of physical infrastructure and networks.

This shift is already visible in market leadership. We wrote about this in our Portfolio Strategy Quarterly, wherein we advocated that investors shift allocation from growth-oriented tech stocks to a broader palette. Clearly, we're not the only ones making this call; there has been a massive rotation in equities. The outperformance of small-cap equities and the S&P Equal Weight Index is telling. Factors such as yield, quality and value are also performing well (Figure 3).

Further, at a sector level, cyclical sectors have been playing a larger role in market performance. Investors have rotated away from the winners of the previous few years into the laggards whose businesses are mostly grounded in the physical economy, and therefore saw less disruption from advances in AI (Figure 4).

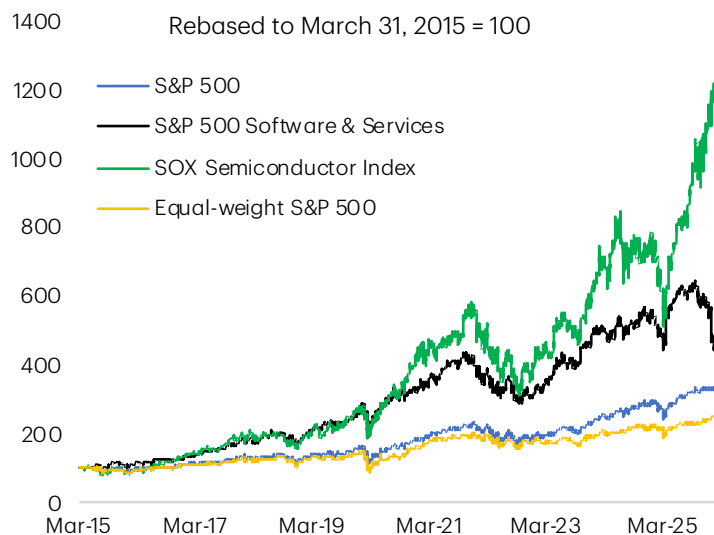
For most of the past decade, markets have rewarded the weightless — and this was especially true for software companies. Investors favoured asset-light businesses with high profit margins, valuing them at multiples several times higher than companies in “old economy” industries. That changed last October, when investor concern about the potential for AI tools to replace incumbent software players began to mount (Figure 5).

Figure 4: Massive rotation out of big tech, into cyclicals



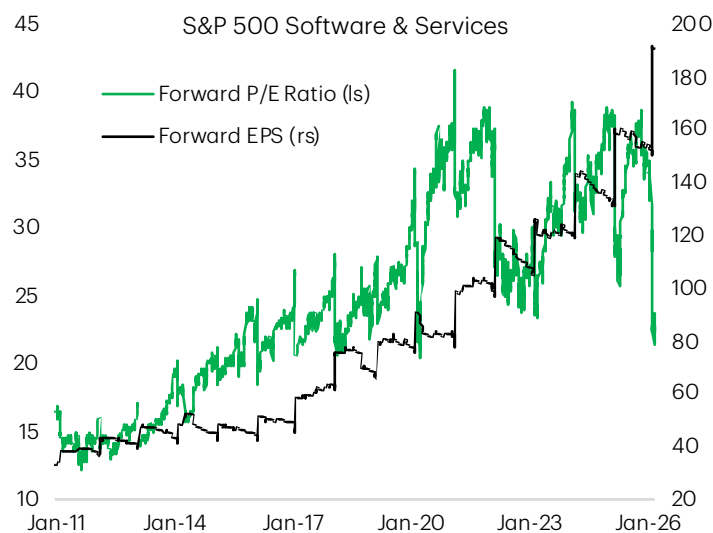
Source: Macrobond, Wealth Investment Office as of March 9, 2026 *Rotation from February 23 to March 9, 2026.

Figure 5: Software disrupted by self-coding hardware



Source: Macrobond, Wealth Investment Office as of March 9, 2026.

Figure 6: Software slump reflects concerns about short-term prospects, not long-term



Source: Macrobond, Wealth Investment Office as of March 9, 2026.

To be clear, however, the selloff in AI-disrupted equities highlights investor concern about the longer-term outlook for such businesses rather than immediate business fundamentals (Figure 6). Investors are now broadly expecting margins in the software sector to erode and are therefore discounting a lower terminal value as the probability increases that AI co-working tools will meet demand for such software. It's still too early to say whether these tools will truly disrupt the software industry, but given the difficulty in disproving such a threat, we don't think the market will re-rate these businesses back to prior earnings multiples anytime soon.

The good news is that software accounts for only 9% of the S&P 500 Index — limiting the damage from AI disruption for diversified investors. However, investors are increasingly concerned about the knock-on effects stemming from the dramatic devaluation of software companies. Here's a breakdown of those risks:

1. Private market

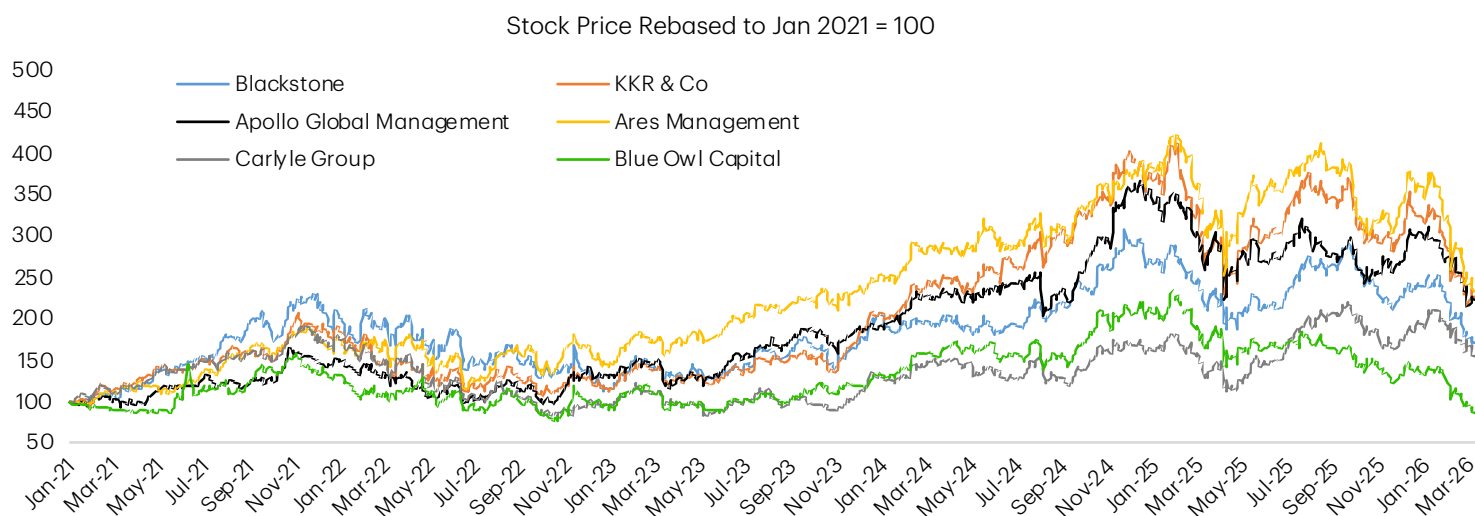
Bank of America's Fund Manager Survey highlights private credit and private equity as one of the main tail risks today, given the difficulty of assessing risks in the space amid opaque holdings and less transparent calculations of underlying asset value. For instance, in one extreme example, Blue Owl — a private-credit player — said that most (70%) of the 200-plus companies it lends to are in the software category. The company has also halted redemptions on its private-credit fund. The stock prices of more diversified managers (outside

private credit) have not been spared either, with the group on average down around 50% from recent highs (Figure 7). Perhaps investors are wondering how different the conditions really are for private-equity funds, which have also invested in software companies and lower capital stacks.

2. Banking sector

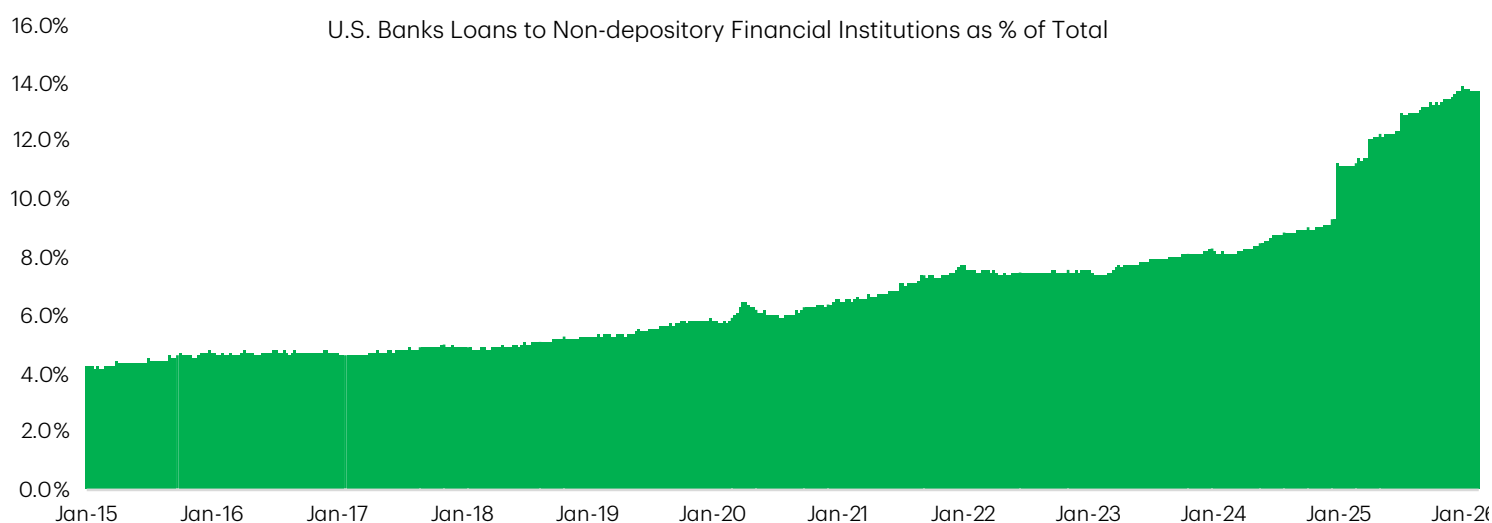
Roughly 14% of U.S. commercial bank lending is conducted at "shadow banks," or non-depository financial institutions (NDFIs), which have been an important intermediary for private-market players (Figure 8). If defaults rise in the private market, it will likely have a ripple effect on the banking sector, although we believe it should be limited given the thick cushion from equity investors. We do not think a credit event or liquidity issue in private markets will translate into broader systemic risk for the financial sector.

Figure 7: Alternative asset managers have sold off ~50%



Source: Macrobond, Wealth Investment Office as of March 9, 2026.

Figure 8: NDFIs account for 14% of U.S. commercial lending



Source: Macrobond, Wealth Investment Office as of March 9, 2026.

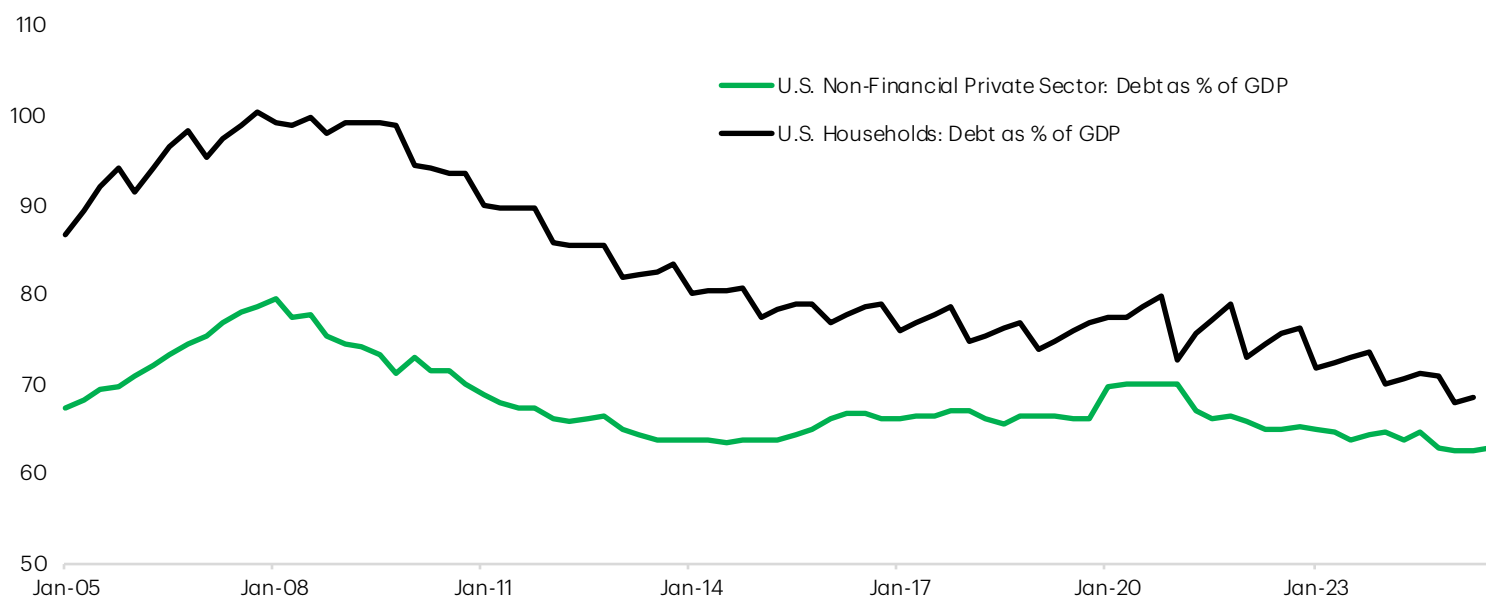
3. Tightening financial conditions and liquidity

Currently, the liquidity backdrop remains supportive given ample reserve balances in the banking sector, and after the Fed returned to de facto quantitative easing. However, liquidity has a habit of evaporating just when the market needs it most. We are mindful of stretched positioning in yen carry trades, Treasury basis trades and record retail positioning in leveraged ETFs — all of which have the potential to unwind and amplify volatility across asset classes.

That being said, the U.S. economy is in a good position to weather such a credit event. First, private-sector debt (household and corporate) has been declining since the global financial crisis, and fiscal policy is turning stimulative this year — both of which should cushion the economy from a credit shock (Figure 9). Second, the decline in software stock prices reflects much lower terminal values rather than fundamental concerns over the short term, which has negligible near-term macroeconomic impacts. Third, the macro backdrop remains conducive for risk assets. GDP growth is still expected to be around 2% this year, the Fed remains on a monetary easing path, and fiscal policy is becoming a tailwind, at least for the first half of the year.

In short, the macro backdrop remains constructive for risk assets. The key variable now is the duration of the conflict in the Middle East. As TD Economics has noted, how long disruptions last — particularly around the Strait of Hormuz and regional energy supply — will be critical for the medium-term outlook. The longer disruptions persist, the longer energy prices are likely to remain elevated, increasing the risk that inflation shifts back toward a higher-for-longer interest-rate environment.

Figure 9: Deleveraging after the financial crisis



Source: Macrobond, Wealth Investment Office as of March 9, 2026.

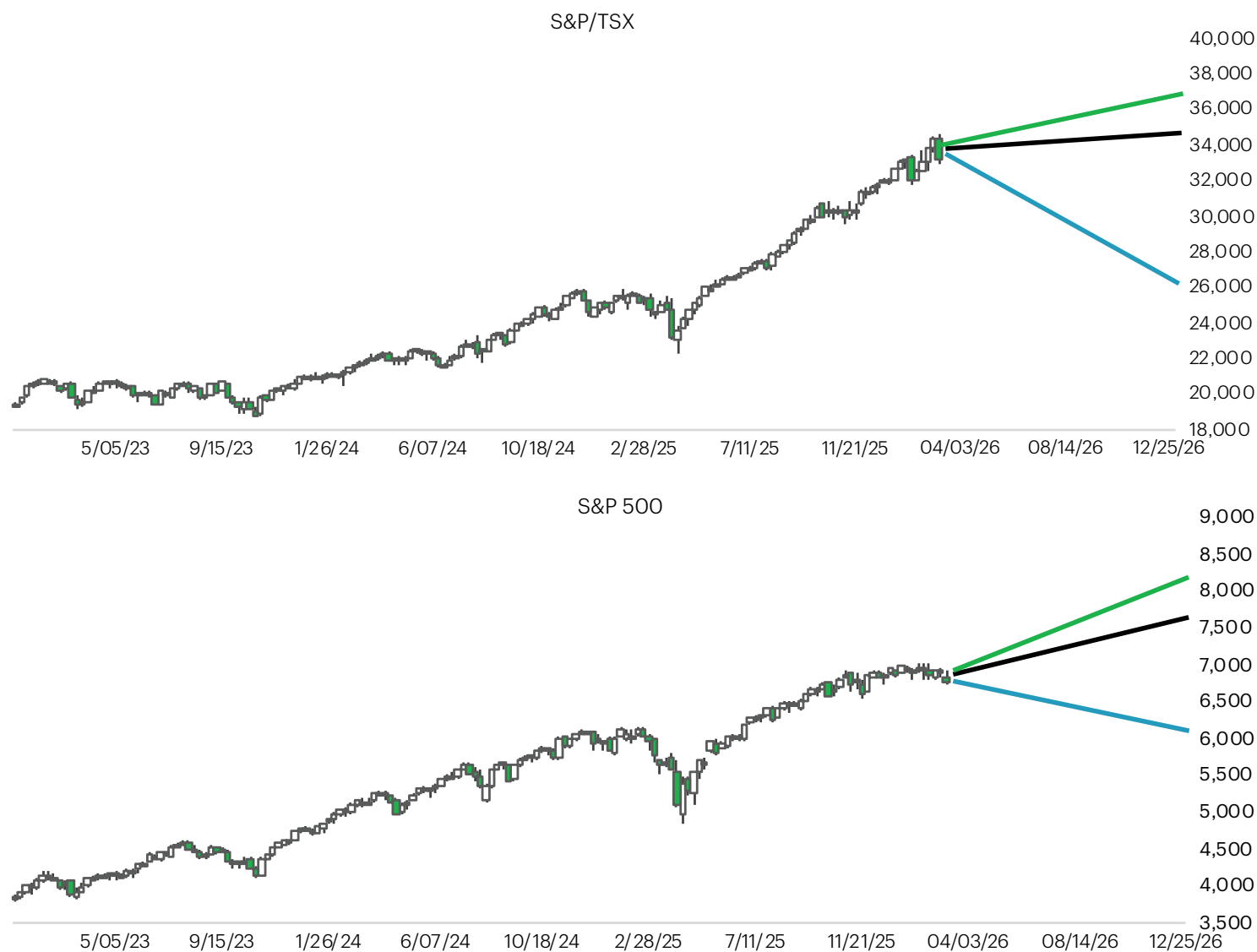
Recent inflation data reinforces this point. U.S. CPI rose 0.3% month-over-month in February, leaving headline inflation unchanged at 2.4% year-over-year. Core inflation softened modestly to 0.2% on the month, reflecting cooling travel and recreation costs, but on a three-month annualized basis core prices are still running closer to 3%. Even before the recent spike in oil prices, progress on inflation was already beginning to stall. With limited room for services inflation to cool further and new risks emerging from tariffs and higher energy prices, the Federal Reserve is likely to remain in a holding pattern unless the labour market begins to soften more materially.

In the end, geopolitics may drive volatility, but it is the strength of the underlying economy that ultimately determines the direction of markets. The market today is being driven by “conflict, atoms and electrons” — that is, the impact of war, as well as the push and pull of market sentiment as investors rotate away digital growth into physical sustainability. These three forces also reflect the range of outcomes investors must consider as geopolitical uncertainty, energy markets and technological change intersect.

Revisiting Our Base, Bull and Bear Cases

Our base case remains constructive. The global economy continues to expand at a moderate pace, monetary policy is gradually easing and corporate earnings remain resilient. In this environment, equity markets can continue to advance, even if the pace of gains moderates following the strong rally of the past several years.

Figure 10: Revisiting our scenarios for the TSX, S&P



Source: FactSet, Wealth Investment Office as of March 11, 2026.

In the bull case, investment in artificial intelligence continues to accelerate and productivity gains begin to emerge across a broader range of sectors. Capital spending tied to AI infrastructure — including data centres, power generation, semiconductors and network capacity — supports both earnings growth and broader market leadership.

The bear case reflects a combination of geopolitical escalation and financial tightening. A sustained energy shock, a slowdown in AI-related investment or a sharper-than-expected tightening in financial conditions could pressure earnings expectations and lead to a period of valuation compression in equity markets.

Importantly, the presence of these scenarios reinforces the importance of diversification. Markets rarely move in a straight line during periods of structural change. Leadership broadens, sectors rotate and new opportunities emerge.

Final Thoughts

The forces shaping markets today are complex, but they are not unknowable. War can move markets quickly, but it does not always change the path of markets. In the end it's about time. It is the evolution of the global economy and the balance between atoms and electrons that will determine market outcomes. The headlines may change quickly. The structural shifts shaping markets will not.

For investors, the challenge is not predicting which force dominates at any given moment, but building portfolios resilient enough to navigate all three.

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)	146226	7.72	10.06	8.63	38.79	22.89	17.10	13.67	8.68
S&P/TSX Composite (PR)	34340	7.57	9.42	8.29	35.23	19.31	13.71	10.32	5.54
S&P/TSX 60 (TR)	6878	6.60	7.75	6.39	32.33	21.20	16.49	13.58	8.77
S&P/TSX SmallCap (TR)	2765	12.56	25.27	22.37	86.80	29.67	17.82	14.17	6.65
S&P/TSX Preferred Share(TR)	2477	0.89	2.85	1.28	14.42	13.47	7.26	8.01	3.64
U.S. Indices (\$US) Return									
S&P 500 (TR)	15324	-0.76	0.74	0.68	16.99	21.80	14.19	15.50	10.88
S&P 500 (PR)	6879	-0.87	0.43	0.49	15.52	20.11	12.54	13.54	8.77
Dow Jones Industrial (PR)	48978	0.17	2.64	1.90	11.72	14.47	9.63	11.48	7.76
NASDAQ Composite (PR)	22668	-3.38	-2.99	-2.47	20.27	25.55	11.43	17.40	12.17
Russell 2000 (TR)	14448	0.80	5.58	6.20	23.34	13.14	5.05	11.30	8.08
U.S. Indices (\$CA) Return									
S&P 500 (TR)	20886	-0.42	-1.75	0.01	10.43	21.84	15.79	15.58	11.88
S&P 500 (PR)	9376	-0.52	-2.04	-0.18	9.04	20.15	14.12	13.62	9.76
Dow Jones Industrial (PR)	66757	0.52	0.11	1.23	5.45	14.50	11.17	11.56	8.73
NASDAQ Composite (PR)	30897	-3.05	-5.38	-3.12	13.53	25.59	13.00	17.48	13.18
Russell 2000 (TR)	19693	1.15	2.98	5.49	16.42	13.17	6.52	11.38	9.06
MSCI Indices (\$US) Total Return									
World	21740	0.76	3.90	3.03	21.83	21.12	12.98	13.85	9.02
EAFE (Europe, Australasia, Far East)	16203	4.64	13.42	10.11	35.31	19.38	11.34	10.80	6.28
EM (Emerging Markets)	4403	5.51	18.34	14.86	50.83	22.14	6.79	11.14	6.55
MSCI Indices (\$CA) Total Return									
World	29632	1.11	1.33	2.35	15.00	21.16	14.56	13.93	10.01
EAFE (Europe, Australasia, Far East)	22084	5.00	10.62	9.37	27.72	19.41	12.90	10.88	7.25
EM (Emerging Markets)	6002	5.88	15.41	14.10	42.37	22.18	8.29	11.22	7.52
Currency									
Canadian Dollar (\$US/\$CA)	1.36	0.20	-2.41	-0.61	-5.68	-0.02	1.38	0.07	0.91
Regional Indices (Native Currency, PR)									
London FTSE 100 (UK)	10911	6.72	12.24	9.86	23.85	11.47	10.97	5.99	3.22
Hang Seng (Hong Kong)	26631	-2.76	2.98	3.90	16.08	10.41	-1.68	3.37	2.61
Nikkei 225 (Japan)	58850	10.37	17.11	16.91	58.39	28.95	15.23	13.89	6.66

Benchmark Bond Yields	3 Months	5 Yrs	10 Yrs	30 Yrs
Government of Canada Yields	2.20	2.66	3.13	3.63
US Treasury Yields	3.67	3.50	3.95	4.62

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	487	0.17	0.54	0.35	2.63	4.03	2.95	1.95
FTSE TMX Canada Universe Bond Index	1227	1.66	0.94	2.25	2.58	4.92	0.83	2.06
FTSE TMX Canada All Government Bond Index	1143	1.84	0.83	2.36	1.96	4.31	0.29	1.58
FTSE TMX Canada All Corporate Bond Index	1533	1.07	1.28	1.88	4.50	6.75	2.39	3.41
U.S. Corporate High Yield Bond Index	324	0.06	0.83	0.43	5.32	8.10	3.58	5.80
Global Aggregate Bond Index	270	1.29	1.02	1.40	3.09	4.20	0.28	1.66
JPM EMBI Global Core Bond Index	601	1.29	1.91	1.42	10.64	9.17	1.61	3.28
S&P/TSX Preferred Total Return Index	2477	0.89	2.85	1.28	14.42	13.47	7.26	8.01

Source: TD Securities Inc., Morningstar®, TR: total return, PR: price return, as of February 28, 2026.

Wealth Investment Office, TD Wealth

Head of Wealth Investment Office

Brad Simpson | Chief Wealth Strategist

North American Equities:

Christopher Blake | Senior Portfolio Manager

Chadi Richa | Senior Equity Analyst

David Beasley | Senior Quantitative Portfolio Manager

Andrej Krneta | Senior Equity Analyst

Neelarjo Rakshit | Senior Equity Analyst

Managed Investments:

Fred Wang | Senior Portfolio Manager

Adam Weingarten | Senior Fixed Income Analyst

Mansi Desai | Portfolio Manager, Equities

Kevin Yulianto | Portfolio Manager, Equities

Shezhan Shariff | Senior Alternative Investments Analyst

Daniel Carabajal | Senior Fixed Income Analyst

Jack Zhang | Investment Management Analyst

Portfolio Management Consulting:

Christopher Lo | Senior Portfolio Manager, Lead of Discretionary Portfolio Management Consulting

Shanu Kapoor | Senior Manager, Portfolio Management Consultant, Non-Discretionary

Anita Linyu Li | Senior Manager, Portfolio Management Consultant, Financial Planning

Shaun Arnold | Senior Portfolio Management Consultant

Greg McQueen | Senior Portfolio Management Consultant

Ivy Leung | Senior Portfolio Management Consultant

Shaiara Hossain | Senior Portfolio Management Consultant

Joseph Abinaked | Senior Portfolio Management Consultant

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Jerry Chang | Portfolio Management Consultant

Anshul Kaliravna | Portfolio Management Analyst

William Yuan | Portfolio Management Analyst

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