TD Wealth

Round Two

Market Insights

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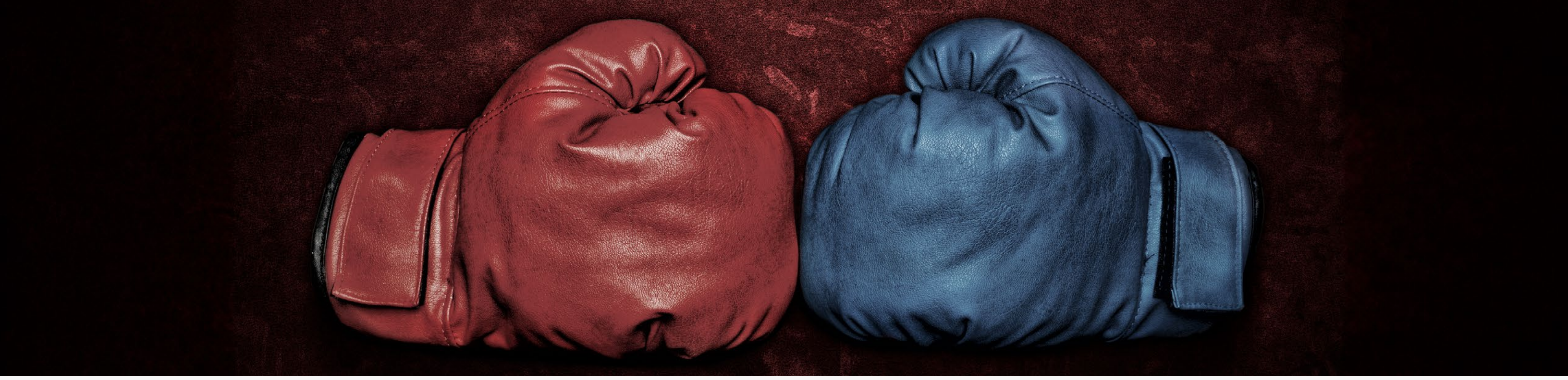
Wealth Investment Office



Round Two

The Canada-U.S. trade fight has escalated. Investors must distinguish between the noise and what actually matters for portfolios. The near-term economic damage should be contained, but the strategic signal is larger. We remain modestly overweight Canada.

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

A boxing match can last 10 rounds. This is round two. There will likely be many more: tariffs and counter-tariffs, exemptions and escalations, suspended negotiations and political bargains. Each exchange will generate headlines, forecasts and declarations about the future of the Canada-U.S. relationship. Investors should resist the temptation to score the entire fight after every punch.

Late Friday evening, Canada suspended its trade negotiations with the United States and instructed its representatives to return to Ottawa. Hours later, Washington imposed 50% tariffs on a targeted basket of Canadian goods representing approximately 5% of Canada's exports to the United States. Canada pledged to respond "dollar for dollar."

This isn't a blanket tariff shock, but neither is it mere political theatre.

The new tariffs apply regardless of whether the affected goods comply with the current North American trade agreement, known as CUSMA or USMCA. That makes the latest action feel less like a failed negotiation than a betrayed agreement. The North American trade agreement was intended to provide a stable, rules-based framework for trade on the continent. If compliant goods can still be subject to unilateral tariffs, businesses must place less value on the agreement's protection and attach a higher risk premium to cross-border investment. The signalling effect is therefore larger than the immediate economic damage.

TD Economics estimates that, if the tariffs remain in place, they could subtract approximately 0.3 to 0.6 percentage points from Canadian economic growth over the next year, with the ultimate effect likely closer to the bottom of that range. That's meaningful, but it's not enough by itself to produce a recession or overturn the Canadian investment outlook.

For investors, that distinction is essential. The political noise between two large and deeply integrated trading partners will remain loud. Our job is to determine what materially changes the outlook for growth, inflation, interest rates, currencies, corporate earnings and asset prices — and what does not.

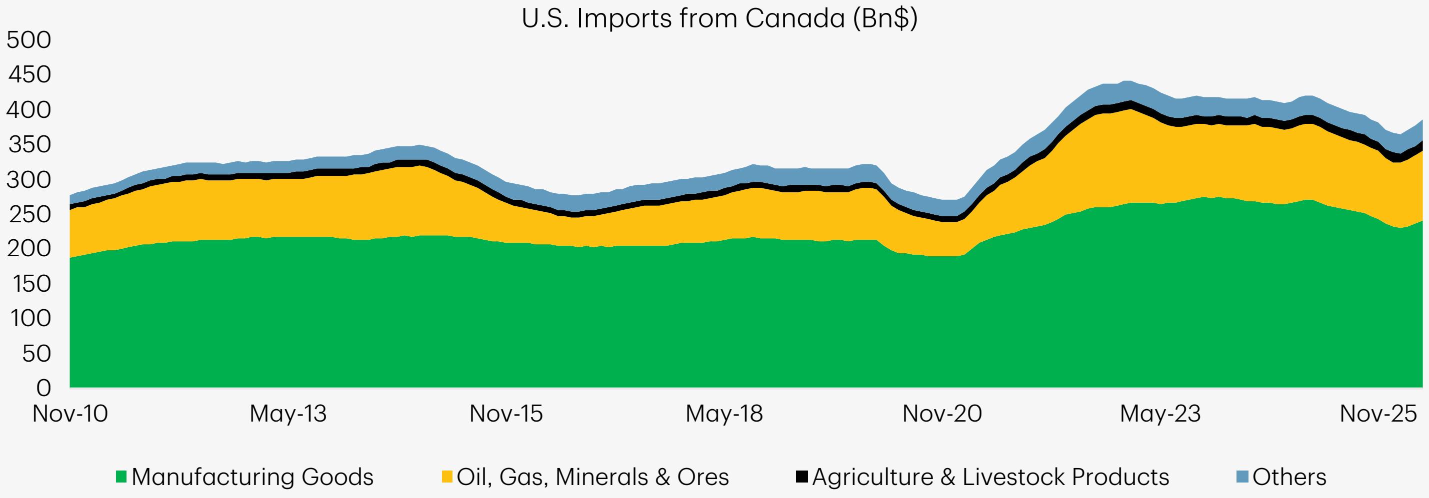
On that basis, we remain modestly overweight Canada.

We do so not because tariffs are irrelevant or because the Canadian economy is immune to trade shocks. We remain overweight because the structural forces defining what we've dubbed the "Resilience Regime" continue to create demand — demand for energy, commodities, infrastructure and financially strong, globally competitive businesses. Canada offers all four in meaningful measure.

How the trade fight escalated

Canada-U.S. trade tensions have moved back onto the macro map. After last-minute negotiations failed, Washington imposed an additional 50% tariff on a targeted basket of Canadian goods under Section 338 of the Tariff Act of 1930. The measure covers roughly US$20 billion to US$24 billion of Canadian exports to the U.S., or about 5% of Canadian exports to the U.S. (Figure 1). The affected categories include alcohol, dairy, cement, wood/paper products, furniture, apparel, sporting goods and a wider mix of consumer and industrial products. Given that compliance with the North American trade agreement does not exempt goods from Section 338 tariffs, all covered products are subject to the full 50% rate.

Figure 1: Natural resources unlikely to face tariffs, manufacturing more vulnerable



Source: Macrobond, Wealth Investment Office, as of August 24, 2026.

The U.S. administration has framed the action as retaliation for Canadian policies it views as discriminatory toward U.S. commerce, including provincial restrictions on U.S. alcohol sales, auto-related measures and long-running disputes over access to Canada's supply-managed dairy market.

The legal vehicle matters: Section 338 allows duties of up to 50% and does not carry the same automatic expiry mechanism as some emergency trade tools. In practical terms, removal will likely require a political bargain rather than a simple calendar-based rollback. On Monday, President Trump also pledged to double tariffs on Canadian vehicles and parts to 50% starting next year, escalating the trade fight even further.

The product list appears designed to maximize pressure on Canada while limiting the direct hit to U.S. consumers and supply chains. Energy, critical minerals and most strategically sensitive cross-border inputs remain outside this specific round, while the tariff basket leans toward sectors in which Canadian exporters are more exposed and U.S. buyers may have alternatives. That design reduces the probability of an immediate, economy-wide shock, but it increases the pain for specific industries and regions.

Canada's response raises the risk that a targeted tariff episode becomes a recurring source of macro volatility. Ottawa has signalled dollar-for-dollar counter-tariffs, expected to begin in early September and target U.S. steel, dairy, appliances, agricultural equipment, electronics and pulp/paper products, among other goods. The immediate question is whether both sides use tariffs as leverage to reopen negotiations or whether the measures harden into a new baseline for North American trade.

Canadian economic impact remains contained

The direct growth hit should be manageable if the dispute remains narrow. TD Economics estimates that the U.S. tariffs could subtract roughly 0.3 to 0.6 percentage points from Canadian GDP growth over the next year, with Canadian retaliation potentially generating another small drag on economic activity, depending on the final scope. That's meaningful but not recessionary by itself. The bigger issue is that the shock arrives after more than a year of tariff uncertainty, when business confidence and capital-spending plans are already more fragile.

The steel sector provides a useful template. Earlier tariff rounds led to a sharp decline in Canadian steel exports to the U.S. while demand adjusted, contracts rolled off and buyers looked for alternatives. That experience suggests the current round will be felt most acutely in specific export-oriented industries rather than evenly across the economy. Manufacturing, forestry-linked products, selected consumer goods and some non-energy industrial categories are more exposed; energy, financials, domestic services and parts of the broader commodity complex should be more insulated.

The inflation channel is mixed. Weaker export demand and softer business confidence point to slower growth, which should reduce pressure on the Bank of Canada to tighten further. Counter-tariffs, however, can lift prices for affected goods and create a temporary inflation impulse. Canada's starting point is better than that of the U.S., with core inflation closer to target, but policymakers will still need to distinguish between tariff-driven price increases and a more durable inflation problem. For the U.S., the policy mix is also awkward: tariffs act like taxes on inputs and consumer goods, adding to price pressure even as trade friction weighs on growth.

The affected export share is small, but the signalling effect is large. CUSMA was supposed to provide a stable framework for North American trade. If preferential market access can be overridden through unilateral tariff action, businesses will attach a higher risk premium to cross-border investment. That's the slower-burn risk — not an immediate collapse in trade, but a sustained repricing of supply-chain certainty.

The upcoming review of CUSMA now becomes more important. The collapse in talks suggests there was enough overlap to make a deal plausible, but not enough trust to make it durable. That's a bad signal for firms planning multi-year investments in autos, machinery, logistics and advanced manufacturing.

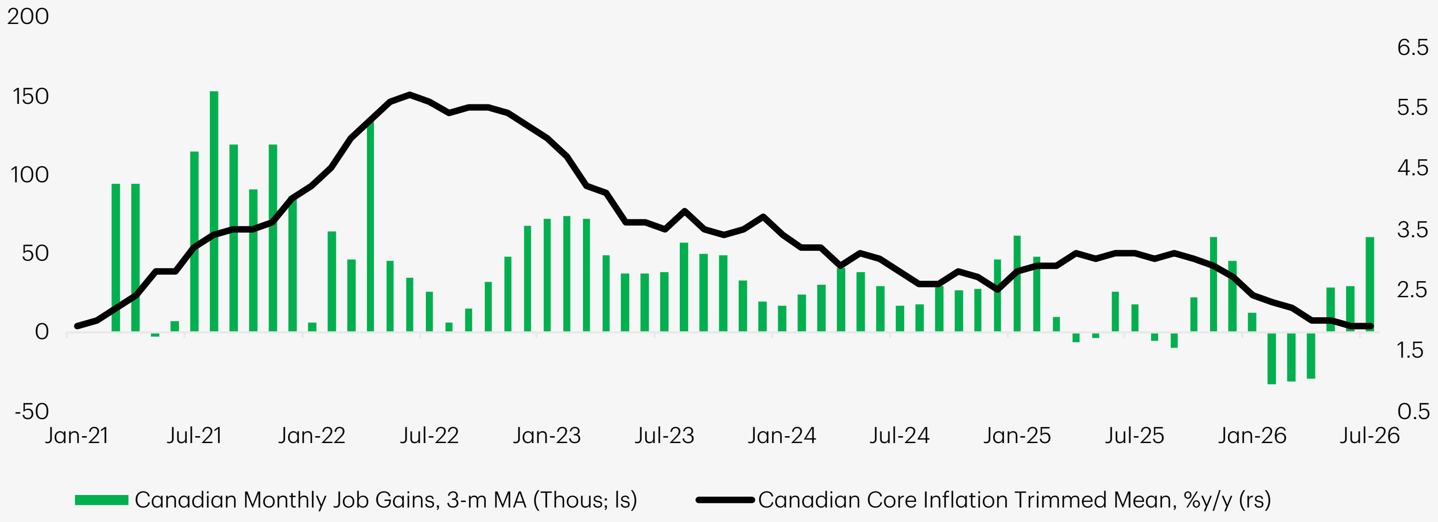
Even if the current tariff list stays narrow, uncertainty over the rules of the game can delay investment, reduce inventory efficiency and push companies to build more redundancies into supply chains.

But the politics will cut both ways. In the U.S., the November mid-term election increases pressure to address cost-of-living concerns, which argues against letting tariffs broaden too far if they visibly raise consumer prices. At the same time, tariffs remain politically useful because they signal toughness on trade and can be framed as defending domestic workers. In Canada, retaliation carries economic costs, but it may be necessary to preserve negotiating credibility and dispel any notion that unilateral U.S. pressure will go unanswered.

Canadian assets show greater resilience

The Canadian dollar should remain choppy, but downside looks more limited than in earlier phases of the trade war. Canada's domestic growth backdrop is stronger than it was in 2024 (Figure 2), and the U.S. dollar is fighting headwinds from fiscal sustainability concerns, softer global risk appetite and renewed interest in currency-debasement hedges. The better framing is not simply that "tariffs are bad for CAD"; it's that both currencies are being repriced against a more uncertain policy backdrop.

Figure 2: Canadian inflation, labour in a better spot than two years ago



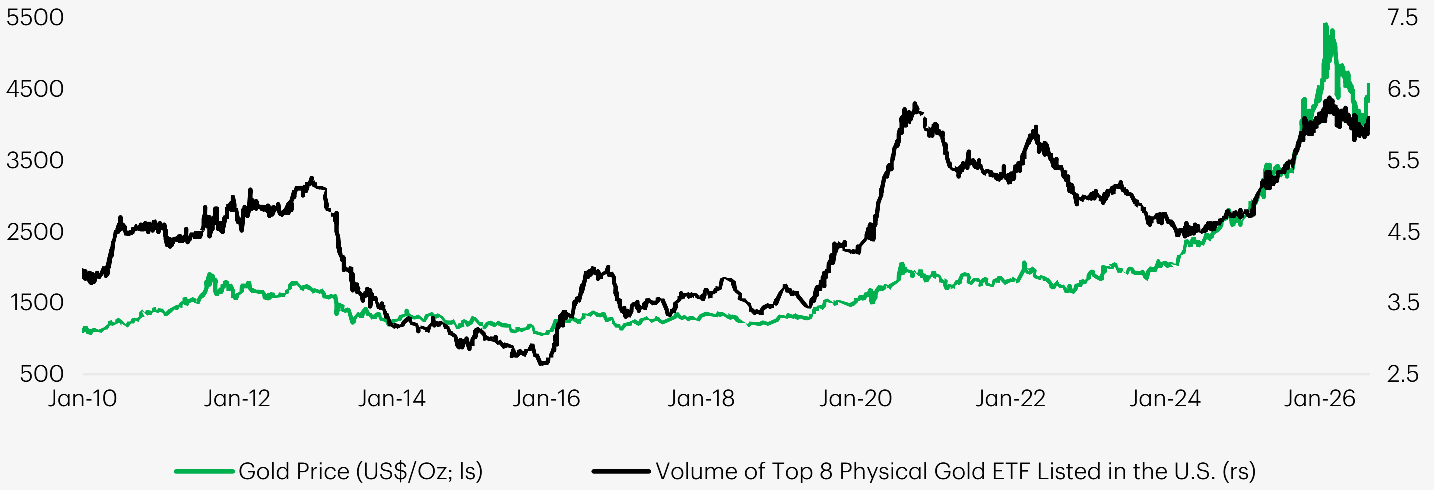
Source: Macrobond, Wealth Investment Office, as of August 24, 2026.

For rates, the trade shock tilts the balance toward a more constructive view on Canadian bonds relative to U.S. Treasuries. Export weakness reduces the probability that the Bank of Canada needs to hike again this year, while any tariff-related inflation should be treated as a relative price shock unless it feeds into broader inflation expectations. The U.S. rates backdrop appears less clear: tariffs add inflation risk, fiscal sustainability remains a concern and long-duration bonds are still vulnerable if investors demand more term premium.

For equities, the Canadian market's sector composition provides some insulation. The index is heavily weighted toward financials, energy and materials, which are less directly exposed to this specific tariff basket than manufacturing-heavy benchmarks would be. Energy prices are driven more by global supply/demand balances and geopolitical risk than by this bilateral dispute. The clearest losers are export-oriented manufacturers, especially firms in categories directly captured by the tariff list, including autos, consumer goods, and wood and paper products.

The escalation also supports the broader case for real assets and safe-haven exposure. Precious metals have already benefited from a weaker greenback, fiscal concerns and a more risk-off backdrop (Figure 3). When multiple developed economies are struggling with fiscal sustainability and trade policy becomes less predictable, the debasement trade stops looking like a U.S.-specific hedge and starts to look like a structural allocation. Gold miners screen particularly well when spot prices are high, margins are expanding and free cash flow is improving relative to other capital-intensive equity themes.

Figure 3: Gold demand increasing as fiscal concerns mount



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Bottom line: Contained damage, persistent uncertainty

The near-term macro damage from this tariff round should be contained, but the strategic significance is larger. For Canada, this translates to a drag on growth, modest inflation complications and another warning that North American trade certainty is becoming less reliable. That favours selectivity within Canadian equities, a relative preference for Canadian duration over U.S. duration, continued demand for gold and gold miners, and a more nuanced view on the Canadian dollar rather than a simple bearish stance, as was the case in previous years.

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