Timely Premiums | 2026 Q3



Manager Commentary

Benjamin Gossack, CFA
Managing Director, Portfolio Manager
TD Asset Management Inc.

A Market Between Two Signals

In the third quarter of 2026, the Portfolio Advisor ("we", "our") witnessed a sharp reversal across artificial intelligence ("AI") beneficiaries, including within the Information Technology, Industrials and Utilities sectors. The same leverage that helped accelerate the rally into the end of June also appeared to intensify the subsequent unwind, leaving investors facing two competing interpretations of where we stand today:

1. Did the gains in the second quarter of 2026 pull forward years of expected performance?

2. Or did forced selling push fundamentally sound businesses below reasonable value, creating opportunity?

Both scenarios are possible. The challenge is determining which force is having greater influence while the evidence continues to evolve. This is where a disciplined investment process becomes particularly important.

When flows overwhelm fundamentals, conviction should come from a repeatable and rigorous process, rather than the urgency to explain every price move with a headline.

From Positive Feedback to Forced Selling

The second quarter rally into June was supported by strong earnings and fundamentals, but in our view, market structure likely magnified the move. Looking at market activity over the second quarter, exchange-traded funds ("ETFs") provided investors with leveraged exposure to semiconductor and AI-related equities, while some participants added further leverage through options on those same products. As prices rose, option dealers hedged their exposure by buying the underlying securities, reinforcing the rally, attracting additional capital and creating a positive feedback loop that may have extended the move beyond what fundamentals alone justified.

That same mechanism also worked in reverse during the third quarter. As prices declined, margin calls and risk reduction created additional selling pressure. In turn, long positions were reduced, short positions were covered and funding trades were unwound across regions and sectors, further amplifying the reversal.

In short, markets can move for reasons that have little to do with what a business earned in a given quarter. That does not make the price move irrelevant, but it does change what the move can reliably tell us.

Did the Rally Pull Forward the Returns?

The first scenario outlined above demands humility from fundamental investors. Companies exposed to AI infrastructure may continue to see robust growth in backlogs and earnings. However, when share prices have already appreciated significantly, strong results may no longer be rewarded by the market. In other words, it is the **change in expectations** that drives share prices, not fundamentals in isolation.

This creates a difficult allocation decision. If the market has already reflected several years of expected growth in a company's share price, maintaining the same exposure may offer less potential for future returns even if the original investment thesis remains intact. In that case, the appropriate response may be to reduce or reallocate capital, not because the businesses have weakened, but because the remaining return opportunity has become less attractive. The opposing case is equally credible. The third quarter unwind was abrupt and, in several instances, indiscriminate. Investors compelled to sell may not have reassessed the long-term earnings power of the underlying businesses, but instead reduced positions as prices declined and concerns about future losses increased.

A lower price is therefore an invitation to investigate, not an instruction to buy or sell.

Is the Industrial Supercycle Ending?

The discussion around pulled-forward returns extends beyond AI. Since 2022, predating enthusiasm for generative AI, Industrials sector equities have benefited from a broad global cycle spanning infrastructure, data centres, power demand, defense and commercial aerospace. The breadth of this cycle has made it one of the market's more durable trends, and many of our funds have benefited from exposure to these segments. The change in this trend during the third quarter, however, has been severe. Former market leaders surrendered substantial gains in a matter of days as relative strength across the Industrials sector deteriorated. Our exposure has consequently declined through a combination of active risk reduction and market depreciation. While forced selling may have contributed to the move, we do not believe the changing market signals should simply be dismissed.

Several interpretations remain possible. The cycle may be ending after pulling forward too much demand and return; it may simply be pausing as leverage is removed; or the unwind may be producing a false signal that temporarily obscures otherwise intact structural demand.

Regardless of the outcome, our process remains the same: we continue to monitor both company fundamentals and market signals, adjusting as the evidence evolves. Discipline matters most when the evidence does not yet support a clear conclusion.

Opportunity Set is Changing but Signals Remain Mixed

What makes the current backdrop equally challenging for market participants is determining how to navigate out of the winners within the Industrials sector and AI. While the move in these sectors has been pronounced, it has not necessarily been accompanied by a significant broadening in leadership, leaving the resulting opportunity set somewhat narrow and uneven. That said, pockets of strength have emerged. Refiners and marine shipping have both benefited from tight capacity and supportive margins, while select European and Asian financials continue to demonstrate relative strength. However, concentrating a portfolio into these areas can create the illusion of diversification while relying on a relatively narrow set of underlying economic drivers for performance. This is a risk we seek to avoid when constructing portfolios.

Elsewhere, sectors such as Consumer Discretionary, Consumer Staples, Utilities and Health Care have offered positive but mixed signals, while within Information Technology, leadership continues to shift from early cycle winners (ex. data center winners) towards software and hyperscalers. Attractive companies can still be found, but the available alternatives are not yet strong enough in our view to fully abandon prior views.

In periods like these, patience and selectivity can be valuable. Maintaining flexibility allows our research teams to assess whether good news has been fully reflected in prices, whether selling has become excessive and whether emerging leadership can prove durable.

In practice, when there are few obvious places to allocate capital, activity can become a risk in itself.

Discipline and Process Remain as Important as Ever

In a market where signals remain mixed, disciplined decision-making becomes especially important. Our role remains the same: understand what the market is rewarding, test those signals against company fundamentals and adapt as the evidence evolves. Holdings that no longer receive confirmation should not be defended indefinitely, just as fundamentally sound businesses should not be abandoned simply because forced selling has disrupted their share prices.

We believe markets reward companies that are growing and that asset prices tend to trend over time. We will continue to apply our process consistently, balancing fundamental research with market signals as we seek to deliver strong risk-adjusted returns over the long-term.

In uncertain markets, our objective is not to predict the next turn. It is to remain disciplined, preserve flexibility and avoid making long-term decisions based on temporary signals.

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