That Bears Watching – Probability, Skepticism and Persistence of the Bull

From the Desk of the Public Equities Team
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At TD Asset Management Inc., (TDAM, we, our), our business is about partnership with you – the investor and long-time unitholder. The better you understand the rationale for our decision-making, the more clarity you have on how our returns follow.

Geopolitical Risk and Market Pricing: Managing Knightian Uncertainty

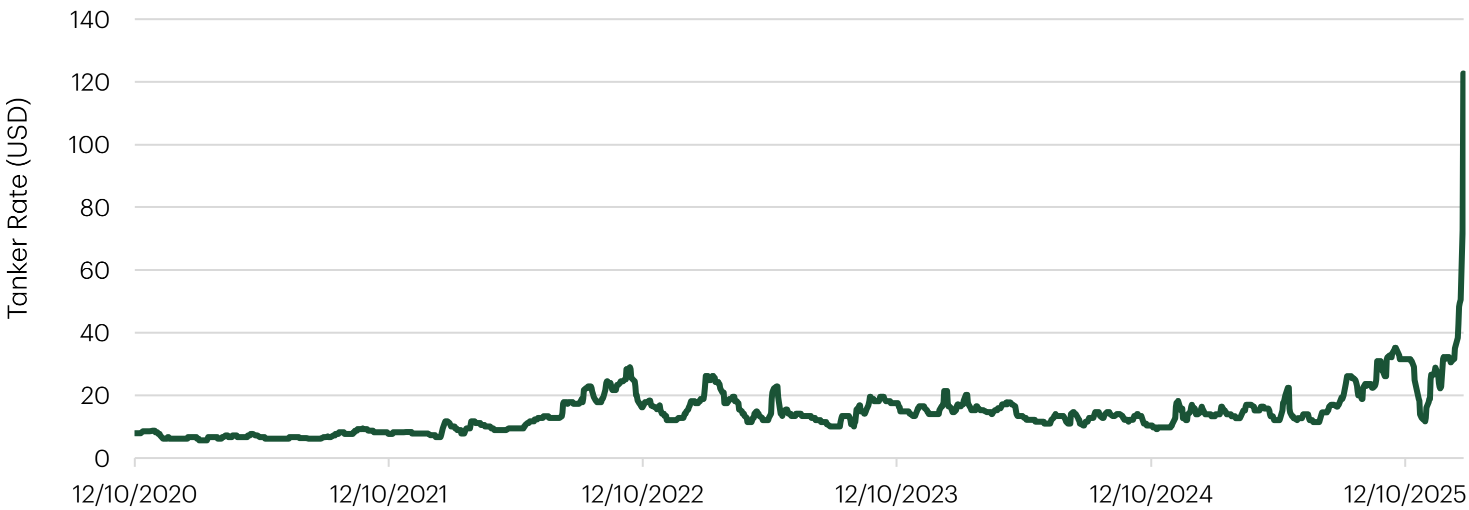
Periods of geopolitical conflict introduce Knightian uncertainty into markets – environments where outcomes are unpredictably difficult to quantify and probability distributions are non-linear. Rather than forecasting timelines or political outcomes, our focus remains on how risks are transmitted into markets and whether they meaningfully alter economic fundamentals, earnings expectations or financial conditions. From an analytical perspective, there is limited visibility into either the initial drivers or potential end states of the conflict in the Middle East. As such, projections that rely on precise timelines or definitive outcomes should be treated with caution. The situation remains highly fluid, characterized by evolving geopolitical dynamics, non-linear risk pathways, and a wide range of potential outcomes.

Key risk factors include disruptions to critical infrastructure and trade routes—such as the Strait of Hormuz—which could materially affect global energy markets. Developments that broaden the scope of the conflict, including increased involvement by external state actors, would likely raise both the severity and duration of market impacts. Conversely, progress toward a less adversarial political or security framework could reduce risk premia currently embedded in commodity markets. Our approach remains rooted in identifying the signals that indicate whether risks are contained or metastasizing and position portfolios accordingly.

Energy and Transportation

Exhibit 1 illustrates Very Large Crude Carrier (VLCC) shipping rates from the Arabian Gulf to Japan. Rates have spiked sharply, reflecting logistical disruption following reduced transit through the Strait of Hormuz. We are monitoring whether rates will stabilize or retrace.

Exhibit 1: VLCC Shipping Rates from the Arabian Gulf to Japan



Source: Bloomberg Finance L.P. As of March 3, 2026.

To provide additional context, the European natural gas pricing benchmark (TTF) indicates that while natural gas prices have increased, they remain well below the stress levels observed during the Russia–Ukraine conflict. This distinction is important, as energy price pressures appear material but manageable.

In our investment portfolios, we are monitoring our weights in countries with negative terms of trade stemming from higher energy prices. If sustained, economic growth rates in those regions will need to be revised lower, like what transpired in Europe following the Russia-Ukraine conflict.

Many Asian and European economies are net importers of energy and more sensitive to sustained price increases. Conversely, the U.S. economy is a net exporter of energy, and energy costs represent a smaller portion of the consumption basket relative to global peers. If higher prices persist, the U.S. economy should fare much better on a relative basis. A reallocation back into U.S. assets and away from Europe, Australiasia, and the Far East (EAFE) may prove prudent. We are not there yet but remain on watch.

As an example, Japan is the largest Liquefied Natural Gas (LNG) importer in the world (70 to 75 mt LNG), and imports from Qatar account for approximately 15% of that total. As inventories are exhausted, Japan will be forced to substitute with more expensive spot purchases. This increases fiscal strain, reduces consumption as expenditures on energy rise, potentially aggravates headline inflation via pass-through costs, and can reduce monetary flexibility (i.e., the need for higher rates to contain rising inflation).

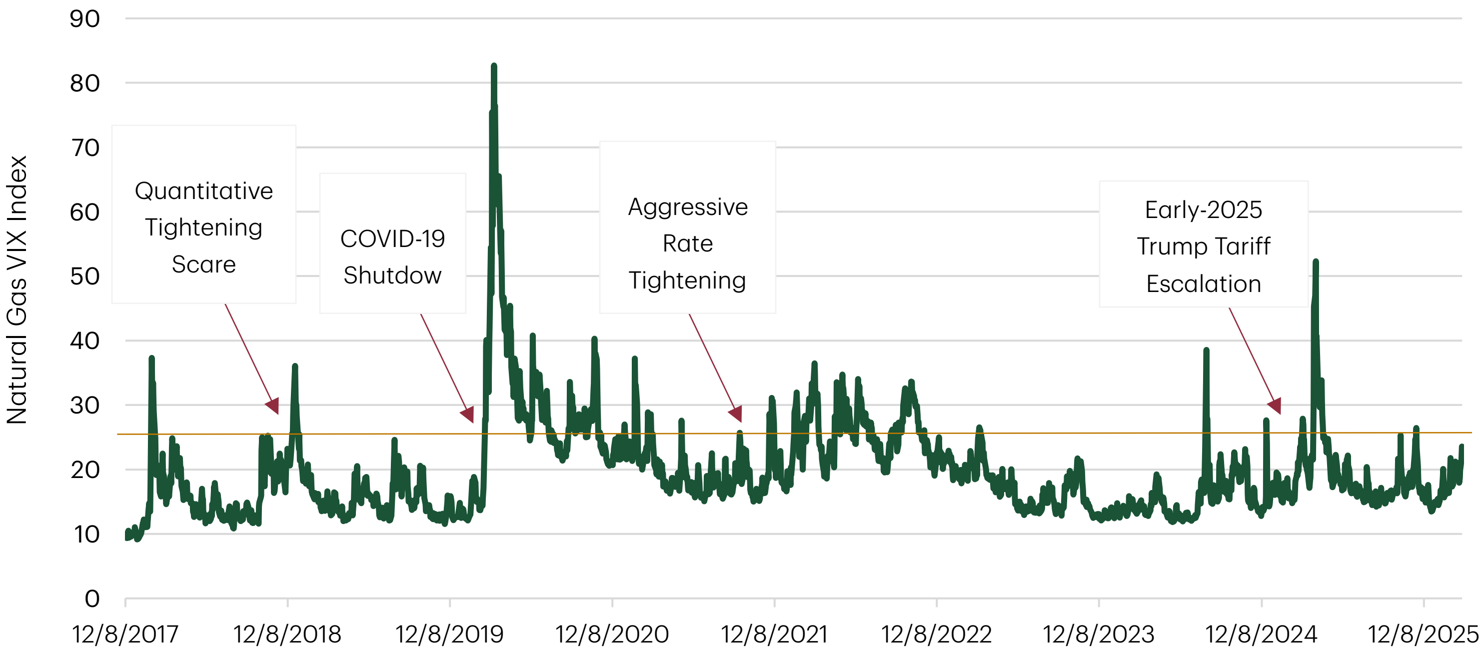
Financial Stress Indicators: Volatility and the Dollar

Beyond commodities we are monitoring financial indicators - the Volatility Index (VIX) and the U.S. Dollar Index (DXY) index – relating to measures of financial stress that have historically signaled tightening conditions. The transmission channel to lower economic growth is the wealth effect and CEO caution (i.e., reduced household consumption and deferred corporate investment due to uncertainty).

Exhibit 2 shows the CBOE Volatility Index (VIX) over recent cycles starting in 2018. The line in the sand historically associated with market tumult is a VIX reading north of 25. With the exception of the Japanese carry-trade unwind in 2024 - which resolved within a few weeks - all other instances where the VIX crossed 25 subsequently led to weaker risk appetite and more volatile markets.

We are watching for a sustained VIX above 25 and for the DXY to break above 100. Either signal would warrant a more cautious cyclical bias in portfolios.

Exhibit 2: Volatility Index over Recent Cycles at Pre-COVID-19 levels



Source: Bloomberg Finance L.P. As of March 3, 2026.

Datacenter Capex: Redistribution, Not Destruction

We attempt to avoid exaggeration in communication, but how else can one describe the enormous spend being directed toward datacenter build-outs? Fourth quarter 2025 results from the hyperscalers are now in the books, and the biggest surprise - driving attendant share-price corrections - was the magnitude of the increase in capital expenditures.

To belabour the obvious, more cash allocated to building datacenters means less cash available for share repurchases, dividend increases, or debt reduction, all in the hope that these investments will ultimately generate a higher future value than the alternatives. Many investors this quarter voted with their feet.

We could engage in an exhaustive discussion of monopolistic game theory when a new competitor enters (and AI qualifies as a new competitor to existing hyperscaler business models) or conduct scenario analyses to underwrite the current investment cycle (how much incremental revenue, at what margins, and over what time horizon). However, we have always favoured parsimony in both thought and action.

Increased investment by these companies reduces our ex-ante estimates of Free Cash Flow (FCF), and portfolio weights should be adjusted accordingly. Conversely, this capex shows up as someone else's revenue and given the speed with which it is being deployed, bottlenecks are inevitable. These bottlenecks should translate into higher pricing power for the fortunate few - meaning FCF estimates for suppliers to this spend are likely too low. These are the companies we want to target, research, and invest in.

An example of this dynamic, **Exhibit 3** below highlights the aggregate capex increase from six hyperscalers. (Note the large year-over-year percentage increases and the resulting modest FCF yields for 2026 and 2027. In the cases of Amazon.com, Inc., and Tesla, Inc., FCF is expected to be negative in 2026.)

Exhibit 3: Capex Impact on FCF Yields Across Major Hyperscalers

Technology Sector Leaders	Capex			Market Cap	Free Cash Flow			
	2025	2026	% Increase		2026	2027	2026 Yield	2027 Yield
Meta Platforms, Inc.	69,691	123,211	77%	1,631,726	7,635	19,020	0.5%	1.2%
Microsoft Corporation	64,551	107,442	66%	3,036,785	70,323	80,890	2.3%	2.7%
Google LLC	91,447	180,606	97%	3,609,908	23,400	37,987	0.6%	1.1%
Amazon.com, Inc.	131,819	197,272	50%	2,288,792	-6,250	26,122	-0.3%	1.1%
Tesla, Inc.	8,527	19,688	131%	1,488,702	-4,834	1,071	-0.3%	0.1%
Nvidia Corporation[1]	6,042	7,165	19%	4,321,026	182,449	241,298	4.2%	5.6%
Apple Inc.	12,715	13,310	5%	3,779,806	134,707	143,781	3.6%	3.8%
Broadcom Inc.	623	978	57%	1,565,022	49,291	79,369	3.1%	5.1%

[1]NVDA reports a January year end, so estimates for FY26 and FY27 are used instead.
Source: Bloomberg Finance L.P. As of March 3, 2026.

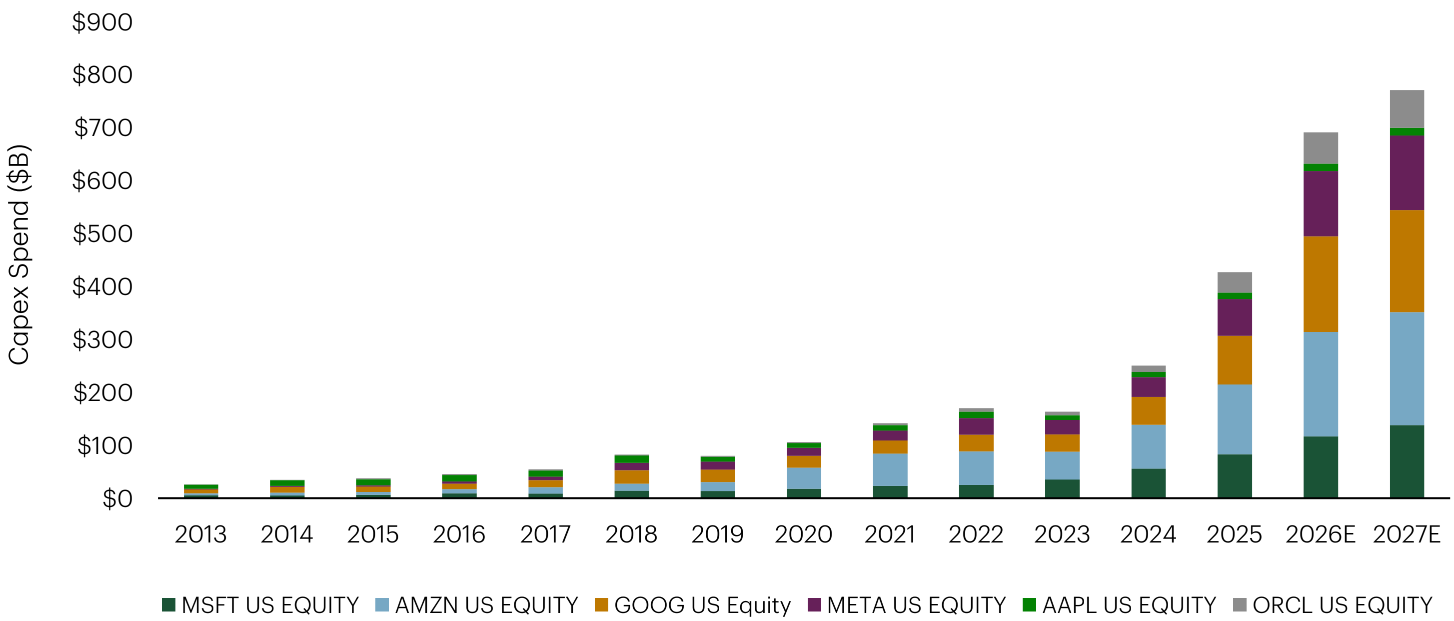
Bottlenecks Create Opportunity

Constraints in high-bandwidth memory, power generation, construction and physical infrastructure are already emerging. Pricing for high-bandwidth memory has already risen significantly (80% to 90%) as AI inference workloads demand require dramatically more memory bandwidth and capacity than traditional servers. These constraints are an early-cycle infrastructure investment all represent viable secular investment opportunities with the potential for faster free-cash-flow growth.

If a picture could communicate a thousand words, it would be the one below. 2026 datacenter capex is forecasted to exceed $700 billion in 2026, as shown in **Exhibit 4** below. Assuming 70% is spent within the U.S., that equates to roughly $500 billion. If U.S. Gross Domestic Product (GDP) estimates are $32 trillion in 2026 (assuming 5% nominal growth versus 2025), datacenter spending alone would account for close to 1.5% of GDP - before accounting for positive externalities such as productivity spillovers and multiplier effects.

Datacenter capex remains a secular growth theme, and we remain focused on the primary spenders and the secondary beneficiaries.

Exhibit 4: Data Center Capex Spend



Source: Bloomberg Finance L.P. As of March 3, 2026

Odds and Ends – Credit and Breadth

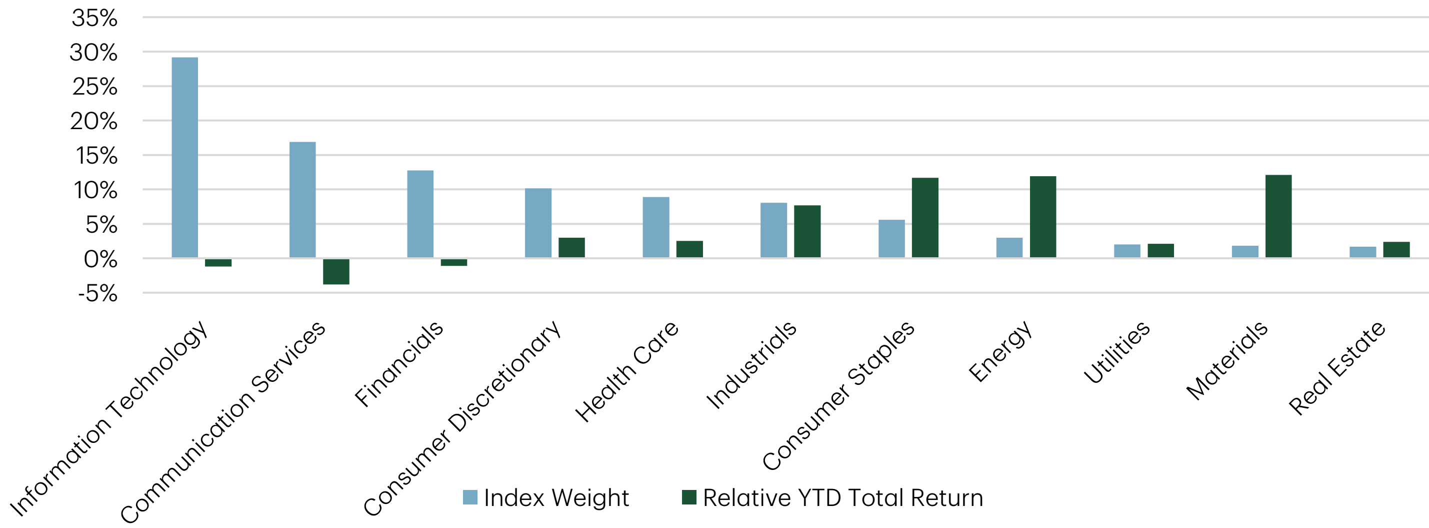
Geopolitical risk has understandably captured investors' risk-management attention, and datacenter spending remains a source of medium-term alpha. There are two developments that risk being overlooked, but remain firmly on our radar, are the unwinding of private credit and the broadening of equity gains.

On private credit, the news that Blackstone Inc. was forced to deploy its own capital - supplemented by employee contributions - to meet record redemptions from its flagship credit fund ($3.8 billion in redemption requests, or roughly 8% of assets under management) serves as a case study in what happens when illiquid assets meet fickle, nervous investors. Our mandates have no exposure to alternative managers, but experience has taught us to respect the virulent contagion effects of forced selling: de-grossing due to leverage, lower marks triggering capital calls, reduced credit availability, and ultimately defaults.

On breadth, year-to-date (YTD) returns in the U.S. market have been a dichotomy. Refer to the **Exhibit 5** below. The largest sectors in the market – Information Technology (Microsoft Corporation., Nvidia Corporation., Apple Inc.) with a 29% weight, Communications Services (Google LLC., Meta Platforms, Inc. , Netflix Inc.) at 17%, and Financials at 13% (JPMorgan Chase & Co., Goldman Sachs Group, Inc.) are all negative on the year, yet the market is flat to slightly positive. With 60% of the market cap in negative territory the remaining eight sectors have done a lot of heavy lifting. Smaller-cap stocks and equal weighted indices have outperformed, suggesting a healthier opportunity for active stock selection.

The broadening of returns also holds for the small cap index which is up 6.4% YTD, or the S&P Equal Weighted index (each stock is a 0.2% weight) that is up 6.0%, vs. the S&P 500 Index that is flat, or the Nasdaq that is down -2%. More stocks outperforming is fertile ground for stock picking, and we remain optimistic about the opportunity set to add alpha. Bad Breadth no more!

Exhibit 5: S&P 500 Index Sector Weights and YTD Relative Returns



Source: Bloomberg Finance L.P. As of February 5, 2026.

For further information, please contact your TDAM Representative.