WEEKLY STRATEGY
Perspectives

BMO | Private Wealth

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"Volatility is often a symptom of risk but is not a risk in and of itself. Volatility obscures the future but does not necessarily determine the future."
- Peter L. Bernstein, American financial historian and economist

The Through Line: The equal-weighted S&P 500 index and the S&P/TSX both hit new highs this week. But you wouldn't know it from the headlines, which have instead fixated on the extreme intraday price swings of stocks. Volatility is back, thanks in no small part to an unwinding tech trade, renewed fighting in the Middle East, rising bond yields and stress over the direction of central bank policy. This week, we offer some perspective on AI anxieties that are cropping up – despite a backdrop of fundamentals that are making solid progress.

A good as it gets?

Earnings season is off to the strong start we expected (WSP - Great Expectations: What to Watch for This Earnings Season). In the U.S., where nearly 40% of the S&P 500 companies have released results, nine of 11 sectors posted earnings increases of at least 10%. Upside surprises are trending far above average (nearly nine in 10 reports were beats). Canada's S&P/TSX hints at a similarly constructive direction, logging 45% growth in earnings per share although only 28% of company reports are in. Recent economic releases (e.g., favorable employment reads, expanding manufacturing activity, tamer inflation) lend credibility to the earnings story and suggest it has staying power. Despite the robust underpinnings, we're hearing some investors express concern over a combo platter of issues that have dominated the financial press:

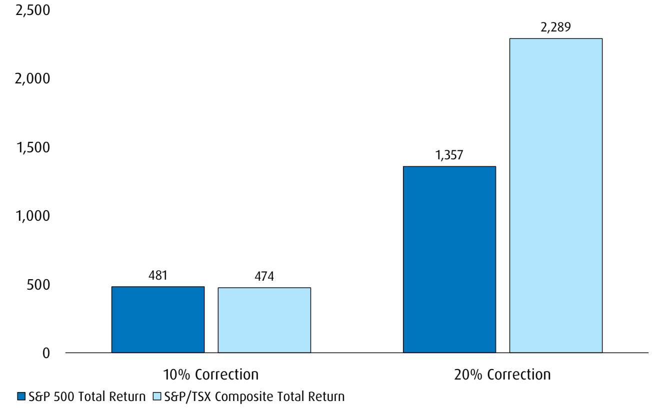
- **All things AI,** which includes existential spending on data centers; subpar demonstrations of return on investment (ROI); rogue frontier models; billions of dollars in debt and equity issuance for markets to absorb (and substantially more in the wings); increasingly competitive Chinese capabilities (models, chips, chip-making machines, ability to fund)
- **Renewed war in the Middle East** and large swings in oil prices
- **Bond yields** that have reset to a higher trading range, making an increasingly attractive alternative for investors looking to diversify away from whipsawing stocks
- **Inflation and lack of clarity re Federal Reserve policy**
- **Tariffs** and the uncertainty they bring to businesses
- **Technical factors** such as crowded trades (many people taking positions in a single-type trade, especially if there are only a handful of ways to participate, e.g., chip stocks); leverage; high volume and rapid trading in stock/sector-related options and leveraged ETFs

In short: plenty to worry about, none of it particularly new. When anxiety levels mount, investor psyches have a way of lumping their worries together into one overwhelming basket. Against a backdrop of markets, earnings and growth rates at lofty levels, a core fear that we might be peaking overwhelms the senses; the slightest piece of unexpected news provokes an outsized market reaction. *Lather. Rinse. Repeat.*

Volatility is back – and that presents opportunity

The fundamental story hasn't changed although the perception of its sustainability has. This nervousness is leading to increased volatility – but hasn't yet produced an overarching "typical" drawdown of 10% or more. (We did come close in the days after the war started.) Pullbacks are the norm, not the exception. From our vantage point, they are the price of admission to participate in the equity markets. Equities are one of the best assets for guarding against inflation and creating long-term wealth.

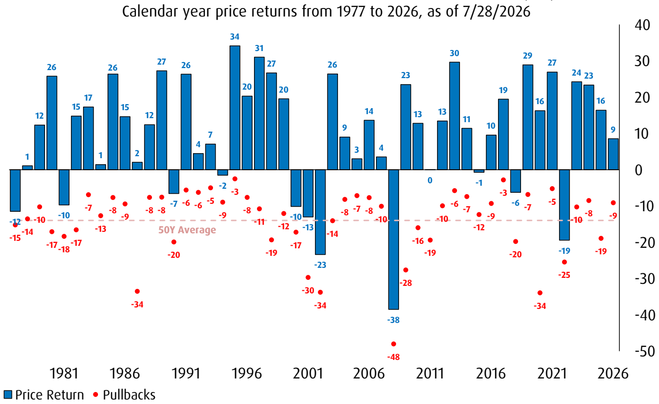
Days Since Last Correction



Source: Bloomberg L.P. (2026), as of 7/28/2026

S&P 500 Returns & Intra-Year Pullbacks (%)

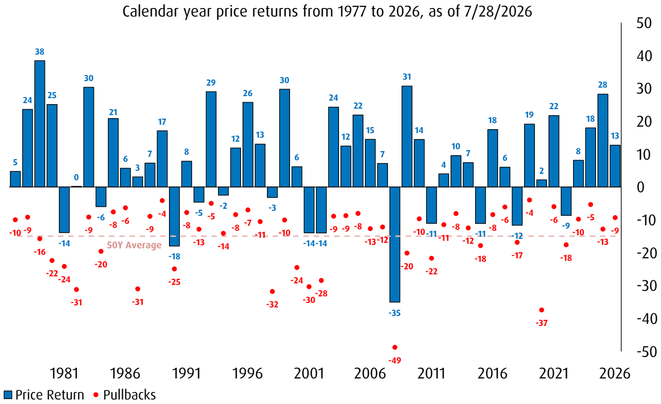
Calendar year price returns from 1977 to 2026, as of 7/28/2026



Source: Bloomberg L.P. (2026)
Annual returns are based on calendar years including price only, not including dividends. Intra-year pullback refers to the largest peak to trough market decline within a calendar year.

S&P/TSX Composite Returns & Intra-Year Pullbacks (%)

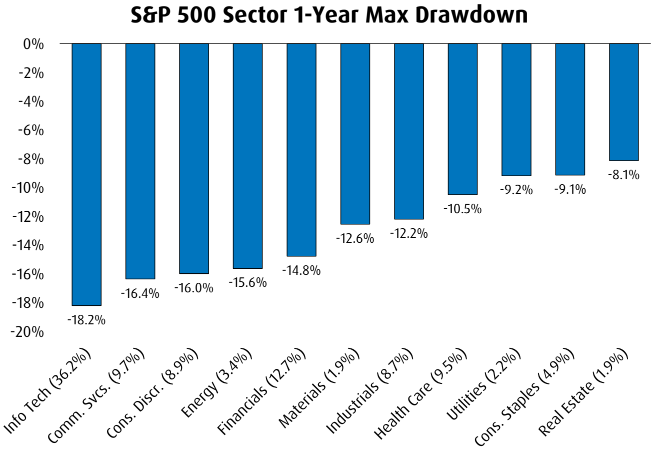
Calendar year price returns from 1977 to 2026, as of 7/28/2026



Source: Bloomberg L.P. (2026)
Annual returns are based on calendar years including price only, not including dividends. Intra-year pullback refers to the largest peak to trough market decline within a calendar year.

Investors' nerves are on edge thanks to the longer-than-average period since the last notable drawdown, exacerbating the outsized reaction to "new" news. Our thesis for why the aggregate hasn't declined in unison: individual sectors have done the heavy lifting. Eight of 11 GICS sectors that make up the S&P 500, for example, have experienced pullbacks of 10% or more. Tech and communciation services have each contracted more than 15%; subsectors (e.g., software, chips) have declined even more dramatically. **In total, some 70% of the index has declined over 15% already in the past year.** Like the proverbial duck furiously paddling under a calm surface, there have been ample under-the-surface opportunities for investors to shift allocations.

S&P 500 Sector 1-Year Max Drawdown



Sector weights in parentheses. Source: Bloomberg L.P. (2026), as of 7/28/2026.

Chips and dips

The AI trade has gotten a lot more complicated than it was a year or two ago (when the only relevant metric was which company was spending the most on data centers). The tip of the spear for recent intense market reaction has clearly been semiconductors, proxied by the Philadelphia Semiconductor Index (SOX). The group is down 25% in the last five weeks – after doubling during the first six months. Semis have become the poster child for a key bottleneck in getting the globe outfitted for the next iteration of the knowledge age. Substantially increased demand from hyperscalers in recent months has strained manufacturing capacity, diverting supplies from other users (e.g., cellphone, PC and other consumer electronics companies) while pushing prices up triple digits. The dislocations caused by the imbalances are reminiscent of the twisted supply chains coming out of the pandemic – and the market and economic havoc they caused.

Investors are trying to parse how/whether to continue to invest in the AI revolution. It's a lot tougher now versus back when the only metric was how much a company was spending. Amid the current angst, we offer the following thoughts:

- **Spending on data centers is not new.** Microsoft, Google and Amazon have all been building them for years to power the shift to cloud-based processing and automated manufacturing. Of course, AI data centers differ in many ways in how they're outfitted, but the same basic concept of constructing the infrastructure necessary to fuel the next phase of the knowledge revolution is there. The best part? **This infrastructure build has primarily been financed by ample free cash flow from seasoned industry leaders generating tens of billions in cash flow from existing activities.** It is also underwritten by deep pools of private capital and recycled liquidity. Corporate investors see significant long-term potential and are willing to fund the necessary buildout, doing it from a position of strength.
- **Stock and bond markets are warning that tolerance for additional capital raises is waning.** Fixed income investors are demanding higher yields, particularly on the longer-dated bonds. SpaceX stock is trading below its IPO price. So is Cerebras, another highly anticipated new issue this year. **This feedback loop is the sign of a healthy, functioning market;** there's an effective governor on letting valuations and debt levels get carried away. Hydration break, anyone?
- Theoretically, **slowing the build process is already happening**, given delays in arranging for power, land and permitting, along with the need to counter growing regional resistance. The spend and financing are happening across a wide variety of private companies – not via the government (which would fall back on taxpayers should parts of the industry stumble in years to come).
- **Demand is backlogged** by many orders of magnitude. When Alphabet reported last week, it noted $25 billion in cloud sales – and a backlog of $500 billion.
- A year ago, we saw a lot of handwringing over the jobs apocalypse that rapid AI deployment was going to produce. While some specific job categories are being impacted, there is no overt evidence that this has come to pass. New categories are being created, overall employment statistics are showing green shoots of improvement and companies are back to hiring (even entry-level workers) as it becomes evident that AI implementation is a bit more nuanced and complex than originally thought. It takes time to rewire a business – and an economy.

- It took 50 years and significant infrastructure build to go from the agrarian society of the early 1900s to the manufacturing-dominant structure of the mid-1950s. This evolution required building out plants and electrical infrastructure, plus roads, bridges, ports and equipment to transport goods. (Sound familiar?) The current build won't take 50 years. Nor will it be done by the end of this (or next) quarter. It will undoubtedly happen in fits and starts, pulling companies and asset prices in different directions as the story plays out. Yet, history offers many examples of how infrastructure and technological investment in the intermediate term benefits long-run positioning and productive capacity.

Implications for investors

Despite solid economic and market progress year to date, investor angst is high – and it shows. When markets move violently, it can be hard to keep our cool simply because the most primitive parts of our brains are hardwired for action. A few tactics can help short-circuit that instinctive tendency:

- **When surprising news hits – pause.** We are the only species with the capacity to put a space between stimulus and response. Lean into the moment, using it to breathe, think critically and evaluate.
- **Remember the financial media's business model is to generate clicks and create fear.** Don't expect the press to congratulate you on your sterling stock picks or savvy portfolio allocation.
- **Focus on the things you can influence –** (turnover, your costs, taxes, spend rate). Avoid obsessing over macro events out of your control.
- **Own different asset classes.** Understand the purpose each one serves in your portfolio (e.g., volatility dampener, growth, income, place holder for a future purchase).
- **Use volatility to your advantage.** Rebalance strategically when price moves push your long-term allocations outside the range you've set.
- **Use dollar-cost averaging.** Buy/sell set amounts or at periodic intervals; don't succumb to all-or-nothing thinking.
- **Avoid anchoring to a specific price –** especially when pruning overweights or cutting losses and moving on. For any given asset at any given moment there is arguably a clearing price. It just depends how motivated each side of the transaction is to get it done. Recognize that nobody cares what you originally paid.

Working with your BMO financial professional to understand and plan for volatility can help mitigate the shock when it inevitably shows up.

Next week in North America

A data-heavy week in the U.S. that will deliver key employment reads from ADP, Challenger Gray & Christmas and the Bureau of Labor Statistics' non-farm payrolls, plus a variety of manufacturing surveys. U.S. central bankers are out of their mandatory quiet period and will be on the talk circuit. Commentary from central bank governors will be especially closely monitored in coming months as investors adjust to the focus and communication style under the Fed's new leadership. Canada, too, will receive various labour market snapshots and purchasing manager survey reports.

Monday 8/3:	**U.S.** S&P Manufacturing PMI, Manufacturing ISMs, Construction spending | **Canada** none scheduled
Tuesday 8/4:	**U.S.** trade balances, Factory orders, JOLTs, Durable goods orders | **Canada** International merchandise trade, S&P Global manufacturing PMI
Wednesday 8/5:	**U.S.** ADP employment, S&P Global Services and Composite PMIs, ISM Services | **Canada** none scheduled
Thursday 8/6:	**U.S.** Initial and continuing jobless claims, Productivity, Wholesale inventories | **Canada** S&P Global Composite and Services PMIs
Friday 8/7:	**U.S.** Non-farm payrolls, Consumer credit | **Canada** Employment reports and Ivey purchasing managers' index

Index Definitions

Equity indices

S&P 500® Index is an index of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

NASDAQ Composite Index is a market-cap weighted index of the more than 3,000 common equities listed on the Nasdaq stock exchange.

Dow Jones Industrial Average ("DOW") is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

PHLX Semiconductor Sector Index™ (SOX™) Index is a modified market capitalization-weighted index composed of companies primarily involved in the design, distribution, manufacture, and sale of semiconductors.

Russell 2000® Index (Russell 2000®) is an unmanaged index that measures the performance of the smallest 2000 U.S. companies in the Russell 3000® Index.

S&P/TSX Index is a capitalization-weighted equity index that tracks the performance of the largest companies listed on Canada's primary stock exchange, the Toronto Stock Exchange (TSX).

MSCI EAFE Index (Developed Markets —Europe, Australasia, and Far East Index) is a standard unmanaged foreign securities index representing major non-U.S. stock markets, as monitored by Morgan Stanley Capital International. The index captures large and mid-cap representation across 21 developed markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a market capitalization weighted index representative of the market structure of the emerging markets countries in Europe, Latin America, Africa, Middle East and Asia. Prior to January 1, 2002, the returns of the MSCI Emerging Markets Index were presented before application of withholding taxes.

Fixed income indices

Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the U.S. investment-grade fixed-rate bond market, including government and credit securities, agency mortgage pass-through securities, asset-backed securities and commercial mortgage-based securities.

Bloomberg U.S. Treasury Index is an unmanaged index that includes a broad range of U.S. Treasury obligations and is considered representative of U.S. Treasury bond performance overall.

Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

Bloomberg U.S. Corporate High Yield Index is an unmanaged index that covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+ or below.

Bloomberg 1-10 Year Blend Municipal Bond Index is a market value-weighted index which covers the short and intermediate components of the Bloomberg Capital Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market.

Bloomberg Canada Aggregate Bond Index measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market. It includes treasuries, government-related, and corporate issuers.

Bloomberg Canada Aggregate Bond Index - Treasury is the treasury sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

Bloomberg Canada Aggregate Bond Index - Corporate is the Corporate sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

Benchmark data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced. You cannot invest directly in an index.

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