Monthly Market Insights

Data and opinions as of May 31, 2026

Changing drivers, changing markets

Markets are adjusting to a new regime where persistent government borrowing, not just central bank policy, is keeping interest rates structurally higher, reshaping both asset valuations and income opportunities. At the same time, geopolitical tensions particularly in energy-sensitive regions like the Middle East, remain a key transmission channel into inflation and interest rate expectations, reinforcing macro uncertainty. Against this backdrop, global equity leadership is beginning to broaden, with improving fundamentals and more attractive valuations outside the U.S. creating a stronger case for diversified portfolios.

NEI perspectives

Higher rates: fiscal is the new driver. Long-term yields are rising even with expected rate cuts as markets focus on growing government borrowing and debt issuance, pushing investors to demand higher compensation. **Bottom line**: Expect a structurally higher rate environment, with fiscal policy now a key force shaping bond markets.

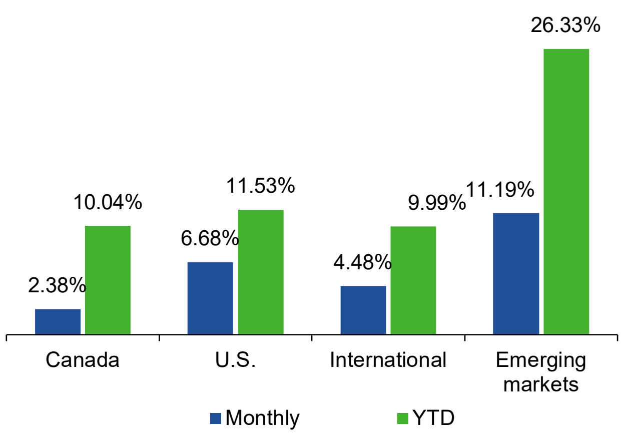
Oil and geopolitics: inflation transmission channel. Middle East tensions matter less for headlines and more for their impact on energy supply, which feeds directly into inflation and interest rate expectations. **Bottom line**: Energy is the key link between geopolitics and markets—diversification helps avoid costly reactionary decisions.

Global diversification: leadership broadening. International equities are gaining traction on improving fundamentals and cheaper valuations, while U.S. dominance may be less concentrated going forward. **Bottom line**: Diversification is shifting from defensive to opportunistic, positioning portfolios for a broader set of return drivers.

– NEI Asset Allocation team

NEI

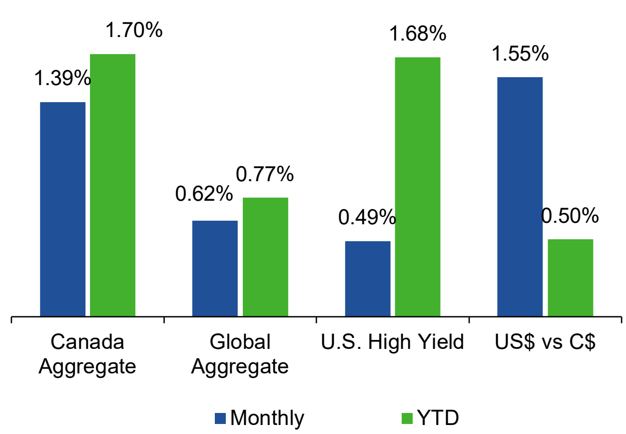
Equity returns (in C$)



Canada: MSCI Canada Index TR; **U.S.:** MSCI USA Index TR **International:** MSCI EAFE Index TR; **Emerging markets**: MSCI Emerging Markets Index TR.

Source: Bloomberg.

Fixed income and currency returns (in C$)



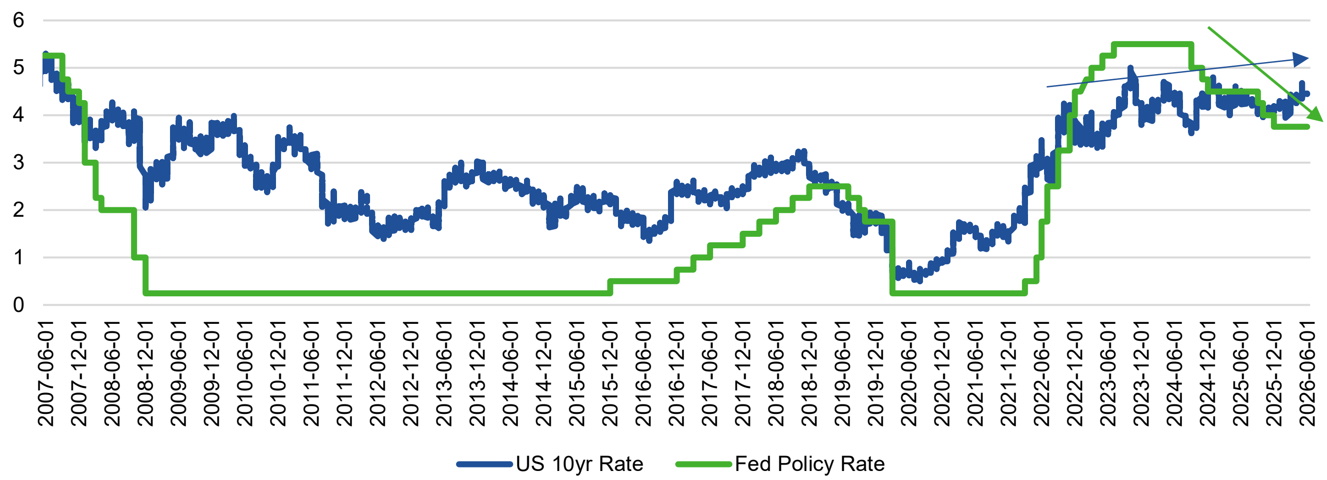
Canada Aggregate: Bloomberg Barclays Canada Aggregate Bond Index; **Global Aggregate:** Bloomberg Barclays Global Aggregate Bond Index; **U.S. High Yield:** Bloomberg Barclays U.S. High Yield Index.

Source: Bloomberg.

When fiscal policy takes the lead

For much of the past decade, interest rates were anchored by central bank policy, with markets focused on the timing and magnitude of rate cuts. In May 2026, that framework was challenged as long-term bond yields surged to multi-decade highs despite expectations for easier monetary policy, with the U.S. 30-year yield rising above 5% and the 10-year approaching levels not seen since before the financial crisis. Importantly, this move reflected more than inflation or central bank signaling; investors are increasingly focused on persistent fiscal deficits, heavy Treasury issuance, and declining structural demand for government bonds. As supply rises and traditional buyers step back, term premium is re-emerging, reinforcing a structurally higher rate environment and reshaping asset allocation dynamics.

Chart 1: Longer term interest rates remain higher, diverging from Fed policy rate cuts



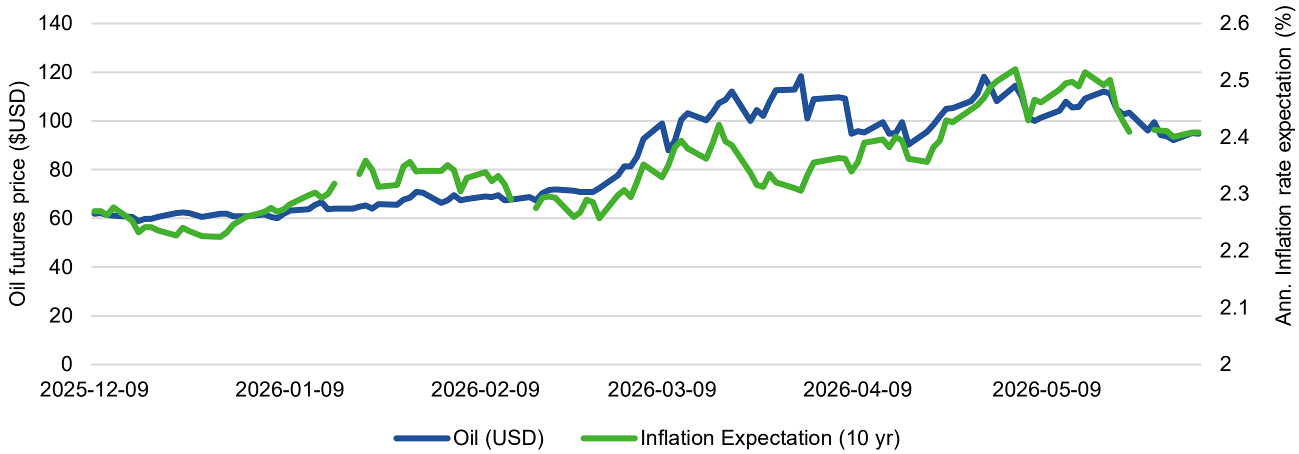
Source: Bloomberg.

Bottom line: Fiscal dynamics are now a key driver of yields, reinforcing a higher-for-longer rate backdrop and restoring the role of bonds as a meaningful source of income.

Energy markets: The geopolitical transmission channel

Geopolitical risk stayed in the forefront in May, but markets are increasingly focused on how these events transmit into the economy rather than the headlines themselves. The ongoing Iran conflict and uncertainty around the Strait of Hormuz, a corridor that carries roughly one-fifth of global oil supply, continued to drive sharp swings in crude prices and risk sentiment. This was evident late in the month, as oil prices moved materially on conflicting signals around U.S.–Iran negotiations and shipping disruptions, reinforcing how sensitive energy markets remain to even incremental developments. Because oil feeds directly into inflation, transportation costs, and consumer spending, these shocks can quickly influence interest rate expectations, making energy the primary channel through which geopolitics impacts portfolios.

Chart 2: Energy shock has moved in lockstep with long term expected inflation



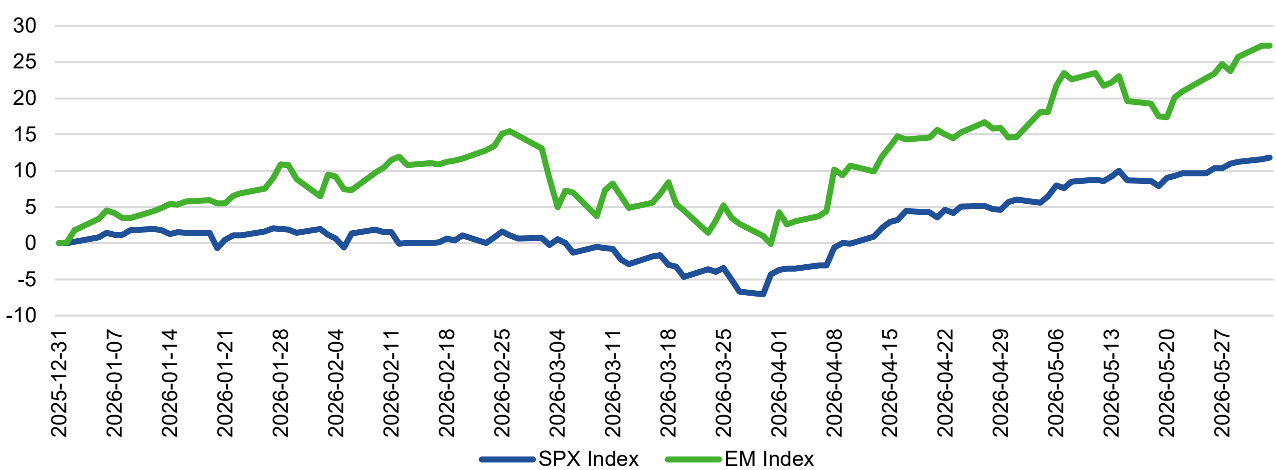
Source: Bloomberg.

Bottom line: Energy remains the clearest link between geopolitics and markets, with oil price moves directly influencing inflation and rate expectations.

Global diversification regaining its edge

After years of U.S. market dominance, evidence continued to build in May that global equity leadership is broadening. Emerging markets, particularly in South Korea and Taiwan, and parts of international equities, have been attracting renewed investor attention, supported by improving earnings expectations and meaningfully lower valuations relative to the U.S. Notably, emerging markets equities have already outperformed U.S. markets in 2026 in local currency terms, reflecting a shift in investor positioning toward opportunities outside mega-cap U.S. technology. This follows a strong 2025, where international and emerging markets equities significantly outpaced U.S. returns, aided by a weaker dollar and valuation dispersion across regions. While U.S. companies remain global leaders, the opportunity set is becoming more balanced, reinforcing the case for global diversification.

Chart 3: YTD emerging markets stocks versus U.S. stocks



Source: Bloomberg.

Bottom line: As leadership broadens, global diversification is shifting from defensive to opportunistic, enhancing return potential across portfolios.