2026: A Tale of Two Credit Markets

Our expectations and strategy for a turbulent year

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As we enter 2026, we see a Canadian IG credit market defined by strength, resilience, and opportunity. Despite record issuance of $157.8B in the second half of 2025, CAD IG spreads held firm, averaging just 89 bps – underscoring robust investor demand and highly supportive market technicals. While spreads remain near historic tights, our disciplined approach recognizes that attractive outcomes in 2026 will be driven less by broad beta and more by thoughtful security selection and active risk management. Grounded in rigorous market analysis, our 2026 strategy is purpose-built to navigate this environment and positioned to deliver compelling, risk-adjusted returns for investors.

2026 Credit Market Strategy

In this environment, our 2026 strategy rests on three pillars:

1. **Canadian fundamentals remain solid**, but we are moving into the later stages of the credit cycle where issuers shift from balance sheet preservation to growth, which typically leads to a deterioration in credit
2. **Record-breaking supply** – both domestically and globally – will overwhelm demand in the second half of 2026
3. **Technical demand will weaken mid-2026** in a market where corporate index deletions flip from outpacing maturities to lagging them

Current spread levels are more vulnerable to widening than tightening, particularly as the credit cycle matures. Our base case calls for CAD IG spreads to trade range-bound at 80-100 bps through the first half (H1) of 2026, supported by favorable technical dynamics and still-healthy fundamentals, before drifting wider to 100-120 bps in the second half (H2) of 2026 as late-cycle dynamics, overwhelming issuance, and deteriorating technicals take hold.

Our 2026 strategy responds to this timing bifurcation: maximize carry in H1 through shorter bank subordinated debt, and selective BBB exposure; then we expect to shift to defensive positioning in H2, including rotation away from high-beta cyclical sectors.

Of course, as active managers we constantly test our base case and make strategy adjustments as new information emerges.

Macro Backdrop: Constructive but Maturing Cycle

Economists predict Canadian GDP growth of 1.0 - 1.4% in 2026, consistent with below-trend but stable expansion. The Bank of Canada has largely completed its easing cycle, with overnight rates expected to settle in around 2.75 - 3.00% by mid-2026. Inflation pressures have moderated toward the 2% target, and labour markets remain balanced. Traditional long-only fixed income benefited from falling rates in 2025. Our expectation is that Canadian rates are fully priced in and in 2026 rates will be range-bound with a bias to drifting higher.

South of the border, US GDP growth is projected at 1.8% in 2026, with the Fed expected to deliver two rate cuts (January 2026 and April 2026) to 3.125%. Tariff impacts from trade policy have been largely absorbed, and recession probabilities sit at 30% - 35% – elevated but not imminent.

Of course it is impossible to predict how geopolitical events will weigh on the macro backdrop. In our view, the sheer number of known possible shocks – continued US political instability, USMCA renegotiation, mid-term US elections – combined with the unknown shocks will lead to elevated volatility.

Fundamentals: Exiting Mid-Cycle, Entering Late-Stage Dynamics

Canadian Banks: Robust but Facing Refinancing Wall

Canadian banks remain the bedrock of the CAD IG market, with $40-45B in expected 2026 issuance. This is down from 2025, but still substantial as COVID-issued bonds mature.

We are watching big 6 Bank credit health, which is positive:

- **Capital Buffers:** CET1 ratios 250-275 bps above regulatory minimums, providing ample cushion.
- **Asset Quality:** 2025 write-offs were slightly higher than reserved loan loss allowances, but underwriting quality remains strong. Gross impaired loan ratios are stable, and stress test results indicate resilience to adverse scenarios.

And we are watching supply dynamics:

- **Wholesale Funding Maturities:** Canadian banks face $187 billion in wholesale funding (i.e. market debt, not retail deposits) maturities across all currencies in 2026, with $40-45B in CAD. This is a manageable but non-trivial refinancing need.
- **LRCN Reset Activity:** 2026 is the "Year of the Low Back-End" — we assign high probability to LRCN extensions given favorable reset spreads relative to new issue premiums. This view is held by the market as many low back-end LRCN securities are pricing a high probability of being extended. These resets will reduce new issues, removing supply pressure.

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Canadian Non-Financial Corporates: Transitioning to Growth Mode

Fundamentals for Canadian corporates are solid but showing clear signs of late-cycle behavior:

- **Leverage Metrics:** Benchmark BBB-rated corporate Debt/EBITDA sits at 3.8x in Q1 2025, down from 4.4x in Q3 2018. This represents a multi-year deleveraging trend that is now plateauing.
- **Capital Intensity Declining:** Capex/Capital has declined from ~8.0% in Q1 2023 to ~7.0% in Q1 2025, signaling reduced infrastructure investment and a shift toward shareholder returns in the form of buybacks, dividends, and M&A.
- **Inaugural, Returning & M&A Issuers:** These cohorts are leading indicators of risk appetite and have exhibited strong inverse correlation to CAD IG spreads in the past. In 2025, we saw inaugural issuers like MassMutual Global Funding, Definity Financial, and BPC Generation Infrastructure Trust; returning issuers (5Y+ absence) like Crédit Agricole and Glencore Finance Canada; and M&A-driven issuers like Gildan, Keyera, and Cenovus Energy. This trend accelerated in H2 2025 and we expect further acceleration in 2026, signaling the transition from balance sheet preservation to aggressive growth.

Strategic Implication: The transition to late credit cycle dynamics increases default risk at the margin and the risk of widening spreads, particularly in high-beta BBBs. In anticipation of this phenomenon, we expect that we will push further into higher quality bonds in H2 2026.

Supply Outlook

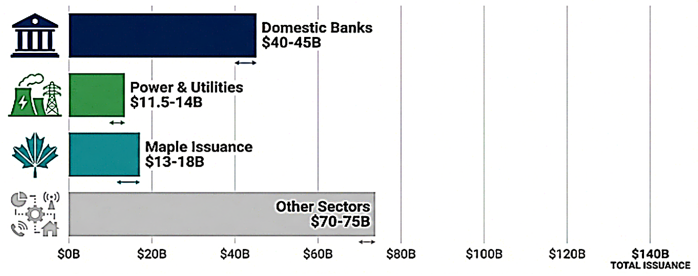
Canadian Issuance: $135-145B Gross

BMO is forecasting $135-145B in CAD IG issuance for 2026 (down from $157.8B in 2025) against $104B in maturities, resulting in $31-41B in net new issuance. However, with $27-28B in annual coupon reinvestment capacity, true net new paper is only $4-13B – a modest, but positive supply / demand imbalance.

Sector-by-Sector Breakdown (C$B):

Sector	2026 Forecast	2026 Maturities	Net New
Big 6 Banks	40 - 45	35 - 40	5 - 10
Pipelines / Midstream	8 - 9	3.4	4.6 - 5.6
Power & Utilities	11.5 - 14	3.6	7.9 - 10.4
Telecom	4 - 6	3.5 - 4	7.9 - 10.4
Autos	9.5	7 - 8	1.5 - 2.5
Maple Issuance	13 - 18	8.9	4.1 - 9.1
Real Estate / REITs	9	7.6	1.4
Insurance	2.9	1.9	1
Industrials	6.8	2.6	4.2
Infrastructure	4	0.8	3.2

2026 CAD IG ISSUANCE FORECAST: SECTOR BREAKDOWN



Key Supply Themes:

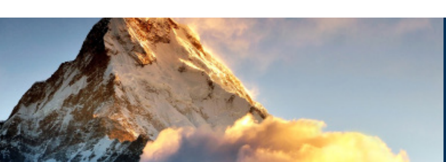
- **Power & Utilities:** Significant net new issuance driven by data center power demand and grid modernization. This sector benefits from AI-related infrastructure buildout spillover.
- **Pipelines / Midstream:** Moderate net new issuance as energy transition capex continues. Key issuers include Enbridge ($2.0-3.0B), TC Energy ($2.0B), and Keyera ($0.5B).
- **Maple Issuance:** Expected at $13-18B, with potential for US hyperscalers (Microsoft, Alphabet, Meta, Amazon) to tap CAD markets to diversify funding. This could add incremental supply pressure if realized.
- **Real Estate / REITs:** Modest net new issuance as the sector remains capital-constrained. We remain cautious on REIT credit quality given office/retail headwinds.

US Issuance: Record-Breaking Supply

2025 was greatly influenced by strong inflows as yields remained attractive versus the average over the last 5 - 10 years. While inflows are hard to predict, issuance and bond maturities can be more reliably forecast. While our focus is Canadian, US IG issuance provides critical context for global spread direction. Dealers expect $2.1-2.25 trillion in US IG gross issuance in 2026, driven by:

- **AI Infrastructure Buildout:** Hyperscaler capex (Microsoft, Meta, Alphabet, Amazon, Oracle) is expected to exceed $600B in 2026 (up from ~$440B in 2025). AI-related debt issuance grew 3.5x y/y in 2025 to $165B across 107 deals, and they expect another step-change in 2026. Notably, a growing proportion of capex is directed toward short-lived assets (GPUs, CPUs) with uncertain returns—Oracle's negative ratings outlook highlights leverage risk when capex outpaces cash flow.
- **M&A Renaissance:** Favorable regulatory environment and CEO confidence are driving deal activity. M&A-related issuance is projected to add $240B to US IG supply in 2026.

Strategic Implication: Record US supply will exert upward pressure on global IG spreads, with spillover effects to CAD. This reinforces our view that spreads widen in H2 2026 as the global supply wave crests.



Technical Factors: Bifurcation Between H1 and H2

The technical picture is the most critical driver of our bifurcated spread view. We see strong technical support in H1 2026 with a H2 2026 reversal.

Index Deletions vs. Maturities: The Key Dynamic

H1 2026 (Technical Tailwind):

- Next-twelve-month (NTM) corporate index deletions (deletions = the number of 1 to 2 year bonds in the index that will be leaving the index) will outpace maturities by approximately $10B through H1 2026.
- When bonds roll out of the index (<1-year to maturity), credit investors typically exit these positions, leaving sub-1Y bonds to money-market funds and creating dry powder for reinvestment in new issues.
- Maturities, by contrast, signal refinancing-driven issuance needs (i.e., new supply).
- **The +$10B favorable differential in H1 creates structural demand that supports spread stability / compression.**

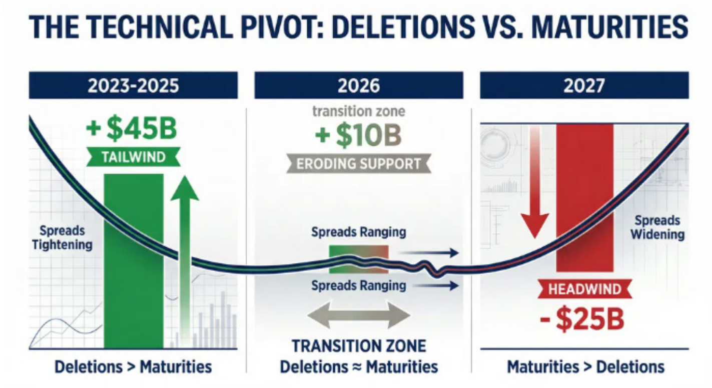
H2 2026 (Technical Headwind):

- The deletion / maturity dynamic reverses sharply in H2 2026 as maturities begin to outpace index deletions.
- **2027 Headwind: maturities will outpace deletions by approximately -$25B — the largest negative differential since 2021.**
- This dynamic creates a supply / demand imbalance that pressures spreads wider.

Historical Context:

- **2025: NTM deletions outpaced maturities by +$40B, the strongest technical support since 2023 (+$30B). This was a key driver of spread tightness in H2 2025 despite record issuance.**
- 2022-2023: Similar positive differentials supported spreads during volatile macro periods.
- 2024: Deletions lagged maturities by -$10B, contributing to modest spread widening mid-year. However, this was offset by central bank easing, which provided countervailing support.

2026 Difference: Unlike 2024, we do not expect central banks to be in active easing mode in H2 2026, meaning the technical headwind will be unmitigated.



Coupon Reinvestment Dynamics

- **2026 Coupon Payments:** Approximately $27-28B available for reinvestment, up from ~$18B in 2021 and flat with ~$27B in 2025.
- **This represents a 50% increase in reinvestment capacity** versus five years ago, driven by the rise in coupons and bonds outstanding post-pandemic.
- **Demand Calculation: With $104B in maturities + $27-28B in coupons = $131-132B in total demand-side reinvestment capacity.**
- **Against expected gross issuance of $135-145B, this leaves only $4-13B in net new paper to be absorbed by incremental buyers (pension funds, insurance, foreign investors)**

Strategic Implication: Coupon reinvestment provides a stable bid throughout 2026, but it will be insufficient to offset the H2 technical headwind from the deletion/maturity reversal. Net new buyers must step in to absorb the incremental supply, and we doubt their capacity given elevated spread levels.

Inaugural, Returning & M&A Issuers: Risk Appetite Indicator

These cohorts are leading indicators of credit cycle positioning:

- **Historical Pattern:** Strong inverse correlation with CAD IG spreads. When spreads are wide (e.g., 2016, 2020, 2022), first-time/returning issuers step back. When spreads tighten (e.g., 2018, 2021, 2025), they crowd into primary markets.
- **2025 Activity:** Last 12 month inaugural + returning + M&A issuance resumed in H2 2025 after pausing in H1 2025 due to macro uncertainty (tariffs, election). This trend started in H2 2024 as corporates adjusted to the higher-rate environment.
- **2026 Forecast:** We expect acceleration of this cohort's activity, a clear signal of increased risk appetite and a shift toward growth/shareholder returns over balance sheet preservation.

Strategic Implication: Rising inaugural / returning M&A issuance is a late-cycle signal. It adds incremental supply - particularly in BBB-rated new issuers - and increases tail risk of M&A-driven downgrades or fallen angels.

Long Bonds Supply Scarcity: Persistent Structural Bid

- Corporate Share of CAD Long Bonds (12Y+): Currently 17.0%, down from a 21.9% peak in 2020 and below the long-term average of ~20%.
- Issuance Trend: From 2012-2021, 12Y+ paper represented ~10% of total CAD IG issuance. Since 2022, this has fallen to ~7% (and below 6% excluding the one-off Coastal GasLink issuance).
- Drivers: Issuers are highly sensitive to absolute coupon levels and steeper all-in coupon curves, favoring shorter tenors. With rates expected to remain elevated through 2026, this supply scarcity is persistent.
- To Restore 20% Market Share: Would require >$20B of incremental corporate long bond issuance—unlikely given issuer behavior.

Strategic Implication: Long corporate spreads benefit from structural scarcity and exhibit curve flattening in generic widening regimes – i.e. when underlying rates are elevated, mids-to-longs credit curves flatten. We remain hesitant shorting the long end through H1 2026, despite nose-bleed valuation levels, though H2 widening is expected to eventually erode the strength of these tailwinds.

Quality Spread Compression: BBB-A Differential at Decade Lows

- **BBB-A Long Spread Basis:** At tightest levels since 2010, meaning incremental BBB carry offers less than historical average breakeven protection versus A-rated exposure.
- **Beta Relationship:** BBB long spreads display consistent beta to A-rated longs, so quality downgrades do not offer diversification in widening scenarios.

Strategic Implication: Quality upgrade to A-rated (or higher) exposure becomes more attractive in 2026, particularly in H2 as spreads are expected to widen.

Insurance & Pension Fund Demand

- Baseline Expectation: Insurance and pension demand should hold up through 2026, supported by positive real IG yields (nominal yields above inflation).
- Risk Factors
    - o **Bull Flattening:** If the GOC curve bull-flattens (long rates fall faster than long rates), long-end insurance demand may weaken.
    - o **Yield Threshold:** If 10-year GOC yields fall below 3%, insurance appetite for duration may decline.

Strategic Implication: Insurance demand is a stabilizing force but not a growth driver. Any deterioration (e.g., rates falling below 3%) would remove a key pillar of support.

Conclusion: Navigate the Bifurcation

2026 presents a tale of two halves for Canadian IG credit. H1 offers a favorable setup—supportive technicals, healthy fundamentals, and constructive macro—that warrants maximizing carry. H2 should bring a regime shift—deteriorating technicals, net issuance, and late-cycle risk appetite—that will demand defensive repositioning through quality upgrades, duration reduction, and sector rotation to lower-beta exposures. Our expected 80-100 bps (H1) ->100-120 bps (H2) spread trajectory reflects this bifurcation.

We remain vigilant for early warning signs, both technical and macro. On the technical side, acceleration of inaugural / M&A issuers or unexpected fallen angels could bring forward the H2 widening narrative. On macro, top known potential events that could impact spreads include: US political instability, USMCA renegotiation, mid-term US elections, and economic growth or general credit strength surprises.

In a market where the cure for tight spreads is tight spreads, 2026 will test investors' ability to take profits when they are offered rather than chasing the last basis point of carry into a widening regime. Once spreads widen, we will look to deploy our significant amount of dry powder.