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Mapping the Aftershocks

Dylan Smith
May 2026

Q2 2026 Update

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36 Toronto Street
Suite 850, Toronto
M5C 2C5

Email: info@arcmacro.com
www.arcmacro.com



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Executive Summary

The macroeconomic outlook has shifted significantly since our 2026 Outlook. The Iran conflict has already spiked global energy and food prices, and the stalemate keeping the Strait of Hormuz closed to commercial shipping could create supply chain disruptions that send underlying inflation soaring.

The US economy lost momentum in March as uncertainty spiked and inflation-weary consumers and businesses paused spending plans to assess the damage. This has cast doubt on the durability of the pickup in economic activity and labor markets that was evident on the eve of the conflict.

The near-term implications for markets run through the shifting path of forward interest rates. The gradual easing trajectory for US rates that was expected at the start of the year has been priced out. Traders don't yet expect outright hikes, but the odds that the Fed's next move will be up rather than down rise with each day of the blockade of the Strait.

Tell that to the stock market, which is partying like it's 2025. After initially correcting as oil prices shot up, equities have now shrugged off inflation and interest rate risk as strong pre-war earnings roll in. The AI infrastructure buildout and government largesse supporting growth appear impervious to hot geopolitical developments. We think another correction is due, but we do see opportunities for stock pickers in undervalued industries, notably software.

The long-promised pickup in private equity activity continues to elude the industry, which was poised to benefit from a surge in M&A before the Iran conflict put deal-making plans on ice. The prospects for a reacceleration are now scenario-dependent.

In Canada, we've been surprised by the robustness of the economy to a series of policy realignments and external shocks. A successful renegotiation of the trading relationship with the US could clear the way for an investment-led recovery. If you're willing to carry risk on the trade negotiations, now may be the time to go long domestic equities and the loonie.

Finally, we've refreshed our medium-term scenarios. Typically, these evolve gradually between quarterly refreshes, with updated probabilities and minor tweaks. It's a sign of the scale of the supply shock underway that we have formulated three new scenarios, primarily on the persistence of that shock and the Federal Reserve's response to it.

MEDIUM-TERM SCENARIO SUMMARY

Scenario 1: Supply Shock Sorted

Weight: 40%

A stalemate in the Iran conflict persists through most of 2026, driving annual headline inflation to 5%. Growth slows but remains positive, driven by AI-related investment and fiscal largesse.

The Fed shifts to a hawkish tone mid-year, and a rate hike follows around the turn of the year. This proactive stance means that the Fed can limit the response to two 25bp moves, which transmit through equity prices and credit conditions to cool the economy and contain second-round effects.

Scenario 2: Stagflation Nation

Weight: 30%

The Strait of Hormuz blockade is not fully lifted until 2028, with intermittent closures amid a frozen conflict keeping oil prices volatile and global hydrocarbon-linked supply chains severely disrupted. The inflation shock dampens demand.

The Fed opts to “look through” the shock initially, allowing price pressures to move beyond volatile headline categories and into slower-moving core prices.

A Stagflation regime results, with anemic growth and asset prices driven by their inflation betas.

Scenario 3: Rapid Resolution

Weight: 30%

This scenario contemplates a deal to reopen the Strait of Hormuz in the very near term, enabling tariff-related inflation to fall out of the index in 2026. Within 12 months, the Fed eases interest rates and delivers another cut in the second year of the scenario to arrive at its judgment of the neutral rate. Meanwhile, growth remains around the long-run average, supported by the AI investment boom and fading economic uncertainty as a Democratic-controlled Congress mitigates executive economic policy risk (but lingering consumer weakness outside the top deciles prevents an overheating).

What's Changed

A HAWKISH SHIFT TO RESHAPE MARKETS

Macroeconomic Update: An Unanticipated Supply Shock

At the start of the year, we wrote that the odds of a major geopolitical risk event were rising as President Trump came under increasing pressure on the domestic front.

This prediction was necessarily vague because of the wide scope of action it implied. In a few short months, we've seen the President threaten to annex Greenland from Denmark, use military action to replace Nicolás Maduro in Venezuela, and harass allies with tariff threats. While these events created some volatility, they did not fundamentally alter the global or US economic picture.

That changed drastically on February 28, when US and Israeli forces began their bombardment of Iran, assassinating its leaders in the hope of sparking regime change.

Eight weeks later, the consequences are clear. There has been no revolution. The Strait of Hormuz is closed to commercial shipping under a dual blockade with no obvious end in sight. Beyond that, we enter the realm of scenario analysis.

Hydrocarbon energy prices have roughly doubled, and those of a host of refining byproducts – notably urea (a fertilizer input) and various types of plastics – have risen by more. The resultant shift in the global inflation and growth outlook is now the primary driver of financial markets.

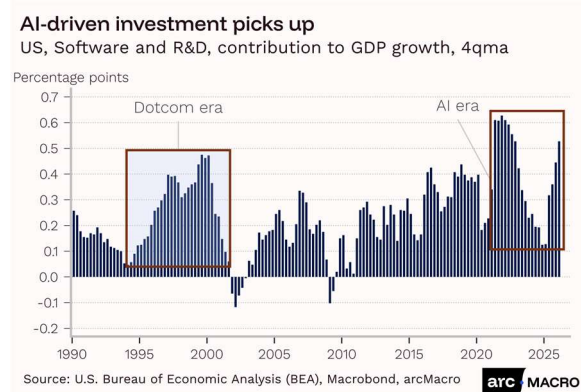
What makes this negative evolution in the near-term outlook particularly unfortunate is that on the eve of the war, incoming data were improving. The signal was strong enough that our models identified an inflection point, indicating a regime shift from “Sluggish” (below-trend growth) to “Goldilocks” (above-trend growth with stable inflation and supportive credit conditions — see appendix for details). Softer March data, as a result of the war, have put an end to that, and for now we’re back in the “Sluggish” regime that dates back to June 2023.

The near-term outlook is a case of improving demand meeting deteriorating supply. Basic economic theory will tell you that’s a recipe for rising prices and rapid inflation. To mitigate the very real risk that second-round inflation hits core prices, the Federal Reserve will need to begin preparing markets for possible interest rate increases sooner rather than later.

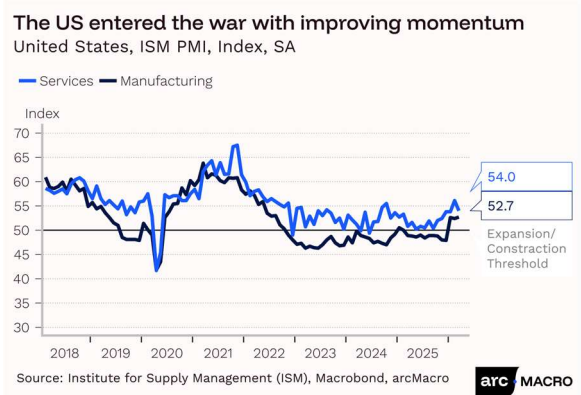


ACTIVITY: CROSS-CURRENTS WITH NET IMPROVEMENT

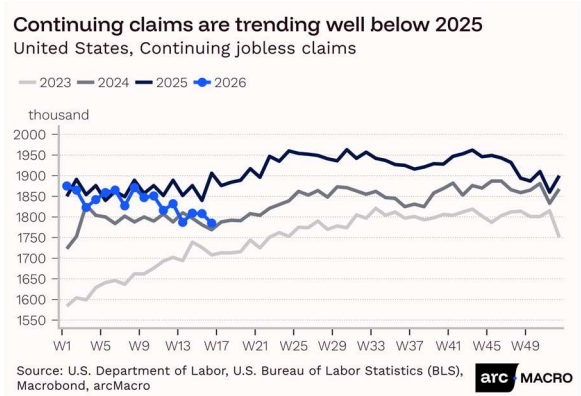
The conjunctural data for Q1 have signaled an unambiguous improvement in economic conditions compared with the soft patch in the second half of 2025. Tax refunds enacted under the 2025 One Big Beautiful Bill Act are supporting consumption growth and small business investment. On the capital spending side, the AI infrastructure build-out continues apace, with non-residential construction and R&D spending contributing to GDP growth at levels not seen since the dot-com boom.



We do not yet have enough information to judge the net impact of the Iran conflict on activity. It's likely negative relative to the pre-war outlook, but perhaps not by very much. Energy and related manufacturing industries are already benefiting. The US is no longer a net oil importer, so the main negative impact will come from consumers being forced to reduce consumption of other goods when food and energy costs rise. This effect will initially be small (but could grow with time) and could be offset by the demand boost from other factors.



Robust demand for AI-linked skills and the booming healthcare industry are offsetting weaker labor demand from stagnating sectors such as public services. Taken together with the reduction in labor supply from tighter immigration policy (across skill levels), labor markets appear to be on an improving trajectory. This is most evident in the weekly claims data, which have improved markedly over the same period in 2025.



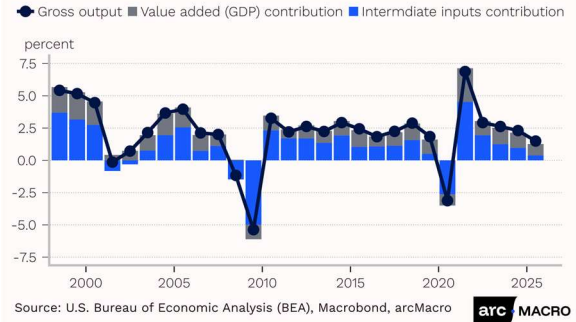
Two “Ks” are holding the economy back from higher growth and pinning the economy in a “Sluggish” regime.

The first is the K-shaped consumption profile of American consumers, with those in the top decile of the income distribution currently driving an outsized share of consumption growth while lower-income consumers continue to cut back on spending to offset a more onerous inflation burden.

The second, less well-understood “K” is the divergence between consumer-facing (B2C) and supply-chain-integrated (B2B) businesses. The latter are facing slowing demand as tariff-stricken supply chains thin out in an

effort to protect margins, as evidenced in the divergence between Gross Output and GDP.

Strong GDP but a slowing intermediate economy
United States, Contributions to annual real Gross Output growth



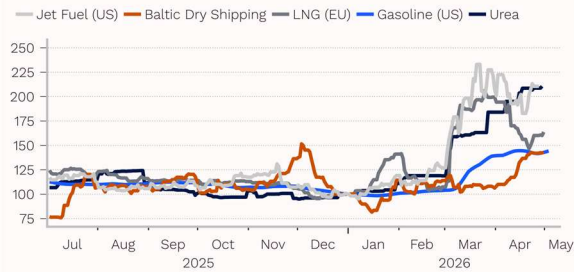
INFLATION: RUNNING EVEN HOTTER

The inflationary impact of the closure of the Strait of Hormuz will propagate more quickly than a typical oil price shock. This is because it’s not limited to oil prices. The supply of refined fuels and a host of other commodities will feed into core goods prices, alongside the usual increases in food and energy costs.

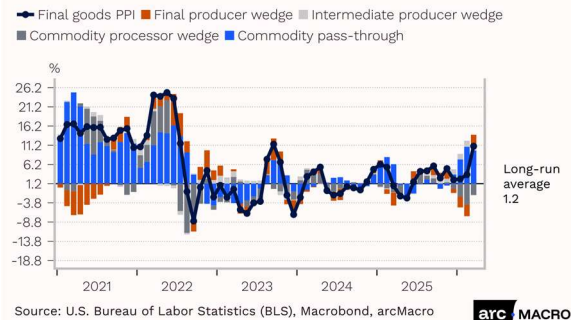
Tariffs mean that America has a higher inflation outlook than its peers.

The cost of tariff-affected inputs for businesses has been rising sharply since President Trump took office, running counter to both historical trends and international price patterns. Margin compression in firms along the affected supply chains has softened the pass-through to consumers (currently adding approximately one percentage point to headline inflation). Firms are now using higher energy costs as cover for margin recovery, adding a secondary source of inflation pressure to the commodity price spike.

Key commodities up by 50-200% YTD
World, Commodity prices, rebased, Jan 1 = 100



Firms are using the price shock to recover margin
United States, Decomposition of final goods prices, 3m ann.

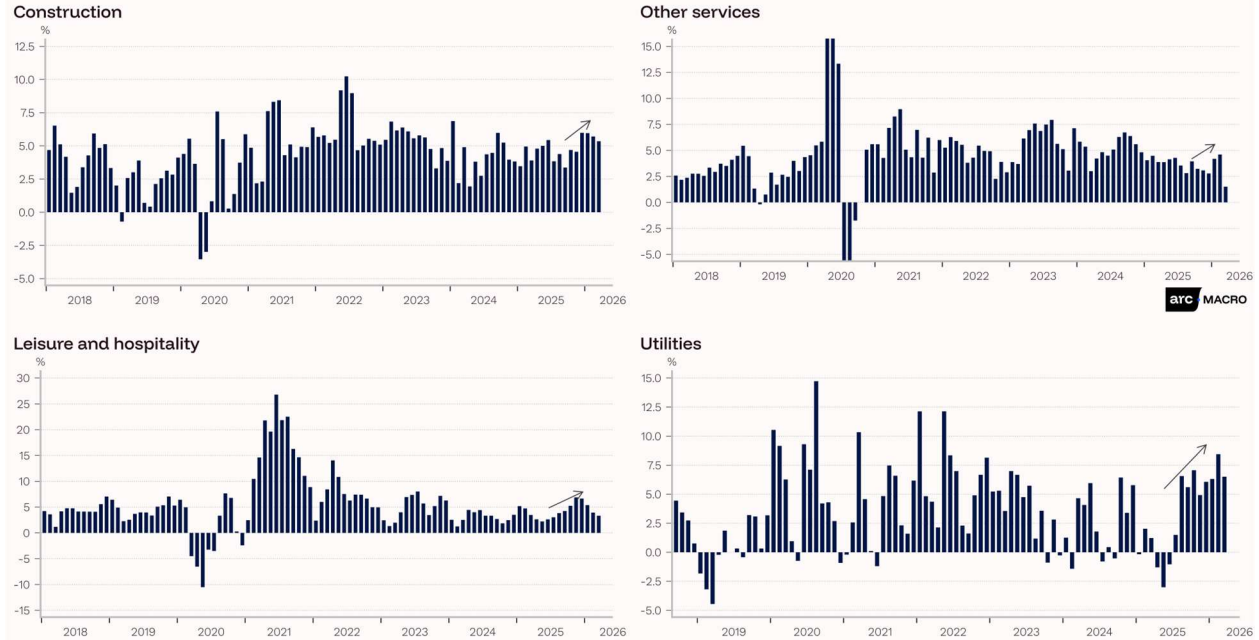


Pockets of tightness in labor markets are also looking inflationary. Where hot demand is meeting supply constraints

from tight immigration policy, wage growth is rising.

Industries with high immigration and/or AI exposure are seeing wages rise

United States, average hourly earnings, production & non-supervisory employees, 3-m annualized growth, SA



Source: U.S. Bureau of Labor Statistics (BLS), Macrobond, arcMacro

FINANCIAL CONDITIONS: STILL EASY

After initially tightening, financial conditions are looser than they were before the Iran conflict began. This dynamic has been driven by volatility in equity markets, which initially responded negatively to oil price shocks, before breaking that correlation and rallying to new record highs on the back of strong earnings growth and the improving activity outlook described above.

Financial conditions remain easy

United States, Financial stress and financial conditions, z-score



Source: Federal Reserve Bank of Chicago, The Office of Financial Research (OFR), Federal Reserve Bank of St. Louis, Macrobond, arcMacro

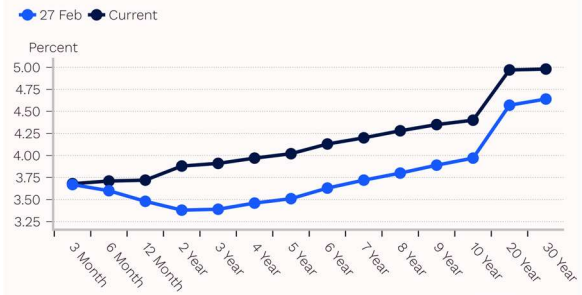


Rising credit spreads and a gradual realization that central banks will need to become more hawkish are providing a partial offset. But only a partial one; credit remains easy to come by for any US business or consumer looking to spend.

Central banks are sending a message that bond markets are partially hearing, but equity markets are shrugging off. In the latest round of central bank meetings, three Fed officials voted to remove the easing bias in the Fed's forward guidance. In the UK, Bank of England Chief Economist Huw Pill voted to raise rates, as did three of his peers at the Bank of Japan. In line with global trends, there

is a very real possibility that the next move in US interest rates is up rather than down, tightening financial conditions to offset inflationary pressures.

Markets have priced out lower interest rates
United States, Treasury yields



Source: U.S. Department of Treasury, Macrobond Financial AB, arcMacro **arc** **MACRO**

Market Views: Risks of Rising Rates

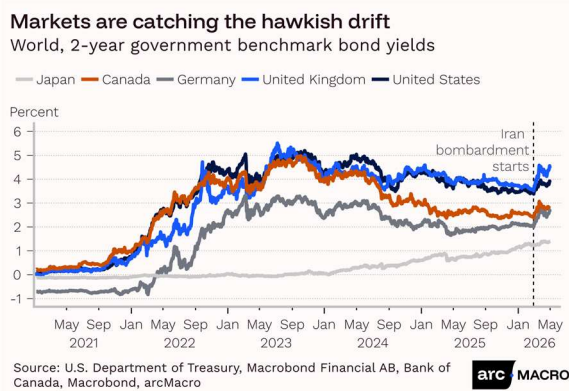
TRADITIONAL ASSETS: TRADING THE TIGHTENING

We typically analyze asset prices and potential returns on a medium-term horizon, tying our views to a given probability-weighted macroeconomic path.

Before we get to that (see next section), we're sensing a shift in the near-term outlook that warrants careful analysis and possibly some adjustments across asset classes and relative to underlying factor exposures.

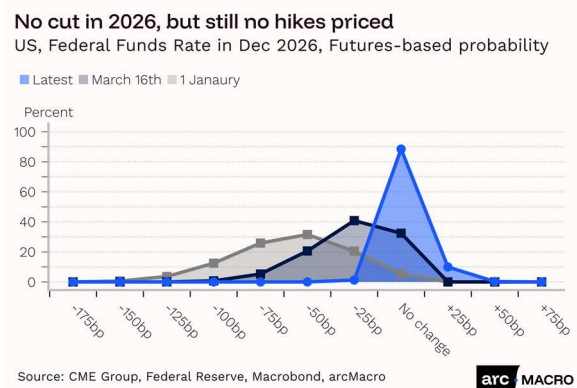
FIXED INCOME: LEADING A SHIFTING MARKET DYNAMIC

We see an underappreciated hawkish shift in interest rates as the key short-term dynamic in financial markets. The Federal Reserve is already getting behind the curve relative to global central banks, with the change in Chair from Jay Powell to Kevin Warsh complicating forward guidance. Still, we think markets are underestimating Warsh's hawkishness. In his Senate testimony, he identified the Fed's slow response to the 2021/22 inflation spike as a "fatal policy error."



From a positioning perspective, this means a risk/reward setup that heavily favors reducing exposure to interest-rate-sensitive assets, most obviously the short end of the yield curve.

Positive and negative factors are all leaning toward higher-for-longer rates further along the yield curve, too. We're in the early phases of a strong investment/productivity cycle (AI, followed by advances in quantum computing and potentially nuclear fusion). This is accompanied by an unsustainable debt trajectory that will likely be tamed by higher average inflation. Additionally, the Baby Boomers are transitioning from net savers to spenders. All these factors imply high long-term interest rates.



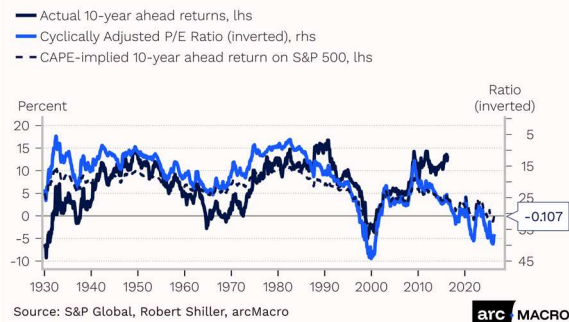
In credit markets, a gradual deterioration in pandemic-era credit quality and increasing AI-related borrowing are pushing up spreads, or, to use more historically aware

language, normalizing them from ultra-tight levels. This dynamic will persist, but we see the coming rise in base rates swamping spreads in terms of return dynamics in the near term.

EQUITIES: STILL CHALLENGING VALUATIONS PICTURE; OPPORTUNITIES IN SOFTWARE

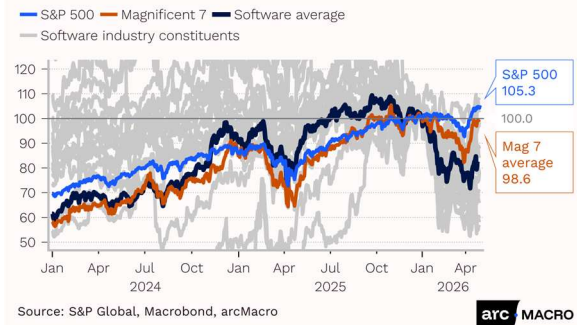
After an initial correction, equities have surged to fresh record highs. The valuation picture is still challenging in terms of future return implications. The classic cyclically adjusted PE ratio (CAPE) indicates a 10-year outlook of exactly flat stock prices.

Current S&P 500 valuations imply poor returns
United States, CAPE-implied 10-year returns, annualized



Equities are not pricing in higher interest rates. The most powerful (really the only) factor that has been able to dent the equity market since COVID-19 has been the interest rate outlook. Unlike bond markets, stock traders appear to be shrugging off the factors pointing to higher rates, and a near-term correction to account for higher discount rates appears to be in order.

Market still skeptical on software
United States, S&P 500 price indices, 2025-12-31 = 100



Crosscurrents are setting up a stock-picker's market. Companies with a combination of inflation resilience, low interest rate sensitivity, and positive exposure to durable growth themes (e.g., AI buildout) are positioned to perform strongly. Utilities stand out, and the current discount at which many software companies are trading means that investors with a strong thesis on AI adoption/adaptation have attractive entry points.

DOLLAR DEBASEMENT THEME ON PAUSE, BUT LONG-TERM RISKS ACCELERATED BY WAR

The broad-based “dollar debasement” trade that was on before the Iran conflict has been put on pause. During the more panicky moments of the conflict, US Treasuries rallied strongly, confirming their position as the ultimate backstop for global liquidity needs. The recent rise in yields is more connected to the inflation outlook than a debasement trade.

Gold is, for the time being, a risk asset, having become positively correlated with equities and negatively correlated with the oil price. This is the opposite of a geopolitical or inflationary hedge. Nonetheless, the longer-term constructive driver of higher gold prices – the complete absence of an alternative store of value for anyone trying to hedge dollar exposure – remains intact. Ironically, reopening the Strait is now a catalyst for gold prices.

Gold has decoupled from risk perceptions of late United States, 90d correlation with change in Gold Price



In the long run, the war will weaken America’s position as the global financial hegemon by increasing China’s leverage over some countries (e.g., Indian energy transactions in yuan) and prompting others to diversify to some degree. This again implies higher US interest rates to attract the required capital flows to maintain fiscal borrowing requirements.

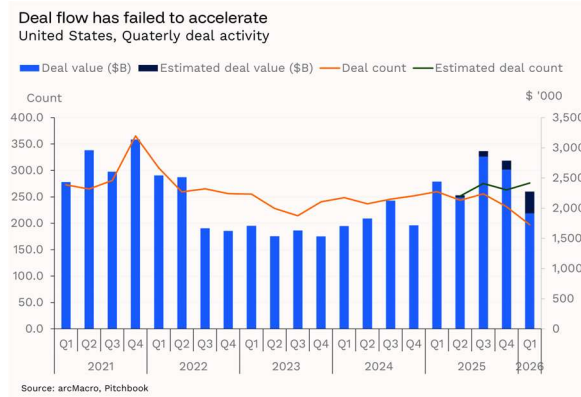
The multipolar case for higher US interest rates should not be confused with USTs being replaced as the global reserve asset. China does not offer third countries a better guarantee of stability or liquidity and will make limited inroads outside of the strategic support it is providing to global pariah states like Russia and Iran.

PRIVATE ASSETS: WANING OPTIMISM

PRIVATE EQUITY: A DREAM DEFERRED (AGAIN)

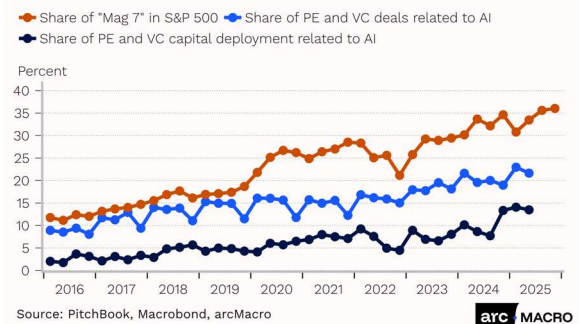
The prediction from our 2026 Outlook that is most likely to be completely undermined by the Iran conflict is that “there is a macroeconomic window for an acceleration in dealmaking.”

Higher interest rates and economic uncertainty are coming at a bad time for an industry that was just getting up off the mat. We don't expect deal flow to collapse, but 2026 may be another year in which a promising resurgence in M&A activity has been cut short by ill-advised political decisions. The secondaries boom will continue apace.



We see the decline in software valuations as a major deployment opportunity for funds with a strong AI thesis, and we encourage LPs to screen for GPs that can capitalize on it.

A Rising Proportion of Investments are AI-Focused
United States



PRIVATE CREDIT: NOT A SYSTEMIC RISK

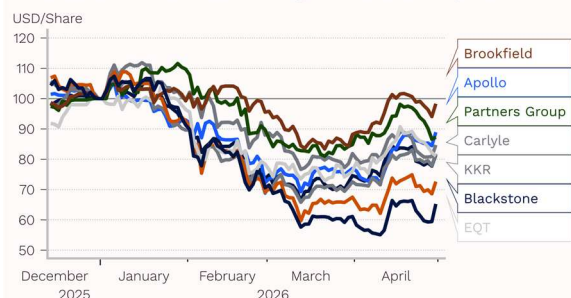
Concerns over a blowup in the private credit space remain overdone. Private credit is not systemically important, and while we expect defaults to rise and performance to normalize, we see returns for institutional investors remaining strong. The recent market dislocations only prove that public markets and retail investors are not a good match.

Private credit is not systemically important, and while we expect defaults to rise and performance to normalize, we see returns for institutional investors remaining strong. The recent market dislocations only prove that public markets and retail investors are not a good match.

Indeed, we see an opportunity for institutional LPs to gain quality exposure through investment vehicles targeting undervalued loans in retail-focused (semi)-liquid funds.

Annus horribilis for listed private credit

Global, Listed Private Asset Managers, Index, January 2026 = 100



What's Coming

THREE NEW SCENARIOS

Medium-term scenario-based outlook

The major supply shock generated by the conflict in Iran has forced us to radically rethink our medium-term scenarios for the US economy. Out with the three scenarios from our [2026 Outlook](#), and in with three entirely new ones.

All our new scenarios involve an inflation shock, but they differ significantly in how high inflation peaks and how long the episode lasts. Both are contingent on assumptions about the timing and extent of the reopening of the Strait of Hormuz and the Federal Reserve's interpretation of the inflation outlook.

The probability distribution over the three scenarios is much flatter than it was at the start of the year. This reflects genuine uncertainty. At present, we have limited information on the global economic propagation of the Iran shock, and the fog of war makes any strong predictions on its path to eventual resolution difficult to justify.

Scenario 1: Supply Shock Sorted (40%) is the modal scenario, though only narrowly. The key assumptions regarding the opening of the Strait of Hormuz and inflation pass-through roughly match the current median view in the market. The assumption on the Fed is somewhat more hawkish; this scenario incorporates two interest rate hikes in 2027 and a tightening of financial conditions (suppressing market returns). This limits inflation pass-through and is our interpretation of a well-managed supply shock.

Scenario 2: Stagflation Nation (30%) is now a serious concern. In our regime framework, "Stagflation" is any situation with spiking inflation rates and below-potential growth. One of those boxes (growth) is already ticked, and there is a meaningful chance that regional hydrocarbon product shortages dislocate global supply chains enough to push inflation to the levels seen in 2022. This becomes more likely if the Fed is slow to act — a key assumption in this scenario. Asset-level inflation betas are king in this scenario.





Scenario 3: Rapid Resolution (30%) represents the bull case. The core assumption is that President Trump folds in negotiations (still claiming a win) and the Strait reopens early enough to do almost no serious damage. The Fed resumes its easing bias, and AI-driven investment spending and (gradual) productivity gains anchor a "Goldilocks" regime with growth at potential and stable inflation. This is positive for most asset classes.

There is one key insight across scenarios that we should emphasize. The probability of a significant tightening of financial conditions over a 12–24-month period is above 70%. This is market-negative for both rates and equities and strongly argues for diversification into commodities and real assets.

SCENARIO 1: SUPPLY SHOCK SORTED

Scenario Overview

Probability weights and baseline macroeconomic forecasts





Current	1-12 Months	12-24 Months	24 Months +
Sluggish 	Financially Constrained 	Financially Constrained 	Goldilocks 
Model weight	50%	Negative subjective adjustment reflects uncertainty over the Federal Reserve's willingness to proactively tighten financial conditions, and the equity market's resilience to war developments, which may keep financial conditions easier than current data imply.	
Subjective adjustment	-10 pp		
Blended weight	40%		
GDP Growth (% Ann.)	1.5	2.0	3.0
CPI inflation (% Ann.)	3.8	3.1	2.3
Fed Funds Rate (% EOP)	3.88 (1 hike)	4.13 (1 hike)	3.88 (2 cuts)

Scenario Narrative

Narrative	<p>A rocky stalemate in the Iran War persists through most of 2026, with intermittent windows of transit and an eventual deal ahead of the mid-term elections.</p> <p>This drives annual headline inflation to 5%, first through fuel prices, then through hydrocarbon-related core goods, spillovers to food prices, and tariff-driven margin recovery. Growth slows, but remains positive due to AI-related investment and fiscal largesse.</p> <p>The Fed shifts to a hawkish tone mid-year, and rate hike follows around the turn of the year. This proactive stance means that the Fed can limit the response to two 25bp moves, which transmit through equity prices and credit conditions to cool the economy and contain second-round effects.</p> <p>As inflation cools in mid-2027, the table is set for the Fed to ease rates and growth to pick up.</p>
What you need to believe	<ol style="list-style-type: none"> 1. The Strait of Hormuz is fully open for shipping traffic in the fourth quarter of 2026. 2. Fed is willing to get ahead of the curve and tighten financial conditions proactively. 3. Rate hikes weigh on equity and credit valuations, but do not cause a market collapse.

Public Market Marks

Average historical scenario performance and risk skew relative to history in current outlook

		Current	1-12 Months	12-24 Months	24 Months +
		Sluggish 	Financially Constrained 	Financially Constrained 	Goldilocks 
Equities	Historical regime performance		10.3%	10.3%	14.4%
	Current Scenario Skew		Neutral	Negative	Neutral
Fixed Income	Historical regime performance		2.9%	2.9%	10.4%
	Current Scenario Skew		Negative	Neutral	Neutral
Currency (US\$)	Historical regime performance		5.2%	5.2%	-2.9%
	Current Scenario Skew		Negative	Negative	Negative
Commodity	Historical regime performance		0.0%	0.0%	1.2%
	Current Scenario Skew		Positive	Positive	Neutral

Private Market Activity Heatmap

Blue = weak (cool) activity; Orange = Strong (hot) activity

	Current	1-12 Months	12-24 Months	24 Months +
	Sluggish 	Financially Constrained 	Financially Constrained 	Goldilocks 
Fundraising				
Deal Flow				
Valuations				
Returns				

Corporate performance heatmap





Top 5 performing industries by metric

	Current	1-12 Months	12-24 Months	24 Months +
	Sluggish 	Financially Constrained 	Financially Constrained 	Goldilocks 
Revenue Growth		<ul style="list-style-type: none"> - Furniture Manufacturing - Internet - Clothing Manufacturing - Specialty Retailing - Vehicle Retailing 	<ul style="list-style-type: none"> - Furniture Manufacturing - Internet - Clothing Manufacturing - Specialty Retailing - Vehicle Retailing 	<ul style="list-style-type: none"> - Building Construction - Furniture Manufacturing - Primary Metal Manufacturing - Specialty Materials - Textiles Manufacturing
Margins		<ul style="list-style-type: none"> - Software - Air Transportation - Internet - Healthcare Services - Clothing Retailing 	<ul style="list-style-type: none"> - Software - Air Transportation - Internet - Healthcare Services - Clothing Retailing 	<ul style="list-style-type: none"> - Real Estate - Air Transportation - Funds & Trusts - Accommodation - Entertainment
Valuations		<ul style="list-style-type: none"> - Furniture Manufacturing - Other Transportation - Air Transportation - Clothing Retailing - General Merchandising 	<ul style="list-style-type: none"> - Furniture Manufacturing - Other Transportation - Air Transportation - Clothing Retailing - General Merchandising 	<ul style="list-style-type: none"> - Internet - Furniture Manufacturing - Air Transportation - Entertainment - Personal and Social Services

SCENARIO 2: STAGFLATION NATION

Scenario Overview

Probability weights and baseline macroeconomic forecasts

Current	1-12 Months	12-24 Months	24 Months +
Sluggish 	Stagflation 	Stagflation 	Financially Constrained 
Model weight	10%	Model requires significant adjustment due to limited data sample with elevated oil and hydrocarbon-linked prices, and judgemental scenario assumption of a delayed Federal Reserve response.	
Subjective adjustment	+20 pp		
Blended weight	30%		
GDP Growth (% Ann.)	1.5%	0.5%	2.0%
CPI inflation (% Ann.)	6.0%	6.0%	4.0%
Fed Funds Rate (% EOP)	3.65 (No change)	4.15 (2 hikes)	5.15 (4 hikes)

Scenario Narrative

Key economic and policy assumptions

Narrative	<p>A significant inflation spike is all that's required to tip the macro regime into "Stagflation." Growth is already below-trend, and in this scenario the highly inflationary oil shock dampens consumer demand.</p> <p>The Strait of Hormuz blockade is not fully lifted until 2028, with intermittent closures amid a frozen conflict keeping oil prices volatile and global hydrocarbon-linked supply chains severely disrupted.</p> <p>Under incoming Chair Warsh, the Fed opts to "look through" the shock initially, allowing price pressures to move beyond volatile headline categories and into slower-moving core prices.</p> <p>A Stagflation regime results, with anemic growth and asset prices driven by their inflation betas. The economy resolves to a Financially Constrained regime once the Fed catches up.</p>
What you need to believe	<ol style="list-style-type: none"> Iran will use its strategic advantage in the Strait of Hormuz to hobble the Trump administration and pursue a better deal under the next government. Both parties will allow occasional openings to move traffic when global shortages bite. The Fed will attempt to look through the shock and act too late to reign in second-round effects. Consumers and businesses will reduce outlays due to inflationary pressures.





Public Market Marks

Average historical scenario performance and risk skew relative to history in current outlook

		Current	1-12 Months	12-24 Months	24 Months +
		Sluggish 	Stagflation 	Stagflation 	Financially Constrained 
Equities	Historical regime performance		3.2%	3.2%	10.3%
	Current Scenario Skew		Higher	Higher	Neutral
Fixed Income	Historical regime performance		8.3%	8.3%	2.9%
	Current Scenario Skew		Lower	Lower	Neutral
Currency (US\$)	Historical regime performance		-2.6%	-2.6%	5.2%
	Current Scenario Skew		Neutral	Neutral	Lower
Commodity	Historical regime performance		13.9%	13.9%	
	Current Scenario Skew		Neutral	Neutral	Neutral





Private Market Activity Heatmap

Blue = weak (cool); Orange = Strong (hot); Grey = Neutral or sector-dependent

Current	1-12 Months	12-24 Months	24 Months +
Sluggish 	Stagflation 	Stagflation 	Financially Constrained 
Fundraising	Blue		Blue
Deal Flow	Blue		Blue
Valuations	Blue		Blue
Returns	Blue		Blue

Corporate performance heatmap





Top 5 performing industries by metric

Current	1-12 Months	12-24 Months	24 Months +
Sluggish 	Stagflation 	Stagflation 	Financially Constrained 
Revenue Growth	<ul style="list-style-type: none"> - Oil and Gas - Petroleum products - Mining Services - Air Transportation - Accommodation 	<ul style="list-style-type: none"> - Oil and Gas - Petroleum products - Mining Services - Air Transportation - Accommodation 	<ul style="list-style-type: none"> - Furniture Manufacturing - Internet - Clothing Manufacturing - Specialty Retailing - Vehicle Retailing
Margins	<ul style="list-style-type: none"> - Oil and Gas - Mining - Primary Metal Manufacturing - Lumber processing - Building Construction 	<ul style="list-style-type: none"> - Oil and Gas - Mining - Primary Metal Manufacturing - Lumber processing - Building Construction 	<ul style="list-style-type: none"> - Software - Air Transportation - Internet - Healthcare Services - Clothing Retailing
Valuations	<ul style="list-style-type: none"> - Other Construction - Conglomerates - Telecommunications - Utilities - Online Retailing 	<ul style="list-style-type: none"> - Other Construction - Conglomerates - Telecommunications - Utilities - Online Retailing 	<ul style="list-style-type: none"> - Furniture Manufacturing - Other Transportation - Air Transportation - Clothing Retailing - General Merchandising

SCENARIO 3: RAPID RESOLUTION

Scenario Overview

Probability weights and baseline macroeconomic forecasts

Current	1-12 Months	12-24 Months	24 Months +
Sluggish 	Goldilocks 	Goldilocks 	Goldilocks 
Model weight	40%	Current data sample has not fully captured the growth and inflation consequences of the Iran War, making the model over-optimistic on the likelihood of a positive transition.	
Subjective adjustment	-10 pp		
Blended weight	30%		
GDP Growth (% Ann.)	2.0%	3.2%	3.0%
CPI inflation (% Ann.)	3.6%	2.5%	2.2%
Fed Funds Rate (% EOP)	3.4 (One cut)	3.15 (One cut)	3.15 (No cuts)





Scenario Narrative

Key economic and policy assumptions

Narrative	<p>This scenario contemplates a deal to re-open the Hormuz Strait in the very near term, enabling physical markets to clear quickly and the inflation impulse to fade rapidly, with tariff-related inflation falling out of the index several months later.</p> <p>Within 12 months, the Fed eases interest rates and delivers another cut in the second year of the scenario to arrive at its judgement of the neutral rate.</p> <p>Meanwhile, growth remains around the long-run average, supported by the AI investment boom and fading economic uncertainty as a Democrat-controlled Congress mitigates executive economic policy risk (but lingering consumer weakness outside the top deciles prevents an overheating).</p>
What you need to believe	<ol style="list-style-type: none"> 1. A US-Iran deal to durably reduce tensions is imminent. 2. AI-related spending will persist sustainably for several more years. 3. AI-driven productivity growth will outweigh costs in terms of employment demand. 4. Democrats will control the Congress and effectively curtail inflationary or growth-negative policies.


Public Market Marks

Average historical scenario performance and risk skew relative to history in current outlook

Current		1-12 Months	12-24 Months	24 Months +
Sluggish 		Goldilocks 	Goldilocks 	Goldilocks 
Equities	Historical regime performance	14.4%	14.4%	14.4%
	Current Scenario Skew	Neutral	Neutral	Neutral
Fixed Income	Historical regime performance	10.4%	10.4%	10.4%
	Current Scenario Skew	Lower	Lower	Lower
Currency (US\$)	Historical regime performance	-2.9%	-2.9%	-2.9%
	Current Scenario Skew	Neutral	Neutral	Neutral
Commodity	Historical regime performance	1.2%	1.2%	1.2%
	Current Scenario Skew	Lower	Neutral	Neutral





Private Market Activity Heatmap

Blue = weak (cool); Orange = Strong (hot); Grey = Neutral or sector-dependent

Current	1-12 Months	12-24 Months	24 Months +
Sluggish 	Goldilocks 	Goldilocks 	Goldilocks 
Fundraising			
Deal Flow			
Valuations			
Returns			

Corporate performance heatmap

Top 5 performing industries by metric

Current	1-12 Months	12-24 Months	24 Months +
Sluggish 	Goldilocks 	Goldilocks 	Goldilocks 
Revenue Growth	- Building Construction - Furniture Manufacturing - Primary Metal Manufacturing - Specialty Materials - Textiles Manufacturing	- Building Construction - Furniture Manufacturing - Primary Metal Manufacturing - Specialty Materials - Textiles Manufacturing	- Building Construction - Furniture Manufacturing - Primary Metal Manufacturing - Specialty Materials - Textiles Manufacturing
Margins	- Real Estate - Air Transportation - Funds & Trusts - Accommodation - Entertainment	- Real Estate - Air Transportation - Funds & Trusts - Accommodation - Entertainment	- Real Estate - Air Transportation - Funds & Trusts - Accommodation - Entertainment
Valuations	- Internet - Furniture Manufacturing - Air Transportation - Entertainment - Personal and Social Services	- Internet - Furniture Manufacturing - Air Transportation - Entertainment - Personal and Social Services	- Internet - Furniture Manufacturing - Air Transportation - Entertainment - Personal and Social Services

What about Canada?

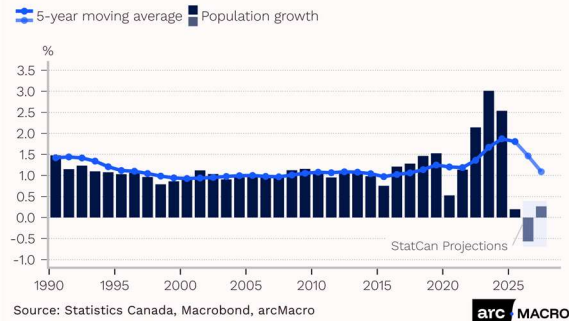
A BULLISH OUTLOOK IF TRADE RISK FADES

Green Shoots and a Stormy Horizon

NO PAIN, NO GAIN

Over the past two years, Canada has been living through a period of painful economic rebalancing. An effective freeze on net immigration through 2027 has removed a key source of GDP growth. Canada's fiscal policy has been less expansionary than that of the US, another factor in its relative underperformance. Until recently, commodity markets and subdued global demand have not helped Canada's case for growth either, failing to provide a much-needed offset to pressure from US tariffs on sectors not covered by the North American trade pact (USMCA to Americans, CUSMA to Canadians).

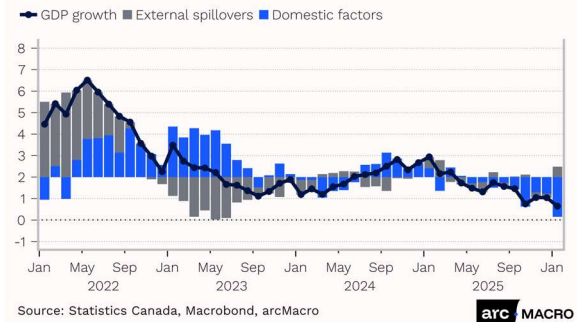
Canada's population growth correction is underway
Canada, Total population, Year-on-year change



As Canada has taken its economic medicine, the Carney government has spent its first year in power laying the groundwork for a period of economic development centered on large infrastructure projects, mineral extraction, and a more supportive regulatory environment for business development. Some green shoots are

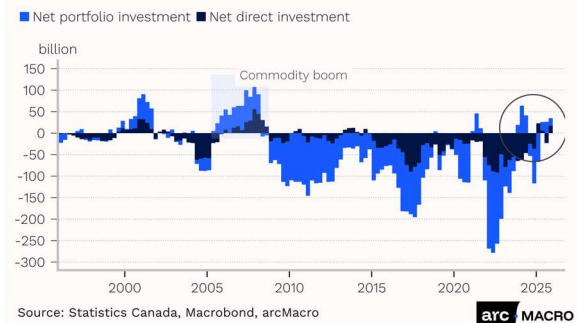
showing through as the investment case for Canada has improved.

Local factors have been weighing on growth
Canada, GDP, deviation from 2% long-run average



Canada has shown unexpected resilience in the face of these economic challenges and has been able to attract capital to finance its deteriorating trade balance. A shift in investor sentiment linked to a stronger economic development program is supporting Canadian capital markets through the transition.

Canada importing capital as trade balance narrows
Canada, Change in international investment, 4q moving sum



THE CLOUD ON THE HORIZON

Canada's favorable access to US consumer markets (over 85% of Canadian exports to the US are currently tariff-free) is under threat as the CUSMA trade deal comes under review and renegotiation this summer. Any firm with a significant American client base is holding back on investment and hiring decisions until it has certainty about its market access.

Despite this, there are reasons to be optimistic that a good deal for Canada can be secured, and our baseline is a near-status-quo deal with minor concessions before the November

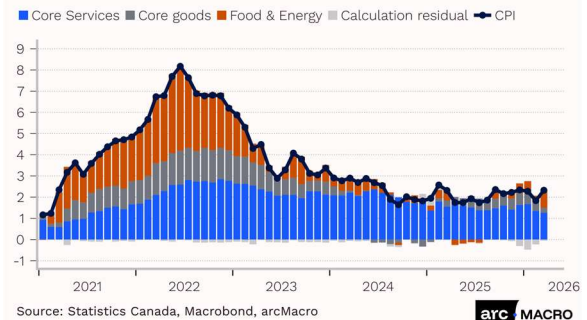
midterms. The CUSMA negotiations may end up more political theater than fundamental economic realignment. With the November midterm elections looming, there is no reason for President Trump to fight the overwhelming support for the status quo from Republicans in Midwestern swing states. At the same time, he will want to announce a deal before elections; otherwise, he would lose his ability to control the terms of any new deal with a Democrat-controlled House (and possibly also Senate) opposing him.

INFLATION IS COMING, BUT IT'S LIKELY TO BE TRANSITORY

The still-fragile state of Canadian demand means the inflation shock is more likely to be “transitory” than in the US. Food and energy prices will rise, although the stronger Canadian dollar is helping to offset some of this pressure. More fundamentally, the goods price increases are coinciding with a slack labor market and cooling shelter costs. Firms are more inclined than in the US to avoid passing costs on to consumers, and there is a lower likelihood of second-round services price increases.

This will enable the Bank of Canada to look through higher prices and maintain a supportive policy stance. In the very near term, this implies stable rates and a weaker easing bias than in G7 peers.

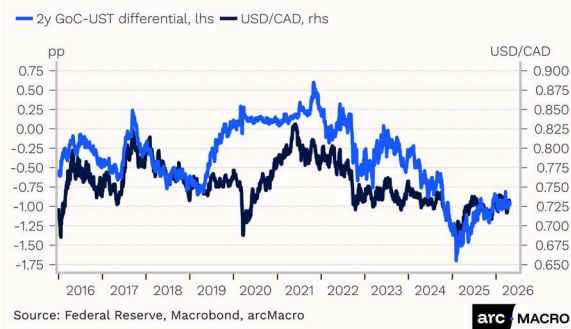
Core services inflation moderation is anchoring CPI
Canada, CPI inflation, YoY



Betting on Canada's Future

A reasonably good CUSMA deal would unleash pent-up investment and labor demand in Canada. If you're willing to take risk on our baseline CUSMA scenario, there is an opportunity in growth-positive assets, not least the TSX (heavily discounted to US comparables) and the Canadian dollar.

We expect a narrower differential and rising loonie
United States, Canada, interest and exchange rates



Interest rate dynamics in Canada are incredibly complex, especially compared to the US. The increasingly optimistic growth outlook and likely stronger exchange rate point to a steepening yield curve on a 2+ year horizon. On the short end, Canada's less inflationary outlook will anchor rates while the US rate outlook drifts higher. The net effect is a steepening of the Canadian yield curve relative to the US, implying a relatively poor outlook for local fixed income.

APPENDIX: arcMacro Regime Summary

arcMacro Regime Summary

Regime	Occurrences		Historical	Average		Average	Average annual S&P		
	Count	Percent	share	duration	Average GDP growth	inflation	500 return		
				Months	Percent	Std. dev	Percent	Percent	Std. dev
Goldilocks	5	27		32	3.2	0.4	2.5	14.5	10.8
Financially Constrained	8	21		16	3.4	0.4	2.9	14.7	15.8
Overheating	5	19		23	3.9	0.8	5.7	3.0	18.0
Crisis	5	10		11	0.0	0.6	2.0	8.5	17.8
Stagflation	4	10		15	-1.3	0.9	8.8	8.7	21.5
Rebound	3	7		13	5.5	1.5	4.0	10.6	23.2
Sluggish	4	7		11	1.8	0.4	3.0	18.5	14.9

Source: arcMacro

Goldilocks: This is the regime that policymakers are aiming for. The real economy is robust without being inflationary or creating financial imbalances. There is a general sense of equilibrium. Since 1970, the economy has spent more time in this Regime (27%) than any other, but we have not experienced a Goldilocks period since 2018.

Financially Constrained: In this regime, financial conditions are tight and are gradually cooling the economy. At times, this regime has reflected a “hangover” from a prior crisis, where growth has rebounded but credit remains tight. It can also result from a traditional central bank tightening cycle. In both cases, growth is coming down from an unsustainably high level (Rebound or Overheating Regimes), which explains why average GDP growth is relatively high. These regimes are common and highly variable in length.

Overheating: Easy credit conditions fuel unsustainable growth, pushing aggregate demand beyond supply and fueling inflation. The post-COVID-19 boom was a classic example. Creates the weakest return environment of all the Regimes as asset values become stretched.

Crisis: Total collapse in growth and credit, accompanied by stable or falling inflation. Very weak aggregate demand, with low-capacity utilization on the supply side. Extreme flight to safety behavior. Usually short-lived, but can stretch several years (e.g., dot-com recession) or double dip (GFC).

Stagflation: Simultaneous inflation spike and real economy collapse, usually accompanied by a credit crunch as monetary policy responds to inflation. Low (nominal) returns, but with very volatile markets. We have not experienced a Stagflation Regime since the First Gulf War, but we may be approaching one.

Rebound: Any period of super-strong real activity, which can only be achieved when idle economic capacity is rapidly reactivated. Always follows Crisis or Stagflation Regimes. Strong (but volatile) return environment, usually sparked off by a sudden surge in the Sentiment Factor (“animal spirits”).

Sluggish: Usually a transition Regime when entering or exiting a crisis. Real activity is below average, but not because of a lack of credit availability. Inflation is stable. The US economy has been mired in a Sluggish Regime, without entering a recession or a recovery, since 2023. This is an unprecedented state of affairs over the past half-century of economic history.

