FIDELITY PRIVATE WEALTH

Quarterly market commentary

DECEMBER 2025

Lessons learned during an extraordinary year

2025 was a remarkable year for performance and displayed the resilience of capital markets in the face of uncertainty. Investors faced a barrage of challenges from tariffs, geopolitical instability and fiscal uncertainty to dollar debasement and concerns around stretched valuations.

In conventional markets, this mix could have potentially influenced prolonged pullbacks. Instead, markets absorbed the noise, and rewarded disciplined investors who did not over-react to headline news. Below, we break down the key themes that defined the year.

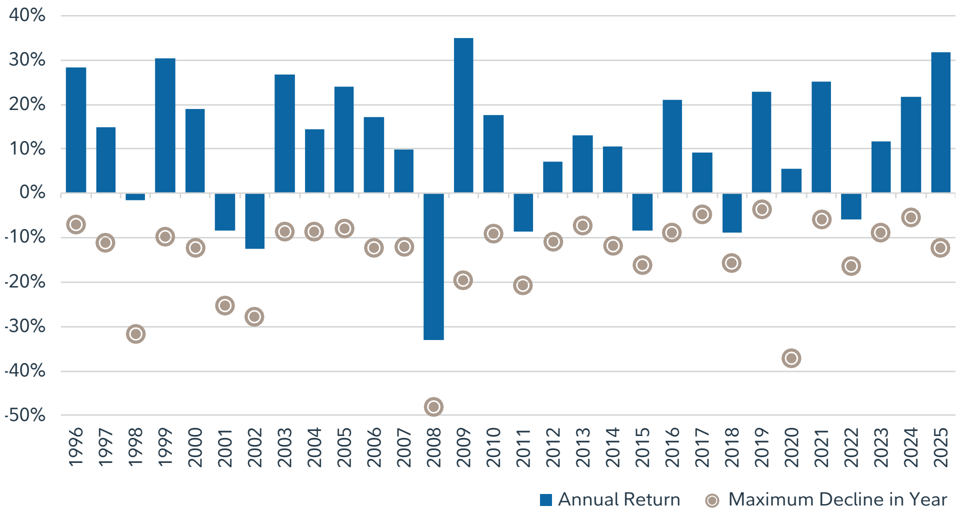
Headline risks versus long-term returns were on full display

Several turbulent moments became headline news and induced volatility in capital markets. However, historical analysis shows large declines occur almost every year, even in bull markets (as per the chart on page two). Of the 30 years analyzed here, 17 years saw the market fall 10% or more at some point.

But here's the interesting part: more than half of those years still ended positive and often posted double-digit gains. In other words, temporary setbacks are normal and do not prevent the markets from finishing the year strong.

2025 vividly displayed this pattern in Canada. The market dropped by 12% from its high, which felt uncomfortable with tariff uncertainty in the backdrop, yet still finished the year with a standout gain of 31.7% in CAD terms.

TSX: Return vs. maximum decline per year



Source: Fidelity Investments Canada ULC.

KEY TAKEAWAYS

Canadian equities posted their best performance in 15 years and ranked among the top global markets.

The artificial intelligence (AI) theme evolved from an experimental technology to a driver of economic growth.

Global diversification regained importance in 2025 after years of U.S. dominance.

The economic backdrop in 2026 looks constructive, but rising geopolitical risks could bring new volatility.

Diversification proved its value

Different asset classes took turns to lead in the year, often see-sawing between growth-oriented and defensive strategies. In Q1, early volatility pushed investors towards safer choices, where bonds, international stocks and value-oriented companies replaced U.S. growth stocks.

By Q2, leadership in the stock market swung back toward risk assets, but with more selective broadening where U.S. technology stocks, emerging markets and gold all delivered strong gains.

Q3 saw a continuation of this trend as early signs of AI-driven profits propelled high-growth names to new all-time highs.

Q4 brought lighter trading volumes, as investors largely maintained balanced positioning rather than initiating any broad risk-on or risk-off moves.

AI dominated markets

AI shifted decisively from an experimental technology to a major economic driver. Record levels of AI-related investment and infrastructure buildouts in 2025 contributed meaningfully to economic activity and corporate earnings, with some estimates suggesting that this investment boom could have helped prevent a broader economic slowdown.

The technology has now entered a phase of broad-based end-user integration, where AI applications are spreading across the entire economy and beyond the handful of chipmakers or software platforms that led the story in earlier years. Globally, the U.S. remains the clear leader in AI today, but innovation is accelerating worldwide, with researchers pushing boundaries in new areas such as robotics and quantum computing.

We believe that capturing the next phase of AI driven growth will require a deeper look under the hood of how companies are leveraging AI technology, rather than who is spending the most on building out AI infrastructure.

Lessons learned

Volatility is a normal feature of markets, not the exception. In fact, the actual volatility and declines observed in 2025 were below the average annual amount typically seen in markets. What did stand out was the speed of rotation, as investors quickly absorbed data and shifted rapidly between U.S. and global markets and across asset classes, which is a sign of how dynamic today's investment landscape has become.

Meanwhile, information overload is at an all-time high, and extracting meaningful insights has never been more challenging. Unexpected events can continue to occur, while innovative technologies reshape the environment at unprecedented speed.

The confluence of these factors has made markets more challenging to navigate. In this environment, a skilled manager can significantly add value by filtering out the noise, staying anchored to a thoughtful investment approach and helping investors stay in line with their goals rather than reacting to every headline.

The past year has served as a powerful reminder that staying invested through volatility has consistently rewarded disciplined investors over the long term and this is the cornerstone of our investment philosophy.

Canadian equities

Canadian equities as measured by the S&P/TSX Capped Composite Index posted their best performance in 15 years, gaining 31.7% for the year and 6.3% in the final quarter of 2025 in CAD terms. The Canadian market was amongst the top performers globally, beating most G7 nations, including U.S. equities. The materials sector powered much of the rally, driven by a remarkable surge in gold and other commodities. The materials sector soared by 100.6% for the year and 11.9% in Q4 alone, while financials came in second place, posting a return of 35.3% for the year. Together, these two sectors drove the majority of the index's performance, maintaining the concentration of returns that typically characterizes the Canadian market.

On the economic front, inflation held steady at 2.2% in November, supported by easing services inflation but offset by rising grocery prices. Meanwhile, the unemployment rate improved slightly, falling to 6.5% in November. Normally, more people working should mean the economy grows but Canada's GDP shrank by (-0.3) % in October. This gap highlights Canada's productivity problem, where, even with more workers, each person seems to be producing less on average. The government has acknowledged this issue and outlined proposed measures to address it in its latest fiscal budget.

Meanwhile on the monetary policy front, the Bank of Canada delivered a 0.25% cut in October and has since paused policy rate at 2.25%, signaling stability in inflation. However, some market participants view this pause as a cautious acknowledgment that expansive government spending could introduce new inflationary pressures in the months ahead. Therefore, the balance of growth and inflation will remain a key area of public focus next year.

U.S. equities

After a negative first quarter, U.S. equities, as measured by the S&P 500 index, staged a strong comeback, gaining 17.9% in USD terms and 12.4% in CAD terms for the year 2025; notably, the difference between these returns reflects the weakening U.S. dollar, which eroded gains for Canadian investors. The final quarter posted more subdued returns of 2.7% in USD terms and 1.13% in CAD terms. The index was primarily led higher earlier in the year by a handful of large technology and AI-related firms that surged mid-year and traded at increasingly stretched valuations. With prices already elevated for the market leaders, investors became hesitant to keep bidding them up in the fourth quarter without new catalysts. Consequently, money rotated into safer, more defensive parts of the market.

Healthcare emerged as the clear winner and made a comeback, gaining 21.7% in USD terms just in the fourth quarter. Beyond that, performance was much more muted; financials were the second-strongest group of the quarter, but they gained only 2.52% in USD terms.

GDP growth in the U.S. delivered a significant upside surprise, increasing by 4.3% in the third quarter, which is the fastest pace of growth in two years and a notable sign of the economy's resilience. Meanwhile, inflation fell to 2.7% while unemployment markedly rose to 4.5% in November, its highest level since 2021. This mixed economic picture points to early signs of gains from AI-driven efficiency, which have helped the U.S. GDP increase, despite having fewer people employed in the economy. This is an interesting and opposing difference between Canada's economy, where Canada added jobs but lost GDP output. Additionally, the Federal Reserve delivered two 0.25% cuts in the quarter and added support through short term securities purchases, marking a doveish tone and bringing policy rate to 3.75%.

International equities

Although much of the attention this year focused on AI and the large U.S. companies driving it, international equities calmly outperformed and broke the pattern of U.S. market dominance seen in recent years. In many ways, 2025 served as a strong case study in the benefits of global diversification. Developed markets, as measured by the MSCI EAFE Index, returned 25.1% year to date and 3.3% in the final quarter in CAD terms.

Industrials, aerospace and financials led the performance, benefiting countries like Germany and the U.K. Japan was another strong contributor, supported by corporate reforms and rising interest rates that have encouraged households to move some of their large cash holdings (over 50% of current assets) into investments. Looking ahead, ongoing research in AI, rising global defense spending, and targeted structural reforms are expected to continue drawing capital into these markets.

Emerging markets, as measured by the MSCI EM Index, also had a stellar year, posting 27.3% year-to-date and 3.2% in the final quarter in CAD terms. South Korea posted a yearly return of over 70% and led not just the region, but the entire global market, amid a surge in its technology exports. Technology and AI strength drove performance in Asian equities, while commodities and domestic growth supported equity returns in Latin America. Together, these emerging market regions provided exposure to both global innovation as well as cyclical tailwinds to economies. However, they also carry higher trade and geopolitical risks than developed markets, so, while we view them positively, we recognize that they are inherently riskier as well.

Fixed income

Fixed Income delivered mixed results in the quarter as FTSE Canada Universe Bond Index decreased -(0.3%) while the Bloomberg U.S. Aggregate Bond Index (CAD-Hedged) increased 0.6% in CAD terms, respectively, this past quarter.

Generally, fixed income markets were pulled in two directions in 2025 where global central banks cut short-term rates as inflation neared desired levels. However, longer-term rates stayed elevated as governments continued to borrow for expansive fiscal spending; this trend could continue in the next year as fiscal deficits and policy uncertainty remain elevated.

Credit markets are likely to remain cautious about how large AI investments are financed by companies. Investors have pushed back against use of aggressive leverage in recent deals, and could likely continue to favour a more disciplined, self funded approach in the year ahead.

Outlook

After three extraordinary years in the current bull market, we approach 2026 with tempered optimism. Economic conditions remain supportive with interest-rate cuts and large government-spending programs, but elevated valuations are making markets increasingly sensitive to any gaps between expectations and actual results.

The AI theme is entering a show-me phase: investors will want to see continued proof that large spending on AI turns into real productivity improvements and profits.

From a Canadian perspective, we are watching for two things in particular. The first is the upcoming review of the Canada U.S.-Mexico Agreement (CUSMA) in July 2026, where any significant changes or renegotiations could reshape Canada's trade landscape. The second is whether domestic fiscal policy begins to ease long standing productivity challenges and affordability pressures.

On the U.S. side, volatility could remain elevated as investors weigh high expectations for corporate earnings against shifting policy signals, geopolitical risks and continued pressure on the U.S. dollar.

Meanwhile, international equities enter 2026 with a constructive backdrop, supported by structural reforms, rising defense spending, and exposure to themes beyond the dominance of U.S. technology.

Against this backdrop, our approach to markets in 2026 remains consistent. We remain globally diversified, anchored in long-term investment fundamentals, and focused on your investment goals and objectives.

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