We hope that all is well with everyone and that you are enjoying the summer!

**Markets Climb the Wall of Worry — What's Driving the Rally?**

Markets continue to grind higher, climbing what investors often refer to as the "wall of worry." Events that triggered sell-offs in the recent past—wars, tariffs, inflation spikes, central bank uncertainty, or controversial legislation—are now being absorbed by the markets. Both U.S. and Canadian equity markets have reached all-time highs, driven in part by excitement surrounding artificial intelligence (AI). But this rally isn't just about AI—there's more happening under the surface.

**From Shock to Resilience: A Changing Market Psychology**

One key explanation may be that markets reached "peak uncertainty" in April with the initial U.S. tariff announcements. The "Liberation Day Shock" acted as a kind of market quake. Since then, subsequent headlines have resembled aftershocks—disruptive but anticipated.

This has given rise to a mindset some investors label as TACO: Trump Always Chickens Out. The view suggests that aggressive posturing is often followed by retreat or moderation, and this has kept many investors hesitant to sell.

Meanwhile, retail investors—particularly those focused on growth—have been buying on the dips aggressively. Interest is strong in both AI-related technology and the infrastructure and power sectors needed to support it. Corporate earnings remain solid, and employment data continues to show resilience.

**Tariffs: The Elephant in the Room**

Despite strong equity performance, risks remain. New U.S. tariffs on countries that refuse to sign bilateral trade deals may strengthen the administration's negotiating position, but they also raise inflationary pressure and global uncertainty.

As trading partners seek alternatives to U.S. markets, the short-term result may be volatility—and the possibility of a correction.

So far, many companies have absorbed rising input costs, but that can't continue indefinitely. Tariffs eventually erode earnings, and signs are already visible: hiring plans are cooling, wage growth is moderating, and business investment is slowing. While durable goods inflation has eased, food prices—which cannot be stockpiled—are once again rising in the U.S.

**Disinflation or Demand Destruction?**

Here lies a paradox: falling inflation in some areas may not reflect economic strength, but rather slowing demand. If the economy continues to cool, prices may stay subdued—but the trade-off could be broader economic weakness. On the flip side, if fiscal stimulus from Trump's "Big Beautiful Bill" keeps the economy afloat, we could see a resurgence of inflation later this year as companies begin to pass along rising costs.

A best-case scenario? A strategic pullback by the President: a few symbolic trade victories that allow for easing tariffs without undermining the political narrative. August 1st is a critical deadline—several key tariff measures are scheduled to take effect, and what happens next will likely shape market direction into the fall.

**Canada: Feeling the Heat**

In Canada, the effects of tariffs are more acute. Slowing GDP growth and pressure on both provincial and federal budgets are visible. Governments are experiencing a dual squeeze: lower tax revenues and rising support costs for affected sectors.

Some industries are weathering the storm better than others. Aluminum producers, with entrenched U.S. access, are holding up. Steel producers, however, are facing tariffs as high as 50%.

Canada's response has been strategic: exports to the U.S. have dropped from 78% to 68% year-over-year, a sign of increasing diversification. But geography and economics mean the U.S. will remain our dominant trading partner for the foreseeable future.

**Inflation Watch and the Policy Puzzle**

Inflation in the U.S. has ticked up from 2.4% to 2.7%, with projections as high as 3.0% by year-end. If fully implemented, Trump's fiscal measures could widen the deficit, weaken the U.S. dollar, and push interest rates higher—a challenging scenario for consumers and investors alike.

Meanwhile, proposed cuts to discretionary government spending in the U.S. have done little to reduce debt and have largely impacted essential services.

Still, equity markets remain focused on the long term, interpreting these policies as stimulative for now. But the bond market is worth watching—a shift in sentiment there could be an early warning sign of broader economic concern.

**Central Bank Independence in the Spotlight**

President Trump's recent call to lower the Fed Funds Rate to 1%—intended to offset debt from his own policies—has raised alarms about central bank independence. In normal times, even suggesting the removal of the Fed Chair would shake markets. Chair Powell has remained firm, and any move to replace him is seen as unlikely at this point.

**What Comes Next? Prepare for a Healthy Correction**

Markets have rallied significantly, and many indicators suggest they are technically overbought. A correction would be healthy and is increasingly probable heading into the fall. The August 1st tariff deadline may act as a catalyst for volatility.

Still, the long-term picture remains cautiously optimistic. AI, infrastructure, and energy continue to lead, and unless trade tensions escalate dramatically, the economic and earnings backdrop remains supportive of further growth.

**Final Thoughts: Fundamentals Over Fear**

Inflation isn't behind us. Interest rate policy is still being contested. But for now, corporate earnings and productivity gains—particularly those linked to AI—are driving this market forward.

As always, separating political noise from economic fundamentals is key.

We remain:

- Disciplined in our approach
- Diversified across sectors and geographies
- Vigilant in the face of uncertainty

The wall of worry may be steep—but history shows that markets have a way of climbing it.

As always, if you have any questions or just want to touch base, we are just an e-mail or phone call away.

All our very best,

**The Andras Group**