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Continuing my behavioral finance discussion, I look at how confirmation bias, our natural preference for sticking with our beliefs, can be dangerous for us as investors. In our *Quarterly Economic Report*, Michael Chu and I note the current resiliency of stocks and the economy – while also keeping our eye on potential risks. And Tom Cowans reveals the tax benefits of donating appreciated publicly traded securities.

Stan

Stan Clark is a Portfolio Manager and Senior Wealth Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Stan has direct responsibility for the team and oversees all areas of financial planning, investment selection and investment management.

BEHAVIORAL FINANCE

CONFIRMATION BIAS IS NORMAL – BUT DANGEROUS FOR INVESTORS

By Stan Clark, Senior Wealth Advisor

In the last issue, we discussed how *confirmation bias*, an all-too-human tendency, leads us to selectively search for, interpret, and remember information that confirms our initial views – while overlooking contrary data. Confirmation bias could just as well be called selective unconsciousness, because we don't consciously intend to deceive ourselves. The tendency arises unconsciously from our human nature.

In this issue, I'd like to discuss how confirmation bias, though natural to us as humans, can be dangerous for us as investors.

Confirmation bias is pervasive. It affects what we believe and how we act – sometimes with unfortunate results, leading us to make serious investment mistakes.

Most of us approach investing subjectively. It's no coincidence that, over the long term, many investors underperform market averages. Confirmation bias is one reason subjective investing doesn't work well.

Say I'm an analyst. I'm trying to determine whether ABC Corp is worth investing in. I'm initially biased in ABC's favour. Maybe I once worked for them, a friend recently joined them, or my sister swears by an ABC product. Whatever the reason, my first impressions are positive.

So, when I start researching ABC, confirmation bias kicks in. I think I am being unbiased, but it's hard not to favour information that supports my first impressions. When I tour ABC, I notice things that reinforce my bias. Unconsciously, I ignore or downplay things that don't. I notice the fancy new machines the company has installed. Yet I overlook the atmosphere of employee discontent.

Not only am I selective about the information I find, but I'm also interpreting facts to support my case. Let's say the CEO has spent her whole life at ABC. I can easily interpret that as positive. She's loyal; has extensive direct experience at the company; knows ABC inside and out.

Now let's say the CEO has worked at several companies. I can spin that positively, too. She is widely experienced; sought after by other companies; flexible.

Our minds are adept at crafting arguments to support what we want to believe. When it's time to make my forecast for ABC Corp, I cannot help but craft a favourable one.

If all analysts and investors were evenly distributed in their first impressions, we would expect the same number of people to be positive or negative about any given company. But a surprising number of analysts and investors are predisposed to think favourably about companies that have been doing well for the past few years, and to view unfavourably companies that haven't performed as well. Confirmation bias leads them to favour and buy

overvalued stocks, and, unfortunately, to sell undervalued stocks – the exact opposite of what leads to good investment returns.

The internet has made confirmation bias even more prevalent. It's easy to find information and/or opinions that support almost any point of view. Add thousands of TV and radio stations, magazines, newspapers, blogs, and artificial intelligence (AI) to the mix, and it's not hard to find a steady stream of media that support our biases.

What's the moral of this story? If we approach investing subjectively, we must recognize that confirmation bias exists and will likely harm our buying and selling decisions. Counteracting this bias is hard work. That's why it makes sense to use a disciplined, objective approach to investing – to take bias out of the equation.

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TEAM TALK

Off the Clock with Sylvia Ellis

What's been the highlight of your year?

We took a memorable family trip to Japan, with six of us ranging in age from 22 to 83. We visited Tokyo, Kyoto, Osaka, Hiroshima, and Mt. Fuji and finally saw Fuji in all its glory after it hid behind clouds on Craig's and my last two trips. We also caught a Tokyo Giants baseball game, which was so much fun. We all dressed in red which we were grateful for as it was the only way to keep track of each other!

What are you enjoying now?

After renovating our condo, I'm really enjoying decorating it. Our style is Japandi, blending Japanese minimalism with Scandinavian warmth and function. The space feels calm and open, with simple pieces in natural wood and soft, earthy colours.

What are you excited about going forward?

I'm excited to join Craig in Portugal in May 2027 when he finishes a shorter portion of the Camino de Santiago. After that, we plan to explore the surrounding area, Spain, and possibly Mallorca if time allows.

Sylvia is the Senior Estate Planning Advisor for The Stan Clark Financial Team.



Tokyo, 2026

QUARTERLY ECONOMIC UPDATE

CORPORATE EARNINGS SHOW CONTINUED RESILIENCE – NONETHELESS, BEING CAUTIOUS

By Stan Clark, Senior Wealth Advisor, and Michael Chu, Senior Wealth Advisor

Like every quarter in recent memory, it seems like a lot has happened. In this *Quarterly Economic Update* we discuss the markets for the third quarter of 2026.

Stock markets continued to advance, with many near or breaking all-time highs, supported by resilient economic growth and strong corporate earnings. Artificial intelligence (AI) infrastructure and large tech companies remained important contributors to earnings growth. Market strength was also more broadly distributed, not limited to a small group of technology companies.

At home, the TSX was up 1.6% in the third quarter of 2026. The World Equity Index, a gauge of stocks around the world, was up 2.1% (in C$). Not to get ahead of ourselves, but if things hold up, we're looking at another year of double-digit gains, the fourth year in a row.

Interest rates have been a hot topic lately. Not just short-term rate hikes from central banks, but now long-term rates – which are set by the market – are rising, too. Longer-term government bond yields in developed markets rose meaningfully as investors demanded greater compensation for holding long-term debt. Persistent inflation, stronger growth expectations, widening fiscal deficits, and a higher term premium all contributed to the move.

The balancing act between a resilient economic backdrop and numerous risks continues. Healthy nominal growth and corporate earnings can continue to support equities, particularly if interest rates stabilize. At the same time, higher yields are tightening financial conditions through mortgage costs and debt-service burdens, while early signs of strain have emerged in lower-quality segments of credit markets.

	Q1 2026	Q2 2026	Q3 2026	YTD 2026
Canada (S&P/TSX)	3.9%	7.0%	1.6%	13.0%
U.S. (S&P 500)	-3.0%	17.5%	2.6%	16.9%
Europe	-1.3%	13.8%	-1.9%	10.3%
Japan	2.3%	36.8%	-0.7%	38.9%
EAFE (Europe, Australia, Far East)	0.1%	13.0%	1.1%	14.4%
Emerging Markets	1.2%	26.5%	-0.1%	28.0%
World	-2.2%	16.0%	2.1%	15.9%

Source: Bloomberg

Valuations

The S&P 500 is at record highs, yet valuations are cheaper. We intuitively expect record prices to coincide with record valuations, but this time it's different. For the S&P 500, the current forward price-to-earnings (P/E) ratio is about 19 times, roughly in line with its 10-year average. A year ago, it was about 23 times.

In percentage terms, S&P 500 forward earnings are up about 30% so far this year, while the forward P/E is down about 12%. The index has gotten cheaper as earnings growth has outpaced the stock price index.

There are a number of reasons why things are cheaper: uncertainty about the durability of future earnings, higher interest rates, and more competition for investment dollars as bond rates have become a decent alternative to stocks.

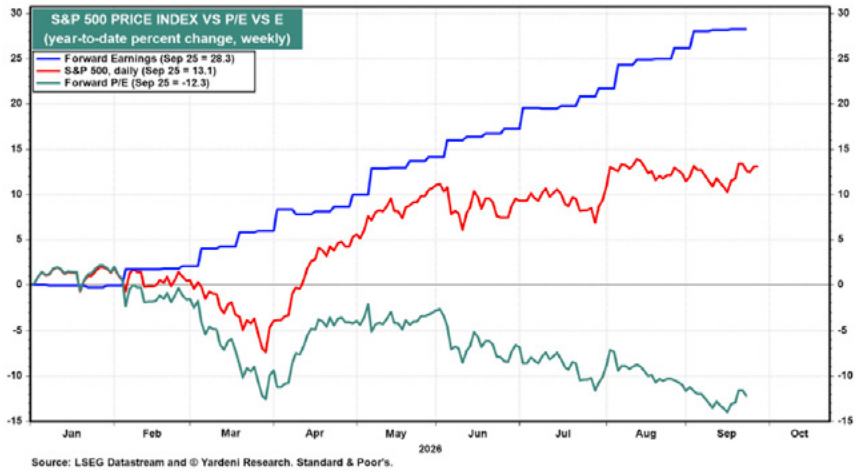
Better valuations aren't always a good thing. But returns would be 13% higher for the S&P 500 if valuations didn't contract. The index is up about 13% so far this year in US$. Without P/E contraction, stocks would be up over 25%!

Still, looking ahead, we would probably prefer lower valuations than higher. Forward earnings yields in Canadian, U.S., and international markets are all higher than 10-year bond yields – indicating good relative value. Not as much value from a dividend yield perspective, though. You can see in the chart that bonds yields are higher than dividend yields, especially in the U.S.

	Forward P/E	Forward Earnings Yield	Dividend Yield	10 Year Bonds*
Canada (S&P/TSX)	15.7	6.4%	2.2%	3.9%
U.S. (S&P 500)	18.6	5.4%	1.1%	5.2%
Europe	14.2	7.0%	2.9%	3.7%
EAFE (Europe, Australasia, Far East)	14.8	6.8%	2.7%	3.5%
Emerging Markets	9.7	10.3%	2.0%	3.6%
World	17.9	5.6%	1.5%	5.0%

Source: Bloomberg

** Weighted average for regions*



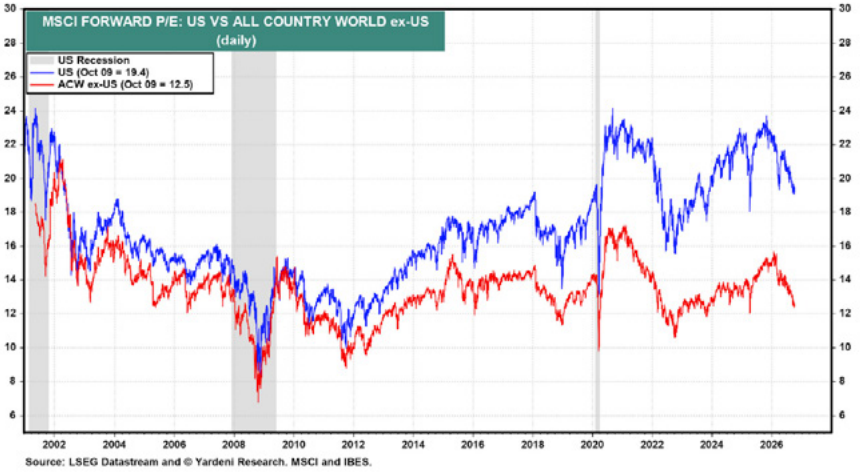
Oil

The Middle East conflict has lasted longer than many expected. Oil prices are more than $100 a barrel. People certainly feel the effects at the gas pump, but higher costs have also pushed up consumer prices and inflation. The Fed and the European Central Bank both raised short-term interest rates. The Bank of Canada remained on hold to balance a weaker economy. But longer-term interest rates globally are climbing to multi-year highs in most developed markets, reflecting concerns about inflation, deficits, and growing debt burdens.

Roaring 2020s

Top economist Ed Yardeni's Roaring 2020s scenario draws parallels between the 1920s and 2020s. Both periods began with pandemics, recessions, and pessimism, yet ended in great economic prosperity. Yardeni predicts that technology-driven productivity gains will drive economic growth throughout this decade, with the 2020s ending without a recession and the S&P 500 at 10,000.

However, Yardeni recently lowered the odds of his Roaring 2020s scenario from 80% to 70%, raising the probability of a bearish outcome from 20% to 30%. He



also lowered his S&P 500 target for the end of 2026 to 7,900 from 8,400, and moved his 8,400 target to mid-2027.

The main risk has shifted from the war in the Middle East and rising oil prices to rising bond yields and their potential impact on valuations. Yardeni's main concern isn't earnings; it's stock valuations. He cited the 2022 bear market as an example of how falling valuations can drive shares lower even when earnings hold up. Nevertheless, he views stocks as long-term investments and sees pullbacks, corrections, and even bear markets as potential buying opportunities.

Reasons to be bullish

Yardeni believes the current bull market is being driven by FEMO (fabulous earnings momentum), not FOMO (fear of missing out). Excluding investment gains, S&P 500 earnings grew roughly 25% year over year in the second quarter of 2026. Analysts' earnings expectations are rising even more, to around 30% growth. If all goes well, this would mark the sixth consecutive quarter with record earnings. Better yet, analysts expect all 11 industry sectors to deliver positive year-over-year growth in both revenue and earnings – a rare occurrence, seen just once in the past 25 years.

Earnings should remain durable if the U.S. economy remains resilient, as it has so far in the face of several shocks: the pandemic, supply chain disruptions, inflation, interest rate hikes, war, and high oil prices. The main drivers are strong consumer and capital spending. It's true that consumer confidence isn't as strong lately, but spending has been well supported by the retiring baby boomer generation and their record net worth. Capital spending is supported by the AI boom.

Stocks for the long run

Jeremy Siegel, emeritus professor at the Wharton School of the University of Pennsylvania, recently changed his view on long-term equity returns. Siegel believes that, with the S&P 500 trading at 19 times forward earnings, the inverse P/E suggests roughly 5.5% long-term real return. But he also thinks that higher real interest rates should be interpreted as a signal that the economy is able to sustain stronger growth. And, higher economic growth supports stronger earnings growth.

Therefore, Siegel has raised his estimate of long-term real equity returns to approximately 5.5% to 6.5%, which is still below the historical long-term trend. Adding maybe 2% to 3% inflation, that would imply around 8% to 9% annual returns over the next 10 years.

So, Siegel remains constructive on stocks. He believes higher interest rates are not necessarily bearish for stocks if those rates reflect stronger productivity and economic growth. If yields stabilize and growth expectations remain intact, stocks can continue to move higher.

What could go wrong?

While things sound bullish, the worry list remains long. With the ongoing conflict in the Middle East appearing to worsen, expect energy prices to stay higher for longer, keeping inflation and interest rates elevated or higher than expected. Other concerns include aggressive Fed rate hikes, rising U.S. debt service costs, an AI investment/profitability slowdown, mid-term elections/bipartisanship, and mega-Initial Public Offerings (IPOs) draining liquidity from the stock market.

Revenge of the bond vigilantes

Yardeni, who coined the term *bond vigilantes* in 1983, says their influence was suppressed during years of quantitative easing and zero interest rates, which kept yields low. However, the vigilantes may return for "revenge" as bond markets operate more freely and interest rates return to normal, demanding higher yields in response to large government debts. Yardeni sees several forces pushing yields higher globally, including government deficits, tightening monetary policy, inflation, and strong economic growth.

He thinks it would take U.S. 10-year Treasury yields rising above 7% to seriously impact the U.S. economy. With the nominal Gross Domestic Product (GDP) growth rate at 6.6%, a 10-year Treasury yield above that could make the U.S. government's debt burden much harder to manage. Furthermore, rapidly rising rates could also be destabilizing if borrowers cannot refinance.

The good news is that the U.S. economy is less sensitive to interest rate changes than it used to be – baby boomers would be happy to earn higher interest rates on their investments.

More rate hikes in the U.S.

In September, the U.S. Federal Reserve raised interest rates for the first time in three years. Under new Chairman Kevin Warsh, the Fed has been deliberately tight-lipped, generally spurning forward guidance to seemingly give itself more flexibility. Yardeni expects one or two more rate hikes this year. This is more about removing "accommodation," that is, shifting rates back to a more normal range.

While equity markets priced in and then pushed through the initial rise in September, a second hike could further test economic growth and have a more meaningful impact on investors. Higher borrowing costs would be hard to ignore, with persistently high oil prices amid the ongoing war in Iran only making the issue worse. Warsh and the Fed are at a fork in the road: Is hiking again in hopes of decreasing inflation worth the risk of slowing the economy? Their answer to this question could have a significant effect on the direction of markets.

Long-term bond rates

Bonds are supposed to be the boring, stable part of a portfolio. But this past quarter they've been anything but. Interest rates have moved higher, pushing bond prices lower. Fiscal deficits have become a persistent theme that probably isn't going away anytime soon. This is especially concerning because the deficits are running in relatively good times.

What happens then when the economy goes south? In the past, federal budget deficits tended to widen during recessions. But in the U.S. over the last three years, the economy has been booming, yet the budget deficit remains very wide. The deficit hasn't narrowed, because outlays are growing faster than receipts. This is due to fiscal recklessness. So, more government debt is needed during an economic boom, and private-sector demand is surging, putting extra pressure on interest rates.

If rates get high enough to cause a credit crunch and then a recession, attempts to revive the economy with deficit-bloating fiscal stimulus could backfire by pushing rates even higher. Again, if deficits are this large during good times, what happens when the bad times arrive?

For now, however, Yardeni believes the rise in rates is driven more by economic growth than by the government deficit. He thinks bond yields are back to their "old normal" – consistent with robust economic growth. Yardeni doesn't believe the U.S. is on the edge of a debt crisis. He expects productivity-led growth to boost government revenues and reduce the deficit relative to GDP. The question is, will the bond vigilantes will be patient enough to wait for this outcome?

Interest rates have risen across the board. The mid- and longer-term bonds, i.e., 10- and 30-year ones, are affecting mortgages and corporate debt. About six years ago, during COVID, U.S. 10- and 30-year rates were only 0.5% and 1%, respectively. Today, they are over 5.2% and 5.5%, which is pretty monumental given recent years' rates. Canada's rates are not quite as high, but the difference is still meaningful.

Corporate borrowing, particularly among the hyperscalers – the massive tech companies powering AI – is starting to crowd out traditional borrowers, adding more pressure on interest rates. On the other hand, rates are looking more attractive to savers with fresh capital. But if you look at today's rates relative to those of the last several decades, as in the graph, they look pretty normal.

What happens when long-term rates go up

In Finance 101, we learned that, all else equal, higher interest rates imply lower stock prices. That happened in 2022, when high inflation and rapidly rising interest rates caused a bear market in stocks.

However, it's not quite as simple as that. Sometimes rates rise mostly because economic growth and company earnings are higher, with inflation only a minor contributor. That's what seems to be happening so far this year: 10-year bond yields are up 30%, but the stock market is up double digits because earnings have been so strong. It seems counterintuitive, but many times when interest rates rise, the stock market tends to perform just fine. And when rates fall, that could be bad for the market.

The key is that there's no iron-clad relationship. There are so many other factors at play, such as the magnitude and speed of changes, as well as inflation and corporate earnings.



AI and productivity

Yardeni believes that AI is the "real deal" and will boost productivity as the baby boomers continue to retire. The comeback in productivity will have a disinflationary impact on the economy, if not a deflationary one. This makes him optimistic that the current inflation problem is cyclical in nature, not structural.

The AI buildout has become a major engine of U.S. economic growth as demand for computers continues to far exceed supply. The five hyperscalers alone are expected to spend $900 billion this year and $1.1 trillion next year. However, doubts about AI profitability may push up borrowing costs, potentially constraining access to capital and ultimately slowing investment spending.

Mid-term elections

By the time you read this, the U.S. mid-term elections will be right around the corner. History shows that a divided government makes significant policy changes harder to implement. Markets often respond favourably to political gridlock, as policy stability reduces uncertainty for business and investors. That said, the past couple of years have been anything but normal, so we should be prepared for a wide range of outcomes.

Looking ahead

In addition to well-publicized headlines such as inflation, war, and upcoming elections, we are now also dealing with the sharp rise in longer-term interest rates. This adds another question to a world already grappling with changing technological and geopolitical issues. On the one hand, in theory, higher rates mean lower valuations, but growing corporate earnings have helped cushion the impact.

Facing opportunities and challenges, we are reminded that our approach remains the same: to be resilient and disciplined by sticking to our financial plans and investment philosophy, and by rigorously following our processes.



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Michael Chu is a Portfolio Manager and Senior Wealth Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Michael is a specialist in investment research and information technology.

ASSET ALLOCATION

ADVANTAGES OF DONATING APPRECIATED STOCKS

By Tom Cowans, Portfolio Manager and Wealth Advisor

Most people, at some time, make a donation to charity. However, many are unaware of the tax benefits of donating ***appreciated publicly traded securities*****. These include stocks whose values have, since purchase, increased in a taxable investment account.**

Just like donating cash, a gift by any person, including a trust, entitles the donor a tax deduction by way of a non-refundable tax credit for the fair market value of the securities donated.

But there's an additional, lesser known, benefit to donating shares that have appreciated: you don't need to pay capital gains tax on any accrued gain.

The most that's eligible for a tax credit is 75% of net income for the tax year in which the gift is made. Unused credits may be carried forward for five years and used to offset tax in those years.

Here's a table showing the difference in the after-tax cost to donate $100,000 of appreciated stock vs selling the stock and donating cash proceeds (for a BC resident at the top marginal tax rate):

Description	Cash donation	In-kind share donation
Fair market value of donation	100,000	100,000
Adjusted cost base (assumed)	(20,000)	(20,000)
Capital gain	80,000	80,000
Taxable gain (50% vs 0%)	40,000	0
Tax on capital gain (at 53.5%)	21,400	0
Tax benefit of gift (at53.5%)*	53,500	53,500
Net tax benefit	32,100	53,500
Tax savings from donating in-kind vs cash	0	21,400
After tax cost to donate $100,000	67,900	46,500

**To the extent that taxable income is in the top tax bracket in BC.*

As you can see, the after-tax cost is over $21,000 (or 21%) cheaper by donating shares. The larger the accrued capital gain in the stock, the greater the tax savings from donating in-kind when compared to cash.

For corporate donors, many of the same advantages apply. When a Canadian-controlled private corporation donates appreciated publicly traded securities directly to a registered charity, the taxable capital gain is generally eliminated, just as it is for individuals. The corporation may also receive a charitable donation receipt that can be deducted against taxable income, subject to applicable limits (75% of net income for the year). This creates a highly efficient way for a corporation to make charitable contributions, using investment assets rather than operating cash.

An additional corporate benefit is through the *capital dividend account*, or CDA. When a corporation realizes a capital gain, the non-taxable portion may be added to the CDA. Therefore the full capital gain can be added to the CDA on donating appreciated securities to a registered Canadian charity from a company.

Tax credits can provide tax relief both during your lifetime and after. If the size of your gift is projected to be greater than your taxes payable at death, consider advancing the gift's timing to reduce your annual taxable income instead. The taxes saved by spreading out your donations over several years could be substantial.

Alternatively, if it makes sense to make a large donation for tax purposes that you do not want to immediately direct towards a specific charity, you could also set up a *Donor Advised Fund*. DAFs allow you to invest the donated amounts tax-free, using the donation and growth to make future charitable grants.

You can also gift by will, or by direct designation as a beneficiary. Your estate would receive a tax receipt for the amount donated. Your estate may claim charitable donations of up to 100% of your net income in the year you die. If the total amount of donations made is more than your net income, the excess donation amount can be applied to your net income in the year immediately prior to death.

Charitable giving is a winning gesture for everyone involved. It is important to view your charitable giving strategy as part of a comprehensive financial plan that takes into account your financial needs, along with your desire to make donations. Balancing your own financial situation with your philanthropic goals will help you optimize your charitable giving.

Changes in 2024 to the Alternative Minimum Tax (AMT) system affected the implications of larger donations of appreciated securities. Given the complexities that can be involved, the prevailing taxation issues at the time of giving, and the irrevocable nature of charitable giving decisions, there are many factors to consider before gifting assets. Professional tax and legal advice is recommended.

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SCFT TRIVIA

Test Your Knowledge

Thank you for reading this month's newsletter. Test your knowledge with our trivia questions! Each question relates to one of the articles featured in this edition. See how many you can get right, and check your answers at the bottom of the page. Good luck and happy quizzing!

Hint: You can find the answers inside this newsletter.

1. Confirmation bias, an all-too-human tendency, leads us to:

a. Stay in the safe zone by avoiding the unfamiliar.

b. Make unwise decisions, because we only search for, interpret, and remember information that confirms our initial views.

c. Remain cautious and therefore never make bad choices.

d. Make a rare mistake, but not significant enough to affect us.

2. Currently, The S&P 500 is near record highs. Yet, counterintuitively, valuations are cheaper. This is because earnings growth has outpaced stock prices.

a. True b. False

3. While Americans' consumer confidence hasn't been as strong lately, the U.S. economy has nevertheless stayed resilient. This is because of:

a. Strong consumer and capital spending.

b. The artificial intelligence (AI) boom.

c. Baby boomers retiring with a record net worth.

d. All of the above.

4. The advantages of donating appreciated publicly traded securities include a tax deduction by way of a non-refundable tax credit for the fair market value of the securities donated:

a. True b. False

Answers: 1. B, 2. A, 3. D, 4. A

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