RJL PCS: MARKET PERSPECTIVES

AUGUST 26, 2026 | 10:14 AM EDT

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Market Perspectives: What you need to know as the Canada-U.S. trade dispute escalates

The story so far

On July 20, President Trump announced that he would be using Section 338 of the Tariff Act of 1930 to impose additional 50% tariffs on US$20 billion (C$28 billion) of a wide range of goods that were being imported into the U.S. from Canada. This move was apparently prompted by Canada discriminating against U.S. products. The primary irritants included the ban on U.S. alcohol sales, by eight provinces, that have been in effect since February/March 2025, in retaliation for Trump's initial tariffs on Canadian goods. There is also a long-standing objection to Canada's supply management system, particularly on dairy, which sets quotas for how much milk, cheese, and other products can enter Canada tariff-free under USMCA, before tariffs of 200-300% apply. A third concern is the drop in vehicles exported to Canada after Canada implemented retaliatory tariffs in April 2025, to Trump's initial barrage of tariffs on Canadian-produced automobiles.

The tariffs were originally scheduled to take effect on August 19 but were delayed by three days after President Trump announced that a deal had been reached. While both sides have offered different accounts of why the agreement ultimately fell apart, reports suggest that last-minute changes to the treatment of exemptions for medium- and heavy-duty trucks, along with provisions that could have restricted Canada's ability to negotiate trade agreements with other countries, and commitments to offer the U.S. preferential access to Canada's critical minerals, may have shifted the deal from palatable to unacceptable for Canada. With the agreement off the table, the 50% Section 338 tariffs subsequently came into effect on August 22.

Table 1 - Evolution of U.S. Tariff Measures on Canadian Goods

	March 2025 - July 2026	Since July 2026
Main legal basis	IEEPA "fentanyl/border" tariffs + Section 232 sector tariffs	Increasing reliance on Section 338 of Tariff Act of 1930, alongside existing sectoral tariffs (Section 232)
General Canada tariff	Initially 25% on non-USMCA goods; increased to 35% since Aug. 1, 2025	The old IEEPA architecture was disrupted by the 2026 Supreme Court ruling; new Canada-specific tariffs have been rebuilt under other authorities
USMCA-compliant goods	Generally exempt from the broad 35% Canada tariff	Not necessarily exempt from the new Section 338 tariffs
New targeted tariff	No equivalent broad Section 338 regime	50% on specified Canadian products tied to autos, dairy, and alcohol disputes
Coverage philosophy	Mainly penalized goods outside USMCA rules of origin, plus sector tariffs	Targets Canadian products because of alleged Canadian discriminatory trade practices, irrespective of USMCA origin
Steel/aluminum/autos	Separate Section 232 tariffs already applied	Sectoral tariff regime remains intact and has evolved separately
Implication for USMCA	USMCA compliance provided substantial insulation	USMCA is a weaker tariff shield for targeted products

Source: Raymond James Ltd.

Canada strikes back

As retaliation to these latest tariffs, Canada will impose retaliatory tariffs, on a dollar-for-dollar basis, on U.S. imports effective September 8. Additionally, the federal government will offer support for businesses affected in this most recent rounds of trade disputes, presumably with the proceeds of the counter-tariffs. As a further response, President Trump announced that tariffs on Canadian autos and auto parts would rise to 50% effective January 1.

The delicacy in selecting counter-tariffs is to entice Canadian importers to choose alternatives to American products, which would presumably be Canadian products, while collecting tariffs from importers that can most likely still absorb increased costs on products that cannot be quickly or easily replaced. This generally applies to consumer goods, for which there are abundant alternatives, rather than goods used in industrial manufacturing that raises costs for Canadian manufacturers, which might then impact their ability to retain Canadian workers. Additional considerations are to try to directly offset U.S. tariffs by enacting counter-tariffs on similar products, and in choosing products from states that are the most politically sensitive for the current administration.

The counter-tariffs slated to come into effect on September 8 will cover C$28 billion of U.S. imports, matching the latest U.S. tariffs dollar-for-dollar and rate-for-rate. Tariffs will be applied at three levels: 50% on products including steel and aluminum, furniture, clothing, smartphones, cosmetics, and paper and plywood products; 25% on selected dairy and seafood products, large appliances, carpets and textiles; and 15% on certain products including air-conditioning equipment.

Another concern: greater uncertainty around USMCA protection

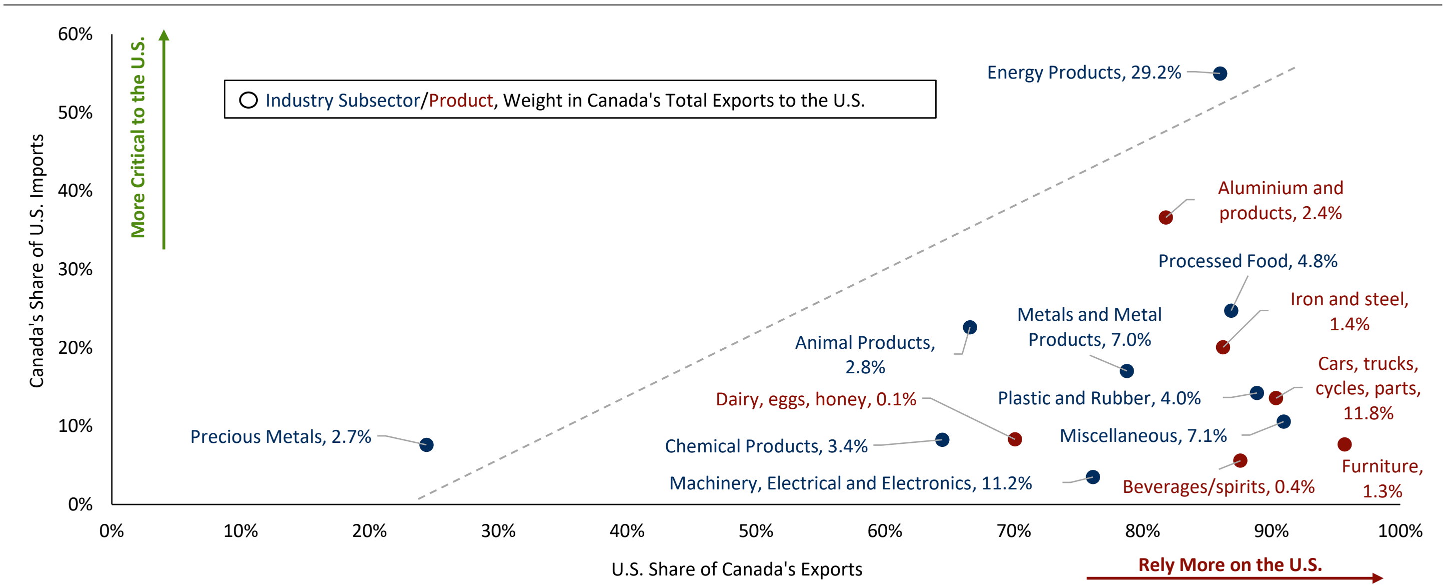
Since the onset of the Liberation Day tariffs, Canada has maintained one of the more favourable trade positions with the U.S., largely because most Canadian exports have remained exempt under USMCA. Roughly 85% of Canadian exports had continued to enter the U.S. tariff-free, keeping the overall effective tariff rate in the 3% range. More recent measures, including the latest Section 338 tariffs, have reduced the tariff-free share to approximately 80% and are expected to lift the effective tariff rate to roughly 5–6%. These estimates are also likely to evolve as trade patterns adjust. If U.S. importers shift toward alternative suppliers to avoid tariffs on Canadian goods, both the value of affected Canadian exports and the tariff revenue ultimately collected by the U.S. could decline. Even so, the result would still be weaker demand for Canadian exports.

Another concern, however, is what Section 338 could mean for the protection provided by USMCA. Some recent U.S. tariffs have applied even to USMCA-compliant goods, creating another avenue for Washington to impose tariffs outside the agreement's preferential treatment. If this approach were extended to a broader range of products, the practical benefits of USMCA could gradually be weakened without the U.S. formally withdrawing from the agreement. The U.S. does have the option to withdraw from USMCA with six months' notice, but this has not occurred and is not our base case.

This adds another layer of complexity through the ongoing USMCA review. During the tariff episodes of 2025, the central issue for many Canadian exporters was whether their products could qualify for USMCA treatment and therefore avoid the broader U.S. tariffs. The question may now be becoming more fundamental: How much protection does USMCA provide if Washington can impose Canada-specific tariffs outside the agreement?

We had been expecting tariff threats, negotiating pressure and lingering uncertainty to remain part of President Trump's approach heading into the USMCA review, and it seems unlikely that the latest escalation will be the end of the story. Over the coming hours or days, we could see either renewed efforts to revive the latest deal or further retaliation that risks a more rapid escalation. The September 8 deadline may provide some room for tensions to cool and give U.S. states and companies that depend on trade with Canada time to make their case to the administration.

Chart 1 - Energy and Precious Metals Stand Apart Amid Canada's Export Dependence on the U.S.



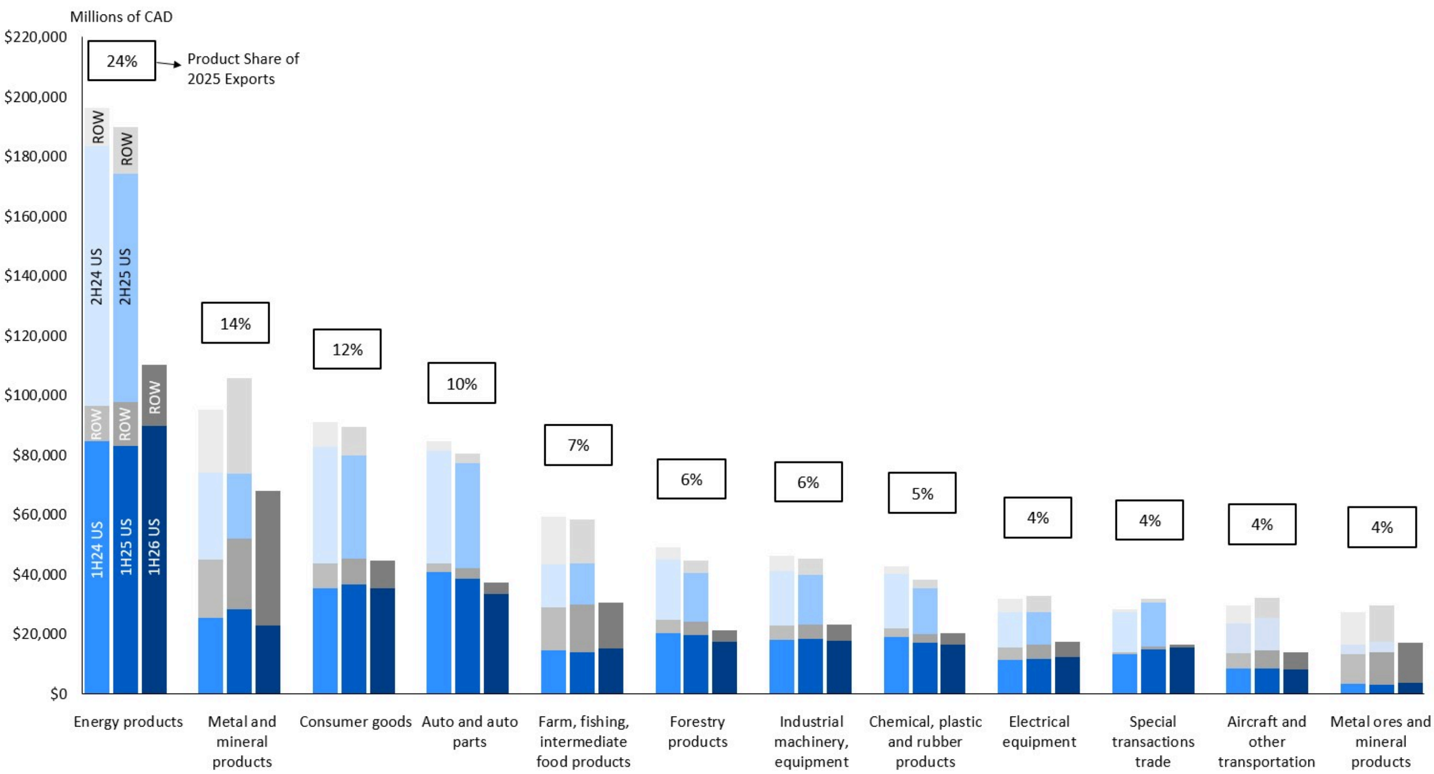
Source: Bloomberg, Raymond James Ltd.; Data for the Calendar Year 2025. Note: Red markers indicate key export product categories heavily targeted by the U.S.

Persistent pressure, with new areas of exposure

With roughly 68% of Canadian exports still going to the U.S., most sectors remain vulnerable apart from energy products and precious metals (Chart 1), and the Trump administration is clearly taking advantage of that exposure. The goods covered under Section 338 are high-profile items and are heavily dependent on the U.S. market. By contrast, energy products and potash, which are more mutually important to both sides, remain excluded. Another important point is that the new tariffs are "very diffuse, and they hit, in particular, small and many medium enterprises... very difficult for the federal government especially to create a package of supports for them," according to Matthew Holmes of the Canadian Chamber of Commerce. This could make the effects of the trade dispute more broadly felt across the Canadian economy, bringing smaller and medium-sized firms that had been relatively insulated from earlier tariff measures into the line of fire, while making targeted policy support more difficult to design and deliver.

In his August 22 remarks, PM Carney again underscored his commitment to make Canada's economy less dependent on the U.S., noting that 27 nation-building initiatives referred to the new Major Projects Office represent about C$500 billion in new private investment. He also said Canada has "removed every single federal barrier to internal trade" and is working with provinces and territories to remove more. In addition, he said the government is helping its hardest-hit industries retool and pivot toward international markets. While shifts in established trade relationships take time, there are some early signs of diversification, even if they have yet to materially change Canada's overall export mix (Chart 2). We also include a tariff update every month in our Insights & Strategies report. We will provide further updates and commentary as the situation evolves.

Chart 2 - Export Diversification Remains in Its Early Stages



Source: Statistics Canada, Raymond James Ltd.; Data as of June 30, 2026.

Impact on Canada's economy

The latest Section 338 tariffs apply to roughly C$28 billion of Canadian exports to the U.S., equivalent to about 5% of total Canadian exports to the U.S. The Canadian value-added associated with these exports represents only around 0.5% of nominal GDP, suggesting that the direct exposure remains relatively manageable at the economy-wide level. The new measures are expected to lift the effective U.S. tariff rate on Canadian goods to roughly 5–6%. Current estimates suggest that, if maintained, the latest tariffs could reduce Canadian GDP growth by roughly 0.4–0.6 percentage points.

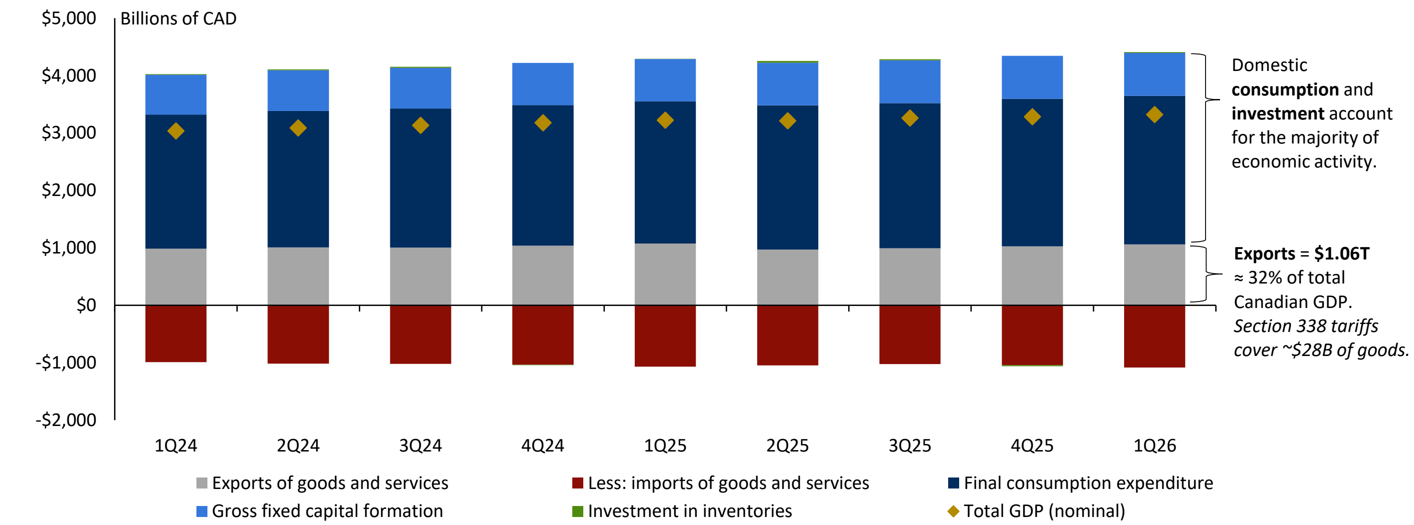
The risks could increase if Canadian retaliation leads to further U.S. countermeasures or if the effects spread through supply chains. The impact will also be uneven, with trade-exposed industries such as autos, steel and furniture bearing a disproportionate burden. However, their relatively modest share of the overall economy should help contain the impact on headline GDP.

The more persistent risk may come through weaker private-sector investment, although the evidence so far has been more resilient than we initially expected. Business investment growth has hovered around zero, but investment intentions have improved for five consecutive quarters since 2Q25 (Chart 4). This likely reflects both greater clarity around the tariff environment, fiscal support, and policy measures aimed at encouraging investment, including efforts to accelerate major projects, reduce regulatory barriers and improve internal trade. Importantly, a larger share of the economy, including domestically oriented goods and services businesses and much of the energy sector, is less directly exposed to U.S. tariffs. Improving economic conditions, these policy initiatives, and continued A.I.-related investment could therefore support capital spending in these areas, partially offsetting weaker investment among tariff-exposed exporters and providing an important source of resilience for the broader Canadian economy (Chart 5).

On inflation, we expect Canada's proposed dollar-for-dollar retaliation to create some upward pressure, but the overall impact should remain relatively modest. As a useful reference point, counter-tariffs imposed on roughly C$60 billion of U.S. goods last year were estimated to have added only around 0.3 percentage points to headline inflation. With the latest retaliation covering a considerably smaller import base of roughly C$28 billion, the inflationary effect should be smaller, particularly given continued excess capacity in the Canadian economy and the likelihood that businesses absorb at least part of the additional costs rather than passing them fully on to consumers.

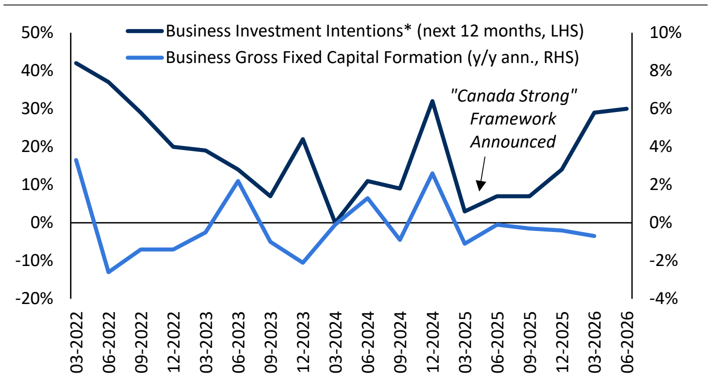
For the Bank of Canada, the balance of risks therefore continues to lean more toward weaker growth than materially higher inflation. Renewed trade uncertainty and its drag on business investment reinforce the case for patience, while the relatively modest expected inflation impact reduces the urgency to tighten policy. With the current policy rate appearing broadly appropriate for prevailing economic conditions, we expect the latest trade developments to push any suggestion of rate hikes further into 2027 rather than prompt a near-term change in policy. The key risk to that view would be a broader escalation in tariffs or retaliation that generates substantially greater inflationary pressure, although significant pressure on the Canadian economy, absent inflationary impacts, could prompt consideration for rate cuts.

Chart 3 - Breakdown of Canadian Nominal GDP



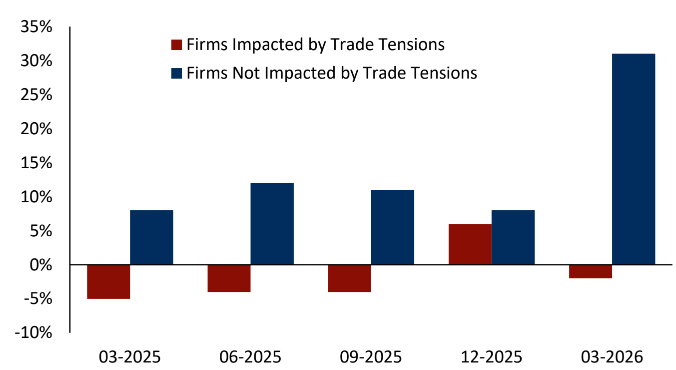
Source: Statistics Canada, Raymond James Ltd.; Data as of March 31, 2026. Note: Investment in inventories contributes minimally to nominal GDP in dollar terms.

Chart 4 - Business Investment Intentions Have Remained Resilient



Source: BoC Business Outlook Survey - 2Q26, Statistics Canada, Raymond James Ltd.; Data as of June 30, 2026. *Balance of Opinion.

Chart 5 - Firms Unaffected by Trade Tensions Lead Investment Intentions*



Source: BoC Business Outlook Survey - 1Q26, Raymond James Ltd.; Data as of March 31, 2026. *Balance of Opinion.

Markets have taken the latest escalation in stride

So far, the political significance of the Section 338 tariffs appears greater than the economic impact, while the impact on Canadian equities has been more limited still. To some extent, investors have seen this movie before. Markets are likely to look through some of the near-term headlines if they continue to expect an initial escalation to eventually give way to negotiation and normalization. Recall that the Liberation Day selloff in 2025 was sharp but relatively short-lived, with the S&P/TSX Composite recovering its losses within 26 days as the worst-case tariff scenarios failed to materialize.

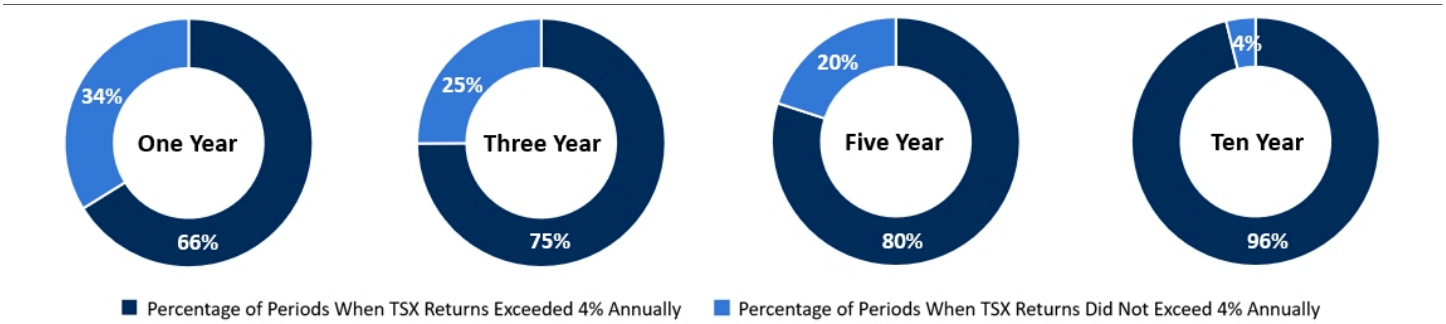
That does not mean markets are immune to further escalation. A broader or more prolonged trade dispute could renew pressure on export-oriented companies, particularly those that were most exposed during the initial tariff threats in early 2025. On the other hand, Section 338 tariffs could also face legal challenges, creating potential upside if their use is ultimately limited or overturned. The impact is also likely to remain uneven across the Canadian market, with strategically important areas that the U.S. has largely avoided targeting, including energy and critical minerals, relatively better insulated from the current measures.

Finally, the composition of the Canadian market provides some natural offsets. During the previous tariff shock, gold performed well as investors sought protection from heightened policy uncertainty, benefiting the gold-heavy Materials sector. Gold's recent strength reflects a broader range of factors, but Materials has nevertheless provided meaningful support to the S&P/TSX Composite. That has helped the Canadian market continue to reach new highs despite renewed turbulence on the trade front, another reminder that tariff headlines do not necessarily translate one-for-one into broader equity-market weakness.

Stay invested through the noise

We continue to recommend that investors stay focused on their long-term investment objectives and look beyond near-term market headlines, as disciplined, long-term investing has historically been rewarded. Importantly, time in the market matters more than timing the market. A consistent investment approach can help build wealth over time while reducing the emotional pressure of trying to anticipate short-term market moves. As our analysis of the S&P/TSX Composite illustrates, consistent investing has generally outperformed a 4% annual return, with the likelihood of doing so increasing over longer investment horizons.

Chart 6 - Consistent Investing in the TSX Composite Has Generally Outperformed a 4%* Annual Return, with Higher Success Rates over Longer Horizons (1997-2026)



Source: FactSet, in Canadian dollars, total return, excluding commissions, taxes, or other fees. Date range: 12/31/1996 – 6/30/2026.

The analysis assumes that $1,000 is invested at the beginning of each 12-month period throughout each investment horizon. Each investment horizon is tested using start dates that move forward one month at a time (one year: 343 periods; three years: 319; five years: 295; 10 years: 235). *The 4% annual return is an illustrative long-term assumption for a conservative portfolio. For illustration purposes only. Past performance does not guarantee future results.

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