HIGGINS INVESTMENT GROUP INC.

August Market Analysis

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The Markets

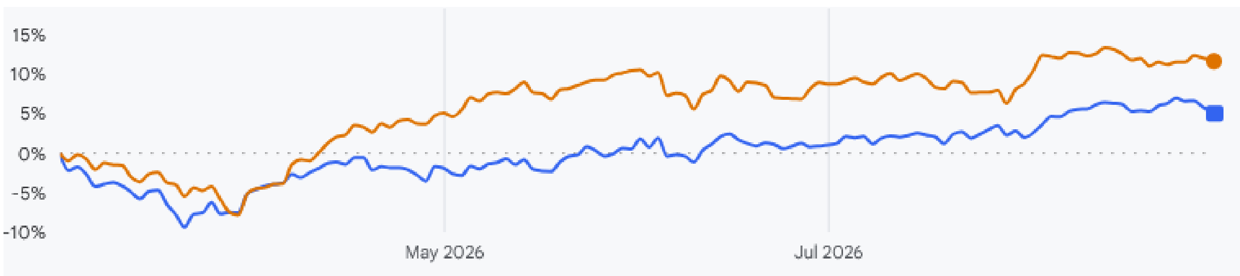
	August	Change in Month	Year –To-Date
S&P TSX	36270	3.0%	14.4%
S&P 500	7689	2.7%	12.3%
Dow 30	53221	1.4%	10.7%
Oil	$88.94	1.7%	49.6%
Gold	$4501	9.7%	4.1%

We have all heard the phrase the market hates uncertainty. This explains a market decline because investors do not know might happen. Since Trump's second term began, we can all agree that there is no certainty. The situation in Iran goes from we have a deal to we are going to make them pay. The new chairman of the Federal Reserve clearly states he will not give forward guidance. We do not know if he intends to raise rates or not. He indicated he wants to bring inflation down but did not say when or how. Rising rates for the 30-year bond in the US caused markets to weaken. Then the Treasury announced a purchase program to bring the rates down. Rates dropped then increased, so the Treasury increased the size of the planned purchases. We could write a novel on the tariff situation. There is massive uncertainty, but the market continues to thrive. It seems the interest rate on the 30-year bond is the biggest risk to the market.

The equity market rose based on movements in Technology and Gold shares. It was a *risk on* month with high beta stocks rising 30% followed by volatile small capitalization stocks. The top performing sector was Mining which was supported by rising gold and other underlying commodities. Mining and Technology were the only sectors to outperform the TSX index. At the other end of the performance spectrum were the interest sensitive sectors. Weakness was broadly based in Income trusts, Utilities and REITs. Other sectors with negative returns were the cannabis heavy Health Care sector and Consumer Staples.

The chart below presents the performance of the S&P 500 and the S&P TSX for the last 6 months.

Performance S&P 500 and TSX



TSX, S&P 500 source google.com/finance

Economic Indicators

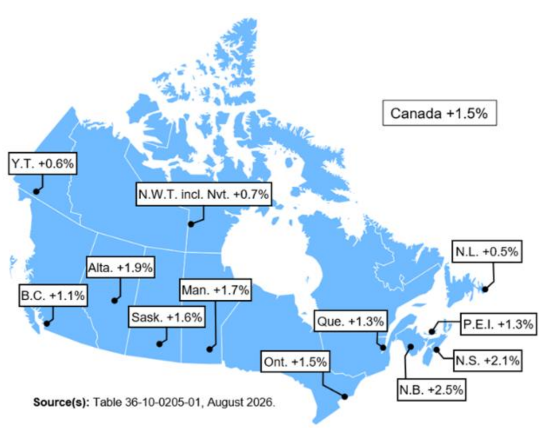
1. Canadian GDP

I have said before and I will say it again. There are liars, darn liars and statistics/economists. Why do we say this? Often the economic releases are presented on a preliminary basis followed closely by the official release. The data is subject to revision as more data is gathered. We heard that Canada was in a technical recession because it had two consecutive down quarters. This was based on the Q1 data following a negative Q4 for 2025. When Statistics Canada released the second quarter GDP they updated the first quarter GDP. The economy grew 0.1% in the first quarter. You might say this is insignificant, but the negative values originally were as insignificant but those who studied economics claimed it was a technical recession. But it wasn't.

The Canadian economy grew in the second quarter, with real GDP increasing 0.8%, helped by stronger exports, household spending and business investment. Exports rose 3.6%, their fastest pace in more than three years, with autos, energy, metals and machinery leading the way. Housing investment also rebounded 2.5% after two quarters of declines. Businesses increased spending on machinery, equipment and engineering structures. Even spending on computers and peripherals jumped 16.7%, largely reflecting higher imports of equipment used in data centres. This is the early stages of the AI build out. Household spending increased 0.8%. Consumers cut back on gasoline and food due to higher prices. It is encouraging to see growth broadening, although the $17 billion inventory drawdown after a $10 billion build in the first quarter reminds us that the numbers can move around quite a bit from quarter to quarter.

There were other interesting developments beneath the headline GDP number. The GDP deflator rose 2.5%, its largest increase in four years, driven by a 6.5% increase in export prices as international oil prices moved higher. Employee compensation increased 1.5%, while corporate incomes jumped 9.6%, led by the energy sector. Households also managed to increase their saving rate to 3.7% as disposable income grew faster than spending, helped in part by higher wages and government transfers. Overall, the Canadian economy appears to have regained some momentum, but the mix is important: stronger exports, energy prices and business investment are doing much of the heavy lifting, while higher prices and borrowing costs continue to influence household behaviour. As always, one quarter does not make a trend, so we will continue to focus on the longer-term picture rather than getting too focused on one economic release.

The map below shows that gains were spread widely across Canada.



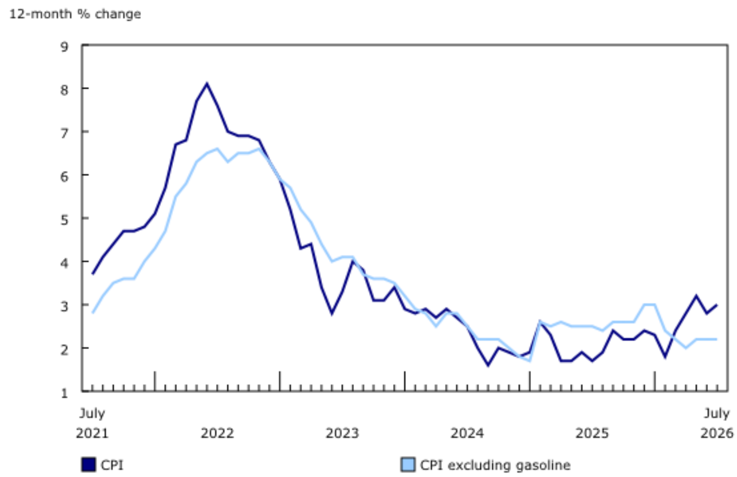
Source: Statistics Canada

We have discussed the impact of inventories on GDP in previous commentaries. If inventories increase it is recorded as growth when calculating GDP. This can be counter intuitive. If inventories rise, then companies may cover future sales from inventory rather than manufacturing more goods. Conversely low inventories can cause companies to bring inventories back to "normal" levels. The data do not show if the increase was planned or was a result of lower sales. In my view the drawdown in inventories is a positive despite the negative impact on Q2 GDP.

2. Consumer Price Index Canada

Canada's annual inflation rate, as measured by the Consumer Price Index (CPI) accelerated to 3.0% in July 2026, up from 2.8% in June. As you might suspect a rise in oil prices led to more than a 25% increase in gasoline prices Travel costs rose as World Cup-related demand pushed up prices for tours (+15.2%) and airfares (+12.0%). This impact should be reversed now the World Cup has concluded.

On a monthly basis, the CPI index rose 0.5% (0.3% seasonally adjusted), while CPI excluding gasoline held steady at 2.2% for the third consecutive month. Any time we discuss the CPI we point out that excluding certain factors can lead to dramatically different inflation levels despite the fact we have to pay the regular CPI., However, volatile energy costs distort the monthly headline figure. The chart on the next page shows the CPI including and excluding gasoline. You can clearly see the CPI Excluding gasoline is more stable. Grocery inflation slowed to 3.1% but remained above headline inflation for the 18th straight month, with fresh fruit prices jumping 4.7% in July. This is the largest monthly increase since 2011.



Source: Statistics Canada

Reflection

A time to buy and a time to sell

Time to sell, still?.

I often read that the stock market is overvalued. The key metric analysts reference is the Shiller CAPE ratio. The index attempts to cyclically adjust the Price Earnings ratio to give an indication if the market is either undervalued or overvalued relative to historic norms, Historicly the cyclically adjusted PE is close to 16 or 17 times. Today the ratio is closer to 40 times which indicates the market is grossly overvalued.

Like the little boy who cried wolf to see if the townspeople would come to his rescue, He called out a few times when there was no wolf, When the wolf came, he called out and the wolf chased the sheep. The index has indicated the market is overvalued for more than a decade. If you had sold 10 years ago you would have missed an excellent market. You could ignore this indicator but one day the market will return to the normal value. The other phrase that might better help view this indicator is that a broken clock is right twice a day.

However, and there is always a however, returns from the US market over a 10-year period have tended to decline the higher the index, When the index has been above 25 the 10-year annualized return has been less than 1%. This may be skewed by the unwinding of the tech bubble in 1999. Back in 1999 we were told that it was still safe to invest in the market despite elevated Price Earnings ratios as we did not understand the full earnings potential of the internet.

Today we are being assured that AI will generate massive opportunities. You can invest in the chip manufactures, the power companies that will provide the energy to run the centres or the companies that sell AI services such as Google, Microsoft or Amazon.

Not that long ago the reason for investing in Apple, Google or Microsoft was they had such a dominant market share and free cash flow that could solve any problem.

	2024 free cash flow $ B	2026 free cash flow $ B
Apple	$108	-$120
Google	$78	$0
Microsoft	$74	-$60

The primary thesis for investing in the major technology companies is gone. Investors are purchasing for the potential profits from AI. It is easy to mock the change in investment thesis but….

Two days before the end of July Microsoft proved the doubters wrong. Microsoft set a record for the largest one-day market value increase, Microsoft's market capitalization rose by $450 BILLION. When a large company's stock rises by more than 15% it creates massive dollar increase, Why the change in outlook? One reason was they did not increase their capital expenditures beyond the planned $175 Billion. For perspective, look at the chart of their expected free cash flow. The second reason is their cloud business grew by 27%, This includes AI services. In other words, they are already monetizing AI and have some semblance of capital restraint.

I have read reports that the Canadian banks typically trade at 11 times earnings or less. The big 5 Canadian banks are trading closer to 15 times earnings. The reports caution that it is time to sell the banks. I read these well reasoned reports at the beginning of August. The banks reported the most recent quarterly earnings in mid to late August. The Bank of Nova Scotia has been a laggard as it has new management are trying to refocus the bank. When the bank reported earnings, the stock jumped more than 5%. This is not to say it is not wrong to advise caution based on valuations but if they increase earnings and dividends it is possible the banks can grow into their current valuation.

Summary

" A time to plant, a time to reap" Pete Seger and Eccliastes

In the reflection section we covered factors that might cause people to sell. Factors including the loss of free cash flow from technology companies, elevated valuations for Canadian Banks and the Cyclically Adjusted Price Earnings Ratio. The CAPE has been screaming sell for years. If you had followed this, you would have missed the run up in the markets over the past few years. The thesis for purchasing technology shares used to be their free cash flow but now they are investing in AI. The Canadian banks have been expensive for more than 2 years but continue to put on strong performance. This makes it sound like it is safe to ignore these warning signs. As the quote indicates there is a time to put money in the market and a time to reap your gains. The question is when is the right time? There is a quote that the only real gain is a realized gain which means unless you sell you could watch your gains evaporate.

It is a bit boring, but we have not changed our approach to the markets. We factor in world events but focus on the long-term potential for the companies in which we invest. When looking at a stock we consider the total return. The total return captures the dividend and the capital return. Dividends provide a couple of advantages including when a client needs cash, they can just take the dividends and not trigger tax by selling a stock. In a similar vein, it helps when rebalancing a portfolio as the dividends can be invested in an area that is below the target level, again without having to trigger tax or commission expenses.