HIGGINS INVESTMENT GROUP INC.

January Market Analysis

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The Markets

	January	Year –To-Date
S&P TSX	20767	7.1%
S&P 500	4076	6.2%
Dow 30	37086	11.9%
Oil	$78.87	−1.8%
Gold	$1974	9.4%

Last year's losses are nothing but a distant memory. Investors transitioned from seeing the negative in announcements to seeing every glass as half full vs. half empty. Last month when China began to reopen investors began to fret about the rise in Covid cases and the threat of future lock downs. This month investors only heard the happy phrase of reopening. When technology companies announced they were laying off more than 10,000 employees each, it was viewed as good news as the companies were reducing their costs. Investors did not view this as a sign of a weaker economy. Even if they did, this was good news as well. Bad economic news was considered positive as the weaker the economic data, the more likely the Federal Reserve would stop raising rates and might potentially lower rates. Everyone was wearing their rally hats.

Every sector on the TSX had a positive return in January. The following sectors had double digit positive performance: Base Metals, Technology, Health Care, Income Trusts, Gold, Real Estate and Industrials. As discussed above the market responded to hopes of a China led economic recovery combined with the potential of lower interest rates. The technology stocks were pulled upward by strength in the US technology shares. Tech shares were weaker last year as interest rates rose hence the prospect of the end to rising rates provided a boost this month. Strength in China's economy raised the expectation for increased consumption of metals which led to strength in the Materials sector. General economic strength supported the Industrial stocks. The less volatile sectors of the market were laggards, yet still had positive performance. Utilities and Consumer staples stocks were the two weakest sectors. The Low Volatility Index was up 4.4% while the high Beta stocks rose 13.1%. It remains to be seen if these gains are transitory.

The chart on the next page presents the performance of the S&P 500 and the S&P TSX over the past 6 months.

6Month Performance S&P 500 and TSX

TSX, S&P 500

<u>Reflection</u>

Perception and the markets

Earlier this week I made a presentation to a local service organization. I have included some of the slides I used with some of the thoughts that support the graphs. It is a view of the markets without the economic outlook separated.

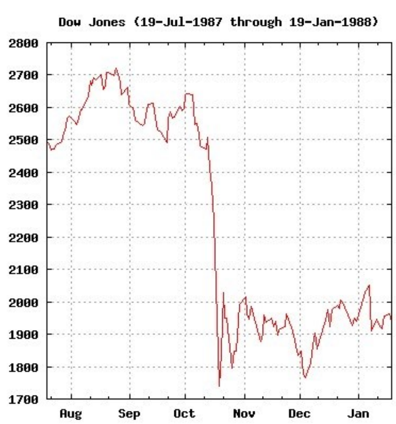
I opened with a slide that looked back at the returns of last year. As the title suggests there was no safe place to hide. It is not very often you get negative performance in equities and bonds at the same time plus weakness across all market capitalizations and major world markets. This has led to discussions that the typical balance fund is flawed as everything went down. This dispelled the notion of diversification protecting the investor.

No place to hide

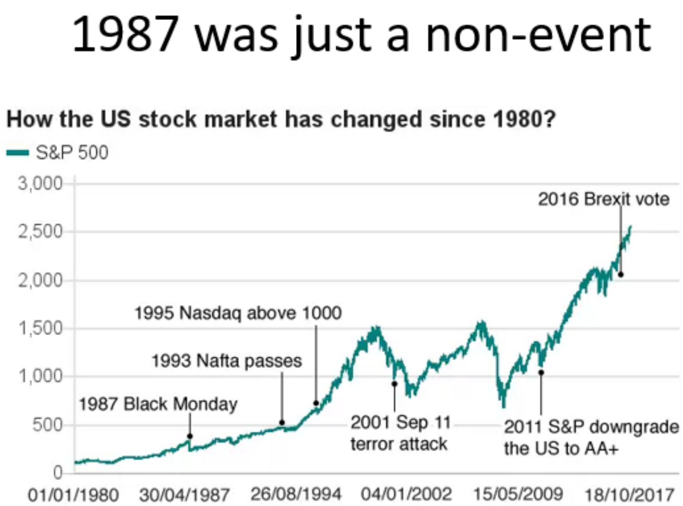
S&P 500		-19.4%
NASDAQ		-33.1%
RUSSELL 2000		-21.6%
MSCI WORLD (LOCAL CURRENCY)		-17.4%
S&P/TSX COMPOSITE INDEX		-8.7%
SHORT Bond		-3.9%
LONG-TERM REFINITIV		-21.5%
COPPER (USD / LB)		-14.1%
NICKEL (USD / LB)		43.1%

The next slide shows one of the worst days in the history of the US stock market. It shows the crash of 1987. The market dropped almost 25% in one day. Many pundits said we should have seen it coming as interest rates were rising and earnings growth was slowing. This is known as 20/20 hindsight. The losses were horrendous. P.S. interest rates are rising and earnings are flat today.

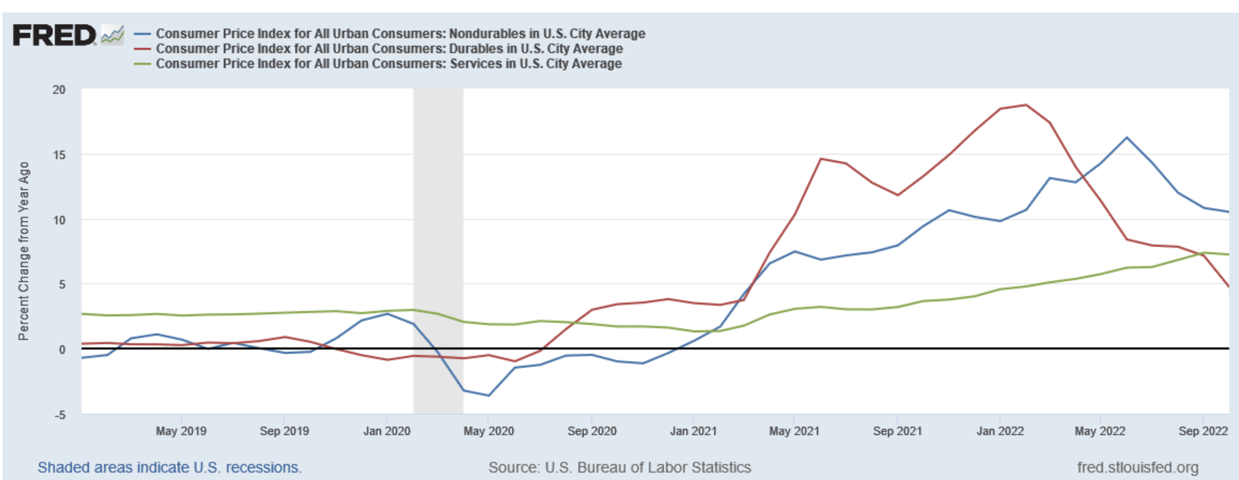
Crash of 87



Then take a look at the next chart with a much longer timeframe. You barely notice the 1987 Black Monday. Not to belittle the declines of 2022 but they are minor when you look over time. Just think of the market decline in 2020 at the onset of Covid. There was another slide that showed the market declines in the UK stock market where it took 4.5 years to recover from the dot.com bubble, it took 4.5 years to recover from the 2008/2009 financial crises and it took under 2 years to recover from the decline related to the beginning of Covid. It is easy to say the losses are short-term but 4.5 years to recoup the losses is not short-term if you are nearing retirement.

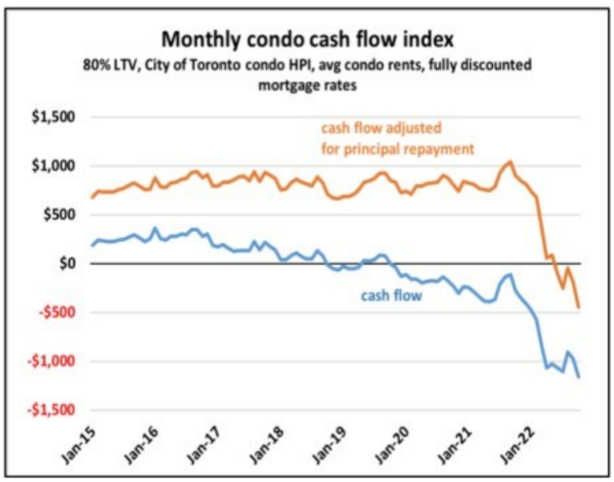


A few slides later we discussed how inflation was the primary cause of the market decline. Well, not just inflation but the fact interest rates had to increase in response to inflation. Even the Federal Reserve has different indicators of inflation. The chart below shows two indicators, one for durable goods and the other for non-durable goods. Durable goods are items that are supposedly built to last like a Washer or a Fridge. Depending on which indicator you use inflation is either above 10% or below 5%.The Fed has to fight inflation but which one?



The Fed moved interest rates from .25% to in excess of 4.25% in 10 months and equity markets reacted. Tech stocks declined since the value of the discounted cash flow declined as interest rates rose. This is true for other assets. The next slide shows that for a condo rented as an investment property rising rates took the net cash flow to a negative number in 2022. This does not include the funds required to cover the principal payment on the mortgage. No wonder that Condo and house prices declined in 2022.

Quondo, Condo



Just because the markets declined does not necessarily make them more attractive. If you use the Price Earnings ratio to judge if the market is cheap or expensive, let's say it is not yet in cheap territory. The P/E ratio takes the price of the market and divides it by the earnings of the market. The higher the number the more expensive the market. The P/E of the S&P 500 is just under 22 times. This is cheap relative to the past few years but is expensive compared to the period prior to 2000, including 1987 when the market dropped 25% in one day. Some argue the Case Shiller P/E which takes normalized earnings, I won't bother getting into the definition other than to say it smooths out short-term earnings fluctuations, is the best method of valuing the market. The CS P/E is close to 30X, is higher than most periods and approximately the same level as just before the cash in the 1930s. We are not as negative on the markets as some of this data may indicate.

Asset mix: (1) We continue to have a positive one-year outlook for equities but expect near term volatility to be the dominant theme.

Summary

Oh, would some Power give us the gift
To see ourselves as others see us!– R Burns (since January 25th is Burns day)

In our reflection section we mentioned the concept of perception. When you are in the midst of a market decline there seems to be no rhyme or reason. When you look a market movements over long periods of time, an event that seem insurmountable at the time fades in time. In 1987 the market suffered one of the worst one-day declines in history. Today if you look at a chart of the market you will barely notice the decline. This is not to belittle market declines as the NASDQ took almost a decade to recover its losses suffered in 2000. One point to consider about the market is that they say it is a discounting mechanism. It is a common axiom that the market reflects expectations of conditions in 6 months or a year and not how things are now. Just look at the market rally this month. Economic data was mixed but investors viewed this as a positive as this could mean lower interest rates in a year. It is all a matter of perception.

Our approach to looking for value has not changed over the past few years despite market gyrations. Three years ago, we closed our commentary with the following observation. "*We cannot accurately predict where the market will be in a day, month or year. We can analyze stocks and look for companies with a history of paying dividends that can provide income even if the market becomes more volatile than recent history. We try to take a longer-term view and build a portfolio of stocks. That means sometimes we might pick a stock that might not pay a dividend if it offers exposure to an undervalued area of the market. There is a big difference between buying stocks with the same attributes and building a portfolio. Sometimes we purchase stocks the same way you purchase an umbrella on a sunny day, you know it will come in valuable at a later date*."