HIGGINS INVESTMENT GROUP INC.

January Market Analysis

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The Markets

	January	Year –To-Date
S&P TSX	25533	3.2%
S&P 500	6037	2.8%
Dow 30	44543	4.8%
Oil	$73.08	1.8%
Gold	$2830	7.3%

Not what you expected. The S&P 500 and the S&P TSX closed the month at, or close to all time highs. This in the face of a new president and the prospects of a trade war. Generally, the stock market does not like uncertainty and we have it in abundance in Canada. Our largest province in the midst of an election, the Prime Minister has resigned and tariffs are about to be imposed. The level of uncertainty was evident in the stories about tariffs on the 31st alone. At breakfast they were on, at noon they were delayed until March, then they were going to be partially applied and by dinner it was confirmed they would be fully applied. This does not even include the volatility in the technology sector caused by a China based AI company, Deepseek, that announced they trained their AI model for $5.6 million, not billion and they used second tier chips. This sent technology shares and their suppliers, or potential suppliers, to have double digit share declines on January 27th. At one point on the 27th the S&P 500 was down 4% intraday. At least one thing made sense. The higher level of uncertainty led investors to move into to a perceived hedge, Gold. By the time you read this the tariff uncertainty will likely have moved to a new level and we will not comment on that in this review.

As alluded to in the previous paragraph, gold shares led the Canadian market with a 16% return in the month. This is more than double the performance of the underlying commodity. The second strongest performer were the Technology stocks. The Canadian market does not have any chip companies or true AI companies in our index so the technology sector was virtually unscathed by the movements in the US technology sector. Mining and Technology were the only 2 sectors to outperform the broader S&P TSX. At the other end of the market were Health Care stocks. The cannabis stocks pulled the health care sector to a negative 6% return. The Industrial sector declined by 3% as the threat of tariffs weighed on stocks such as the auto parts suppliers like Linamar and Magna. Despite a decline in the Canadian prime rate the interest sensitive REITs and Utilities had negative returns. The impact of Deepseek on the market sectors is discussed in our reflection section.

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

6 Month Performance S&P 500 and TSX

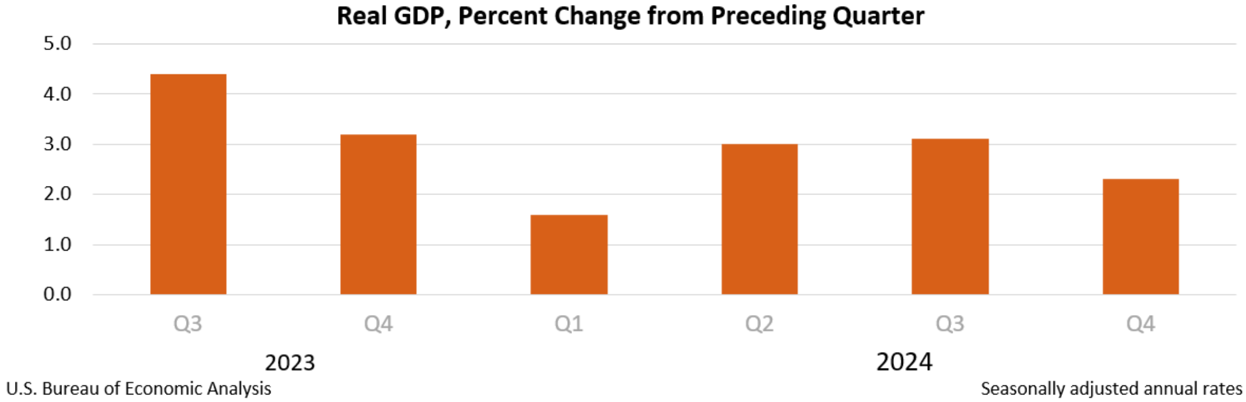
TSX, S&P 500 source google finance

Economic Indicators

1. **US Economy**

   The US economy continues to thrive. US GDP grew 2.3% in the fourth quarter after a 3.1% increase in the third quarter. Growth was primarily a result in an increase in consumer spending. Consumers increased spending on both goods and services. I am not sure if it is actually good, but the biggest increase in spending was on health care, primarily hospital services. Consumers increased spending on computers and light trucks.

   One problem with working with the raw numbers is that they are so many other one-time factors running in the background that skew the results. Hurricane Milton hit the coast of Florida and that caused businesses to close. At the moment, the government cannot estimate the impact on the economy. They do estimate that $27 BILLION of privately owned fixed assets, primarily homes, were lost in the California fires. The California fires have caused massive damage and caused people to lose their place of business. Some people are out of work so GDP will shrink but then goods will be needed to replace homes and their contents. The chart on the next page shows the annualized quarterly change in GDP



Reflection

Deepseek or Deep Six

I can honestly say, “I did not see that coming”

On Monday the 27th Deepseek, a Chinese Artificial Intelligence company, announced that it had produced a model equivalent to ChatGPT for a fraction of the cost. This announcement caused investors to rethink their perpetual growth assumptions for AI providers. Deepseek announced they trained their model for a mere $5.6 million. They indicated they did not used any of the latest Nvidia chips to make their computers. This means the chips will cost less and cost less to operate.

There is an investment thesis that one should not buy the company exploring for a mine but one should by the companies selling the picks and shovels. If you sell goods to the miners, you make money even if the mine is a failure. Nvidia is the first in line as the prime supplier of high-end chips for AI centres. Other companies might be viewed as the companies that sell the handles to the shovel company. You would not think of it but uranium stocks were caught up in the downdraft.

To put things in perspective, DeepSeek charges just $0.55 per million input tokens and $2.19 per million output tokens, which compares to OpenAI's rate of $15 and $60 for the same services. This gets back to the mining analogy where the data centres may not be as profitable but the providers could still be profitable. Except if the miners do not need as many picks and shovels then the providers could end up making less money. Lower demand leads to lower profits which in turn leads to lower share prices.

As you would expect, the chip manufactures were the first to get hit. US stocks declined by $1.6 Billion on the 27th. Nvidia declined by 16%, Oracle dropped by 15% and Taiwan Semiconductor fell 11%. Nvidia and Taiwan Semiconductor manufacture chips and Oracle offers software as a service support for AI. In our previous commentaries we raised concerns about the valuation of the stocks associated with AI. That said, these stocks rallied on the Tuesday but did not fully recoup their losses.

What is more interesting is that power producers fell more than the chip companies. Even in Canada Transalta and Capital Power fell more than Nvidia. The power producers were trading at elevated levels as Alberta was courting data centres based on the cheap steady power. Yes, Transalta and Captial Power fell more than the chip companies despite the fact they had not lost any contracts. In the US, Constellation Energy declined more than 20% on the 27th. Constellation plans to reopen Three Mile Island nuclear powerplant to provide power to a Microsoft AI centre. Microsoft has not given any indication that they have changed any plans for their AI expansion.

Next, we can look at the companies that are the equivalent to the shovel handle manufacturer. Some of the companies that were going to produce power were going to create it using nuclear energy. So how much uranium was going to be consumed in AI data centres? It must have been more than I would have thought as the price of uranium oxide fell $3.90 to $67.30 per pound. Uranium miner NexGen energy fell 16% on the 27th. Cameco which mines uranium and services some nuclear facilities plummeted from $80.34 to $68.26. Unbelievable that companies indirectly associated with AI fell more than the direct suppliers.

As I began this discussion, who would have thought. To put things in perspective I asked Deepseek to explain what happened.

On **January 27th, 2023**, NVIDIA's stock experienced a decline, and the primary reason was related to broader market dynamics and investor concerns about the **semiconductor industry**. Here are the key factors that likely contributed to the drop:

1. **Market-Wide Selloff in Tech Stocks**:
    - On January 27th, 2023, there was a broader selloff in the technology sector, driven by concerns about rising interest rates and economic uncertainty. NVIDIA, as a leading tech and semiconductor company, was impacted by this trend.
2. **Earnings Concerns**:
    - Around that time, there were concerns about weakening demand for semiconductors, particularly in the consumer electronics and gaming sectors. NVIDIA's gaming GPU sales had already shown signs of slowing in previous

quarters, and investors were worried about how this trend might affect future earnings.

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3. **Valuation Pressures**:
    - NVIDIA's stock had experienced significant growth in prior years, leading to concerns about overvaluation. As macroeconomic conditions tightened, investors began to reassess the valuations of high-growth tech stocks, leading to a pullback.
4. **Broader Semiconductor Industry Weakness**:
    - The semiconductor industry faced headwinds in early 2023, including inventory corrections and slowing demand in key markets like PCs and smartphones. These industry-wide challenges likely weighed on NVIDIA's stock.
5. **Macroeconomic Factors**:
    - Rising interest rates and fears of a potential recession in 2023 created uncertainty for growth-oriented companies like NVIDIA. Higher interest rates tend to reduce the present value of future earnings, which disproportionately affects tech stocks.

Context:

NVIDIA's decline on January 27th was part of a larger trend affecting the tech sector at the time. While the company remained a leader in GPUs, AI, and data center technologies, short-term market sentiment and macroeconomic factors played a significant role in the stock's performance.

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

" ***I am putting myself to the fullest possible use, which is all I think that any conscious entity can ever hope to do.?*****." – HAL, the computer in 2001 A Space Odyssey**

AI is not a guarantee to make money. Within the space of a week, we saw an announcement that some key technology players were going to spend $500 BILLION on AI and associated data centres. A Chinese company, Deepseek, announced they had an AI model that cost only a few million dollars to train and was able to work with a prior version of Nvidia's chips. This sent shock waves through the markets. If it is cheaper to run and does not need top level chips then you do not need to buy the most expensive Nvidia chips and you don't need as much computer power sucking on the electrical grid. Share of Nvidia dove 17% but shares of power companies dropped even more. This is shades of 2000 when people were focused on the potential of the internet. It is not that dire as 2000 as there is the need for more data centres and more power to run them. The question is how much power and how many data centres? At the end of the day, you have to measure the value of the stock in terms of price to earnings and not price to perfection. All I know is that some stocks are trading ahead of their valuation, note I said ahead of, not that they could not reach the higher price, it is just a matter of time. (HAL was the ultimate AI and was the name was derived by taking the letters in front of IBM, he was ahead of IBM in the alphabet and capabilities)

As we wrote this the threat of tariffs was still just a threat. By the time you read this the tariffs will likely be in place and retaliatory measures may also be enacted. We still do not know how long the tariffs will be in place nor do we know what steps the Canadian government will take to support the economy. Look back to the beginning of the Covid related lockdowns and how short a period of time the stock market stayed down, as government supports kept the economy from collapsing. We are concerned about the uncertainty but most of the stocks in our portfolios have minimal direct trade with the US and most stocks will be able to continue to pay dividends to the shareholders. We expect the markets to be volatile but do not expect to make significant changes to the client portfolios. But if the facts change or the markets over react, we will make appropriate changes.