HIGGINS
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June Market Analysis

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The Markets

	June	Change in Month	Year –To-Date
S&P TSX	21899	−1.7%	4.5%
S&P 500	5453	3.9%	15.0%
Dow 30	39117	1.1%	3.8%
Oil	$81.60	6.0%	13.9%
Gold	$2337	−0.4%	12.8%

The magnificent seven technology stocks that drove market upward have been replaced by two letters, AI, Artificial Intelligence. The US markets have left the rest of the world behind thanks to AI and more specifically NVIDIA. The technology heavy NASDQ index has had its longest run of daily closes without a 2.5% decline. Even the S&P 500 has gone more than 340 days without a 2% decline. Some market leading stocks are trading at 20 times sales and not 20 times earnings. World events have had little impact on the market, how many people noticed the announcement from the G7 nations this month. Announcements from the G7 used to be closely watched. However, many of the leaders are on a short leash as they face elections in the near future. Therefore, their announcements might not be policies in the near future. Even the US election has had little impact on the markets.

It was a month of thematic investing. Investors continued to gravitate to large capitalization technology stocks. The greater weight an index had in technology the better it performed. The S&P was led upward by Nvidia and other technology names. The Dow 30 had a positive return but lagged the S&P. The Dow is even performing worse than the TSX on a year-to-date basis. For the month, the TSX was pulled downward by commodity-based stocks. The price of copper pulled back after a stellar run and this contributed to an almost double digit decline in in the Base Metals subindex. Gold stocks, that are also part of the Metal Mining index, declined as the commodity price weakened. The US economy continues to be relatively strong and inflation has levelled off. Both of those factors have lowered the odds of a decline in interest rates which in turn has put pressure on the cyclical metals and golds. When investors turn on commodity stocks it takes the good down with the bad. Even with the price of oil up this month the Oil and Gas index was down more than 4%. Fears of a weaker Canadian mortgage market kept the Canadian banks as underperformers for another month. It was not all doom and gloom. Canadian technology stocks had a positive 3% return in May. Consumer staples and Industrial stocks rose approximately 2% in the month.

The chart on the below presents the performance of the S&P 500 and the S&P TSX for the Year-to-Date.

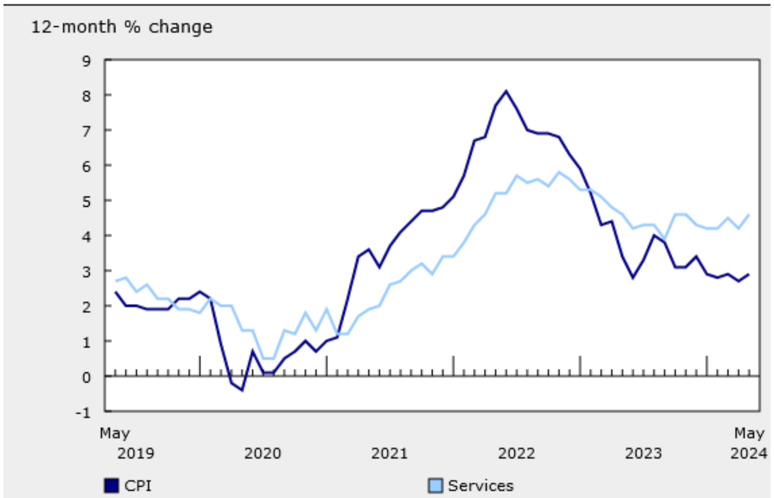
YTD Performance S&P 500 and TSX

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

Economic Indicators

1. Canada Inflation

After the Bank of Canada lowered interest rates for the first time since the beginning of COVID all eyes were on the next inflation report. Tiff Macklem, governor of the Bank of Canada, made it abundantly clear that interest rate movements will be data dependent. The last data point before the most recent drop in rates was a decline in the rate of inflation to 2.7% from 2.9%. An interesting article reported that inflation excluding mortgage rates was closer to 2%. Since 2% is the bank's target rate this is a very good sign. However, and there is always a however. There are many ways to calculate inflation rates.



Source: Statistics Canada

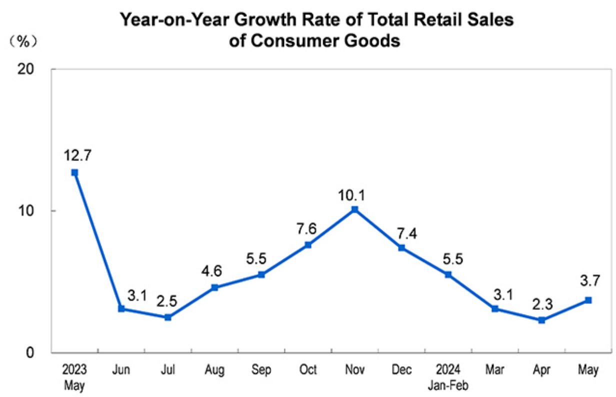
As you may have noticed there was a slight uptick in the May's inflation rate, reported in June. Inflation, as measured by the Consumer Price Index, rose back to 2.9% from 2.7%. Maybe Mr. Macklem would like to change his last decision to lower interest rates. As you can see in the chart above, inflation has been pushed higher by services and not goods you purchase. The increase in the price of services was led by the cost of travel tours and air transportation. You cannot avoid the price of fuel at the pump or the cost of food at the grocery store but you can avoid the cost of a flight or a tour. Speaking of food prices grocery price inflation year-over-year was only 1.5%. Grocery price inflation can be impacted by a bad harvest driving prices up or Galen Weston needing a new car (that is a joke).

There are many ways to measure inflation and each is helpful. The core rate of inflation excludes volatile items like food and energy. This takes out volatility which makes it more reliable but does not reflect how people experience inflation. This method will give the Bank of Canada reason to look for further rate decreases. The Core inflation rate was 3.3% in January and has decreased each and every month this year. In May the rate was 2.4% compared to 2.6% the last time the Bank of Canada met to discuss interest policies. The Bank's governor's favorite measure of inflation is CPI Trim. This takes out the largest movers both upward and downward to come to a version of core inflation. CPI Trim was 3.3% in January and reached a low of 2.8% in April but had a slight uptick in May. The 0.1% increase could be a rounding error and not lead to a change in the view of the Bank.

2. Chinese Economy

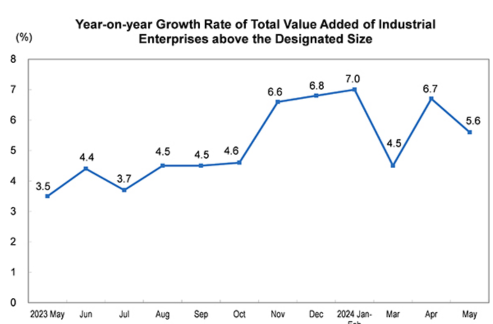
We have to consider what is happening in China as it is the world's second largest economy and is important trading partner. This has become a greater issue as the US, Europe and even Canada are proposing tariffs on Chinese Electric Vehicles. I was reading a Chinese newspaper's website and they did not mention the tariffs from Europe or the US, but did have a full article indicating Canadians would be hurt as all the Tesla model Ys sold in Canada are manufactured in China. Obviously, Tesla could ship the model Y from their US factory. Enough about Canada, lets look at China. One thing that strikes me about the Chinese economic data is that it used to show double digit growth in most sectors, not so much any more.

For the first 5 months retail sales were up 4.1% versus the same period last year. If you exclude automobile sales then sales were up 4.4%. Last year included some months with double digit growth so it can be argued that the increase in sales is from a higher base. Sales in rural areas were stronger than in urban areas. It may be that the poorer areas are catching up. Sales in smaller specialty stores and convenience stores rose 5% while sales in department stores declined.



Source: National Bureau of Statistics of China

So far, we have looked at consumption now we should examine the production of the goods consumed. The total value of significant industrial enterprises grew 5.6% year-over-year. Over the past 5 months industrial production grew 6.2% over the previous year. Manufacturing grew by 6% while mining grew 3.6%. Production of electricity and heat grew by 4.3%. When analysts did not believe the reported GDP, they would look at electricity production as a proxy since you need power to manufacture goods. Growth was stronger in private companies and public share companies than in state sponsored enterprises. I like the that they report the growth rate of companies financed by foreigners and investors from Hong Kong and Taiwan as one group. They consider HK and Taiwan as part of China but the statistics allow them to show them as outside sources of funds. Some areas of strength include chemicals, transportation and electronic equipment, all of which had growth rates in excess of 11%.



Source: National Bureau of Statistics of China

Reflection

Is it good or bad?

1. The NASDQ has had its longest streak of days without a 2.5% decline.

Everyone knows the market does not only go in one direction but the technology heavy NASDAQ appears to have done this., Think of NVIDIA. NVIDIA trades on the S&P 500 and on the NASDAQ. This winning streak is even longer than during the technology bubble of 1999. The market is partying better than 1999. Investors now realize the potential of AI.

Even the more broadly based S&P 500 has gone more than a year without a daily decline of 2% or more. This is the fifth longest streak and the streak will become the 4th longest by the middle of July, The S&P 500 is a capitalization weighted index so the larger the market value the larger the impact on the market. As Nvidia's price increased the more it influenced the index, this explains why the S&P has been rising. However, when a large stock declines it has a larger impact on the market. Near the end of June Nvida declined by more than 6% one day but the market declined by less than 1%.

To some, a rising market is a reason to invest. Momentum investors prefer to purchase a stock that is rising. The strategy is predicated on the concept that a good stock will attract new buyers. When the stock market is trending upward without a significant decline it is an attractive market for momentum investors. Just like Newton's first law "an object in motion continues in motion in a straight line until another force acts on it". We have not repealed the law of gravity so the stock market will pull back at some point.

They say a cynic knows the price of everything but not the value of anything. Certain stocks look pricey as they rise. That is the price. The value depends on whether the companies meet expectations. Yes, Nvidia is trading a multiple of sales that most companies do not even trade at as a multiple of earnings. The estimates for Nvidia's earnings have done nothing but increase every month in the past year. It is good the market is rising; it could be bad if the stock rises faster than its prospects. Just think of Gamestop that doubled then halved in value.

2. The bank of Canada lowered interest rates a quarter of a percent.

The positive of this move is it is the first step to lower mortgage rates and better housing affordability. The negative is they only lower rates when the economy might be slowing.

We can go many directions with this discussion,

I was talking with one investor and they raised the concern that the US did not appear ready to lower their rates. What does this matter? International investors have a choice of where they invest and many seek the best yield on their fixed income. If the spread, differential, widens between the US and Canada then the US will attract investors seeking yield. Since the playoffs have just ended it makes me think of the time Canada lost 2 hockey teams to the US. The Quebec Nordiques and Winnipeg teams moved to the US when the Canadian dollar hit 68 cents to the US dollar. One reason for the decline in the Canadian dollar was the spread or differential to the US interest rates was wider than normal and investors took their money out of Canada. Since hockey players are paid in US dollars the Canadian teams could not afford to meet their payroll. A lower Canadian dollar makes imports more expensive and our exports cheaper in the other country's currency.

You have to ask why rates are declining? A respected economist who is often quoted in the newspapers has espoused for months that Canada needs to drop rates frequently to offset a potential economic slowdown, Yikes! If rates are declining because the economy is slowing and might enter a recession then lower rates are a bad thing. There is a phrase that the US central bank takes away the punch bowl once the party gets going. What that means is to control inflation and an overheated economy the Federal Reserve raises interest rates once the economy gets going and in other words the party gets started. At the other end of the spectrum when the economy slows the Federal Reserve has to either inject liquidity or lower rates. How did rates get to 0.25 percent in the first place back in 2021? Central banks around the world injected liquidity and lowered interest rates to forestall an economic collapse caused by COVID related shutdowns. To follow the earlier phrase, you could say the Bank spiked the punch bowl at the prom to get the party going.

Summary

" Is the glass half empty or half full or half empty"

In our reflection section we looked at two events that could be interpreted as either good or bad. The major US indexes have gone an extended period without a daily decline of more than 2%. From one perspective it is great that the markets have been rising without a significant daily decline. Low volatility is good for investor sentiment, The other side of the coin is the market is getting more expensive? The real question is not is it more expensive but is the market TOO expensive. If you get to an extreme you will definitely experience a decline. The second event was the Bank of Canada's decision to lower rates. The lower rates are positive for borrowers such as homeowners with large mortgages, The potential negative is why did the bank lower rates? If employment were full and getting tighter the bank would not be able to lower rates. The bad, or negative, is that the economy has enough slack to allow the Bank to lower rates. You can view the glass as half empty or half full,

We have not changed our approach, we continue to like earning income from dividend paying stocks, especially from companies with a history of paying dividends. I remember back in 2009, in the midst of the US banking crisis when you could buy a Canadian bank with a 10% yield. The Bank of Montreal traded close to $33 per share. Today the bank is trading around $115 per share during the intervening years the stock has had dramatic fluctuations but the dividend has never been cut and in fact it has increased most years. This strategy works over longer periods. The Bank of Montreal has traded as high as $144 per share in the past year. If you look at your statement you might question the decline from $144 to $115. We like the 5% dividend yield you collect no matter what the stock price, We believe you are getting paid to wait for the recovery. I use the Bank of Montreal as an example as the other Canadian banks have had similar movements. We are disappointed the price has declined but as long as the long-term fundamentals have not changed, we view the banks as attractive.