HIGGINS INVESTMENT GROUP INC.

March Market Analysis

Views of Gordon Higgins CPA CA, MBA, CFA,

This and prior newsletters are available at www.Higginsinvestment.com

The Markets

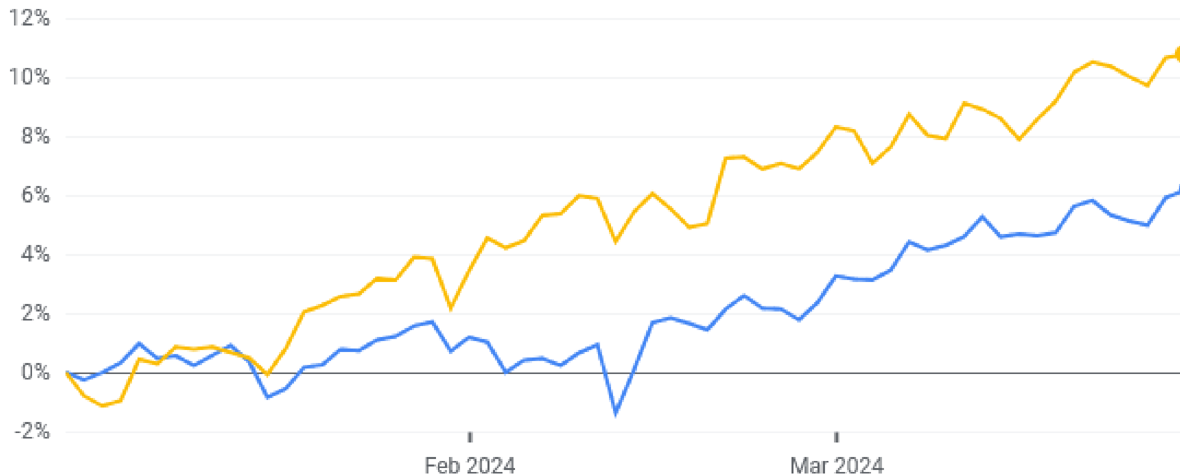
	March	Change in Month	Year –To-Date
S&P TSX	22167	3.8%	5.8%
S&P 500	5254	3.1%	10.2%
Dow 30	39807	−0.5%	5.6%
Oil	$83.11	6.1%	16.0%
Gold	$2254	9.9%	8.8%

It was a Goldilocks month for economic data. The markets remained strong as inflation was tepid. The Federal Reserve indicated they still expected 3 rate cuts this year. This removed some fear of further delayed interest rate cuts. Consumer spending remained positive but subdued. This combined with positive economic growth, provided a catalyst for the market. Continued growth with lower interest rates was just the tonic investor needed. The major US indexes closed near their highs for the past year.

As mentioned above, investors started to believe in the Goldilocks recovery. The prospect of continued economic strength combined with lower interest rates led to a 16% increase in the Materials sector, also know as metal and mining. Gold is a subsector to the metals index. In response to a recovery in the price of gold the Gold subsector rallied more than 25% in March. The gold stocks, after this rally are up less than 10% for the year-to-date. The energy stocks also rallied on hopes for continued economic strength. Oil prices rose 6.1% in March and contributed to the 10 percent increase in the Energy sector of the TSX. The prospect of interest rates remaining higher for longer combined with the prospect of lower immigration led to weakness in the Communications Services index, to you and me, the telecom companies including BCE, Telus and Rogers. The only other sector with a negative return was Consumer Staples. The consumer is beginning to get tapped out as government supports have ended and inflation has taken its toll.

The graph on the next page presents the performance of the S&P 500 and the S&P TSX for year-to-date.

Year-to-Date Performance S&P 500 and TSX



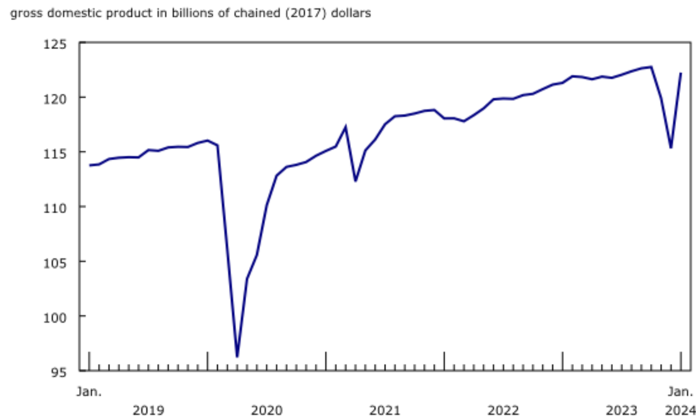
TSX, S&P 500 source google.com/finance

Economic Indicators

1. **GDP**

The fear of a recession has been proven wrong, so far, real, after backing out the impact of inflation, Gross Domestic Product grew 0.6% in January alone. There are statistical anomalies in the data. One area of growth was in educational services. This is a case where some of the growth is not actually growth as you would normally expect. Public sector workers were on strike in Quebec for the last 2 months of 2023. The strikes ended in January, as the teachers returned to work this led to an increase of GDP as the teacher's income is part of the GDP calculation. You could say this growth should have been anticipated by economists who closely follow GDP and you can question how we value education's impact on GDP.

The chart on the next page shows the fluctuation in education service sector as calculated by Statistics Canada.



The public sector grew by 1.9% in January. The educational services sector, their term not mine, grew 6% as the strikes ended. Health care also grew at its fastest rate since October 2020 as the Quebec public sector strike ended. In the more traditional economy, there was a 0.9% increase in manufacturing. This offset a decline in December. Motor vehicle production grew by almost 5% as factories resumed production after retooling for new models.

The weather can have a significant impact on GDP and is another reason to be cautious when reviewing monthly data. While those of us in Ontario basked in a winter that was more like Spring other parts of Canada had severe cold weather. The cold weather both contributed to GDP and detracted from GDP. Extreme cold weather in the West led to a significant increase in electricity demand. On a national basis electric power generation grew by 3.4% in January. You don't think of heating your house as contributing to GDP. Cold weather caused the railways to suffer delays and rail transportation fell 5% in January. Mining and oil production were also negatively impacted by the cold weather. Oil sands production, which essentially mining, declined by 5.2% in January.

2. China economic statistics

It is almost mandatory to follow the economic reports from China as it is the world's second largest economy. A key point to consider is China has a centrally planned economy. In the preface to their economic summary, they include the following sentence that clearly outlines the benefits of having a directed economy. Yes the paragraph is one sentence.

"Faced with complex and grave international environment as well as arduous tasks to advance reform, promote development and maintain stability at home, under the strong leadership of the CPC Central Committee with Comrade Xi Jinping at its core, all regions and departments took Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era as the guideline, fully implemented the guiding principles of the 20th CPC National Congress and the Second Plenary

Session of the 20th CPC Central Committee, followed the decisions and arrangements made by the CPC Central Committee and the State Council, adhered to the general working guideline of making progress while maintaining stability, fully and faithfully applied the new development philosophy on all fronts, accelerated efforts to foster a new pattern of development, strove to promote high-quality development, comprehensively deepened reform and opening up, strengthened macro control, and redoubled efforts to expand domestic demand, optimize structure, boost confidence and prevent and defuse risks."

- In 2023 the Chinese economy grew by 5.2%. Early releases for the first few months of 2024 show this trend is continuing
- China's population shrank by 2 million in 2023. The birthrate is no longer providing future supply of cheap labour. On the other hand, GDP per person grew from 131109 yuan per person in 2019 to 161615 per person in 2023.
- From January to February, total retail sales of consumer goods grew by 5.5 percent year on year, Retail sales of consumer goods, other than automobiles, increased by 5.2 percent.
- In the fist 2 months of 2024 the value added by industrial enterprises grew by 7% year-over-year. Mining was up 2.3% while manufacturing surged 7.7%
- In the first 2 months of 2024 the service sector grew by 5.8%
- Investment in fixed assets grew by 4.2%

All signs of a still health economy. This economy will continue to provided demand for goods produced in the rest of the world.

Reflection

Seven and then there were four

Not that long ago almost every article about the stock market included the phrase "the magnificent seven" They were not referring to an old Western but to seven technology stocks that were the catalyst for the surge in the NASDQ and the S&P 500. The seven stocks were Nvidia, Meta, Amazon, Alphabet, Apple and Tesla. These stocks propelled the markets upward and the larger they got the more they impacted the market. The major US index returns are market capitalization weighted. What does that mean? If the total market capitalization of all the stocks is $1 billion and one stock has a market cap of $100M, If the stock goes up 10% then it moves the market (10% times $100M/$1 billion=) 1%. If the stock has a market cap of $10M then the impact of a 10% move would only be 0.1%. It matters what stocks are going up more than how much they rise. The magnificent 7 comprise approximately 30% of the market cap of the S&P 500, so they definitely have a significant impact.

In 2023 the magnificent seven rose 111% on average while the total index rose 24.2%. As the stocks continued climbing, they drove the index higher. The stocks were propelled by expectations for continued growth and the hope for continued AI driven sales. Back in the 1960s the market had its version of the magnificent 7 but it was a much broader group know as the nifty fifty.

This became an investing theme as well as a concern for some investors. Momentum investors buy stocks that have upwards momentum. That is, rising prices. This causes monentum investors to buy driving the winners even higher. Often, they have to sell other stocks that are not rising as fast which further exacerbates the difference in performance. The strong get stronger and the weak get weaker. This strategy works until it doesn't. They only sell once it has stopped rising which might be after it has begun to decline. The benefit of this strategy is that it avoid stocks that have a slow steady painful decline. A recent article mentioned the Magnificent Seven have become the Fab Four. Three of the stocks had begun to lag the market, Tesla, Amazon and Alphabet.

I recently had a conversation with a client about Nvidia. They correctly pointed out that AI has been a topic for a year and that if someone sat down and spent time thinking about it, they would realize Nvidia would benefit. The problem with this is did the analysts whose job it is to follow a limited list of technology stocks, include this AI growth in their earnings estimates. I remember talking with a client about buying Nvidia before its big run up and explained that the stock was trading for more than 40 times earnings. A lofty valuation based on the expected earnings growth. Well… the analysts totally missed the boat on this one, as earnings estimates have skyrocketed almost as fast as Nvidia's stock price. A recent article in Barrons magazine pointed out that companies such as Microsoft are rapidly expanding their AI offerings. This means demand is surging for AI chips manufactured by Nvidia. The question is in a couple of years will Nvidia's competitors have chips to rival Nvidia's and once the major expansion is complete will demand level off? If that is the case then Nvidia's earnings will definitely be higher than this year but the growth rate will level off. Lower growth could lead to a lower price earnings multiple. Maybe Nvidia is fully valued despite its amazing growth rate.

You have to ask how the Magnificent Seven became the Fab Four. Maybe AI will have a lesser impact on some of the seven, take Telsa as an example. Or maybe AI competitors will eat into Alphabet's clients. Some of these stocks were the worst performers in the index a few years ago.

I have told this story before but I feel in encapsulates the nature of value and the price of a stock. I am old enough to remember when Amazon was a new company on the stock exchange. It was during the tech bubble when people were willing to pay for eyeballs looking at a website and not earnings. Do you remember pets.com? Amazon was an online book retailer. I remember reading a report that Amazon would have to sell every book sold in America to justify its stock price. The analyst was correct the stock crashed along with all the other tech stocks in 2000. Then Amazon morphed in to an online selling platform selling everything from toothpaste to technology. They did not need to sell every book. Then they discovered other sources of revenue,

selling a fee for faster delivery, Prime. Then they became more of a technology company with Amazon Web Services.

We invest based on what we know. Sometimes the trend is your friend and a rising stock attracts new investors just because it is going up. Sometimes management lead a company to adapt to a changing landscape. Sometimes stocks just get over valued.

Summary

"What we lost in the fire we will find in the ashes.". Magnificent Seven the movie.

The magnificent seven is not just a movie but seven stocks that have driven the stock market to record highs. The most recent surge has been related to expectations for further AI inspired growth. At times these stocks had rising prices because they had rising prices. A class of investors purchase stocks with upward momentum which only reinforces the stocks' winning ways. They stay until the stock stops rising. Recently 3 of the Magnificent Seven have been burned and declined. You have to ask yourself if the price of the stock fully reflects the potential of the stock to grow earnings. Only 6 months ago analysts totally misjudged the potential for Nvidia to grow its earnings based on the need for specialty chips required by AI. These stocks could still be cheap or they could be pricing in hope and not reality. Just think of the early days of Amazon when it was solely a website for selling books and today it is a global retail powerhouse with a technology division, Amazon Web Services. I can assure you no one could have predicted the potential in Amazon.

When we look back, we see we missed trends like the Magnificent Seven. Given the benefit of new information these stocks presented an opportunity but we did not know that information at the time. We are comfortable purchasing stocks that might be buried in the ashes. The pipeline companies are unloved but present the investor with 7% yields. If the shares appreciate by 3% then the investor will get a 10% annual return. Ten percent is a healthy rate of return. The return is not guaranteed nor will it be a steady 3% per year. The stocks could decline 10% in a year and recover over a couple of years. Investing requires patience but it is nice to get paid a steady, potentially increasing, dividend while you wait.

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