HIGGINS INVESTMENT GROUP INC.

August Market Analysis

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The Markets

	August	Change in Month	Year –To-Date
S&P TSX	20292	−1.6%	4.7%
S&P 500	4507	−1.8%	17.4%
Dow 30	34721	−2.4%	4.8%
Oil	$83.53	2.0%	4.0%
Gold	$1966	−1.9%	8.9%

Investors spent most of the month concerned about the next pronouncement by the Chairman of the Federal Reserve. Powel was scheduled to make a presentation to a group of elite economists in the Teton mountains of Wyoming. Last year markets pulled back after he announced he would keep increasing rates. This year the wait was harder than his announcement. In the end, he more or less indicated that the next move was still data dependent. The economic releases subsequent to his speech were mixed so the provided little clarification on his next move. The market weakened into month end as investors began to focus on problems in the Chinese economy. The Chinese central bank lowered one of the rates it can control but analysts felt it may not be enough to save the economy. After strong markets earlier this year you could say the market consolidated with a slight negative bias.

The three weakest sectors on the TSX were Base Metals, Banks and Consumer Discretionary. The Canadian banks surprised analysts when they increased their loan loss reserves. The banks indicated many mortgagees were extending the length of the amortization and many were paying less than the interest on their mortgages. No big change in defaults but the risk of default was higher. This led some investors to sell the banks. The threat of a slow down in the Chinese economy led to weakness in the base metal stocks. At the other end of the spectrum was the surge in the Oil and Gas sector. Confidence in the discipline of OPEC led to a recovery in the price of oil and accordingly in the price of the energy related stocks. The volatile cannabis stocks had a good month and led the Health Care sector to a positive performance.

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

6-month Performance S&P 500 and TSX

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

Economic Indicators

1. Canadian GDP

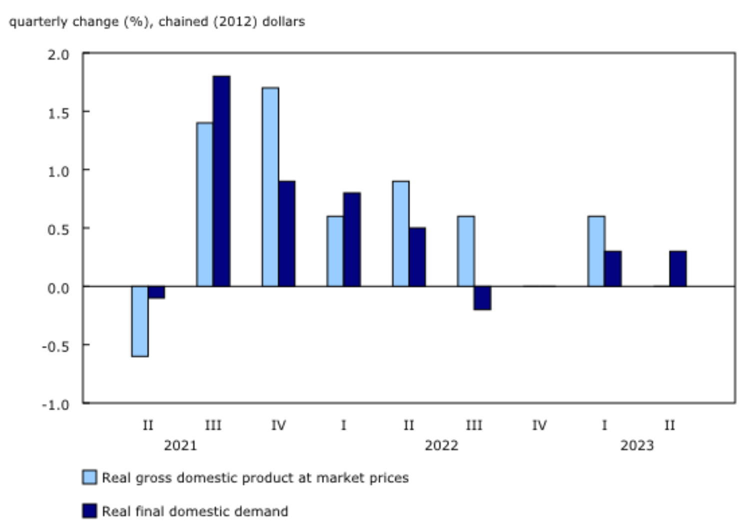
The Bank of Canada may have got the gross domestic product announcement it needed. Statistics Canada reported the Canadian economy neither grew nor shrank in the second quarter. The B of C wants to see the economy slow as it should ease inflationary pressures. This could be the Goldilocks situation the bank wants, not too hot and not too cold.

Rising interest rates hit the interest sensitive housing sector. Housing investment declined for the fifth consecutive quarter. New construction plummeted more than 8%. Renovations also declined by more than 4%. Often people make improvements to the home they purchased and after a decline in resale housing activity it is logical this segment of housing investment declined.

As you would expect, rising interest costs to homeowners impacts cash available for other activities. Household spending had a minor 0.1% decline in the second quarter. Expenditures on furniture fell 3.3% in the quarter. Expenditures on new passenger cars fell almost 10%. If you cannot afford your mortgage, you cannot afford an expensive car loan. Total household spending rose but fell almost 1% on a per capita basis. Per capita spending declined in three of the past four quarters.

There might be a tale of two cities, or a tale of the indebted and the debt free. Compensation rose 2.2% in the second quarter which followed a 2% increase in the first quarter. This is skewed by certain groups getting above average raises. Payments to health care workers rose 3.5%. The increased wages impact disposable income. Disposable income rose 2.6% in the quarter, which is refreshing, after a contraction in the first quarter. Those people with investments saw gains on interest on deposits of 19% and a 3.8% increase in dividend income. This was offset by higher payments on mortgage debt, up 5.8% and consumer credit expenses which rose 6.9%. Household savings as a percentage of income rose to 5.1% in the second quarter compared to less than four percent in the first quarter.

You can see that real GDP was almost negligible in the second quarter. Real GDP is what matters as it backs out the impact of inflation.



Source: Statistics Canada

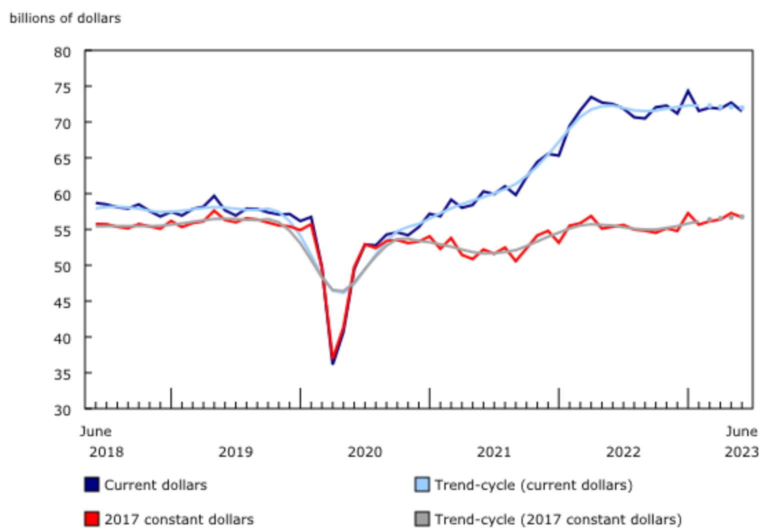
2. Canadian Manufacturing

As we discussed above, the Canadian economy is beginning to slow. Consumer expenditures are the largest segment of the economy but you have to track the strength in manufacturing as it impacts employment levels.

Manufacturing sales fell 1.7% in June. Losses were broadly based with declines in 2/3rd of the subsectors. Weakness was evident in petroleum, chemicals and machinery. A recovery in auto production partially offset the shrinkage in the other segments of the manufacturing sector.

There were indicators of both strength and weakness. On the negative side, inventories rose. The ratio of inventory to sales rose in June. This could be an indicator of excess inventory which is a precursor of lower future production. On the positive side, the value of unfilled orders rose. Rising orders is an indicator that more production is needed to meet the new orders. This could mean some industries have excess inventories while others have good prospects due to rising orders.

The chart below shows the level of manufacturing sales in both inflation adjusted and reported dollars. If you adjust for price changes manufacturing activity is back to the levels in mid 2019. We have recovered from the Covid induced slow down.



Source: Statistics Canada

Reflection

If you don't say it, it didn't happen

The first headline was "China reports record youth unemployment" the second headline was "China suspends youth jobless data". After an embarrassing increase in youth unemployment the department charged with reporting these statistics stated they need to review the method for calculation youth unemployment. The Nation Bureau of Statistics indicate they need to optimise collection methods. They had an interesting comment "The main responsibility of students is studying. Society has different view on whether students looking for jobs before graduation should be included in the labor force survey." If you assume the definition of unemployed youth did not change over recent history the all time high is still an all time high based on the method that was previously accepted. However, we will not be able to kick this number around until they find a clearer way to show the improvement. As an aside, in a recent article in a Canadian newspaper there was an article stating there were 1 MILLION more immigrants in Canada than our government reports. The Canadian statistic assumes that people leave 30 days after their visas expire while many stay and request an extension. There is a phrase "there are liars, real liars and statistics". Maybe it is good they have stopped releasing flawed data.

Then there is the meeting with Canada's environment minister at a Chinese hosted climate conference. To make sure Canada knew what it could say because once it is said it is out there, Canada was warned not to take a condescending tone in the discussions. A Chinese based newspaper, known for espousing the party line, raised two items to remind the Canadian minister to be carful of his choice of words. The majority of the article used the word co-operation several time, so this seems very positive. However, the last two paragraphs indicate the "or else" side of the discussion. The last two paragraphs comment when Canada seized Huawei's Meng at the behest of the US, Canada damaged bilateral relations between Canada and China. The last paragraph mentions that China expanded the list of countries to which they allow group tours but specifically did not include Canada. Therefore, we should be polite Canadians and not say what we think and that the perceived lack of climate initiative did not happen.

Closer to home, we have an increase in individuals extending their mortgages. A headline in the Globe and Mail made it very clear about disclosure "Major mortgage insurer cuts back on disclosing information about homeowners with underwater loans". Underwater loans have nothing to do with flood levels but is an industry term that indicates the value of the home exceeds the amount of debt – indirectly the owner is drowning in debt. The mortgage insurer no longer discloses when borrowers exceed a loan to value ratio of 100. When the loan to value ratio exceeds 100 it indicates the mortgage is bigger than the value of the home. If the bank seizes the property, it will not recover the value of the loan by selling the home. The insurer now discloses mortgages that exceed 95% of LTV. This is still valuable but not as clear as the number of houses that are underwater. Their argument is this new disclosure is industry practice. At the end of 2022 this one company had approximately $4 billion of loans that exceed a LTV of 100. It is only getting worse, but we will never know since we aren't told any more.

The quote we began this segment seems appropriate and there are other ways to capture the thought. Like a phrase used in the US for another issue, Don't ask and don't tell. If you are not told then it does not exist.

Summary

When a tree falls in the forest, and no one is there, does it make a sound."

Over the past few months, we noticed a trend. We noticed some economic releases are being modified or just not released. It is almost as if the those reporting data realize the data does not look good, it is best to hide it. If you do not release the information no one can compare the current situation to the previous months. It might not be a pattern but these revisions occur after someone comments it was the worst… since some previous period. The quote above might be appropriate if you do not hear the noise then we can assume it did not happen?

We continue to see solid returns on stocks with good dividends and the potential for higher dividends. They say that you buy your portfolio every day, as you own it unless you sell something. Our philosophy has not changed but we constantly review the portfolio to see if stocks we do not own may have declined to the point where they are cheap enough to offer a better return than what we currently own.