



**Wealth Management**  
Dominion Securities

Cooper Wealth Management of  
RBC Dominion Securities

# Thoughts on the market

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RBC Dominion Securities Inc.

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## Turn, Turn, Turn



“To everything, there is a season.”

- *The Byrds*  
1965 hit song “Turn, Turn, Turn”

The classic song is about life cycles, beginnings and endings. At this point on the market, there are some powerful cycles that are driving capital flows and this month, we are going to examine the market’s most recent upturns, downturns and U-turns to determine how they will impact our investment decisions.

The mega cycle at the moment remains the global artificial intelligence race. The battle for dominance continues as does the ever-increasing spending. Investable areas on the upturn are computer chips, particularly memory, storage, and infrastructure such as power generation, HVAC and warehousing components such as racking and wiring. Our portfolio names in these areas include Microsoft, Amazon, Caterpillar, Carrier, Fortis, Duke Energy and Vertiv. On the downturn in technology are the Software-as-a-Service names such as Salesforce, Thomson Reuters, and Trade Desk, which have all seen significant selloffs as the market fears these companies could eventually be put out of business due to artificial intelligence. These companies all have significant assets and long-term contracts in place but then again, it was hard to imagine that Kodak would be wiped out by digital cameras or the traditional newspaper business by the Internet. We will stay away from this sector until further long-term clarity emerges.

There have been two notable U-turns in technology, one positive and one that bears watching. The positive turn has come on the form of data security. These stocks were weaker until mid April over concerns that the AI models being built would have built-in cybersecurity provisions. Since then, the stocks have almost doubled in price as the market has taken a favourable view towards the importance of independent security, companies such as CrowdStrike. The potential U-turn we are keeping an eye on is Nvidia. Their chips remain the most sought after and they continue to post record earnings. However, we are seeing a worrying increase in the number of circular contracts they are entering into. Basically, Nvidia has been buying billions of dollars of equity positions in various companies and in turn, these companies are turning around and using the cash to buy Nvidia chips. If the companies are successful, Nvidia will record huge profits. If they are not, they would start to realize losses. Another reason this trend is negative is that despite record earnings and net profit, Nvidia's free cash flow, the lifeblood of any company, only increased by 2% once the circular transactions are factored out. If free cash flow goes negative, or write-offs begin to mount, it will definitely be a danger sign for the sector. No changes for now but we will keep a close eye on developments.

Commodities have been another key area of the market. The wars in Iran and Ukraine have severely disrupted the global supply chain for key commodities, such as oil, natural gas and chemicals, such as fertilizer. While the focus has been on Iran, Ukraine has been able to damage energy infrastructure hundreds of kilometres inside Russia and the damage is mounting. Combined with the ongoing Iran war, oil prices are likely to remain on the upturn into the new year and possibly longer if energy infrastructure continues to be damaged. We are maintaining our portfolio weighting in oil, natural gas, and pipelines for the immediate future, along with our fertilizer position in Nutrien. The short-term downturn has been in gold. As we have written before, gold tends to drop in price during times of crisis as investors prefer the liquidity of the US dollar. However, the price of gold remains well above the historic average, and we continue to expect outsize profits from our holdings in Barrick, Newmont and Agnico Eagle.

US corporate earnings are again in focus for this month. With this quarter, approximately 85% of S&P 500 companies have beaten analyst estimates. That is a significant upturn over the 10-year average of 76%, with earnings beating estimates by 16.7%. Now we could be cynical and say we need better analysts, but the truth of the matter is that corporate America remains strong. There's been downturns in areas such as packaged foods and importers, where inflation and tariffs have been a big negative on profit margins. After a poor year last year, there has been a big U-turn to the upside for the rails, with both CN RAIL and Canadian Pacific up 20% year to date.

Current US economic statistics are also pointing in multiple directions. US inflation started the year at 2.4% but is now risen to 3.8% as of the most recent reading. Food costs are higher, but the major factor has been higher energy costs, which are directly attributable to the Iran war. Inflation has sent US consumer confidence to near record lows according to the University of Michigan index. Despite these challenges, US Gross Domestic Product (GDP) grew at 1.6% in the first quarter, with consumer spending remaining consistent, higher business, and government spending, as well as increased exports. The AI spending spree and government spending on defence helped drive the growth but is important to remember that US crude oil exports have recently surged to 6.4 million barrels per day as European and Asian refineries have needed more supplied to due to the Strait of Hormuz remaining closed. To help offset exports, the US imports between 3.8 to 4.4 million barrels per day of Canadian heavy crude at the current price of \$74.54 and exports their lighter oil at \$90.54 which helps to keep down their cost of processed fuels.

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In Canada, the market continues to be driven by financials and energy stocks primarily. Canadian bank earnings continue to grow as market activity has increased, which has offset any weakness in consumer spending and mortgage activity. Pipelines and energy stocks continue to perform well thanks to the higher oil price. We do expect to pull back at some point after a resolution with Iran, but we expect oil to remain above normal levels for the balance of the year.

On fixed income, both the Bank of Canada and the US Federal Reserve are currently viewing the rise of energy prices as temporary, but the market is betting it will be enough pressure to keep interest rates at current levels. New Fed Chairman Warsh will be in spotlight in the coming months to see if he can resist White House pressure to reduce rates. In the meantime, bond and preferred share prices should remain steady, barring any further dramatic geopolitical events.

The markets will continue to move up, down and sideways. We expect some corrections in technology and energy but remain diversified to help mitigate any downside. Our two driving forces, corporate earnings and US consumer spending remain in place, so we expect more positive results moving forward. Until next time, enjoy the summer and stay well.

As always, questions, concerns, comments and feedback are welcome.

Yours truly,

Walter, Charles, Trevor and the Cooper Wealth Management team



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