Wealth Management
Dominion Securities

Cooper Wealth Management of
RBC Dominion Securities

Thoughts on the market

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Consequences

"What we think or what we know or what we believe in is in the end of little consequence. The only thing of consequence is what we do."

- *John Ruskin*
  Victorian era author

The current wars in Ukraine and Iran are having a profound effect on the global political and economic landscape. After failed negotiations over the weekend, the US is moving forward by further blocking the Strait of Hormuz. With spring coming, we expect Russia to again push forward with renewed attacks on Ukraine. The consequences of both these military actions have both short-term and longer-term implications. This month, we will go into our overview of the current global status and discuss how we are navigating through it.

The brightest red flashing light at the moment is the Iran war. With no movement on a peaceful settlement, the US has decided to further blockade the Strait of Hormuz. Basically, any ship leaving an Iranian port will be blocked. Iranian oil tankers will not be allowed to leave either. Consider the time it would take for the US to board the hundreds of ships now stopped. According to a JP Morgan analyst, the last oil tanker to leave the Strait was on February 28th, and it's due to come into port next week. Even if the war were to end today, it would be mid-July before 20% of the world's oil and gas trade would normalize, assuming similar tanker delivery times. This also assumes that there is no further damaged energy infrastructure in the region once the 15-day cease-fire ends.

Another potential deadline for the war in Iran is April 29th. The War Powers Resolution of 1973 forces the President to get congressional approval in the form of passed legislation authorizing the use of military force, once the war reaches the 60-day mark. Given the unpopularity of the war, the inability of the current Congress to pass legislation, and the pending US midterm elections, it will be interesting to see if enough Republicans have the courage to vote. We view this as a highly unlikely outcome given the potential backlash from the White House, but it will be an interesting story to follow.

The consequences of war have different weights for different parts of the world. North American energy producers will greatly benefit from higher cash flows, and we are well positioned within the portfolio with Suncor and Canadian Natural Resources, as well as pipeline companies, such as Enbridge and Pembina. Unfortunately, consumers will feel the brunt of higher energy prices likely into the fall. Also, Canada and the US have their lowest level of energy dependence for manufacturing of all time due largely to the declining importance of manufacturing goods versus developing technology. The impact on the European Union and Asia is much greater given their greater need for energy and is expected to have a broader impact on both inflation and Gross Domestic Product (GDP). Given this scenario, we have limited international investments, preferring to use North American-based multinationals for opportunities in foreign markets.

While everyone is talking about oil, there are two other key global commodities that flow through the Strait: fertilizer and helium. Roughly 1/3 of the global transport of these commodities pass through the Strait. Fertilizer prices, particularly potash, have spiked just as the planting season begins in North America. In the US, farmers also faced an additional 10% tariff on Canadian potash, where 2/3 of their suppliers originate. Once again, consumers will have to bear the brunt of higher inflation, particularly when you factor in transportation costs. We added Nutrien, one of the world's leading potash producers, to the portfolio prior to the war, and it has helped to hedge the portfolio against market volatility.

The commodity that is least talked about is helium. Helium is an irreplaceable commodity used in the production of computer chips. It is used primarily for cooling and providing a sterile vacuum environment for the chips to be etched. Qatar produces 1/3 of the world's helium supply and that supply has stopped. Nvidia gets their chips predominantly made by Taiwan Semiconductor, who import 69% of their helium supply from the Middle East. Taiwan Semiconductor has other sources as well as a robust recycling program, but any prolonged disruption could lead to chip rationing and a slowdown in the global artificial intelligence arms race.

The war in Iran has also sent the US dollar higher. This occurs for two reasons: first, the spike on global commodity prices has increased demand for US dollars, as most global commodities trade in USD; and secondly, international money managers have traditionally moved to USD as it is seen as a safe haven during times of crisis. The USD has been at an elevated level since the start of the Ukraine war, but we believe that at $1.39 to the US dollar, we are at or near the top of the traditional US/CAD rate range. To protect the gains, we have earned from currency appreciation, we have begun to hedge some of our US positions by substituting Canadian Depository Receipts (CDRs) for new US purchases such as Broadcom and Caterpillar. The CDRs own the underlying shares but are currency hedged to protect against a depreciation in the US dollar.

Inflation is also an important discussion point. US inflation is expected to climb as high as 3.3% annualized, with Canada up to 2.4%. These projections could move higher, depending on the duration of the Iran war. This will likely eliminate the possibility of further interest rate cuts in Canada or the US for 2026. However, with a newly Trump appointed Federal Reserve chairman starting May 23rd, there could be pressure from the White House to cut rates sooner.

US GDP is still expected to come in between 1.5% to 2.1% as artificial intelligence productivity benefits are expected to offset some of the negative effects of higher energy and food prices. The key for us to watch is the US consumer, who drives 70% of US GDP. Consumer confidence is currently at its lowest level since 2009. Low to middle income families are the hardest hit but move the GDP needle the least. It is important to note that US households have over $14 trillion in savings, so they can increase spending without taking on debt, making any increase in spending more likely to be sustained. The group to watch will be seniors, a large and growing segment of the population. They tend to spend less on big-ticket items and more on travel and leisure activities. If the seniors keep spending, the economy will be OK, but we will be watching overall US spending and adjust the portfolio if required.

Canada is like the tail of a kite at the moment: up in the air and following behind. The government faces the challenge of getting major infrastructure projects off the ground, but these take years to complete. We also have another 2½ years of current US administration to contend with. However, the current high energy prices will bring in much-needed tax revenue and help shrink the budget deficit. The TSX is doing better as energy and material stocks have led the way, further aided by the recovery of bank shares. We still look at Canadian stocks to help balance the portfolio risk through higher dividends than the US. Fixed income largely remained unchanged as there has been little movement in interest rates. With potential food and energy inflation ahead, the Bank of Canada will likely stand pat on rates this year. Our preferred shareholdings continue to deliver consistent dividends, and all remain investment grade.

A quick comment on gold: it is said that in times of crisis, investors buy gold. The reality is that people sell gold and hold US dollars. Gold actually sold off from over $5,000 to the current $4,300 level today. At the current price, mining companies are highly profitable, and we have Agnico Eagle, Hudbay, and Freeport McMoRan in the portfolio to take advantage of current gold and silver prices, which we believe are sustainable at this level.

It has been a year filled with both political and stock market drama, and the full consequences of these events have yet to play out. However, we continue to rely on the strength of the US economy and US corporate earnings as our guideposts for long term success. With US corporate earnings season just starting, we'll have plenty to talk about next time. Until next month, stay well.

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

Yours truly,

Walter, Charles, Trevor and the Cooper Wealth Management team

PS - To illustrate how fast things change, Iran has stated the Strait of Hormuz is open as of today. There are final negotiations to be concluded but this is a step in the right direction, and we are seeing a strong, positive market reaction. Once a final deal is reached, we expect the market to continue to improve.

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