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Dominion Securities

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RBC Dominion Securities



Thoughts on the market

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The Winter of Discontent



“Now is the winter of our discontent”

- *Opening of Richard III by Shakespeare*

It has been a difficult winter on a number of fronts. Record cold temperatures kept us indoors. Changing politics kept us off guard and the market has been moody at best, one day up then one day down regardless of good or bad news. There are a lot of topics that need discussion so we will review the broader markets, and we will see where we can avoid the cold and find some sunshine.

The hottest topic at the moment is the new war between the US and Iran. This has repercussions in many areas. First, Iran essentially controls the Strait of Hormuz, where 20% of the world's oil production passes through daily. With missiles and drones flying through the air, shipping has stopped, which has caused the price of oil to spike to over \$100 per barrel. If the war lasts for weeks, analysts predict that oil could rise to over \$125 per barrel. We view this spike as temporary unless the US decides to attack Iran's oil infrastructure. In that scenario, prices would definitely stay higher for longer. The same will be true if Iran manages to damage any oil facilities in either Saudi Arabia or Qatar. In any case, oil prices will remain higher for now. If the war does end quickly, then we would expect oil prices to return to the \$60-70 range. The other major commodity that flows through the Strait is fertilizer which could impact next year's food prices.

This year, the market has been going through a rotation where last year's winners, such as technology and financials are being sold, and investments moved into commodities, gold and industrial stocks where there is a perceived better value. This rotation tends to have a larger effect on commodities as the sector is much smaller than the stock market and therefore has created a larger price swing upwards.

The sell off in technology has been largely driven by concerns about the sustainability of spending on the development of artificial intelligence. The market has seen more deals where companies are giving chip suppliers such as Nvidia ownership in the companies rather than cash. It is a trend we are monitoring, but for now, the major players such as Microsoft, Google and Meta are still funding development of AI from cash flow. If outsized borrowing by these companies start to occur, it'll be time to sell and move on.

Current events also impact the economy. The rising price of oil and copper will definitely be inflationary. As a result, we expect both the US Federal Reserve and the Bank of Canada to hold interest rates steady until the end of the US/Iran war. Depending on the outcome, we expect interest rates to remain at current levels at least until the new Fed Chairman Kevin Warsh is sworn in after Chairman Powell's term ends on May 23rd.

While the market consensus view has swung back-and-forth from positive to negative and back again, one thing that has remained consistent has been the continued positive growth of corporate earnings. We have continued to see record profits from companies such as Microsoft, Mastercard, JP Morgan and Royal Bank and yet the market price for all these companies remain down for the year to date. While the global leaders are down for the moment, we are confident that the value these companies continue to build will again be reflected in their share prices at some point in the near future.

One area that is working in the market today is the picks and shovels that we highlighted last newsletter. For example, companies like CN Rail, Suncor, Canadian Natural Resources, Freeport, McMoRan, and Agnico Eagle, all current portfolio holdings, are up 10% or more year to date as the market is seeking more value type investments versus traditional growth. With the current market and geopolitical volatility, portfolio diversification across multiple sectors remains a key factor in reducing risk.

As to portfolio activity, we have been adding more industrial names, such as Carrier, Caterpillar, GE Vernova, as well as increasing our gold and copper holdings with Hudbay Minerals. Carrier is a leading HVAC and air-conditioning company that we expect to greatly benefit from the current AI database centre building boom. GE Vernova builds and services natural gas fired power plants that will also benefit from this trend, as well Caterpillar for their backup generators and construction equipment. Overall, we are reducing volatility by reducing exposure to the main US stock

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indices while still seeking long-term growth. With Caterpillar and GE Vernova, we are further reducing risk by purchasing the Canadian depository receipts for these companies, which have the dual benefit of eliminating US dollar currency risk while providing us with a much lower per share price, which allows us to add these shares to portfolios of any size.

Another important topic is the US dollar. During this war, we expect the US dollar to remain at present high levels due to the strong demand caused by the higher oil and gold price, as well as a Federal Reserve that is unlikely to lower rates due to inflation concerns. With that in mind, we'll look to hedge your portfolios where possible to reduce currency risk.

As to Canada, if oil prices remain elevated for an extended period, the overall economic numbers will remain at decent levels. One main issue will be the effect of US tariffs and the potential renegotiation of the CUSMA free trade agreement. We view this as a back burner issue for now as the US is focused on the Iran war. Given how unpopular this issue is with US voters, we see a high likelihood this negotiation could get pushed back past the November midterm elections. The other major issue is the continued development of non-US markets for Canadian goods. The government seems to be heading in the right direction, but time will tell with actual results. The Canadian stock market continues to be led by gold and mining shares, and we see this trend continuing for now. Financials will play catch-up once we see more economic and political global stability.

Our outlook for fixed income remains stable as we don't expect any interest rates cuts until perhaps the second half of this year. We could see US long-term rates drift higher if the Iran war drags on, but overall, we don't expect any large movements at this time.

Our winter of discontent has brought the chill of volatility, but therein lies opportunity. While we have seen many of last year's winners sell off, green shoots have emerged in other sectors, and we must also remember our discipline that strong earnings are always reflected in higher share prices eventually. Spring is around the corner, and we will see brighter days ahead. Until next time, 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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