RESEARCH CAPITAL CORPORATION

Quarterly Newsletter April 2023

The first quarter of 2023 has wrapped up. It has been a quarter when the question of "glass half full or half empty" is not answerable. We are now into the second year of Ukraine being battered by Russia. Power facilities have been pummeled, creating dire and punishing heat and water shortages. Yet the Ukrainians have remained indomitable. Let us hope that we see an end to this in 2023.

Interest rates have continued to rise and may still go higher as the federal banks struggle to wrestle inflation down to 2%. Notwithstanding the higher rates, companies are still hiring and, in some sectors, having difficulty finding the people they need. Inflation has declined from a high of 8% to around 5%, but this is not enough. With staffing issues and catch-up from the lingering pressures of COVID, companies are facing upward wage pressures. The complex challenges contained in the seemingly simple phrase, "increasing wages," means higher prices, which means higher inflation, which means companies have smaller returns and diminished funds to put towards the increased productivity that they so badly need.

On the flipside, layoffs have been happening in the technology sector. This is not too surprising as there was a huge demand during COVID for new programs (e.g., virtual calling) and upgraded hardware. Now the demand has declined. Construction, which is a better indicator, is starting to slow projects and laying off, which can be a leading indicator of recession.

There was euphoria in January as China finally gave up on its zero-COVID policy. Observers believed that the sudden about-face would create more products to be made, and more to be bought, thus improving everyone's economy. Regrettably, this did not happen. It is clear that China will support a base level but does not want to stimulate the country to the dramatic levels of building and financial speculation it had in the past. China, like other countries (such as the U.S.) wants to be more insular. It wants/needs the West to support its economy but also wants Russia on board, so they are playing a game of neutrality and distraction, particularly as the Chinese try to tighten their hold on Taiwan.

Then later in March came the mini-banking crisis. With rising rates, bond prices fall which is where many banks had been stashing their reserve funds. Banks make a profit between what they pay depositors and what they get from those they lent out that money. They are supposed to be stress-tested by the Federal Reserve bank (FED) and maintain a reserve of funds to offset any potential imbalance. This balancing act is not a new invention – it has always been the way banks make money. The Fed did not do their job with the result of a crisis of confidence. The most red-flag result was the run-on cash at the Silicon Valley Bank. To be able to pay the cash demanded, they sold bonds at a loss.

The government had to step in and guarantee all deposits. The contagion spread to Europe, causing the Swiss to force a shotgun wedding on Credit Suisse, which had been having difficulties long before the financial crisis of 2008. This storm has passed for now, but there are still concerns of more failures to come. The result is that the U.S. Fed is walking a tight rope; raise rates too much and more banks fail. Don't raise rates enough and inflation continues to rise. Either action could still create a recession.

With regards to Canadian banks, nothing is too large to fail, but concern for Canadian banks is overdone. They paused dividend increases in the financial crisis of 2008 and again in 2020 at the request of regulators. In both time periods there was never a concern that they would fail.

- The banks are very regulated to the reserves; reserves here have always been higher than in other countries.
- They are stress tested regularly.
- Large and diversified.
- Deposits in each account are covered by a $100,000 deposit protection fund – (this looks like a solid number, but it has been held at this level far too long and needs reviewing).
- They are conservative in their lending and management.

Looking Forward

I have stated many times, forecasts are really a guessing game and are only valid at the moment they are made. We can take some facts and make some assumptions.

- The Ukraine war will continue for some time. The result will be continued shortages, particularly of food and gas in poor countries. When the war is over there will need to be a massive effort to rebuild homes and infrastructure.
- China will continue to play political games, seeking a way to take over Taiwan. Increasing influence in countries, such as in Africa, to create markets for their products,
- Interest rates in the U.S., Europe, and some other countries may make one or two more hikes, hopefully in smaller increments. In Canada, we might have another rate hike, but appear to be closer to a holding pattern. The biggest concern is that the central banks tend to look backwards vs. forwards and thus overdo the rate hikes, creating a severe vs. minor recession.
- Inflation does appear to be in a downward-trend, but if unemployment remains low and wages rise, it could be a difficult job to manage inflation and get it down to an acceptable level.
- Recession, hopefully a small one, is generally not expected until early 2024. If there is a recession, the Fed banks will start to lower rates.

For myself and in my work for you, my primary focus is on the long term, not the specific events that make news and (seem to) drive change, because we do not know when these will come. Thus, I will continue to diversify in the economic sectors: financial, utilities, manufacturing, consumer, and resources.

Housekeeping

At this time of year, when you are getting your taxes done, you should make some of this frustrating work benefit you, not just the CRA. When you have all your tax information out or when you get your tax assessment and review your finances, take a moment to send me your income tax return. Often accountants make a two-year comparison that would be perfect for the purpose of your personal review, as would your tax assessment (it has RRSP information on it). You can also ask your accountant to forward the return to me. We can then set up a phone or virtual call to review your situation and consider your future needs and goals. I am always happy to have your accountant join in this discussion.

Spam and Hoaxes – Various forms of fraud are unquestionably on the rise, for corporations, institutions and individuals. *It can happen to you*, so please be careful about giving out your personal information. I have had texts advising that CRA wants to deposit my refund, an email ostensibly from Shoppers' Drugmart saying I have won a blender – but when you look at the email address, it is from heaven-knows-where. Phone calls saying the sender wants to refund a credit card payment – so I need to provide them with my credit card number!!! The list goes on – some ploys are crude and obvious; some are slick indeed – they are very sophisticated at times. One group/gang even hacked into an accountant's email and used their email account to approach me. If you are not comfortable with something, contact the person/company directly to determine if the message is from them. Ask yourself, "No one has ever offered me a blender before – why would anyone think I want one now?" and keep your guard up.

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