RESEARCH CAPITAL CORPORATION

Quarterly Newsletter July 2024

Welcome to summer and its long, sunny, warm (maybe too warm), days. It's a time for holidays and time to rest and rejuvenate. I do hope your summer is going as planned and that you are in good health and looking forward to a well-earned vacation/staycation.

For me, our sailing racing days are finished, as we lost our crew during Covid. The sailboat was getting to be a lot of work with little sailing, due to persistent lack of wind. We figured if we were going to motor, we might as well motor on a comfortable powerboat. We sold Towser and purchased a Great Lakes trawler. The plan for the year was to get the helm stations and various other things repaired/rebuilt over the winter, then spend the summer learning how to use the boat. She is still at the marina undergoing more work and it may be that we won't get her back this summer. Thus, our summer plans are on hold.

Like our summer plans, the stock markets have been on rather a rollercoaster. The second quarter ending June 30, 2024, The Dow Jones and the S&P/TSX both bounced up and down during the quarter, closing virtually unchanged.

The S&P 500 index which is dominated by the Magnificent Seven hot stocks (Alphabet, Amazon, Apple, Meta-Platforms, Microsoft, Nvidia and Tesla) closed at all-time highs.

The worries in Ukraine and Gaza continue with no sign of cessation of hostility.

China continues its passive-aggressive stance, holding meetings with Russia and other countries that are causing great concern to the western hemisphere.

With the U.S. election in November, Mr. Biden is stumbling badly, and Mr. Trump appears to have the U.S. Supreme Court in his pocket.

Inflation does appear to be coming down in a two-step down-one-step-up pattern. The EU and Canada thought the trend was heading towards the targeted 2% and lowered their respective bank rates by 0.25%. The U.S. was not so sure about lower inflation as data was providing mixed messages, consumer spending was still strong and unemployment numbers not rising. The result is that the U.S. is on hold regarding rates and the betting continues as to: will they /do something/this month/next month/or maybe in September??

The consumer and corporations are losing confidence not only in the economy but also with their politicians and are thus reluctant to spend. As stated, because of lack of political and economic improvement, companies are retrenching. They are reluctant to spend dollars to improve productivity because it is expensive (rates are too high) and consumer is starting to reduce purchases (rates are too high). The result, the stock market's performance was neutral. The pressure has been mainly on the interest-sensitive dividend stocks.

Added to the depression of continuing high interest rates on equities some of our key holdings have had additional issues such as Toronto Dominion Bank (TD) due to U.S. allegations of lax anti-money laundering actions. BCE dropped due to concerns of elevated debt levels and a dividend payout ratio now over 100%. These issues have put further concerns on securities.

Hot stocks/themes: We see this in RRSP season every year. I notice the theme as each mutual fund promotes the same "new" idea about where to invest your RRSP contributions. Cannabis was the theme one year. It was going to make everyone a millionaire. You had to own some of the stocks in that sector preferably through a packaged product such as an ETF (Exchange traded fund) or a mutual fund. Cannabis, as with other hot themes, is a dying sector.

There was Nortel, a company that was going for the sky until it went bankrupt. Not to mention the Reddit social media frenzy - you could not lose if you bought GameStop or AMC, right? The dotcom bubble in 2000, to name a few instances. Today it is artificial Intelligence (AI) or generative artificial intelligence (GAI), a technology that will help automate, innovate, and optimize company processes and outcomes. Chatbot can write letters or reports for you (I did not use Chatbot to write this letter).

The Magnificent Seven stocks are flying high and there does not appear to be any limit. So put them all in reality-proof ovenware and bake until one of them blows up. It is these stocks alone that pushed the S&P 500 to an all-time high. It is one or all of these stocks that will create the pin to prick the bubble. There is also concern when respectable analytical groups such as Bank Credit Analyst issue reports questioning the degree of productivity improvements that AI can really make. Generating AI is expensive as it involves massive amounts of electricity, which is not always sustainably developed. Governments are becoming increasingly concerned about privacy, copyright, and other issues and are implementing laws to regulate AI, which may be its downfall.

This year Apple was foundering and not creating anything new or making their products more amazing. They gave up on a self-driving car and announced that they were getting into AI. On an anecdotal basis – when my corporate finance department says that the only way they can get a deal done these days is to add AI to the name of the company, I take that as an indicator that the balloon could blow at any time.

On a research basis, when Bank Credit Analyst and other respected research groups come out with reports cautioning that the stated economic benefit of AI to the world is far less than estimated, I think that is an indicator that the pin is getting closer. Thus, I do not believe in chasing after hot ideas or stocks. My objective is to build a portfolio that will hold value, grow and provide an income – not to speculate. I want all of us to be able to sleep at night. Having said all that, AI technology will change much in our daily interactions. You see it now in the targeted ads and spelling prompts on your computer. When calling a helpline, you get a computer vs. a person. Because of this, there should be some representation in your portfolio but in a way that hedges or adds value. This is achieved by using ETFs which represent an index such as the Dow or the S&P 500. ETFs provide diversification that will allow hot stocks to pull them up but a broad base cushion to prevent a total collapse. Due to tax issues, these products are generally better in registered non-taxable accounts.

You also have representation of AI in certain companies across the theme's value chain such as banks, insurance, utilities, healthcare, and retail. These sectors all purchase or develop AI programs to help manage/promote their business. Utilities, for example, benefit from AI because its development requires massive amounts of electricity (as do electric vehicles). Also, utilities use AI to manage their processes, such as deciding when more electricity needs to be generated, or what will be the source process: i.e., gas or nuclear or hydro (Toronto uses all three at various times).

Capital gains: the Canadian federal budget has yet again further complicated our tax returns. Fortunately, on review and after discussion with accountants, it appears on an annual basis, there will be a little effect to our normal investing process of buying and holding for the long term. It is unlikely that you would have a capital gain in any year of over $250,000.

The increase in the capital gains inclusion rate mainly affects those with corporate accounts, such as lawyers, doctors, etc., estates and owners of second properties.
For corporate accounts, there is nothing to be done to relieve the extra taxes on capital gains.

Doing an estate freeze or selling assets before death over the years may be considered but as we never know when we are going to die, why pay CRA sooner than you have to? Additionally, the gains reported as income could push you into the alternative tax level, which would be a further complication and additional funds sent to CRA. Second properties usually mean cottages and family issues. Tim Cestnick an accountant who writes in the Globe & Mail points out some options that can help to reduce the capital gains tax.

Clever planning can make a cottage transfer tax-smart - The Globe and Mail*

Before doing anything that would trigger a taxable event, be sure to have a discussion with your accountant as to all the pros and cons of what your actions will have.

*Cestnick, T. (2024, July 3). Clever planning can make a cottage transfer tax-smart - *The Globe and Mail*

Looking Forward
Interest rates – will they stay steady or go down? As stated, Canada and the EU started to reduce rates in June, but now have signaled that they are on hold waiting for confirmation that their course of action is the right thing. The U.S. is holding steady as they believe that the data they review does not confirm that inflation is trending down. Each month the markets and federal banks hold their breath as inflation and unemployment numbers are reported. Any time a federal banker makes a comment, each word is analyzed. The current betting is September, but this story has been going on since early 2023, so who knows? As we move closer to November and the U.S. election, a rate reset is more unlikely because it would be viewed as a political move.

Italy, France, England, Iran, all have had elections with the incumbents supplanted by a new group. We are now in a wait-and-see pattern as these new politicians establish their agenda and hopefully it will be one that will bring stability politically and economically to the world.

A recession is waiting on the sidelines to make an entrance. A soft landing is hoped for, but unfortunately the federal banks are known to wait too long to take action. The data they look at is yesterday's news. If there is a recession rates will come down. Unfortunately, it takes many months of being in a recession before the federal banks will admit to it and start to act.

Thus, in summary we continue with a neutral situation. I will continue to monitor your portfolio, rebalancing individual securities and sectors as need be. Continue to diversify amongst the five main sectors and geographically. I remind you that many Canadian companies do business in the U.S. and globally, so while it may appear that you are only invested in Canadian stocks, you do get geographic diversification. As always, the focus on your investment portfolio is to build it to achieve your future financial goals and needs.

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