RESEARCH CAPITAL CORPORATION

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We hope that you are well and enjoying the summer!

There are indications that the current interest rate cycle is close to its peak. It is likely that we see at least one more rate hike over the next quarter, however, bond and equity markets are pricing in that we are closer to the end of the rate cycle than the beginning.

In the U.S., the June CPI came in at 3% for June down from 4% in May and a post COVID peak of 9.1%. In Canada, the latest CPI number from June came in at 2.8%, down from 3.4% in May and 4.4% in April and well below the 8.1% read in June 2022. Although these numbers are encouraging, inflation remains stubborn, and the Central Banks are committed to reaching the target rate of 2%. This means that the hawkish tone will likely continue, and rate hikes remain on the table.

The unemployment rate remains at record low levels and the U.S. Federal Reserve, and the Bank of Canada would like to see a more balanced jobs market. It will either take a continued softening of inflation and/or slowing economic conditions to push central banks to begin lowering rates. The likelihood of rate cuts is very low for now and the markets appear to have priced this in. Although we should get used to higher rates for the foreseeable future, it is important to note that rates in the 5% range are historically reasonable.

China's economy appears to have stalled with producer prices down 5.4% year over year and their CPI at 0.00% compared to 0.2% annualized in May. It should be noted that prices for consumer products manufactured in China should fall, impacting CPI rates going forward. Even Europe, impacted by the Ukraine war, had inflation drop to 5.5% from peak

10.6% levels. This downward trend should continue and should take pressure off global central banks over the next few quarters.

Markets are currently being driven by a very narrow group of companies “The Magnificent Seven” (Microsoft, Apple, NVIDIA, Meta, Amazon, Alphabet, Tesla). Together, these companies comprise 55% of the Nasdaq index and without these companies the S&P 500, instead of being up over 14% in the first 6 months of the year, would have been down over 1%.

Four of the seven companies pay no dividend. Of the remainder, the highest dividend yield is paid by Microsoft at only 0.8%. Investors requiring a steady flow of income typically gravitate to quality high dividend paying equities. We have recently begun to see a broadening out of the rally away from technology into other sectors.

Financials are beginning to strengthen, oil is stabilizing, industrials are improving and housing and consumer-based equities look to be turning the corner. If equity markets are to build momentum, this trend needs to continue.

We believe that investor avoidance of high-quality dividend paying equities is near an end and in many cases was over-done. Many dividend paying equities have been oversold and there could be an upward trend in valuation as investors become more confident that we are at or near peak interest rates. Investors are now focusing on quality and stability.

The technology companies that led the rally in the first and second quarters are good examples of this, as they have solid balance sheets and strong cash flow. Because they are focused on growth, they don’t provide much income. Investors requiring cash flow have tended to hold cash at elevated short-term interest rates and used these equities for growth. This trend will likely change as rates peak.

Investors seeking income and growth should move away from elevated cash positions and will likely search for high quality dividend paying equities. With earnings around the corner, we look to strengthening balance sheets and solid cash flow to draw funds from the side-lines. What we have seen thus far has been encouraging. We could see a correction as we move into the seasonally weak period going into the fall, however if earnings momentum builds buyers will likely step in as we look forward to 2024.

It is important to look at the longer-term picture, especially when recovering from a shock to the global financial system like COVID. In hindsight the recovery and the path towards "normalcy" has seemed sporadic and has caused investors to become extremely cautious. Looking forward to the emerging trends of normalizing interest rates, lowering inflation, better consumer confidence, increasing corporate cash flow and stabilizing bond and equity markets should draw people back to more traditional investing patterns.

As always if you have any questions or just want to touch base, we are just a phone call or e-mail away.

Sincerely,

The Andras Group

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