

QUARTERLY COMMENTARY



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Sweet Summer

Just when I thought that the Magnificent Seven high tech stocks couldn't possibly go much higher, their incredible move reignited, and they shot up even more in the second quarter. Their earnings were very, very strong and corporate earnings ultimately are the harbinger of how a company's shares perform. As the year progresses, the question will be whether earnings can continue to grow to help justify expanding market valuations. As I've discussed, high valuations and positioning will set the stage for an eventual rotation to new leadership. Softer CPI (inflation) readings for three months now are finally starting to help stocks outside the "Mag 7". Indeed, there is evidence that rotation is just now starting to appear away from Growth, Large, and Mega Cap stocks to Value, Small Cap, and everything else. We've had several false starts in the last six months and the fundamentals need to cooperate but there is definitely greater confidence around Fed interest rate cuts coming soon (the Bank of Canada finally made its long-awaited interest rate cut in June, as did the European Central Bank) and that clearly helps to make the case for adding exposure to Value and Small Cap companies.

Even before the attempted assassination of Donald Trump last Saturday he had a widening lead in key battleground states, with the prospect of a unified Republican convention. Now his polls are likely to surge, boosted by what was a rapturous convention with unprecedented unity. It's always possible that Trump could stumble this fall, or that Democrats pick a new,

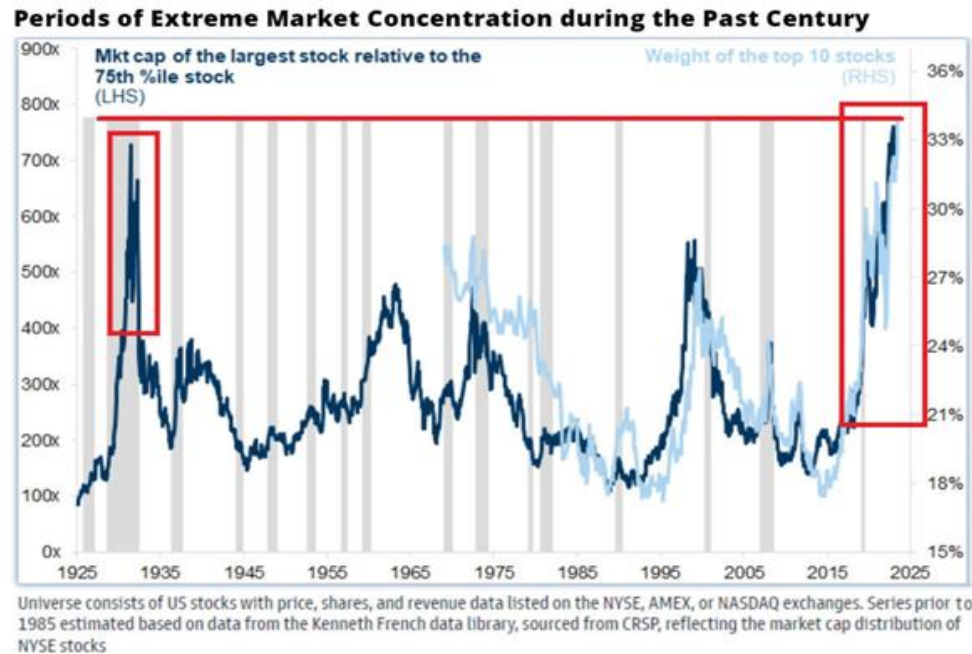
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younger running mate but analysts believe this violent incident will boost Trump's chances in the November election. If that's the case it would be positive for the equity markets because of the potential for less government regulation and lower taxes. That's why we're seeing the US market continue to rally essentially pricing in a Republican win. Equity markets love a stimulative outlook, although more tax cuts and persistently high deficits could spook the bond market (meaning there's potential for interest rates in the US to reverse course in the next year or two). And the likelihood of higher trade tariffs could worry investors if China and other countries retaliate.

As for Trump, his clenched fist and tough guy posture after getting shot is an iconic image that will be remembered for a very long time, just as Teddy Roosevelt (in Milwaukee) and Ronald Reagan defiantly recovered from their wounds. This is Trump's month — as Biden's poor debate performance and Trump's survival strengthens the prospect of a Republican win.

In Canada, the Real Estate sector and Utilities are starting to turnaround — they are interest rate sensitive sectors and since June inflation dropped to 2.7% in Canada the probability for further cuts is strong. REITs have essentially been in a bear market for two or more years and the prospect of lower interest rates has strengthened investor interest. Our base case economic scenario for Canada in 2024 (lower inflation, lower rates, mild recession/economic weakness) has moved Real Estate up to be one of our most preferred sectors this year. Even though it's up around 6% so far, the valuations are still very depressed compared to the pre-pandemic highs. There isn't much debt refinancing this year, they have lower financial leverage than in the past and there is a disconnect between private real estate valuations and publicly traded ones. Canadian REITs are trading at a 25% average discount, well below the historical average of -8%. That being said, even though I'm noticing more and more cars in commuter parking lots these days I don't think the office REIT sub sector will recover for a very long time and shopping center REITs are not on my buy list either.

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US stock market return and index weights have rarely been so concentrated. Nvidia alone drove ~1/3 of the S&P 500's return year to date (YTD) and 44% in Q2. At one point in the quarter, its market capitalization swelled by over \$1 trillion within 30 days. This is more than Berkshire Hathaway's entire market cap, which took Warren Buffet nearly 60 years to build. Seven other mega cap stocks accounted for another ~40% of the S&P's YTD return; and in Q2, seven high price-to-earnings (P/E) AI-related stocks (including Nvidia) drove the entire return of the S&P 500 while the remaining companies in the index cumulatively detracted 1%. Data going back to 1974 shows that a record low percentage of stocks are now beating the S&P 500. It's concerning that up until now a broadening out of the market hasn't occurred in earnest. As I said I do detect a

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rotation starting to take place but we really need to see a continuation of that to make me feel that a real trend has been established. It's tough to justify investing more in the mega cap tech stocks that have had such a big run.

As always if you have any questions or are interested in a particular investment or you would like a comprehensive review of your financial situation please don't hesitate to call. In the meantime, enjoy the summer!

Regards,



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