RESEARCH CAPITAL CORPORATION

John Bru

August 28, 2023

What Happens Now?

Summer is winding down and the cooler evenings of Fall are becoming more frequent. Inflation…recession…Chinese economic slowdown…Russian/Ukraine war…new COVID strain, etc., etc., etc. It always seems like there is something persistently impacting the world that is negative and can harm investors. I have news for you; there is ALWAYS something impacting global markets and the markets historically have climbed a wall of worry.

What is different now? I will tell you. Keep in mind that in this letter it is my opinion based upon what I have observed and learned over the last 40 years of my life. It is simply my opinion.

Inflation: It is the shortest period of time in the last 40 years where North American governments have raised interest rates to slow an over-heated economy. Inflation is like high blood pressure; it's a quiet killer that builds up until a critical point is hit. When rates rise it takes more of your cash to service debt, the items you are used to buying become more costly and therefore less free cash flow to stimulate the economy because people have less money to spend.

As mortgages are renewed, the new rate will be substantially higher than the last time, meaning more money in that household is going to cover the higher cost. Many families have made the decision to buy now and pay later, using their line of credit to do so. Interest rates are the penalty you pay for purchasing something today instead of postponing consumption until tomorrow. It is also the reward you receive for saving and engaging in delayed gratification.

The problem that arises, is that many households that carry high credit debt are finding out that they may not qualify for the best rates because of high debt. The result can be a big shake up when people cannot get financing for such high debt. Banks are not willing to take on this risk and many people are being forced to sell their homes due to inability to satisfy the lenders.

Rising Interest Rates: Nobody knows how high they may go, how long they will stay there or even when they might go down because everything related to inflation is a moving target and it becomes a guessing game at best as to what will happen with interest rates. My opinion on interest rates is that they will go as high as they need to and stay high for as long as is needed to cool inflation and will not stop or come down until they are ready to. In other words, who knows?

Impact of Inflation and Higher Interest Rates: Because higher interest rates mean higher borrowing costs, people will eventually start spending less. The demand for goods and services will then drop, which will cause inflation to fall. When the interest rate is high, it becomes more expensive for people to borrow money. It can slow down the economy because people have less money to spend.

What do we do?

We remain cautious. We dispose of higher risk securities that rely on growth and funding to thrive, which we did last year, and we focus on sectors of the economy that tend to do well in inflationary times. High Interest Savings Accounts (HISAs) are where we can get anywhere from 4.75% to 5.2% depending on the product. If the risk-free rate of investing has moved up to a 5% rate of return, more people will ease away from stocks and increase their exposure to fixed income.

What contributes to stock market declines?

- **People selling stocks to buy fixed income investments:** More sellers than buyers will eventually take stock prices lower.

- **Over Valuations:** When the value of stocks are very high it is because of belief that the company will make substantially more in the future than it is earning now. When earnings estimates miss, overvalued companies can plunge and drop fast.

One company in the news is the microchip manufacturer **Nvidia**. It hit an all-time high of $502.66 a share on August 24th. At this price, you are paying for the future earnings of the company for the next 121 years!! Everyone loves to see their company invested in rise, but only a fool does not, at the very least, sell some of this stock when it has become so highly priced. Many companies in this situation risk sudden declines by profit taking or adverse conditions that appear in the future, and sudden and massive selloffs may occur.

Here Is What We Do

We move our money into low-risk fixed income investments and be content with returns of 4.75- 5.2% depending on what it is we buy. We select fixed income investments that do not lock us in, so that when we see good valuations of companies we wish to own for the longer term, we will not be restricted by having our money locked in for set time periods.

No one knows how long rates will go up, how high they will go up nor how long they will stay up. We do know that if our interest rates continue to rise, we can capture the higher rate with the fixed income high interest savings accounts that I have selected. Then, if inflation persists and does not abate, we will still be able to make a return on our cash and will be ready to buy the companies we want when the prices move down to better valuations.

I will be away until the 15th of September. While I am away if you require anything administrative to your account, please send an email to my assistant Brian at Bdonegan@researchcapital.com.

Sincerely,

Sincerely,

John S. Bruce, CIM®
Investment Advisor | **Private Client Division**

Direct Line - 613-491-3344
Toll Free - 866-860-4190
Fax - 416-860-7671
Email - jbruce@researchcapital.com

http://www.creatingwealth.ca
http://www.researchcapital.com

Brian Donegan
Assistant Branch Supervisor
Research Capital Corporation
4500-199 Bay Street
Commerce Court West,Box 368
Toronto,Ontario M5L 1G2
T 416 860-7787
TF 1-844-860-7787
BDonegan@researchcapital.com
www.researchcapital.com

RESEARCH CAPITAL
CORPORATION

** https://www.macrotrends.net/2622/dow-jones-by-year-historical-annual-returns