



Wealth Management
Dominion Securities

Cooper Wealth Management of
RBC Dominion Securities



Thoughts on the market

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Picks and Shovels



“When everyone is looking for gold, it’s a good time to be in the picks and shovels business.”

- *Mark Twain*

The current gold rush in the investing world is the battle to win the artificial intelligence race. The pot of gold for the eventual winner(s) is beyond calculation. While we continue to own some of the industry leaders such as Microsoft and Amazon, we are starting to be a bit concerned about valuations. At this point, we are looking more at companies that are essential to the build out of AI data centers, the essential picks and shovels, which trade at much lower price/earnings multiples, but will still participate in the growth of the sector. We will also examine the key drivers of the economy to see where there is value to be had. This month, we will review the geography of the AI and economic landscapes and explore where future pitfalls and veins of profit may be.

Our perspective is that AI still has multiple years of development to go, with the chipmaker Nvidia leading the way. For those of you that own it, we have no plans to sell, other than to trim overweight positions. However, we have some concern that many new startups have borrowed tens of billions and secured loans within Nvidia chips. Unless these companies are very well-funded or achieve profitability quickly, Nvidia could be facing losses down the road. The other concern is how quickly chips become obsolete. This is great news for Nvidia as each generation of chips brings new sales opportunities, but it could be bad news for the startup companies as they could get left technologically behind, with Nvidia then having to write off the debt. The big players in AI like Microsoft, Meta and Google can afford to make these huge investments from their free cash flow, but we will keep our eyes open for spending cuts or defaults to see if cracks are appearing in the AI story.

When it comes to chipmakers, Nvidia and Advanced Micro Devices have been the main investment vehicles in this rally. Two companies that are actually making the chips are Taiwan Semiconductor and Broadcom. Taiwan tends to trade at a discount compared to its competitors, as China is viewed as a threat. Broadcom has the advantage of being American based and we will be looking for opportunities to add Broadcom to the portfolio, as it has a wider product line and customer base, featuring a long-term partnership with Google that has developed a chip to rival Nvidia.

Another interesting way to play the AI battle is through power utilities. All the new and proposed data centres use an extreme amount of power. In the US, we have Duke Energy and in Canada, we have Fortis in the portfolio. Utilities also add an element of safety as they tend to pay higher dividends. We expect heavy spending in the sector for some years to come, but it's likely that this new capacity will have a higher profit margin as a technology heavyweights will have to pay a premium price if they want to move up in the data centre power queue.

Another key element of the future of AI development, and the economy as a whole, is banking. The financials in both Canada and the US have outperformed the S&P 500 as well as the US technology sector this year without anyone paying a lot of attention. The Banks had a fantastic year of deal making, particularly putting AI data centre deals together. Earlier this year, Morgan Stanley famously held a technology conference and invited all their investment banking competitors to attend because they had more business than they could handle. It was an unprecedented move, but the industry demand has remained exceptionally strong. It is interesting to note that loan growth and mortgage demand have been noticeably slowing, which would normally be the first sign of a slowing economy, but the investment banking and wealth management segments have been strong.

A core element of investment return is dividend income. Our primary focus for income has been Canadian equity, such as financials, oil, and gas and pipeline stocks. For portfolios requiring a higher level of income, we have selectively introduced covered call exchange traded funds for higher monthly income and smoother cash flows.

A core sector of the economy is industrial stocks. We look for market leaders who not only make products but provide additional services as well, as it is often through either financing deals or service contracts where the real profit margins are made. Paccar is the leader in premium semi truck manufacturing, but they also provide ongoing parts supply and financing. AtkinsRealis builds and services nuclear reactors, along with other major infrastructure builds. GE Vernova builds and services gas turbine generators. Build more, service more, earn more, rinse repeat. From banking, technology, and across multiple business sectors, this motto remains the simple truth, but there is a trick to it. To command a strong profit margin, your company offering has to be unique, or at the very least, significantly different from your competitors. Many major manufacturers who do not have something distinctive have seen profit margins narrow as generic brands have gained wider acceptance. Companies like Kraft Heinz, Campbell's Soup and Proctor and Gamble have all seen their share price stagnate over the last few years. Consider Proctor and Gamble for example. They have 37 dominant market brands that are over \$1 billion in sales each. Sounds ideal, but there is fierce price

pressure in many of their product categories so profit margins are tight. Also, new products often make almost no impact as they would have to sell over \$1 billion in the first year to add even one percent to net sales.

With hundreds of billions being spent on AI, there is one leading tech company that is seemingly being left behind and that is Apple. Our logic is simple: whichever AI model(s) rise to prominence, it will have to be used by the majority. In the great VHS versus Beta debate, it didn't matter that Beta was considered the superior technology, VHS won the marketing race. There are over 1.5 billion active iPhone users worldwide, so Apple will have a significant voice in the future adoption of AI but doesn't need to spend hundreds of billions to get there. Meta, which owns Facebook and has over 3 billion monthly active users, will also be a key player, but they have been busy with their own version of AI. Honourable mention to Google here, but if they are not first to market, their search engine business could get crushed by competitors. Another major tech sector that will benefit will be data storage. All the newly AI created content will have to live somewhere and we believe Microsoft and Amazon will be the winners here.

The overall market environment is being helped by relatively stable inflation and better than expected new jobs being created, particularly in Canada. The Fed cut interest rates by 25 basis points while the Bank of Canada held steady. The President is expected to soon announce the next Fed chairman, and it seems likely that whoever gets appointed will be looking to lower US interest rates in accordance with the views of the White House. Lower interest rates would be a stimulus for the market and would lead to higher stock prices. In January, we are expecting fourth-quarter US corporate earnings which will help guide share prices for 2026.

The market will be closely monitoring the technology sector for any sign of slowing sales and/or diminishing profits. If there is still gold in the technology hills, we expect higher share prices. If the rush appears over, and technology profits begin to suffer, the more defensive pick and shovel stocks will benefit as investors seek lower levels of volatility and higher income. Until next time stay well and all the best of the season and Happy New Year to you and your families.

As always, questions, concerns, comments, and feedback are always welcome.

Yours truly,

Walter, Trevor, Charles, and the Cooper Wealth Management team

PS. In lieu of individual client gifts, Cooper Wealth Management has made an equivalent donation to HOSPICE NIAGARA. We thank you all for your continued trust. Merry Christmas!



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