

The Weekly Beacon

We will be giving some macro economic market updates on a weekly basis. No equity recommendations will be given in this commentary, and we encourage you to contact us if you have questions regarding any observations.

*The two main purposes of a Lighthouse are **to serve as a navigational aid and to warn ships (Investors) of dangerous areas.** It is like a traffic sign on the sea.*



North Sand Bluff Lighthouse, Salmon Bay, Port Edward, 4295, South Africa



Fort Niagara Lighthouse

Feel free to send us your photos of Lighthouses to be featured in our weekly market observations.



Forget Tech, Look at Retail

We have mentioned in issues of *The Weekly Beacon* throughout 2022 why technology stocks have been hit the hardest. Valuations, rising interest rates, and even a shift from goods to services as we head out of Covid-19. Tech stocks have been smacked down. Whether it is a highly speculative fund like ARKK, a mega-cap company like Facebook, a Chinese tech company like Tencent, or a North American Internet ETF, everything is down and down pretty big.

Market Summary > Tencent Holdings Ltd

391.40 HKD

-62.40 (-13.75%) ↓ year to date

Jun 8, 16:08 GMT+8 • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



Market Summary > ARK Innovation ETF

46.55 USD

-50.44 (-52.01%) ↓ year to date

Jun 8, 10:33 EDT • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



Market Summary > Meta Platforms Inc

200.55 USD

-137.99 (-40.76%) ↓ year to date

Jun 8, 10:34 EDT • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



Market Summary > SPDR S&P Internet ETF

87.07 USD

-60.56 (-41.02%) ↓ year to date

Jun 8, 09:30 EDT • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max

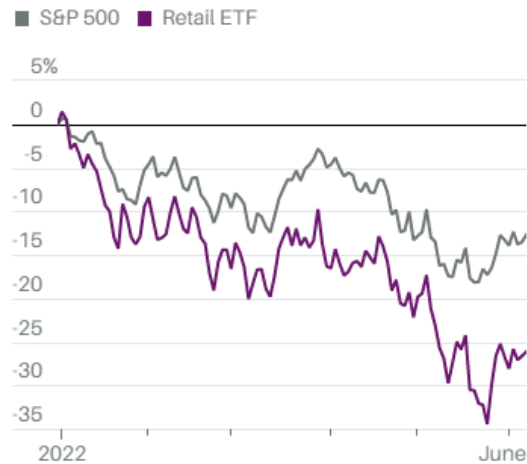


All of the large companies in this sector are down more than the market and many significantly worse. The one sector that has quietly gotten hit almost as hard has been retailers. No, we are not talking about luxury retailers like Gucci or Louis Vuitton, we are talking about Brick and Mortar retailers like Target and Walmart.

A North American Retail ETF is down over 26% year to date while the S&P 500 (which has bounced) is down 12% year to date. Many technology investors in early 2022 may have rotated into these safe recession-proof stocks. Bad news for them, even though they might be recession-proof, they were trading at historic valuations at their peaks.



Retail stocks have suffered deep losses this year.



Note: SPDR S&P Retail exchange-traded fund.
Source: FactSet

We bring this up because Target revised its earnings for the second quarter for the second time this past week. They originally revised their forecast for their second-quarter earnings last month when they reported down numbers for the first quarter. The entire sector has now been caught up in this mess.

Inventory is the main culprit for Target's disappointment. They are having to use steep discounts to clean out ailing inventory, even as their prices are rising due to inflation. In the announcement, they also slashed supplier orders. Target reported last month that its profit for the fiscal first quarter tumbled 52% compared with the same period last year. Sales of big TVs and small kitchen appliances that Americans loaded up on during the pandemic have faded, leaving Target with a bloated inventory that it said must be marked down to sell. The rotation from goods to services/experiences is underway. Corporate management is key even in multi-billion-dollar businesses with proven track records. We are not sure how they did not see this coming. After all bloated inventory is a major reason Peloton went from falling 50% to the verge of collapse.

Market Summary > Target Corporation

157.36 USD

-74.59 (-32.16%) ↓ year to date

Jun 8, 10:53 EDT • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



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Target is not the only name that was brought down by their announcement, Walmart and Costco have gotten hit hard over the last month over the same worries. Costco, however, makes most of its profit from its membership fees and deals with low-margin groceries compared to Target, so the impact should be much less in the short term.

Market Summary > Walmart Inc

122.33 USD

+ Follow

-22.32 (-15.43%) ↑ year to date

Jun 8, 10:54 EDT • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



Market Summary > Costco Wholesale Corporation

472.63 USD

+ Follow

-94.08 (-16.60%) ↑ year to date

Jun 8, 10:54 EDT • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



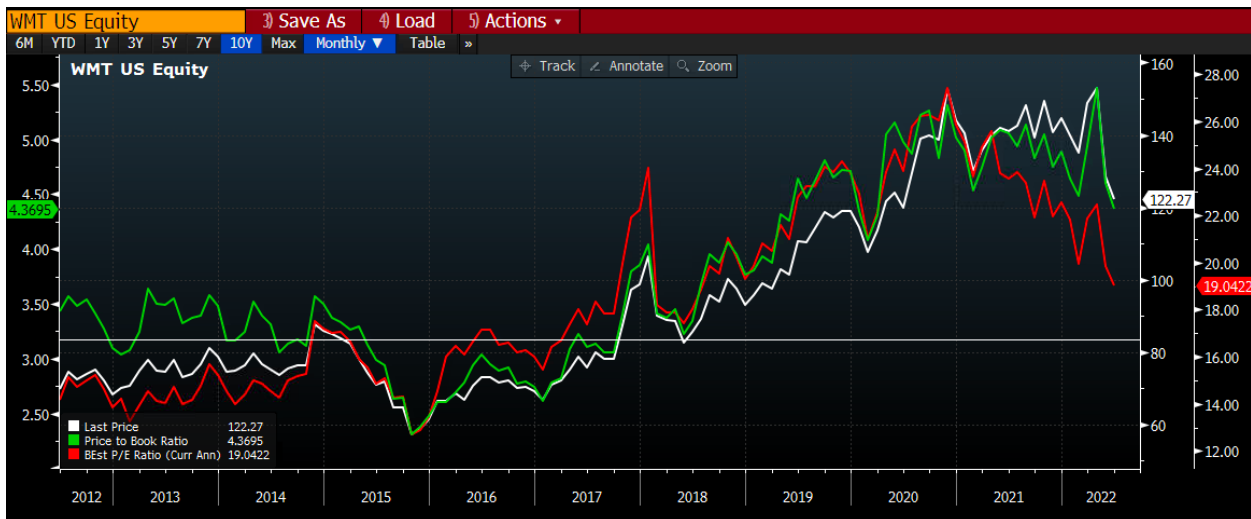
Even specialty retail companies like Lululemon and Macy's have been sold off. However, many analysts point to strong management not making the same mistakes that Target has. Either way, earnings will probably drop for most retailers, especially through the summer.

We mentioned that certain retailers were trading at ridiculous multiples over the last year. What did we mean by that? Well on the charts below you can see what we mean.

Target's price to book ratio has more than doubled over the last 10 years and at its peak earlier this year it was almost 3x higher than 10 years prior. The P/E ratio also remained extremely elevated in most of 2020 and 2021 relative to the previous 5 years. Target was quite the expensive stock at its peak and even without inventory problems was probably due for a pullback to historic averages.



It's a similar story with Walmart over the last 10 years (to a lesser extent). The price to book ratio and P/E ratios both dramatically increased from late 2018 to 2021 and were at historic highs. Over these 10 years, the P/E ratio increased from 14x to 28x at its peak in mid-2020. The one thing that sticks out for Walmart is all three seem highly correlated, which could mean the P/E ratio could have some foreshadowing for Walmart's stock price in the short term.



Finally, Costco where both ratios have increased but have yet to fall off in any significant way. The price to book increased from below 4x to 10.45x right now. The P/E ratio also substantially moved up over the last 10 years.



Why do we bring this up? Even consumer discretionary stocks that are labeled as recession-proof can have massive pullbacks due to historically high valuations.

Sometimes the safest companies are not so safe when you dive into the numbers.

How High and its Only June?

We have often reported of Canada has elevated gas prices relative to the U.S. even though we have more proven oil reserves north of the border. This is due to all those fun taxes we have put in place over the last 5-10 years both provincially and federally. It appears this week in the Vancouver area we reached a new low (or should we say high).

A photo went viral on Twitter from a gas station.



According to the Twitter account, \$2.319 CAD is the highest price across the globe at the moment per liter. Yes, even higher than what some Euros are paying because they have some of the most stubborn and dumb leaders. Europe is in crisis and does not personally own enough oil and gas reserves to solve the problem, in Canada we do, and by a long shot. But our leaders want to be like Europe and use wind and solar energy (the energy that caused their current shortages across the pond). Either way, this policy failure should go in the history books as the dumbest and least surprising thing that happened in modern times. What did they expect would happen when energy demand was expanding, and they decreased capital investment and stunted the entire sector?

Not Just in Oil and Gas

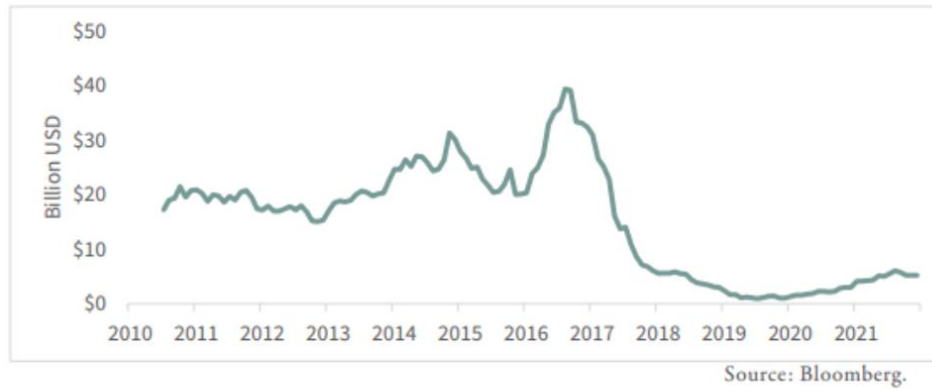
In [our May Webinar we talked about Energy Shortages](#), we found numerous graphics that show the underinvestment in capital expenditures by oil and gas companies causing the current shortages. Companies and countries cannot increase production at the snap of a finger, it takes time and money.

This is not the fault of energy companies; hundreds went bankrupt over the last cycle and many were prevented from expanding due to regulation. Here is a snippet from that presentation:



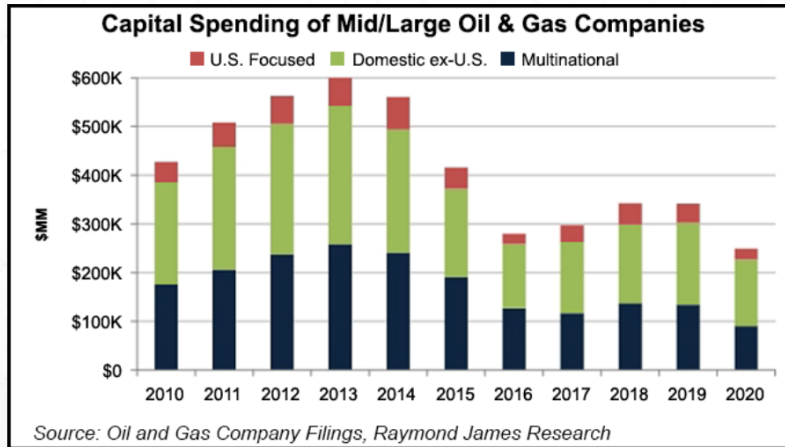
Capital is not available to oil and gas companies as banks steer clear of IPOs and debt raises:

FIGURE 22 E&P IPO and Secondary Fundraising (12 month MVA)



Underinvestment by companies in the sector has also shrunk (Cap ex. In 2019 was almost 1/3 of what it was in 2013):

Underinvestment – Even Before Covid-19



[A copy of the deck and video replay can be found here. \(Click Here\).](#)

This week we bring the capital expenditures by mining companies since 2011:

Exhibit 7: Mining capex has also shrunk, generating large forward deficits in metals



Source: Goldman Sachs Global Investment Research

Mining companies are returning capital to investors and maintaining strong balance sheets rather than taking on debt to increase production. This will cause major deficits in metals over the next decade. Copper, cobalt, lithium, iron, silver, gold, and more will be in high demand especially as we rapidly increase renewable energy and electric vehicle adoption.

If 2020s financial markets (so far) could be described by one word it would be shortages. In the late 2010s capital chased technology companies and high growth companies, yet we forgot about the hard assets that are needed to build everything. Yes, we know oil and gas and copper mining are not the sexiest investments, but they are something we need. We will continue to critique many of the high growth, cash-burning businesses as many of them will go bankrupt and continue focusing on the cycle we are in - real assets.

Historically Bad

This past week, United States Secretary of the Treasury, Janet Yellen finally admitted she was wrong on inflation. More than a year too late! This makes us think: how bad is May's inflation number? Did it hit 10%? By the time you are reading this, the U.S. CPI will have been released and we will know just how bad May was. Perhaps she is stating the obvious before we get to double digits.



'I was wrong': US treasury secretary admits she was wrong about US inflation in 2021

Situation Room

In a one-on-one interview with CNN's Wolf Blitzer, US Treasury Secretary Janet Yellen admits she was wrong about inflation and the path that it would take in the country.

Source: CNN



We are glad she is realizing that inflation is not transitory.

In recent months, oil, gas, and even food prices have surged. Rent has not gotten much cheaper and many other consumer goods remain elevated in price relative to last year. We expect inflation numbers to remain elevated for some time. Natural gas and oil prices look like they will remain high at least until the end of Summer. The supply problem across the global food market will probably not be fixed anytime soon (many impoverished nations are dealing with real shortages; these shortages have caused unrest).

Sri Lanka's economic crisis spiralling into food crisis

News and Press Release • Source: [IFRC](#) • Posted: 8 Jun 2022 • Originally published: 8 Jun 2022

World risks civil unrest amid 'catastrophic' food crisis

Rising prices and dwindling supplies are not expected to resolve before 2024

By Louis Ashworth

1 June 2022 • 8:09pm

It's not just in 3rd world nations. The U.S. is facing a baby formula shortage which could be a preview for real food shortages and Australia is even facing a lettuce shortage at the moment.

We warned of shortages beyond the traditional commodity groups as Ukraine and even Russia play a large part in global agricultural exports. More war, fewer crops. More sanctions, less supply. Less supply, more nationalistic policies (restricting exports, rationing food).

As for our oil and gas issues, any increases in supply have been rejected by international countries and an increase domestically could take some time and investment by companies.



MARKETS | HEARD ON THE STREET

OPEC's Nod to Biden Will Help Saudis, Not Oil Users

Changed OPEC+ agreement has less to do with oil prices than with Saudi Arabia's diplomatic currency with Washington

The best thing the U.S. and Canadian governments can do to decrease the price of gas for consumers is to remove fuel taxes.

MacNicol & Associates Asset Management Inc.

June 10, 2022