

## 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.*



Cape Notoro, Hokkaido, Japan



Paard van Marken, IJsselmeer Lake, Marken, Netherlands

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

## Gridlock Over

After 15 votes the U.S. House of Representatives finally elected a Speaker to succeed Nancy Pelosi. 20 Republicans held Congress hostage for 14 votes spanning 4 days last week as they constantly voted for a new Speaker. Those lawmakers had demanded, and the Republican party seemingly granted them their wishes going forward. We do not care about the politicization of this process or who was holding this up, we just want to mention that this is VERY on-brand for DC.

We also wanted to mention that the next 2 years will more than likely be uneventful in Washington which could be a good thing for financial markets. It is easier to predict gridlock than a one-party rule. For now, it looks like Speaker Kevin McCarthy will be the man to slow down President Biden's agenda. Hopefully, this will slow government spending down.



The only Bill that has passed at this time in the House was Republicans reversing a Joe Biden-backed policy that hired 87,000 new IRS agents. We commented on this months ago when it first happened. We were puzzled then and puzzled now with what 87,000 NEW tax agents (armed with guns no less) would be doing but perhaps this summarizes "wasteful government spending" better than ever.



**NEWS**

# House passes bill nixing \$72 billion in funding for 87,000 new IRS agents

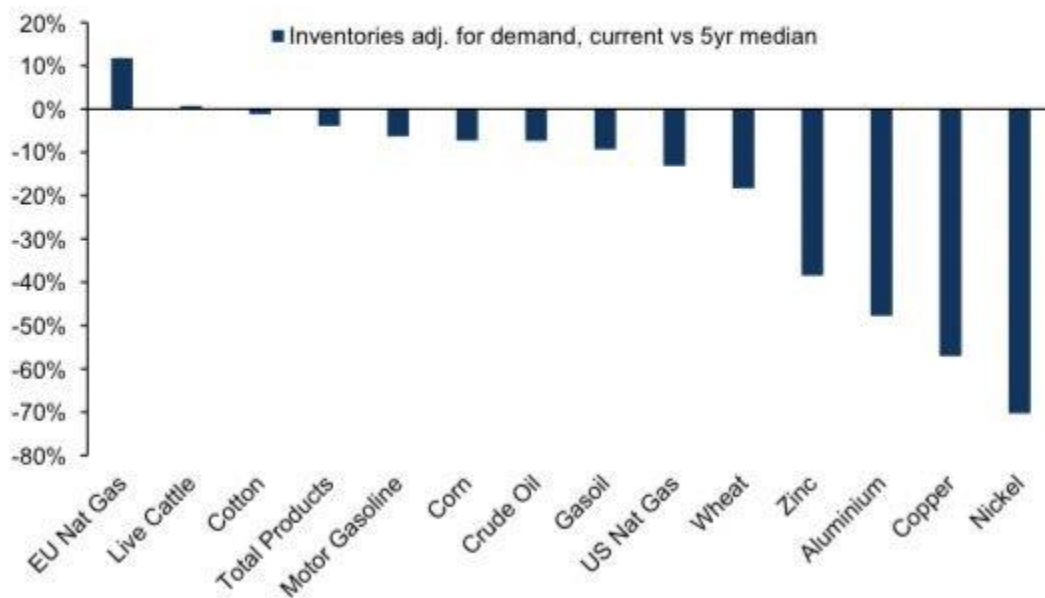
By [Victor Nava](#)

January 9, 2023 | 10:55pm | Updated

## Commodity Inventories

For the last year and a half, we have mentioned the energy play, one of our favorites in public financial markets. Structural supply issues, increasing regulation, and the dependence on non-reliable renewable sources of energy will lead to a surge in fossil fuel prices eventually leading to a surge in demand for clean, and reliable nuclear energy. We still believe that. This week we are here to show you that supply shortage is not just in energy commodities it's across the board.

### **Exhibit 12: Inventories in almost all markets are significantly below the 5-year median and at risk of depletion**



Source: Bloomberg, USDA, EIA, Wind, Goldman Sachs Global Investment Research

Metals, agricultural goods, and even cotton inventories are well below their 5-year median level. How did this happen? A combination of underinvestment, overregulation by governments, and environmentalists who promote new failed/flawed technology, and ESG guidelines.

We have described the market imbalances (in terms of supply and demand) in fossil fuels, agricultural commodities, and EV metals. We believe those imbalances will continue moving forward but, in this week's issue, we wanted to highlight steel. We think it is entirely possible that in 2023 there could be supply disruptions to the steel market.



The steel market is often forgotten. It is not a new age sexy metal that is in heavy demand, and it does not fuel our cars, or houses yet it is quintessential to society. When Russia invaded Ukraine, Western nations sanctioned the living crap out of Russian goods. This included companies pulling out of Russia and western nations decreasing their reliance on Russia for energy. Some European nations have even said they are placing a price cap on Russian oil and gas (this will accomplish nothing). Regardless of what you think of these sanctions, it has led to higher oil and gas prices for parts of the last year. As the conflict continues to heat up with no resolution in sight, we think this conflict could, unfortunately, escalate leading to similar sanctions on other Russian products. We think steel could be one of those exports that are targeted by Western sanctions.

Russia is the world's 5th largest producer of steel.

Rank (2021) ↕	Country/Region ↕	2021 <sup>[9]</sup> ↕
—	World	1,951.9
1	 China	1,032.8
—	 European Union <sup>[19]</sup>	152.5
2	 India	118.2
3	 Japan	96.3
4	 United States	85.8
5	 Russia	75.6

And the world's 5<sup>th</sup> largest exporter of the product according to The Observatory of Economic Complexity.

## EXPORTS

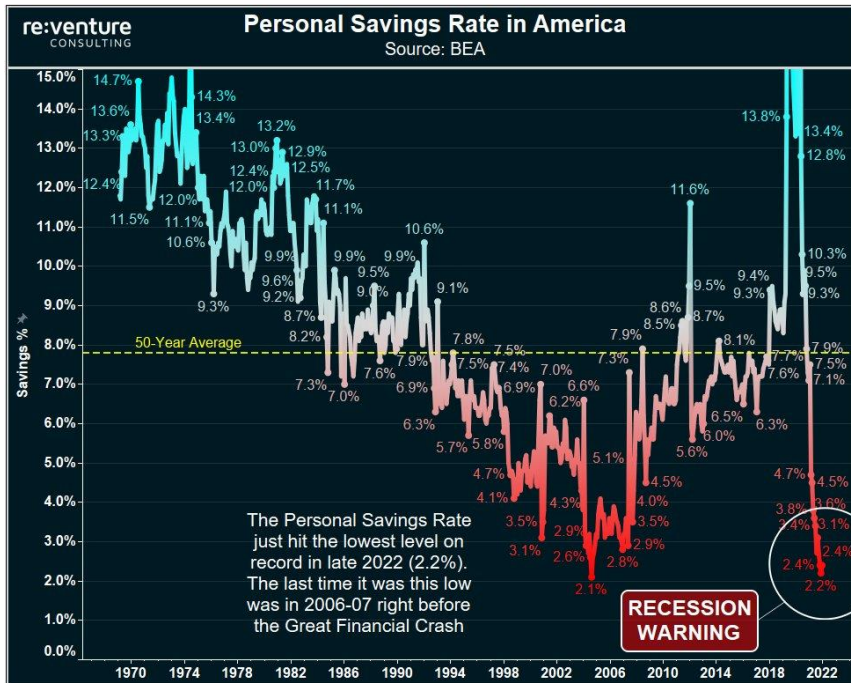
In 2020 the top exporters of *Iron and steel* were China (\$33.8B), Japan (\$23.4B), Germany (\$22B), South Korea (\$20.4B), and Russia (\$16.2B).

Russia is also the world's second-largest net exporter of steel and iron (exports minus imports). Why does this all matter? The world relies on Russian steel and Russia relies on steel exports.

The UN estimates that steel and iron make up almost 6% of Russia's exports. If the war in Ukraine continues, western governments will continue to attempt to hit Russia where it hurts most. They will not stop at oil and gas.







The chart also illustrates the major downtrend in the savings rate that occurred in the U.S. from 1970 to the mid-2000s. What does this mean? Consumer/investor preferences changed. People spend way more now and do not seem to care to save. Many young market participants have pushed off their savings thinking “I can save later”. The current savings rate is also well below the 50-year average of 7.9%.

We assume consumer spending will decline in 2023. Consumers will pull back luxury goods spending. Companies that do not perform well in recessionary environments will report underwhelming numbers in 2023 as consumers pull the plug on unneeded and “extra” spending. This extra spending will even include smaller purchases like an iPhone or laptop upgrade.

A major reason why this has occurred is the spread (that is widening) between wage growth and consumer inflation.



Inflation will more than likely remain in the market for consumer necessities, but the CPI number could retreat with luxury goods dropping in price due to depressed demand. We think energy, food, and shelter prices will all remain high moving forward, but other goods will drop in price due to consumer demand.

We often compare today's inflation to the 1970s. The one major difference is the savings rate by Americans in these two periods. Today it is almost 0%, and in the 1970s it was close to 10%. This could result in a major recession over the next few years.

### Investment bank predicts a flat decade

Stifel, a major investment bank has made its prediction for the S&P 500. They have predicted a 10% return for the first half of 2023, a nice bounce after a horrible 2022. What comes after that prediction is what have many investors worried moving forward.

Barry Bannister, chief equity strategist at investment bank Stifel has warned of a coming decade of low investor returns. Bannister said he believes the EPS of the S&P 500 will double by 2031, but at the same time, the index's price-to-earnings ratio—the index used to value corporations from their earnings will be cut in half. He wrote that the S&P 500 “will be nearly flat in 2031 versus the December 2021 peak.”

Bannister wrote that interest rates will hover around historic averages and will not be near 0 like they were over the last 5-10 years. He also believes decades of strong commodity growth will force investors to value companies more conservatively (investors will utilize lower multiples). This means high multiple

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pipe dreams that trade at fifty times sales will be most at risk, but we are glad we do not own any of that stuff.

Bannister also predicted that we would enter a recession in late 2023 (he does not think we are in one). He believes unemployment will rise through the end of the year and tough times could be ahead in the mid-term.

He believes that the P/E ratio of the market will drop vertically, mentioning past occurrences where it takes close to a decade for the market to adjust. He mentioned a decades-long bear market with elevated periods of volatility where it could look like a bull market.

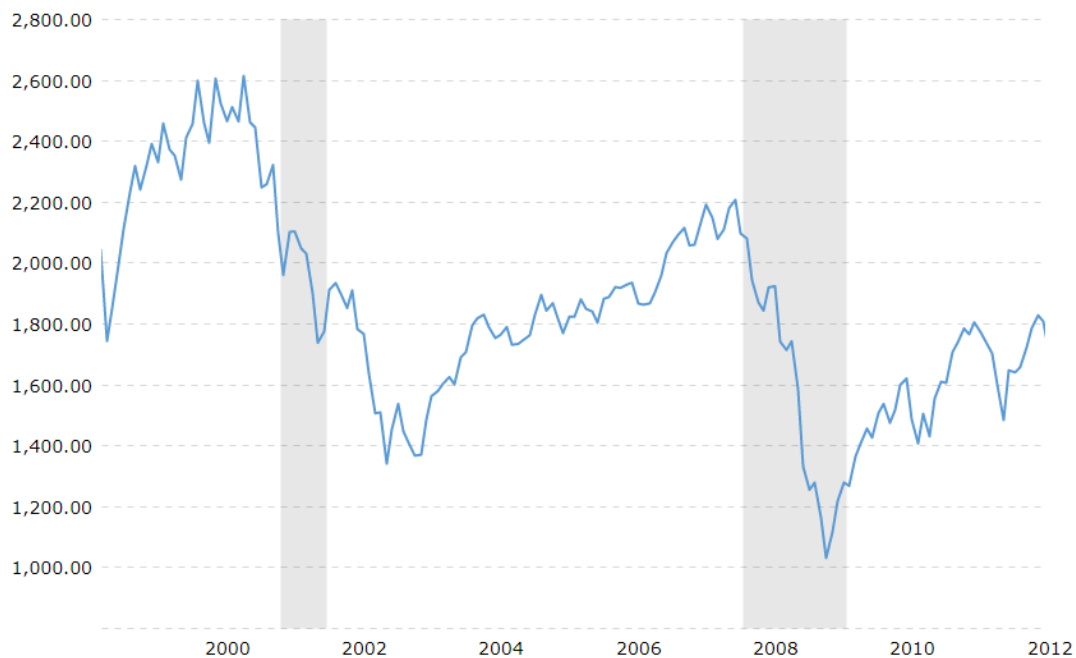
If inflation doesn't drop as sharply as they suspect, the Fed will be forced to keep raising interest rates, which could force the S&P 500 down 15%, to roughly 3,300 by the end of the year (Bannister).

We share and read market forecasts by major banks to diversify our knowledge and share potential paths for the market going forward.

We think this opinion is unique for a global bank as most are bearish in the short term and bullish in the long term for the global economy.

Before you say, a flat 10 years for the S&P 500 are you guys crazy? It has happened before.

Here is the S&P 500 from mid-1998 to the start of 2012.



A lost decade that many investors especially retail investors were not around for. We may get another lost decade. We are not stressing over this as it will impact index investors the most.





Fund Managers will be tested in a lost decade. Investors will chase and value managers who create alpha and find alternatives when markets are struggling.

The one asset class that performed well during this decade was alternative assets. MacNicol's Alternative Asset Trust was not active until 2010 but is modeled after the Yale Endowment Fund. Yale's endowment returned 10.6% per annum over the 10 years ending June 30, 2012. There will be solutions to a lost decade, they will just be harder for managers to find.

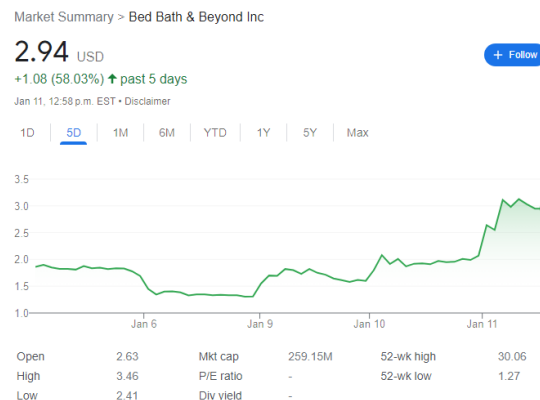
Easy returns will be no more.

### The return of the meme

We all remember GameStop and AMC and other meme stocks surging in early 2021 when retail investors continuously bought shares squeezing hedge funds that were short these companies.

It appears this trend could be back.

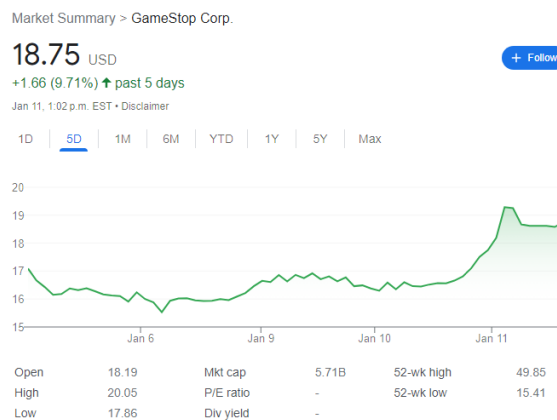
Bed Bath and Beyond shares are up 58% over the last 5 days (as of Wednesday, January 11, 2022).



AMC was up 16% on Wednesday alone.



GameStop shares are up almost 10% over the last 5 days.



The meme is back.

These 3 companies surging in price are purely speculation and retail traders. Also, look at the 52-week high of each stock compared to the current price of each stock. We forgot how dark 2022 was for meme stocks. They performed even worse than high multiple technology stocks and ARKK. We did not think it was possible to perform as badly as Cathie Wood's flagship fund ARKK in 2022.

The news that set retail traders off was Bed Bath and Beyond laying off employees to cut costs. Bed Bath and Beyond missed earnings in Q3, is still unprofitable and is at risk of bankruptcy. Retail traders are betting on the home goods retailer due to the short interest on the stock. Approximately 48% of Bed Bath and Beyond's shares are sold short, the average company is around 5%.

Steer clear of these companies. We would not go long on these risky bets and going short seems challenging due to retail traders.

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