THE WEEKLY BEACON **MAY 5, 2023**

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.

MacNicol & Associates Asset Management

Contact us today if you would like to meet about your investment future. info@macnicol.com

BEACONS OF THE WEEK

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.

Fifty Point Conservation Area, *Stoney Creek, Ontario*

Fifty Point Conservation Area is a hidden treasure where you'll feel like you have Lake Ontario all to yourself. The 200 acre conservation includes this lighthouse, pristine beaches, and various trails.

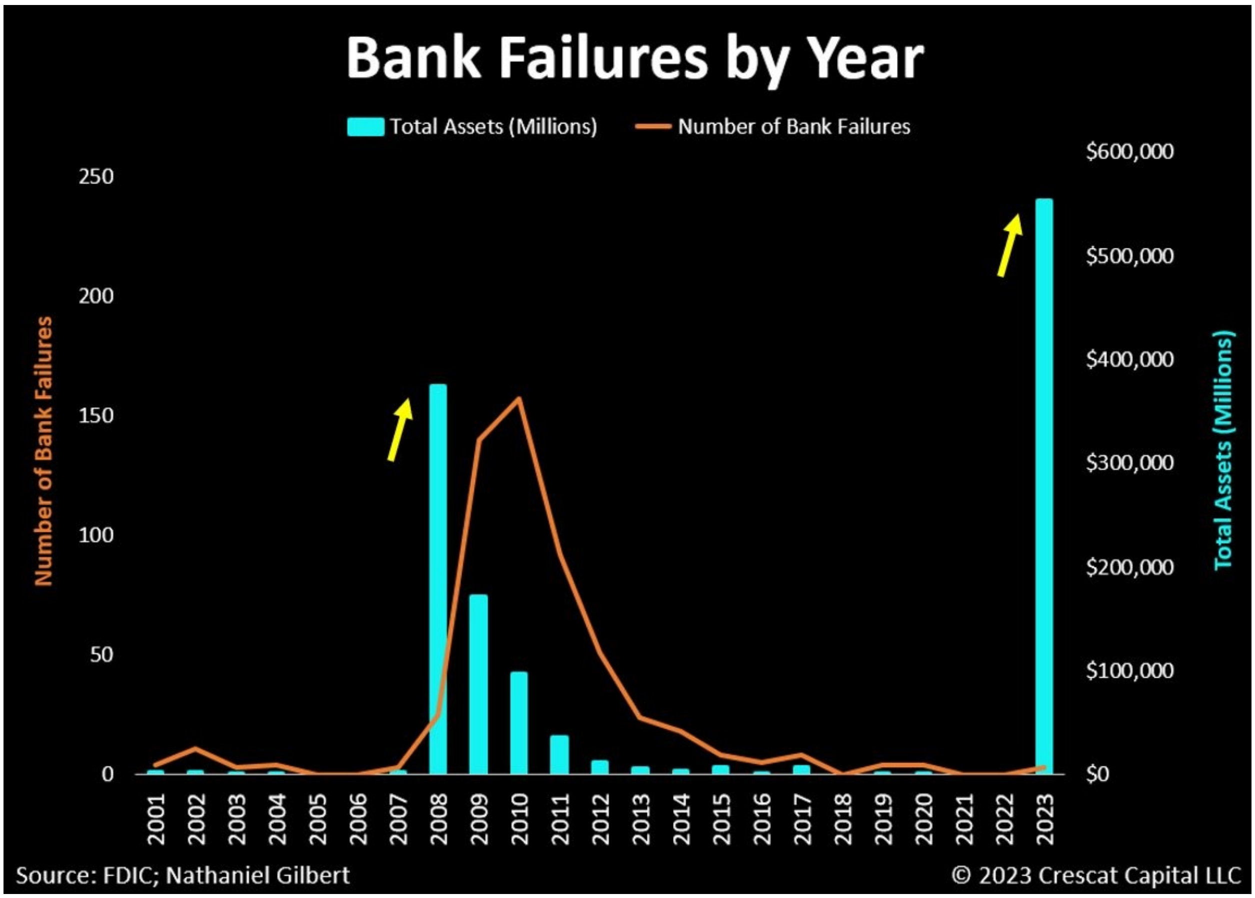
Baltimore Lighthouse, *Baltimore, Maryland*

A private lighthouse, first lit in 1908 on the mouth of the Magothy River. The Lighthouse was added to the National Register of Historic places in 2002.

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

Record Year

Financial markets have reached new heights over the last few years. In 2021, the SPAC market boomed. In 2022, the classic 60/40 portfolio had its worst year on record. In 2023, we reached a new bank failure record. The total assets of banks that have failed in 2023 are almost 1.5x greater than the total assets of banks that failed in 2008.



The only major difference is there have only been 4 bank failures this year. There were more than 150 banks that failed during the Financial Crisis. Does this mean there will be many more bank failures through the end of this year? It is possible. Contagion across the industry looks likely and the big banks will not be able to bail out every regional bank that fails (especially as the frequency increases).

One person who is sure that the current banking crisis is close to its finish is Jamie Dimon, CEO of JP Morgan. JP Morgan led by Dimon has capitalized on the regional banking crisis (they did the same thing during the Financial Crisis).

FINANCE

Jamie Dimon says 'this part of the crisis is over' after JPMorgan Chase buys First Republic

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His company has scooped up the assets of First Republic Bank while avoiding the companies' worst liabilities. JP Morgan took over the bank that had been previously seized by the Federal Deposit Insurance Corporation. The recent struggles that First Republic Bank has faced stem from the bank run that many U.S. Regional Banks faced earlier this year. First Republic reported that clients withdrew more than $100 billion in deposits during the first quarter in their earnings report on April 24th.

The deal will reportedly give JP Morgan about $92 billion in deposits which includes the $30 billion that they and other large banks put into First Republic last month. The bank is taking on $173 billion in loans and $30 billion in securities as well. As a part of the deal, the FDIC absorbs most of the losses on First Republic's mortgages and commercial loans. JP Morgan also was provided with an additional $50 billion credit line courtesy of the FDIC. JP Morgan announced the deal would add $500 million in profit annually. All First Republic branches will be reopened immediately and will be transitioned to JP Morgan's in the coming months.

After overviewing the deal, we noticed a few things:

- JP Morgan is paying $10.6 billion for approximately $18 billion in NET equity (First Republic Bank)
- JP Morgan said this will add $2.6 billion in post-tax profit that can be recognized immediately (pre-restructuring costs)

The deal looks great for the U.S.'s largest bank and Dimon looks like he is earning his pricey salary.

The auction for First Republic Bank was highly competitive due to the FDIC's insurance to whoever would take over the bank. The transaction was almost risk-free to the large bank that would buy First Republic.

The transaction will reportedly cost the FDIC $13 billion less than the $20 billion that the failure of Silicon Valley Bank caused them.

As of Monday morning, all remaining First Republic depositors would become JP Morgan Chase depositors and would have full access to their funds.

Many have applauded Dimon and JP Morgan for this deal as it's essentially risk-free. Dimon has become a folk hero to many in the banking world running JP Morgan since 2005. He has helped the bank navigate the Financial Crisis, Covid-19, and the current Banking Crisis as well as acquiring numerous companies that have helped JP Morgan continue to expand.

Dimon's number one accomplishment remains the Financial Crisis. His bank avoided many of the pitfalls that almost every other institution faced. JP Morgan was also aggressive at this time as they scooped up Bear Sterns for pennies on the dollar (JP Morgan acquired the bank for $236 million, the bank was at its peak worth approximately $12 billion).

Dimon has also led JP Morgan to become the world's largest public bank and 4th largest in the world (in terms of deposits). In 2000, before he took over, they were not in the top 10:

6: TOP 10 WORLD BANKS, 2000

Rank	Bank	Country	Tier 1 capital $m
1	Citigroup	US	47,698
2	Bank of America	US	38,176
3	HSBC Holdings	UK	28,533
4	Bank of Tokyo – Mitsubishi	Japan	26,018
5	Chase Manhattan	US	25,503
6	Dia-Ichi Kangyo Bank	Japan	23,525
7	Credit Agricole	France	23,335
8	Sakura Bank	Japan	23,057
9	Fuji Bank	Japan	22,653
10	ICBC	China	21,918

JP Morgan is estimated to have almost $600 billion more in assets than Bank of America (which is the second largest U.S. bank). JP Morgan's assets sit at $3.74 trillion as of March 31, 2023 (before their transaction to acquire First Republic Bank).
Beyond the success of growing JP Morgan's assets and customer deposits as well as navigating rough periods, Dimon has created tremendous shareholder value during his time as JP Morgan's CEO.

Here are stock returns since Dimon became JP Morgan's CEO on December 31, 2005.

Company	Return
JP Morgan	243%
Bank of America	-39%
Goldman Sachs	160%
Wells Fargo	22%
Morgan Stanley	84%
iShares US Financials ETF	41%
S&P 500	230%

These returns are excluding any dividends and are as of May 3, 2023.

JP Morgan shareholders have been rewarded for trusting Dimon as he has blown the competition out of the water and somehow has beaten the market over the same period.

Even though JP Morgan (and some of the other large U.S. banks) might be facing some unrealized losses on securities like SVB and First Republic, they are very limited, and the large banks can offset this with such a large deposit base.

Consumers continue to spend

Even though consumers' wallets are being squeezed with rising rates, higher unemployment, higher prices, and a potential recession, consumers are continuing to spend on certain things. Usually, tough economic times mean a decrease in consumer spending on luxury goods and non necessity goods. Consumers hunker down and wait out the tough economic times. This is why a recession is bad for public companies as revenue and earnings decrease (we are pretty sure you know this).

Last year, we forecasted to our readers that inflation would rotate from goods to services. We also explained that experiences and trips would not see a slowdown in demand. Historically, in rough times they do. We forecasted this due to Covid-19 and even though we have been "open" for almost a year, many remained hesitant to go on that big trip, or enter a big crowd to experience something. This year it seems this caution (from Covid-19) is gone and even though we are facing a recession, consumers are jumping to go on that trip, or go out for a night, or go on a cruise. Many have been surprised that hotels and even airlines have beat revenue and earnings expectations due to the economic backdrop. We think consumers have not slowed this spending down due to pent-up demand and rotating their budgets from consumer purchases to these experiences, trips, nights out, or whatever they choose to do for fun with family or friends.

This past Tuesday, Marriot International announced their first-quarter earnings and they beat Wall Street estimates for almost every metric.

Marriot's first quarter revenue was $5.62 billion and earnings per share was $2.09. Average estimates pegged the numbers at $5.45 billion and $1.85. The reported numbers also greatly exceeded 2022 first quarter numbers which were $4.2 billion and $1.25. Marriot's CEO said the Asian region's numbers severely improved year over year, specifically mentioning the reopening of China. He also said U.S. and Canadian demand was quite high for this time of the year. They have also seen solid demand in the leisure segment and improving conditions in their business segment despite poor economic conditions. During the earnings call, CEO Tony Capuano described strong demand and believes it will continue. "While the global economic picture is uncertain, demand remains strong, and we are not seeing signs of a slowdown."

Marriot also raised its 2023 fiscal year earnings and revenue estimates.

Marriott also repurchased 6.8 million shares of common stock for $1.1 billion during the first quarter.

Due to the positive earnings release, Marriot shares traded up quite substantially on Tuesday, despite a sell-off across equity markets.

Stock price

178.61 USD

+8.47 (4.98%) ↑ today

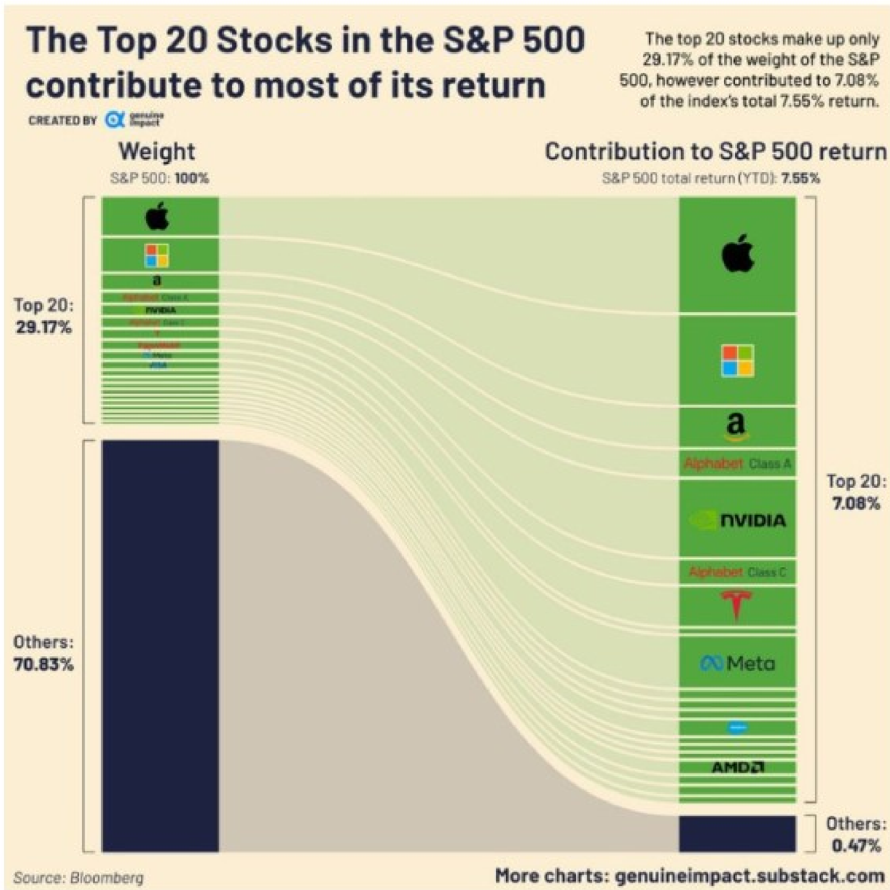
Closed: May 2, 4:16 p.m. EDT • Disclaimer
After hours 178.61 0.00 (0.00%)

Marriot International shares are up 21% year to date and are trading close to their all-time high.

Apple's record

The market has been led by mega caps in 2023. We are sure you remember this image that we shared with you just a few weeks ago in this publication:

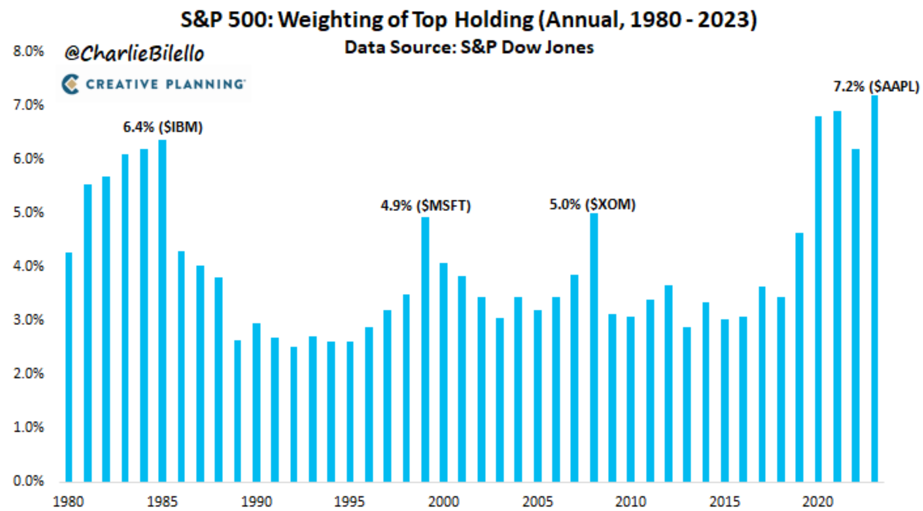
The largest 20 companies have contributed almost all the S&P 500's return in 2023:



The same companies only account for 29% of the indices weight.

Apple is the world's largest publicly traded company with a market capitalization of $2.7 trillion.

Apple is also currently the S&P 500's largest component and as of May 1st, it makes up 7.2% of the index. This is the largest weighting for a company on the index on record, with data that goes back to 1980.

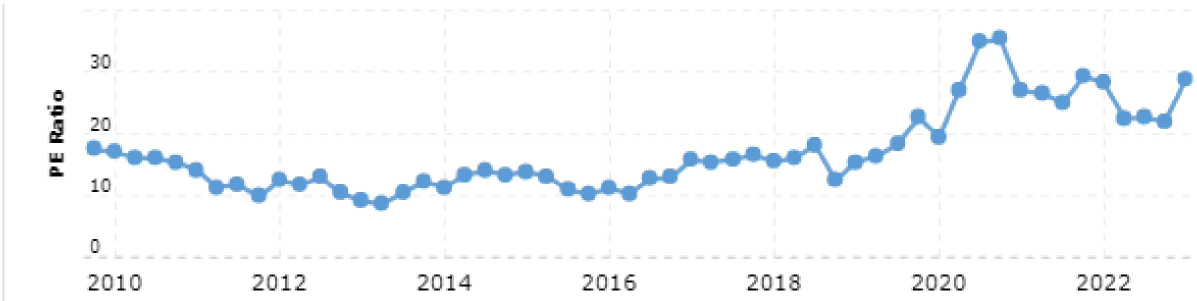


Here are the S&P 500's largest components as of May 1st, 2023.

#	Company	Symbol	Weight
1	Apple Inc.	AAPL	7.278947
2	Microsoft Corporation	MSFT	6.601707
3	Amazon.com Inc.	AMZN	2.682812
4	NVIDIA Corporation	NVDA	2.015188
5	Alphabet Inc. Class A	GOOGL	1.821559
6	Berkshire Hathaway Inc. Class B	BRK.B	1.704885
7	Alphabet Inc. Class C	GOOG	1.597901
8	Meta Platforms Inc. Class A	META	1.54629
9	UnitedHealth Group Incorporated	UNH	1.338673
10	Exxon Mobil Corporation	XOM	1.316594
11	Johnson & Johnson	JNJ	1.252929
12	Tesla Inc.	TSLA	1.252009
13	JPMorgan Chase & Co.	JPM	1.183272
14	Procter & Gamble Company	PG	1.071646
15	Visa Inc. Class A	V	1.071045

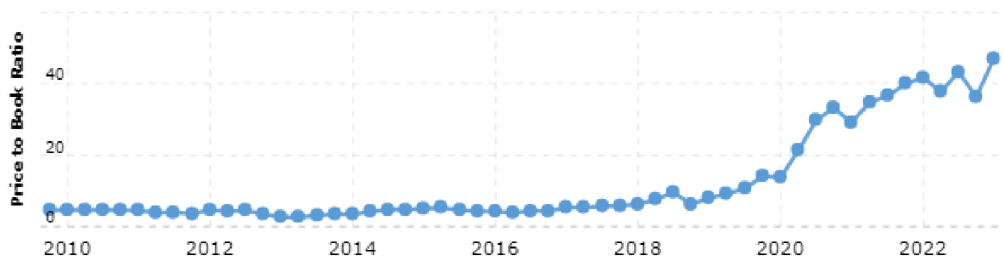
Markets have been pulled in the right direction by companies like Apple (and Amazon and Microsoft) to start this year. However, if Apple does report one bad quarter this could pop the company's bubble and send the overall index tumbling in the wrong direction. Apple is also trading well above its historical averages for price-to-book and price-to-earnings. This makes Apple's earnings even more important as a small miss could send the stock price tumbling.

Here is Apple's P/E ratio since 2010:



It is trading well above its averages over the last 14 years and within striking range of its all-time high (which it reached in 2020/2021).

And here is their P/B ratio over the same period:



We are not saying Apple's stock will crash tomorrow. We are simply stating that overall market returns are a bit misleading as most stocks have struggled in 2023 and the good numbers are for the most part due to the big boys.

Apple's weighting in the S&P 500 also reconfirms how important the company is to markets, how important the company is to consumers, and how big these large technology companies have gotten in recent years.

Look for the S&P 500 to continue to get even more concentrated as companies like Apple, and Microsoft expand and diversify their operations even more.

Opposites attract

Two well-known politicians teamed up this week to tackle a very big issue. The two politicians are complete opposites, with different parties, beliefs, and economic values. Both are also quite polarizing in the media and are often targeted online by the opposite parties' supporters.

New York Congresswoman Alexandria Ocasio-Cortez and Florida Congressmen Matt Gaetz coauthored a Bill that would ban Congress members from trading individual stocks.

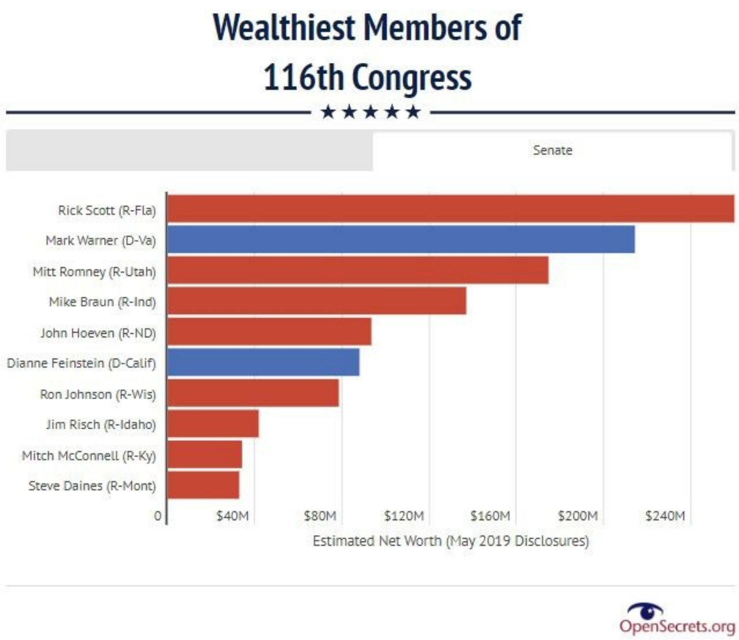
These two individuals could not have more different beliefs on every major issue. They arguably sit on opposite sides of the entire political spectrum and are considered to be extreme due to their separate beliefs.

We have long reported on the advantage that these insiders (Congress members) have had and how they regularly beat the market purely from perfect timing and leveraging the information they have. The advantage is absolute and not even the best fund managers in the world could act on this information (legally).

The market has also helped many members in the past (and present) grow their net worth exponentially purely from stock market returns, and sweetheart deals.

Former Speaker Nancy Pelosi's net worth has grown to an estimated $200 million during her time in Washington.

Senate Minority Leader Mitch McConnell's net worth has also grown exponentially and is estimated to be over $30 million.



Congress members have taken advantage of the inside information that they are privy to and society has only recently noticed. Therefore populists (on both sides of the aisle) like AOC and Gaetz have co-sponsored legislation like this as their supporters have made this an issue that they are passionate about.

The Bill, the Bipartisan Restoring Faith in Government Act, would prohibit financial investments by members of Congress, their spouses, and any of their dependents. Reps. Brian Fitzpatrick (R-Pa.) and Raja Krishnamoorthi (D-Ill.) joined Ocasio-Cortez and Gaetz in introducing the Bill.

This Bill has a close to 0% chance of passing as both parties love to utilize this loophole to enrich themselves and their families. Why fix a loophole that purely helps themselves?

Private equity in an institutional portfolio

Our long-time readers know our secret sauce is our Alternative Asset Trust which exposes investors to private asset classes like real estate, private equity, and hedge funds. Our partners in this fund are world-class managers and all have their specialties. We believe our clients should all consider this investment vehicle. The investment vehicle was designed after the Yale Endowment Fund.

Private equity has been a main driver for Yale's Endowment Fund growing at the rate it has. The fund is now worth over $40 billion and is primarily made up of private asset classes. The fund has delivered high, and stable returns while limiting volatility.

Our Associate Portfolio Manager, Cesar Cossio recently wrote an article for The Association Of Canadian Pension Management (ACPM). The article was featured in The Observer, the organization's publication. Cesar dove into the importance of private equity for institutional clients like pensions, endowments, or religious organizations.

The role of private equity in meeting the funding needs of public pensions

By Cesar Cossio, CFA, Associate Portfolio Manager, MacNicol & Associates Asset Management Inc.

Here is a preview of the article:

History and evolution of Private Equity in public pension portfolios

As the world has progressed, our quality of life has improved, and as a result, life expectancies have increased. While this is great news for humanity, it does pose some challenges for pension managers. With plan members living longer, plan sponsors face increased obligations in terms of projected benefits.

To compound the problem, natality rates have been dropping in developed countries, which means fewer people are entering the workforce to contribute to pensions. As the average population gets older and enters retirement, the burden on pensions increases, as contribution projections drop.

To make matters worse, until very recently, interest rates had been dropping steadily for the past 40 years. This decrease in expected future returns has forced pension managers to seek out alternative investments, including private equity, to meet their higher projected liabilities.

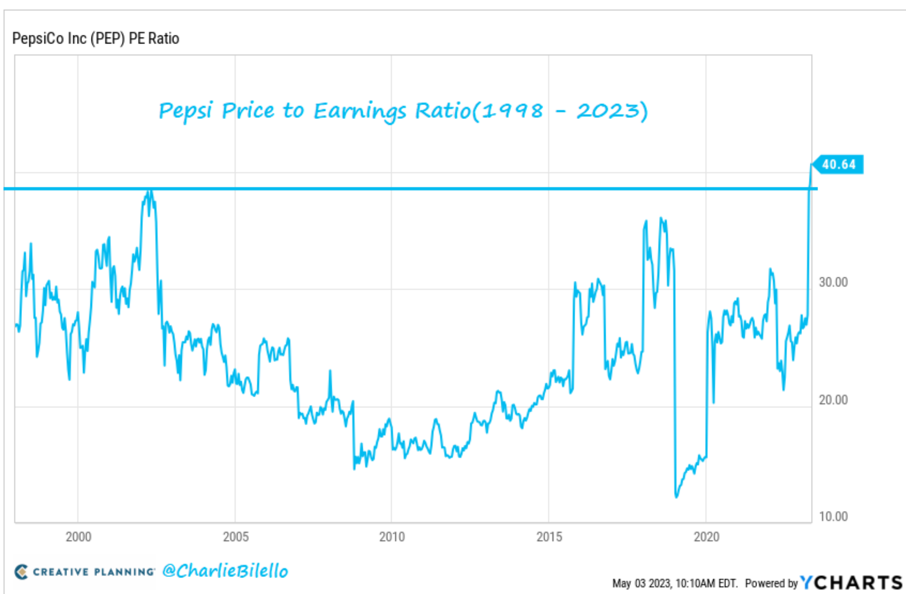
[Click here to read the entire article.]

Consumer defensive stocks trading like tech stocks

Pepsi Co.'s stock is up 15% over the last year:

Times are good for shareholders……at least they are on the surface.

The stock is at a record high, despite net income dropping approximately 35% over the last year. This has caused Pepsi's Price to Earnings ratio to move to its highest level in 25 years.



A PE ratio of 41 is greater than the PE for many other companies including, eBay (37.7x), Nike (36.72x), Netflix (37.38x), Adobe (36.35x), Microsoft (33.1x), and many more companies. Companies trade at different PE ratios due to future growth forecasts. Companies trade more expensively when they are in high-growth sectors (historically not the Consumer Defensive sector).

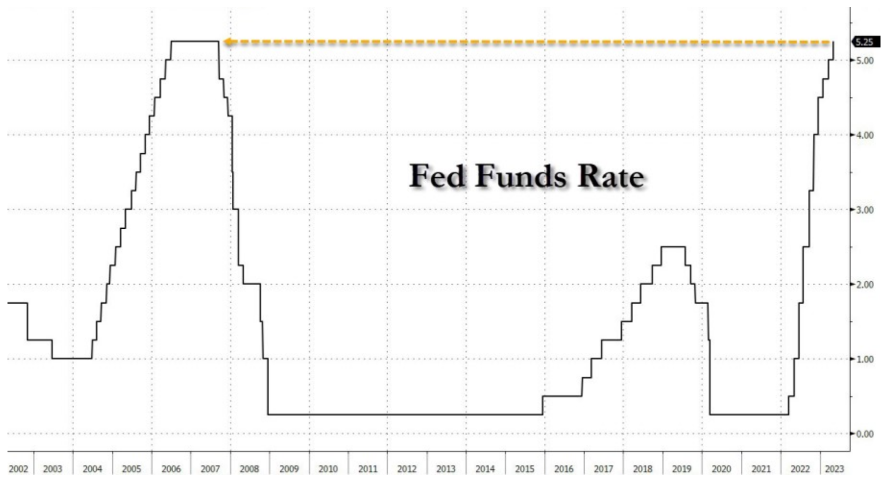
The average Consumer Defensive company across U.S. markets currently trades at a P/E of 24x.

We bring this up not because we are trying to recommend you avoid Pepsi but because even though companies on the surface look good, they fundamentally can be flawed.

The FED hikes again

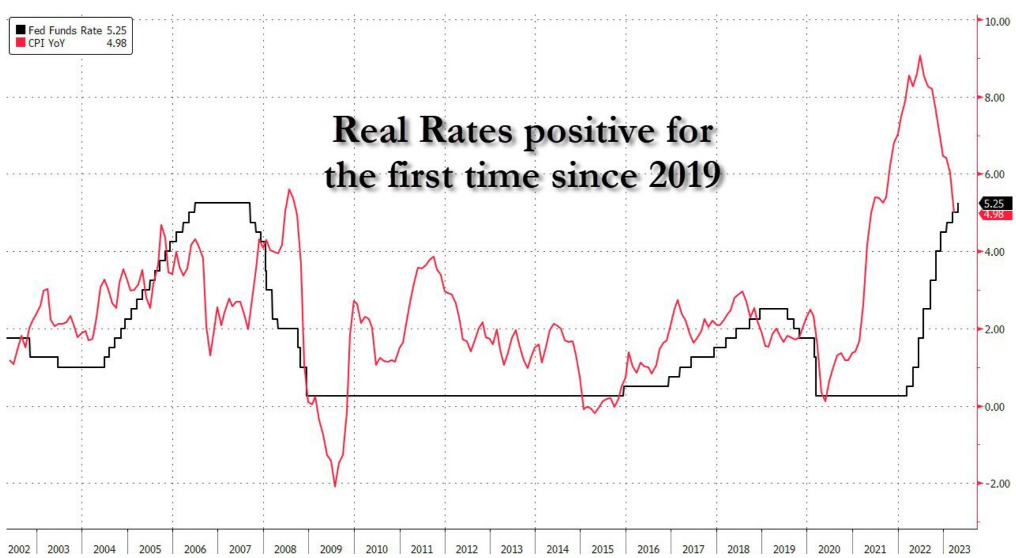
For the 10th straight month, the FED led by Jerome Powell raised its target FED Funds Rate by 0.25%. The FED Funds Target Rate is now 5-5.25%.

Interestingly enough, this is the highest the benchmark rate has been since 2006.



What followed next was rapid rate cuts, will history repeat itself?

The FED Funds Rate is also higher than the government calculated inflation rate (CPI) for the first time in 4 years:



A real rate of return deducts inflation after the nominal rate of return.

Even though a 25-basis point increase was expected and was the consensus amongst market participants and economists, many had recently called for an early pause on interest rate hikes from the FED due to recent market turmoil and financial stress on the banking industry.

Many believe the interest rate hikes are excessive and inflation is already coming down. Many investors think we will head into a recession to end this year and it will be partially caused by the FED. Recession concerns were a major driver of energy and commodity prices this week as they slipped on Tuesday and Wednesday even in a seasonally strong time of the year, and with OPEC+ cutting production for the summer months.

During his press conference, Powell stated that the U.S. government needs a resolution on its pending debt ceiling. He also stated that the FED has not decided if they will pause their interest rate policy at their next meeting.

As of May 3, 2023, most market participants are projecting a pause from the FED:

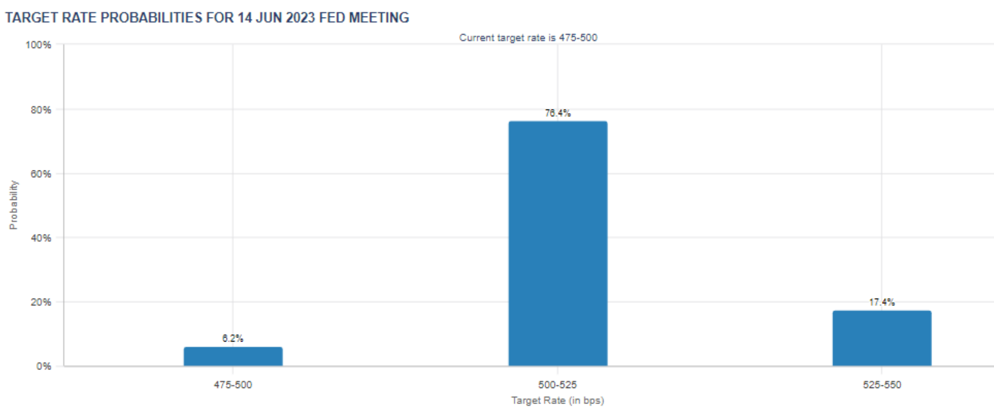


Image of the week

Investing.com shared an image on Wednesday morning and we had to share it with you. No matter how you feel about Jerome Powell, the FED, inflation, or interest rates, it's quite funny.

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