THE WEEKLY BEACON JULY 14, 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.

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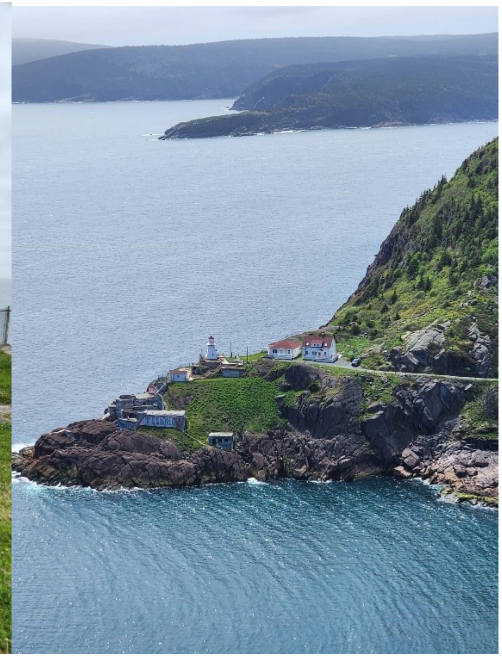
BEACONS OF THE WEEK

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.



Fort Amherst Lighthouse, *St. John's, Newfoundland and Labrador submitttted by Valerie and Phil S.*

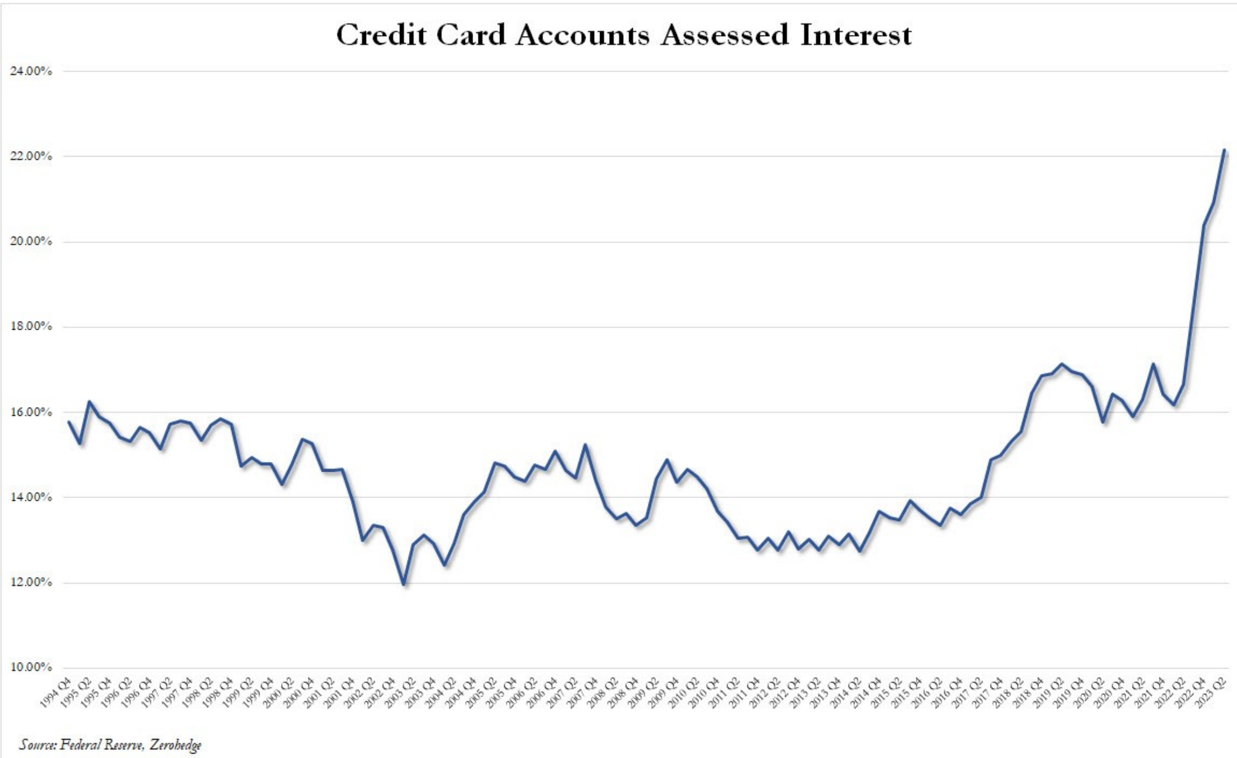
The Fort Amherst Lighthouse is a heritage lighthouse because of its historical, architectural, and community values. The original Fort Amherst Lighthouse was Newfoundland's first lighthouse, built in 1813. The current wooden tower was built in 1951.

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

Consumer crunch

Consumer finances continue to break down as interest rates hit multi-year highs. On top of rising interest rates, consumers have had to battle rapidly rising prices in all facets of their lives.

This has led to consumers adding on debt to maintain their status quo which has in turn increased credit card debt and credit card delinquencies. According to the Federal Reserve, 22.2% of credit cards are currently being assessed interest, an all-time high and well above the historical average.

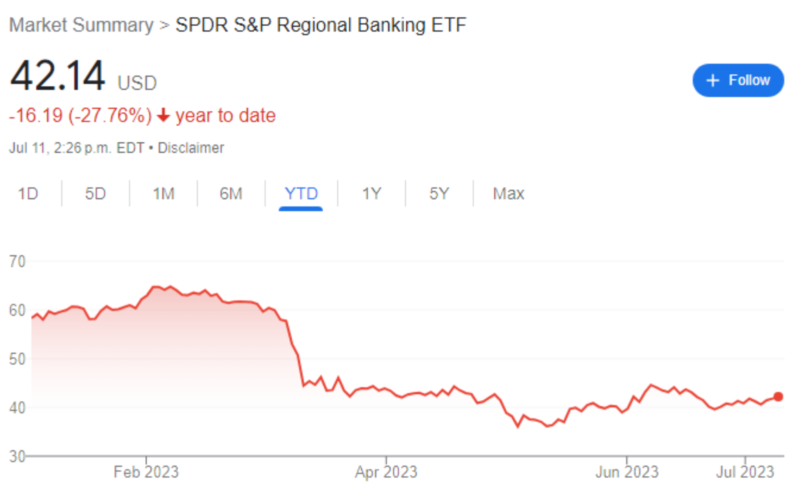


The buy now, pay later mentality seems to be finally catching up to society as it seems fewer and fewer consumers lack budgeting capabilities.

As servicing costs rise for credit card holders, credit card stocks are trading at all-time highs.

It's no surprise that credit card stocks are trading at all-time highs. Visa recently reported record earnings in the first quarter of 2023, and Mastercard reported record annual earnings in 2022 where earnings per share jumped 17% from 2021. This has occurred while other financial stocks have struggled in 2022 and 2023.

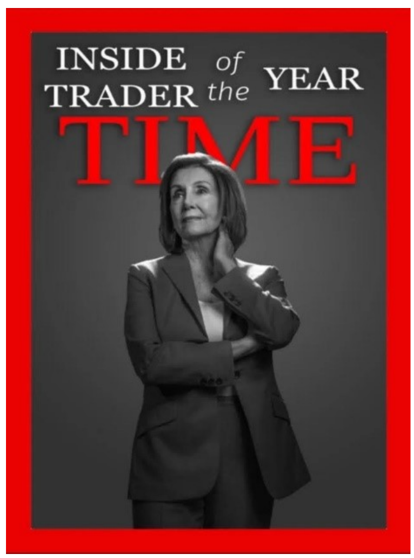
However, the story with credit card stocks is not the same for the entire financial sector. We all know the story of U.S. Regional Banks this year where they have been blown out of the water due to a banking crisis. Bank stocks have also underperformed major indices as they struggle to keep up with the FED's monetary policy decisions.



Returns for financial stocks in Canada are even worse compared to the U.S. this year. The big five banks are all down year to date as they struggle to combat the Bank of Canada's policy decisions. We have expressed our negative neutral to negative views on the big banks in Canada for quite some time. We are not outright negative about them but believe there are better places to invest in Canada then in the financials where we place our investors. Email us at info@macnicolasset.com for more of our thoughts on Canadian bank stocks.

However, we also want to commend those who have held Visa shares since their public market debut. Visa might not be a sexy stock, but it has surged 1,400% since its 2008 IPO compared to the S&P 500 which has appreciated 237% over the same period. One of those IPO investors was none other than Nancy Pelosi, the former Speaker of the U.S. House of Representatives, and a Baron of Wall Street.

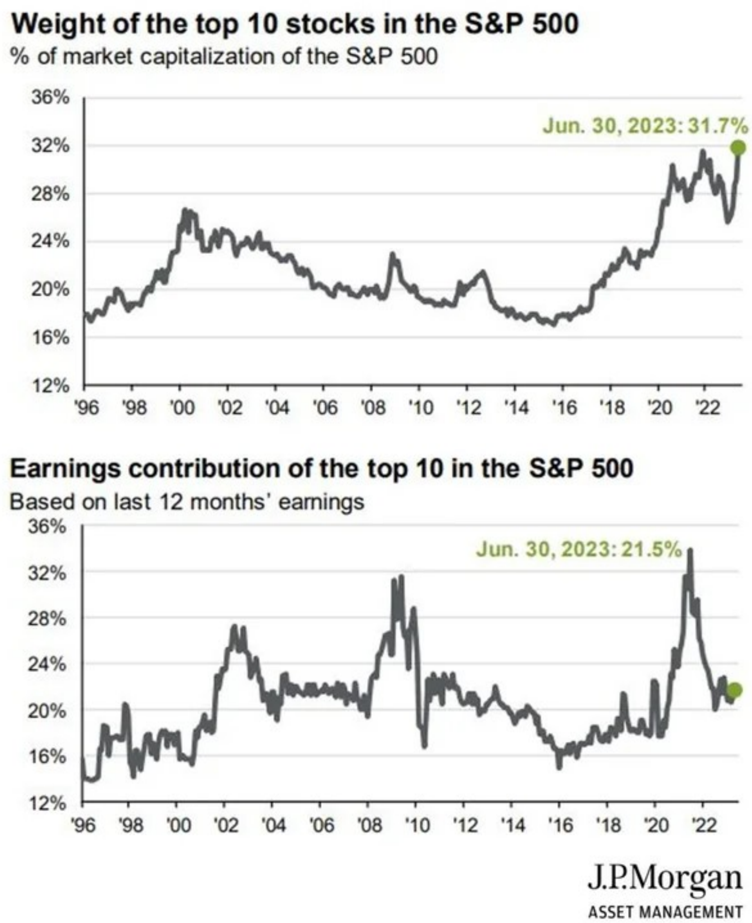
It's no surprise Pelosi and her husband Paul were in on the action back in 2008, they are some of modern days best investors. They have exponentially grown their net worth over the last 30+ years, primarily trading off information available to her through her government position.



The Pelosi's are currently worth approximately $130-250 million. (Reports vary but they are worth a lot.)

<u>Market concentration: where it is and where it is not</u>

We have talked about market concentration over the last 2 months. As mega-cap stocks (specifically technology) melt up and the rest of the indices lag, major U.S. indices have become more and more concentrated, even more than they were at the height of the Internet bubble. The same cannot be said for the largest company's contribution to overall index earnings.

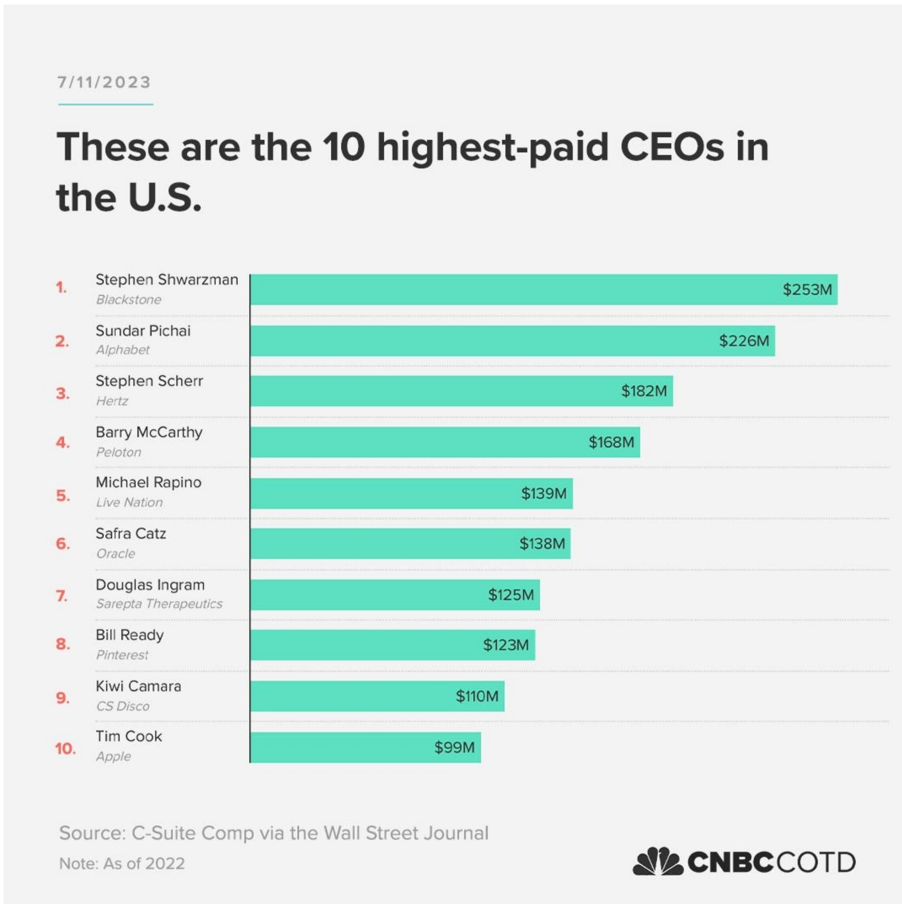


As of June's end, the top 10 components of the S&P 500 made up 32% of the indices' weight but only 21.5% of its earnings. This is well below the 2021 high where the top 10 components had a weighting of approximately 30% and their earnings accounted for 34% of the indices earnings. These statistics and this spread are very interesting to us when we look at equity markets on a holistic level.

Investors by nature want to be bullish, especially retail investors. 2022 taught investors about downside risks, it taught them that not every company that debuted on public markets and that had a cool idea would become the next Tesla, Amazon or Facebook. It taught them that cash flows, operations, and profitability matter to a company's stock price and outlook. This prompted many retail investors to pile into the largest technology stocks, these companies are machines and operate efficiently but are also growing. The fear of missing out phenomenon is quite evident when we look at today's equity markets. This has caused the stocks of the largest companies in the world to soar in price, investors have blindly piled in due to reputation, fear of missing out, and artificial intelligence hopes, completely disregarding valuation. We think these retail investors who are still learning will soon learn that valuations matter even more about high-growth technology stocks.

Worth the wage

We are not judging the compensation of America's largest CEOs and will not get political by taking a stance one way or another. We simply wanted to share this picture that we ran across on Tuesday. CNBC shared an image of the highest-paid CEOs in the U.S. We simply ask, who do you think is worth their wage?



The one that stood out to us was Peloton which currently has a market capitalization of $3.25 billion meaning the CEO was paid 5% of the company's market cap in 2022. Compare Peloton's number to Tim Cook and Apple's ratio which is 0.0033%. One is much larger than the other. Simply put, we would rather pay Tim Cook at Apple than pay Barry McCarthy at Peloton.

We will not go into any more depth but question what goes on at Peloton to warrant a $168 million salary when your stock dropped 78% in 2022 and 77% in 2021. Peloton's share price is also well below its 2019 IPO price. We hope you did not buy this garbage stay-at-home stock back in 2020.

Curbing market concentration

The Nasdaq 100 is set to adjust the weightings of its 100 components to combat the indices concentration that has surged in 2023. Currently, Microsoft, Apple, Nvidia, Tesla, Alphabet, Meta, and Amazon make up half of the Nasdaq 100's weighting. This special rebalance has only been conducted twice before, once in December 1998 and once in May 2011. This rebalance will decrease the indices weighting of these big technology stocks and disperse it amongst other components.

Here are the current weightings of the "magnificent seven". They make up approximately 55% of the Nasdaq-100 whereas the remaining 93 companies only account for 45% of the indices weighting.

Nasdaq 100 Weights Of Magnificent Seven

Company	Ticker	Weight	Market cap, in trillions (as of July 7)
Microsoft	MSFT	12.9%	$2.51
Apple	AAPL	12.5%	$2.99
Nvidia	NVDA	7.0%	$1.05
Amazon	AMZN	6.9%	$1.33
Tesla	TSLA	4.5%	$0.87
Meta Platforms	META	4.3%	$0.75
Alphabet	GOOGL	3.7%	$1.52
Alphabet	GOOG	3.7%	

How will this reduction be made? The Nasdaq announced that the largest 5 components will see their weighting decrease from 46.7% to 38.5%, and no component outside of the top-five market-capitalization companies will have a weighting that exceeds 4.4% (this will decrease Tesla's Nasdaq-100 weight, slightly). The official index weightings will reportedly be released after hours on Friday.

Nasdaq announced that this special rebalance is necessary to maintain the integrity of the index. The Nasdaq 100 is up 39% year to date as of Tuesday, predominantly fueled by the "magnificent seven". The rebalance which will be announced on July 14th will take effect as of July 24th. This could present some major buying opportunities as index funds are forced to scoop up shares of companies whose weighting is increased on the index.

The Bank of America released its predictions for the indices rebalance and here are what it believes will have the biggest weighting increases:

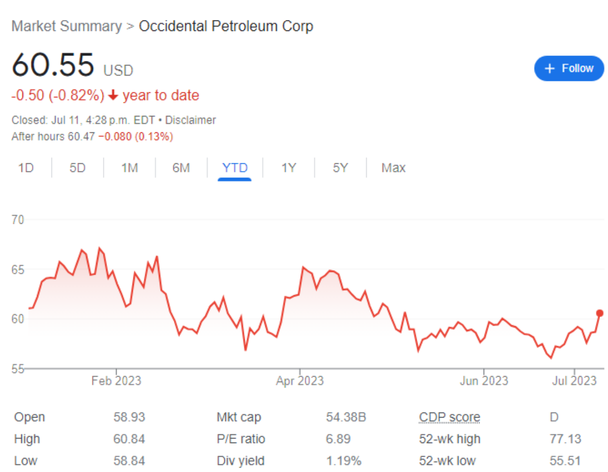
Ticker	Name	Weight Old	Weight New	Weight Change	Shares to Trade
GFS	GLOBALFOUNDRIES INC REGISTERED SHS	0.24%	0.30%	0.06%	2,772,536
HON	HONEYWELL INTERNATIONAL INC REGISTERED S	0.92%	1.15%	0.23%	3,335,622
CTAS	CINTAS CORP REGISTERED SHS	0.33%	0.41%	0.08%	504,729
PEP	PEPSICO INC REGISTERED SHS	1.70%	2.13%	0.43%	6,829,133
COST	COSTCO WHOLESALE CORP REGISTERED SHS	1.59%	2.00%	0.41%	2,234,508
CMCSA	COMCAST CORP SHS -A-	1.15%	1.45%	0.29%	20,499,842
MNST	MONSTER BEVERAGE CORP REGISTERED SHS	0.40%	0.50%	0.10%	5,216,969
ADP	AUTOMATIC DATA PROCESSING INC REGISTERED	0.60%	0.75%	0.15%	2,019,925
CSCO	CISCO SYSTEMS INC REGISTERED SHS	1.40%	1.76%	0.36%	20,249,870
PCAR	PACCAR INC REGISTERED SHS	0.29%	0.36%	0.07%	2,596,507
ISRG	INTUITIVE SURGICAL INC REGISTERED SHS	0.78%	0.98%	0.20%	1,737,831
MDLZ	MONDELEZ INTERNATIONAL INC REGISTERED SH	0.66%	0.83%	0.17%	6,798,614
TMUS	T-MOBILE US INC REGISTERED SHS	1.11%	1.39%	0.28%	5,882,229
CPRT	COPART INC REGISTERED SHS	0.29%	0.36%	0.07%	2,391,204
GILD	GILEAD SCIENCES INC REGISTERED SHS	0.63%	0.80%	0.16%	6,287,181

We are not week-to-week traders but believe this is something worth noting and sharing with our audience.

Buffett buys more energy

Warren Buffett has steadily piled into Occidental Petroleum over the last year and a half. We have assumed he sees what we see, supply-demand imbalances, underinvestment in capex, and more regulation. This has led him and Berkshire Hathaway to scoop up 25% of Occidental Petroleum (OXY). Berkshire now owns approximately 224 million shares, worth north of $13 billion. Occidental is now Berkshire’s sixth-largest equity holding as of June regulatory filings (Berkshire also owns preferred shares and 93 million OXY warrants). Buffett disclosed that he made his original investment in Occidental for several reasons including strong growth drivers and strong leadership. Last August, Berkshire got approval from regulators to buy up to 50% of Occidental Petroleum.

Buffett has continued to pile into the energy giant despite its pull back over the last year. OXY shares are well below their 52-week high.



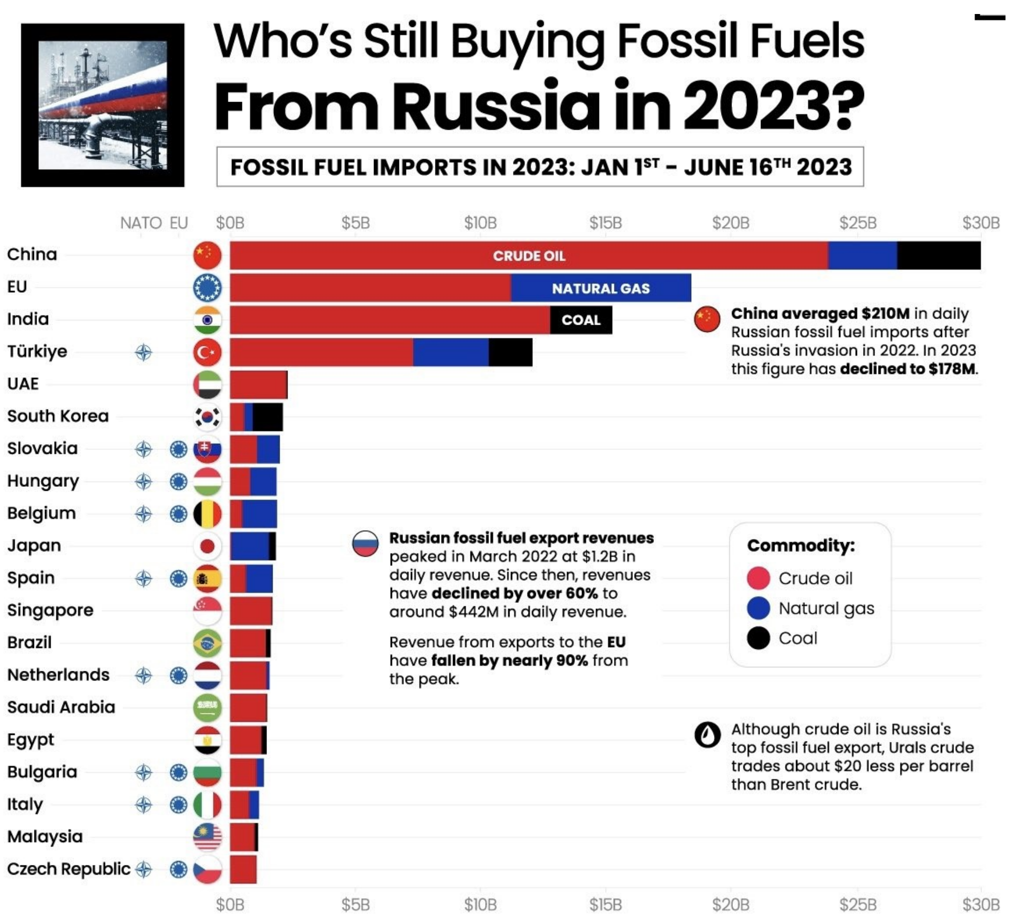
Buffett's energy bet on Occidental does not seem to be a sole investment as this past week it was announced that Berkshire had made another play in the energy sector, this time with a gas company.

Even though LNG prices have dropped significantly over the last year, Berkshire Hathaway agreed to buy Dominion Energy's share of Maryland-based Cove Point LNG, a deal worth $3.3 billion. This brings Berkshire's ownership of Cove Point to 75%. Cove Point LNG operates one of seven operational U.S. LNG export terminals. The Cove Point LNG terminal has a storage capacity of 14.6 billion cubic feet (bcf/d). Its daily export capacity is 1.8 bcf/d, a bit less than 14% of the total U.S. LNG export capacity.

On the energy front, Buffett and Berkshire also own $21.6 billion worth of Chevron stock.

Russian energy

So, after we (Canada, the U.S., Japan, Australia, and Europe) sanctioned Russia and stopped buying their energy, how is Russia still operating? After all, their economy is extremely reliant on the energy industry and energy exports.



Even though the European Union has significantly pulled back on its Russian energy purchases, they remain the country's second-largest buyer. This reflects the stranglehold Russia had on the EU, almost 18 months later and the EU still needs Russia despite their invasion of Ukraine.

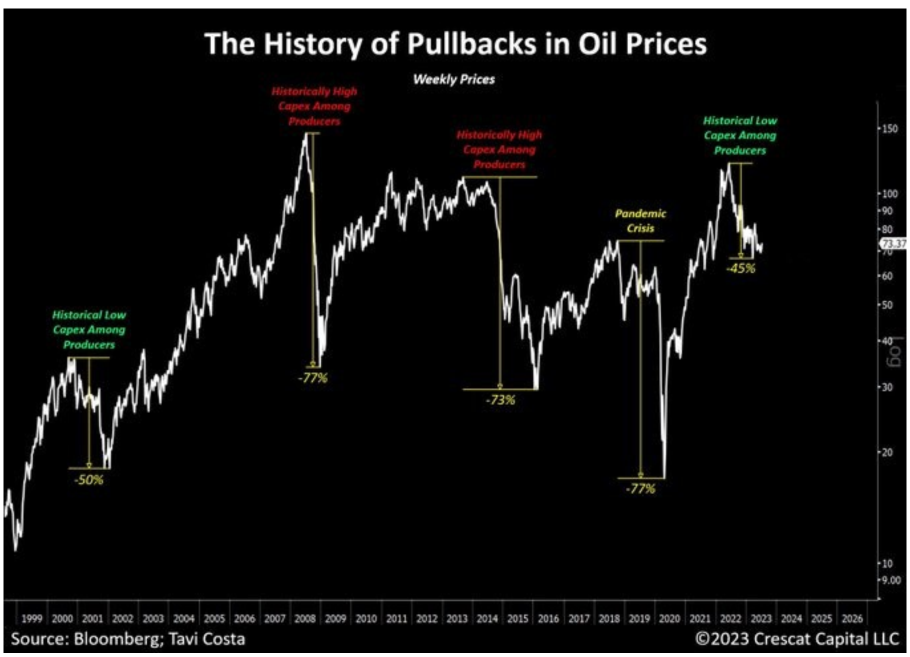
Another country to not overlook is Turkey which is the 4th largest buyer of Russian energy. Turkey is interesting because they are a G20 and NATO country. Turkey does not seem to care where they get their energy from as long as they can keep their lights on.

Oil opportunity

Last thing on oil this week.

A chart from Crescat Capital who write some great stuff on energy, materials, and macro investing.

The chart looks at the last 25 years and highlights oil price pullbacks.



The 45% price pullback that we have recently seen presents a great buying opportunity. The risk/reward to buy oil today appears heavily skewed to the upside.

We will have to see what happens next but still think there is tremendous upside in the mid to long-term prices for energy.

Inflation debate

The U.S. Bureau of Labor Statistics released June's inflation numbers and investors were very pleased. The year-over-year CPI came in at 3% below the consensus estimates of 3.1% and down from May's inflation rate of 4%. This year-over-year inflation rate was the lowest reading since March 2021. The core inflation rate also slowed its pace in June coming in at 4.8%, the lowest reading since October 2021.

So, what's rising and what's falling?

Gas prices rose 0.8% in June but are down 27% year over year. Energy's drop over the last year has been a major driver in the reduced inflation readings. On the rising front, the shelter index is up 7.8% over the last year and the food index has increased 5.7% over the last year.

After the CPI was reported, yields on the 2-year treasury note plunged:

Wednesday's reading for the CPI was the 12th straight monthly decline.

Equity markets rallied as many investors and market participants believed the FED could continue their policy pause or only raise rates once more through the end of this year.

In other news on the inflation front, the Bank of Canada raised rates another 0.25% on Wednesday, bringing their overnight rate to 5%. This takes Canadian interest rates to a 22-year high and brings the Commercial Bank Prime to 7.2%. For many homebuyers who are locked in variable rate mortgages, this could be the final straw as some monthly mortgage payments have ballooned 45% over the last ye

This is the second straight month the Bank of Canada has raised its overnight interest rate.

MacNicol & Associates Asset Management
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