THE WEEKLY BEACON **SEPTEMBER 22, 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

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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.

Cordouan Lighthouse,

Gironde, France

The Cordouan Lighthouse (Tour de Cordouan) is the oldest lighthouse in France and the tenth tallest traditional (built of masonry) lighthouse in the world. The lighthouse was restored in 1855 and was declared a historical monument in 1862.

Kõpu Lighthouse, *Hiiumaa, Estonia*

This lighthouse was originally built in 1531. Since then, a few parts of the tower have been reconstructed. Today, Kõpu Lighthouse serves as a symbol of Hiiumaa and is a major tourist attraction. The lighthouse stands at 118 feet tall.

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

Mexico "Trumps" China

Bloomberg ran an article last week that said Mexico had just eclipsed China as the largest exporter to the U.S. Bloomberg used a 12-month rolling average to conclude this number. The Wall Street Journal and MarketWatch reported that Mexico overtook China for all this year through their simple calculation for exports which measures quarterly trade on a balance of payments basis. Some other publishers reported that Mexico surpassed China earlier this year. The reporting by each outlet and database is inconsistent in timing but not on the major theme we are exploring.

Jul 12, 2023 - Economy & Business

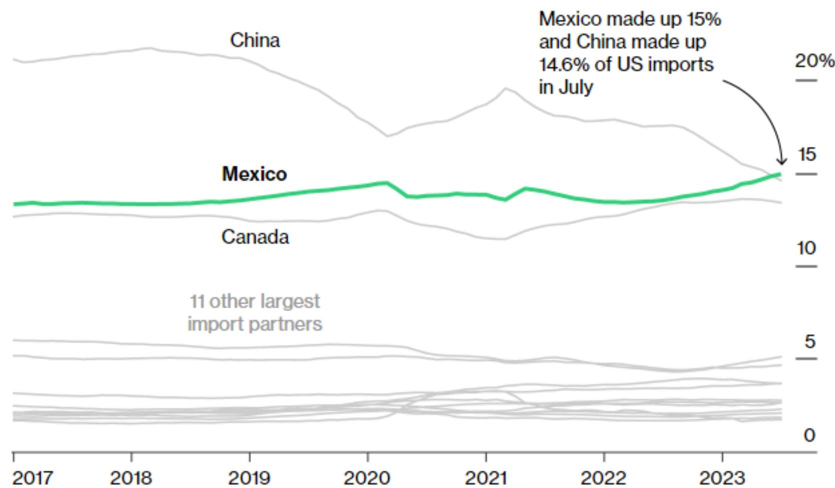
Mexico surpassed China as the top U.S. trading partner

We will not get into the weeds on these two publishers sparring as it is irrelevant to us. Either way, Mexico now is a larger partner than China for the U.S., a huge milestone. The part that interests us is Mexico surpassing China as a trading partner for the U.S.

As the U.S.-China relationship has deteriorated for several reasons, Mexico has slowly slid in to fill the void. This pivot by the U.S. is strategic as the U.S. attempts to decrease its dependence on Chinese products. The relationship between China and the U.S. began to sour during the Trump administration when the former President demanded China buy American products and placed tariffs on the country. The relationship continued to deteriorate at the onset of COVID-19 when China hid the virus from the world. Even though many believed Biden would reverse Trump's policy, which was nationalistic and anti-China, he did not. Most of Trump's Chinese trade barriers and tariffs remain in place today as the world's largest economies combat a major trade war that could accelerate rapidly.

Back to Mexico, as we know trade has decreased between China and the U.S. in recent years. Companies have looked for friendlier governments where labor is relatively cheap but still skilled as they exit the manufacturing giant that China has been. American companies have had difficulties dealing with the Chinese government in recent years as the authoritarian government acts at will.

Mexico has been the country of choice for most U.S. companies when exiting China. The country is an emerging market with a large and skilled population that has relatively cheap labor making it quite attractive for companies headquartered just across the border.



U.S. imports from China over its total imports have dropped by over 5% in just a few years. We expect this trend to continue to run its course and for Mexico to continue to increase trade with the U.S. and its allies.

This boosted trade by Mexico this year paired with strong economic data has made the Mexican Peso the world's strongest currency. Foreign direct investment in Mexico is expected to jump by over 40% in 2023 as numerous large American companies enter the market. Tesla is due to start construction on a proposed $5 billion factory in Mexico. Even though the setup looks great for Mexico to reach the next level as an emerging market, the country has fumbled the bag in past cycles when the setup looked just as good. The one thing that investors should keep at the top of their mind when looking at Mexico is politics which tend to be less stable in Mexico relative to Canada and the U.S. Mexican equities have also performed quite well in 2023 due to high growth, increased investment, and a strong Peso.

Market Summary > iShares MSCI Mexico ETF

60.82 USD

+10.48 (20.82%) ↑ year to date

Sep 19, 4:10 p.m. EDT • Disclaimer

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

The current President has clashed with business interests in Mexico as he seeks to establish the government's role in the economy. This trend has affected other Latin American countries in recent years as populations turn to far-left-wing leaders. We will have to wait and see if this eventually trickles into Mexico.

Investment in machinery in Mexico recently hit an all-time high. Economists are looking for more domestic investment in Mexico, so this nearshoring move by American companies can spread benefits more widely and shift the Mexican economy into a high-growth market.

We believe the Mexican economy is poised for major growth over the next decade if things remain stable and the government allows its economy to flourish. This nearshoring by the U.S. is a strategic move that is dividing the world into 2 markets, a Western alliance, and an Eastern alliance. It looks like Mexico can take advantage of this trend and grow closer to its northern neighbor.

MacNicol & Associates Asset Management owns Mexican equities and managed products for its clients as of 09/22/2023.

Retail investors idolize Tesla

Retail investors saving for their futures are piling into one asset more than any other this year. The asset is not a money market fund, an index fund, or even a global equity fund, it is shares of Tesla.

Retail investors are diving all in on the electric vehicle producer despite its price appreciation. These investors are buying the individual stock over a major S&P 500 index fund. This concentration creates some major risks as these investors go all in on one stock. Since 2019, retail investors have poured $36 billion into Tesla shares compared to approximately $20 billion into the SPDR S&P 500 ETF Trust which tracks the S&P 500.

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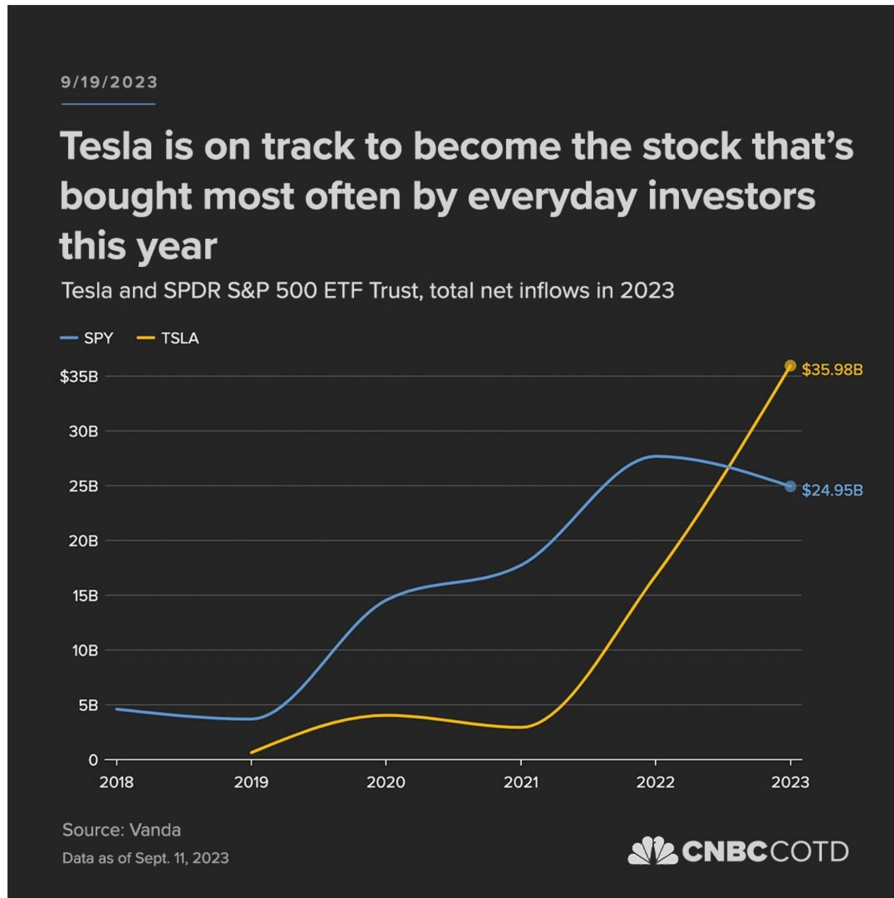

Retail investors have long lauded Elon Musk and have been rewarded for their choice. The company has been a huge success. We just wonder if this concentration will negatively impact them moving forward as the electric vehicle market becomes more competitive and crowded with competitors that can be bought at cheaper prices (stock prices).

Nvidia boss knows what we know

Nvidia shares have jumped in multiples this year. The boom of artificial intelligence has sent the company's shares soaring. Retail investors and institutional investors have jumped on board the hype train of Artificial Intelligence (AI) for several reasons. This price ascension has led to Nvidia becoming the world's sixth-largest company in terms of market capitalization. The company has grown sales and earnings in 2023 at a rapid rate as companies fill their order book. The $1 trillion company is a semiconductor producer and a dominant supplier of artificial intelligence hardware and software.

The price ascension of Nvidia has led to the stock price trading at extreme multiples. The company is trading at 105 times earnings, 33 times sales, and 39 times book. We have mentioned that even though Nvidia might be a long-term winner in this space, buying now presents an extreme risk.

The CEO of Nvidia has slowly been selling large chunks of his holdings in the company in recent weeks, selling $110 million in shares over the 2 weeks of September 6th to 20th. Beyond the CEO and Founder selling his shares, other executives and insiders have slowly scaled out of Nvidia in recent months.

There have also been a few rumors that have been circulating recently that would surely negatively impact Nvidia (if they are true). Other semiconductor producers have reported slowing demand and some orders being canceled, and some market participants believe Nvidia is manipulating its sales and earnings numbers via subsidiaries which have artificially grown numbers this year. The theory which has not been proven went viral online a few weeks back and essentially accuses Nvidia of faking sales to fake nonexistent clients. We are not sure what's true but believe Nvidia is overvalued at its current price and think it could decline in price before it reaches new highs.

Maybe the CEO is creating some liquidity to buy some other assets or maybe he knows what we know that the stock is tremendously overvalued and perhaps these rumors could have some truth.

Adding to China's issues

China's economy has struggled in 2023. The economy that was forecasted to be a high growth star this year after ending its zero-Covid policies has grown much less than forecast. Chinese equity markets hit yearly lows as of yesterday, manufacturing numbers have been reported weak, and unemployment numbers have been extremely high. Unemployment numbers have beat estimates repeatedly leading the Chinese government to stop reporting certain metrics. These issues paired with a real estate debt problem and an unpredictable authoritarian government have led many foreign investors to exit China. For the first time in years, many economists and analysts are turning slightly bearish on the world's second-largest economy.

Economic growth estimates for China have been slashed repetitively in 2023 as analysts' price in all the issues that the Chinese economy has.

All these issues have led to a breakdown in the Chinese Yuan. The Yuan has depreciated over 8% against the U.S. dollar since the Yuan's peak in January.

A major driver of these struggles has been decreased demand for Chinese products. More countries have joined the U.S. in their trade sanctions and chip bans in China hampering the technology giant. Chinese exports have fallen for three months in a row, by as much as 14.5% in July. Exports fueled China's economy during COVID-19 as the country was domestically under major lockdowns for the better part of 3 years.

Another driver of the Yuan's depreciation has been its Central Bank's monetary policy decisions in 2023. The People's Bank of China has slashed rates this year while most other Central Bank's have raised rates. The result has been large fixed-income capital outflows from China. Pre-pandemic Chinese interest rates paid more than U.S. interest rates, fast forward 4 years and that relationship has flipped. Equity investors in China expected fiscal stimulus to spur growth in the economy in the summer but that stimulus never came sending equities further down.

We have not been investors in China in recent years and currently do not hold any Chinese securities. We believe the Chinese economy has some major hurdles in front of it that it needs to address which will impact its high growth. We think other emerging markets will benefit from this pivot from China as they attempt to compete with them. Expect Chinese exports to continue to slide as trade sanctions and geopolitical tensions ramp up. China will be a huge discussion point in the U.S. election next year. Expect most candidates in both parties to have negative views toward the country and suggest trade and military sanctions against China.

Powell hits the breaks

On Wednesday, the FOMC and Jerome Powell announced that they would not be hiking interest rates in October. This pause will keep interest rates at the same level. Although this move was forecasted it brings a sigh of relief for homeowners and investors who thought Powell could surprise us all and hike rates after some hot inflation numbers were recently reported. This leaves the FED Funds Rate at a range of 5.25-5.5%.

Although in the immediate term, this was a good sign for equity investors, the FOMC increased its 2024 median FED Funds Rate from 4.6% to 5.1%, the 2023 median rate remained at 5.6% (the same value as the last meeting in July). The FEDs dot plot which was released in their policy statement points to 1 more rate hike to end this year.

The FED statement repeated that growth is strong, and inflation remains elevated. After inflation kicked into gear last month – with rising energy and food prices it seems the FEDs understanding of inflation was more accurate than what many market participants said. Many market participants have kept reiterating the point that inflation will move down and that the FED has overreacted to inflation, yet inflation heated up once again. If the FED listened to the 0% terminal rate high growth venture investors inflation would be at 11% and the U.S. would become the United States of Venezuela. Keeping rates higher than expected helped slow inflation but if you went online, you would think the FED and Jerome Powell were attempting to rob the American people.

Investors fell asleep at the wheel for years when interest rates were at 0%. Anyone can invest in a period like that. What makes a great investor can create a positive return and preserve capital in any kind of period especially a period when interest rates are elevated.

It is important to mention that Powell said the FED is ready to raise rates if it needs to combat inflation.

As interest rates continue to remain elevated or move higher, servicing debt for consumers, companies, investors, and even governments becomes more expensive. How long can the U.S. government afford to service their debt when interest rates sit at 5.5%? The longer rates remain elevated, the higher interest payments become. It is an important question to ask, after all the U.S. government just hit $33 trillion in debt after hitting $32 trillion on June 15th. 3 months to add on $1 trillion in debt is ridiculous and something we are surprised more voters are not looking at. Perhaps our governments have spending problems, not taxation problems…….

When virtuous names come to an end

The SEC quietly banned fund managers from mislabeling their fund names in a major crackdown on Wednesday. This rule will prevent investment companies from misleading investors through misleading fund names.

The crackdown comes as many green activists have been complaining that many ESG-focused funds do not invest their funds in strong ESG companies. Some investment companies have labeled funds (ETFs, mutual funds, closed-end funds, or private funds) as ESG through their names to attract investor capital while the fund barely invests in its implied theme.

Gary Gensler, the SEC Chair, said this rule will make funds have their name reflect most of their holdings. The new rule requires a portfolio to have an 80% match to the fund's name (meaning 80% of the investment fund needs to be invested in what the funds name suggests (ie. ESG investing in strong ESG scoring companies)). Fund managers will also have to add disclosures to their prospectuses to define the terms in their fund names and the criteria used to determine which investments meet those criteria.

The rule will eliminate virtue signaling from investment companies and will decrease the practice of greenwashing from large institutions.

The new regulation will go into effect 60 days after its publication in the Federal Register. Fund groups with assets of $1 billion or more will have 12 months to comply with the amendments, and fund groups with assets of less than $1 billion will be given 18 months.

As readers of this publication, you know we are not big believers in ESG but think this is a step in the right direction as institutions cannot fool investors with flashy names and mislead them.

MAAM turns 22 years old

MacNicol & Associates Asset Management Celebrates 22 Years of Investing Excellence

[Toronto, September 20th, 2023] - MacNicol & Associates Asset Management is pleased to announce its 22nd anniversary on September 17th, 2023. Over the past two decades, MacNicol & Associates has established itself as a leader in the investment industry, providing clients with a prudent and independent alternative for their investment needs.

Founded in 2001, MacNicol & Associates was established with the goal of offering investors a unique approach to asset management. Today, the company is proud to be recognized as one of Canada's leading independent asset managers, thanks to its talented and dedicated staff and the support of its valued investors.

David MacNicol, President and Portfolio Manager of MacNicol & Associates, expressed his gratitude for the contributions of both the staff and clients. He said, “Twenty-two years ago, we started this business to give investors an alternative grounded in prudence and independence. It is thanks to the exceptional efforts of our talented team and the trust placed in us by our investors that we have achieved our current standing within the industry.”

MacNicol & Associates is committed to delivering value to both its investors and portfolio companies. Based in Toronto, the firm specializes in identifying and nurturing high-potential companies across various sectors. With a focus on driving growth and innovation, MacNicol & Associates uses its expertise to support the success of its portfolio companies and maximize returns for its investors.

MacNicol & Associates Asset Management
September 22, 2023