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.

Hook Lighthouse, *Hook Head, County Wexford, Ireland*

Hook Lighthouse (also called Hook Head Lighthouse) is the second oldest continuously operating lighthouse in the world. The lighthouse stands at 115 feet tall, and the original structure was reportedly built in the 12th century.

Lighthouse of Genoa,
Genoa, Liguria, Italy

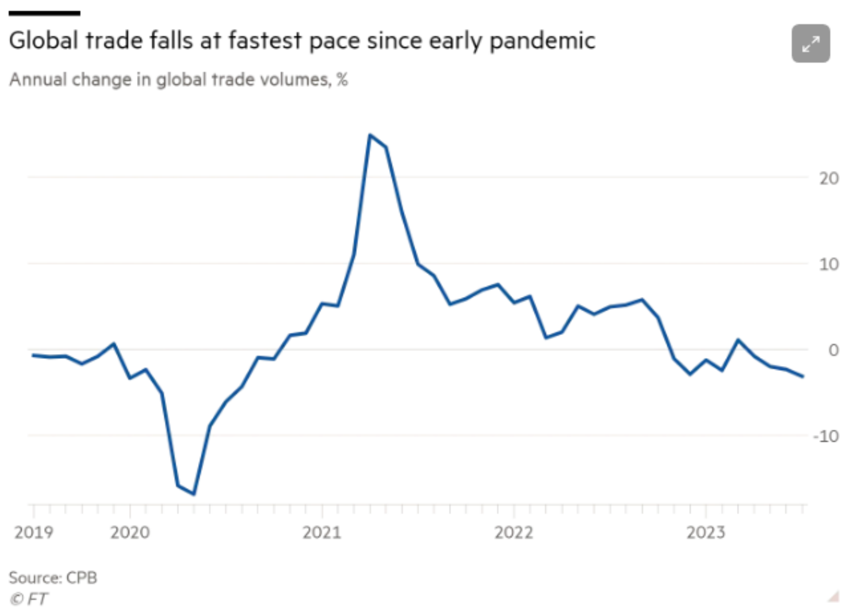
This lighthouse was originally built in 1128 and was rebuilt in 1543. The lighthouse remains active and stands at 249 feet tall. From 1543 until 1902, it was the tallest lighthouse ever built.

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

The global economy hits the brakes.

Global trade is a major indicator of the health of the global economy. Many economists use a blend of economic growth, investment, consumption, unemployment levels, and international trade to track global macroeconomic performance.

This week, it was reported that global trade fell at its fastest pace since the early days of the COVID-19 pandemic. You remember, those early days of COVID-19 when people were stuck on cruise ships, stores closed, restaurants closed, oil prices plunged, and global commerce screeched to a halt. Well at that point global trade fell year over year by approximately 19%, a massive drop reflecting the struggles of the global economy. This past week it was reported that global trade is down almost 5% over the last year. This slowing demand reflects consumer spending decreasing and the impact of rising interest rates across the world.



Financial Times

This slowdown in global trade could impact top and bottom-line numbers for companies across the world that depend on consumer spending and that produce non-necessity goods or services.

Who would have guessed?

The world was a different place just a few years ago. Some of the world was operating at full force, and some of the world was still locked down by a pandemic. Trillions of dollars were pumped into the financial system by Central Banks to support the global economy. This money was thrown into financial markets eventually creating numerous bubbles which have now popped. The Special purpose acquisition companies (SPAC) boom, crypto mania, and Non-fungible Token (NFT) surge were all direct results of easy money flooding the financial system.

This week we will not be looking at the SPAC boom which looks like a massive transfer of wealth from retail investors to founders and SPAC sponsors. We will not be looking at the crypto mania which saw massive returns in speculative crypto tokens. Both asset classes subsequently plunged when easy money ran out and investors realized they were promised a bag of goods that never existed. These investors also were more than likely woken up to the fact that fundamentals do matter.

This week we will be looking at the NFT market which looks to be the biggest bubble in modern finance.

Before we jump into what has happened, let's have a refresher on NFTs. NFTs are defined by Investopedia as assets that have been tokenized via a blockchain. They are assigned unique identification codes and metadata that distinguish them from other tokens. Two NFTs from the same blockchain can look identical, but they are not interchangeable. NFTs are unique as they cannot be replicated.

Many sellers of NFTs created online art sometimes as simple as clip art and sold them to investors online for high prices. Today, tens of thousands of NFTs that were once deemed as the newest thing in tech and a new hot asset class have been declared worthless. NFTs were promoted and sold regularly by celebrities across the world including Melania Trump, Snoop Dogg, Floyd Maywether Jr., Logan Paul, Lindsey Lohan, Eminem, and many more. These celebrities sold these tokens to their loyal followers who bought them thinking they would be a stable investment.

According to a new report, 23 million people are holding worthless NFT investments. NFT trade volume peaked at $17 billion a day during the 2021 bull market. The report that was released last week highlights the risks associated with incredibly high-risk asset classes and notes the need for more regulation and investor due diligence going forward.

Who would have thought that this picture would eventually become worthless?

Art, Finance

NFT of a Rock Sells for $1.7 Million

By Sam Mangioni - News
Published: 31 Aug 2021, Last Updated: 23 Feb 2023

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The NFT bubble is truly mind-blowing. How some investors bought this hype is beyond us.

Before you jump and read an article from the New York Times or CNBC on NFTs, remember they bought this hype during the bubble.

WEALTH MATTERS

A Painting or an NFT of It: Which Will Be More Valuable?

We are glad we never bought into the hype.

Here is the chart of a popular NFT collection known as the bored ape project which peaked in price in early 2022. The value of this project has subsequently collapsed leaving investors, including numerous celebrities, with massive losses.

<u>Geopolitical update</u>

We regularly write on the evolving geopolitical environment across the world over this publication's history. We usually look at economics and trade and highlight economic relationships like Brazil, Russia, India, China, and South Africa (BRICS) which is quickly becoming a powerhouse that is more powerful than the G7. This week, we read an interesting piece from Barron's that looks at alliances across the world that will be critical when there is a major global conflict that involves the U.S. (and Canada). Barron's highlights that there will be a large-scale conflict one day this century as history repeats itself. We will not argue with them as it is more likely than not that we will see a large conflict in our lifetimes.

Barron's claims that the U.S. and its allies simply cannot rely on each other and expect to win or come out on top. Relying on the G7 could be a losing formula as the East has formed a strong bloc that outstrips the G7. They believe America needs VIPS in a hypothetical future conflict. VIPS stands for Vietnam, India, Philippines, and Saudi Arabia.

The articles highlight numerous reasons why America and its allies need each country to compete with BRICS economically and militarily, but we will summarize them.

Vietnam could help the G7 on land in Southeast Asia, and despite Vietnam's rocky history with the West, it agrees with the U.S. on where the largest threat comes from - China. Vietnam has regular disputes with Beijing which could continue to push them toward the West.

The reasoning behind America and the G7's need for India is more complex as it is a member of BRICS. India aligning with the G7 would weaken China and its allies in a conflict. The U.S. and the West could help India on an economic level to persuade them to join an alliance. The Indian government historically and currently acts in its own best interests and could turn its back on Chinese communism and embrace the West.

The Philippines-American relationship has been good, bad, and indifferent in recent years as the Philippines has taken a neutral stance on the conflict. The U.S. and its allies would need numerous allies in Southeast Asia to stop China from dominating the area upon conflict.

The U.S. is currently firming up its long-time security deal with Saudi Arabia and has strong relations with the country. The reason the U.S. and the West need Saudi Arabia is to weaken Russia. Saudi Arabia could weaken Russia which is extremely reliant on oil prices. Saudi Arabia could one day stop Russia from disrupting global energy markets and would give the U.S. and its allies a strong ally who could supply their energy needs.

We highlight this article not to jump into the geopolitical world but to highlight some relationships that could evolve moving forward. Economic partnerships could be agreed on moving forward and we want you to know they could have much deeper meanings. Moving forward, the U.S. and its traditional allies need help economically and militarily especially as the East and West decouple.

However, these alliances will not be easy to smooth over. America and its allies face a difficult road ahead. Vietnam is nominally a communist power, India does what it wants, the Philippines could wonder if a relationship with China would have more benefits, and Saudi Arabia has the money, and power to go into conflict alone or stay neutral like Switzerland has done in the past.

ESG exodus

Asset managers who have faced pushback on their ESG funds over the last year or two have decided to close their funds rather than change their composition.

BlackRock and State Street have decided to shut down various ESG investment vehicles this year. More ESG funds have closed this year than the previous 3 combined as the investment fad looks to be hitting the brakes.

BlackRock, State Street Among Money Managers Closing ESG Funds

- More ESG funds in US closed in 2023 than in three prior years
- BlackRock said it continually evaluates its range of products

ESG funds have been scrutinized for their inconsistencies over the last year as scores for companies vary by platform. Environmentalists have also pushed back that these funds have not done enough to address climate concerns. On the other side, investors have pulled their money from these managers believing that they are adding to the problem and are investing through beliefs and not fundamental data. We are not sure what to think but believe ESG scores are extremely flawed and inconsistent and believe discounting returns for ideology is also bad practice as an Asset Manager.

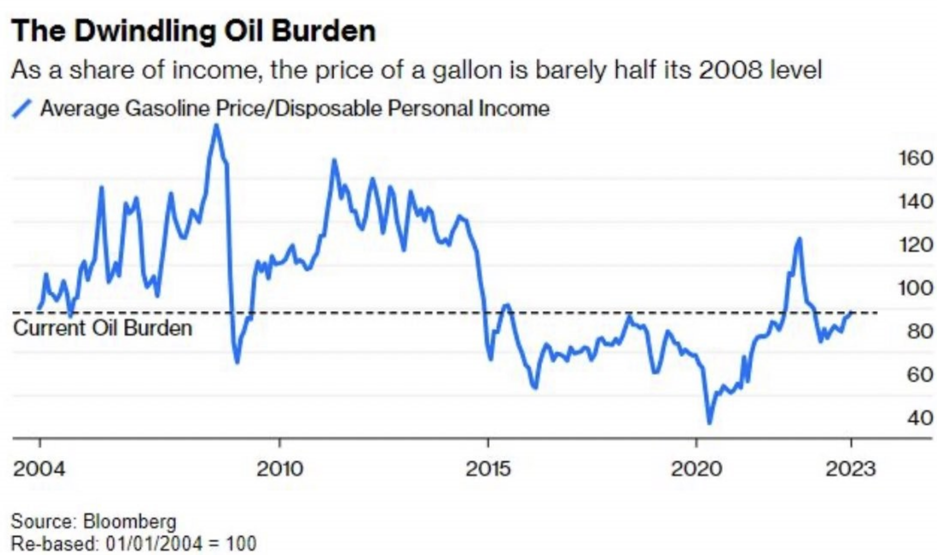
Political backlash from both sides of the aisle paired with investor outflows seems like a good reason to quietly close these funds. It seems like a lose-lose situation for these massive managers and perhaps closing a few funds is the smartest thing to do.

Is oil expensive?

Oil has rebounded in price, reaching the low 90s in recent days. This is after oil surged in price to start 2022 peaking at $120 per barrel in June of last year as Russia invaded Ukraine. Subsequently, prices retreated eventually reaching the mid $60s this past spring. The rebound we have seen has consumers, companies, and governments up in arms about rising energy prices. The rise in energy prices has even led to a resurgence in the annual inflation rate which is now increasing yet again (in both Canada and the U.S.).

Our thesis on the oil market and oil stocks never wavered. The structural deficit between supply and demand paired with limited capital investment from companies will lead to higher oil prices for the foreseeable future. Governments around the world vilified oil companies for the last decade and now are begging them to increase production. Oil companies have been left out to dry while companies across other sectors have been bailed out during tough times. This has resulted in oil companies cleaning up their balance sheets, increasing efficiency, and decreasing capital expenditures which has led to boosted earnings, huge free cash flows, and a great setup for energy investors.

Beyond the setup, higher energy prices lead to higher costs for companies across every sector as well as higher costs for consumers. However, today's oil prices as a share of income are barely half of the 2008 level that we saw.



Consumers have gotten used to higher housing prices, higher food prices, higher clothing prices, higher flight prices, and higher electronic prices, over time but not energy prices.

Will these high prices become the new norm for consumers? Is the demand destruction price for oil much higher than in previous cycles? Will consumers be forced to rebalance their monthly budgets to account for higher energy prices? We think so. However, we think some energy investors are a bit naïve in their "let's see oil go to $150-200" narrative. Oil companies can create juicy cash flows at current oil prices and consumer demand will not decrease. We are currently at the low to mid-end of the sweet spot for energy investors. We hope you come along for the ride, for now, we think oil prices could move higher and consumers will have to get used to higher prices on their gas bills and at gas stations.

Mexican election

Mexico is gearing up for a presidential election next year like its northern neighbors. The election will be held in June and the major party leaders have already been decided on. The voters of Mexico will vote for a new president to serve a 6-year term. The current President is a 1 term President and decided earlier this year that he would not seek an unconstitutional second term. According to Mexican law, a president can only hold office for one term. Many feared the current leader would ignore this and continue his undemocratic tendencies. The leader stepping down respects the rule of law and upholds democracy in Mexico at a time when authoritarianism has taken hold of Latin America (Venezuela, Nicaragua, and El Salvador).

The next election will see former Mexico City Mayor Claudia Sheinbaum who leads the incumbent left-leaning Morena party facing off against several leaders. Her principal opposition will be a center-right coalition led by Xochitl Gavez. The two largest parties are currently led by women who many believe will not negatively impact the Mexican economy and Mexican financial markets with aggressive policy.

The incumbent left-leaning party is polling ahead but many believe this election could end up being closer than expected as the right-leaning coalition gains popularity.

Mexican markets have performed well this year. We have regularly written about this in this publication as we have positions in Mexican equities. The peso is up 14% relative to the U.S. dollar this year, the Mexican GDP is expected to grow by 3% for the second year in a row, inflation in Mexico has halved this year, the Central bank has space to cut rates to spur growth as the prime rate is 11.25%, and Mexican equities have performed quite well. Not bad for a country with a self-proclaimed leftist revolutionary President.

BCA, a geopolitical strategy firm highlighted that both candidates are strong and look like they will positively impact the Mexican economy. The leader of the incumbent party is not as combative as the current president and leans a little less left which will benefit Mexican capital markets.

Many believe that both leaders will embrace U.S. private enterprises and will capitalize on the nearshoring trend that is in its infancy stage as the U.S. decouples its manufacturing from China.

Mexican equities trade-in value territory and will more than likely benefit from policy decisions from both parties. Mexican bonds could also be an option as many believe the Central Bank in Mexico will begin to slowly cut rates to spur investment and growth.

We are not geopolitical experts and understand things can change in Mexico but for now believe the election will benefit the Mexican economy, no matter the result.

Another government shutdown?

If you have read the news this week you would see familiar headlines "Government shutdown" or "Congress faces shutdown". We are facing yet another federal government shutdown just months after we almost faced one. As of this writing, Congress appears on track to trigger a government shutdown on October 1, 2023, as it cannot pass 12 appropriations bills that fund the government before the start of the new fiscal year.

Under the Antideficiency Act (passed in 1884 and amended in 1950), federal agencies cannot spend or obligate any money without an appropriation from Congress. During shutdowns, many federal employees are told to not work. Benefits such as Medicare and Social Security continue to be paid as they do not need an annual approval. The Treasury can also pay interest on outstanding debt at this time.

On Tuesday, the Senate passed a stopgap funding bill to temporarily avoid a government shutdown but in the House of Representatives, division continues to threaten a shutdown. The Senate voted 77-19 to begin debate on a measure that would fund the government through Nov. 17 and includes around $6 billion for domestic disaster responses and another roughly $6 billion in aid for Ukraine. The Republican House continues to push forward measures that will not pass in the Democrat-led Senate causing the shutdown worries.

Democratic President Joe Biden and U.S. House Speaker Kevin McCarthy had aimed to head off a shutdown this year when they agreed in May, at the end of a standoff over the federal debt ceiling, to discretionary spending of $1.59 trillion for the fiscal year beginning Oct. 1.

We will not get into the major implications of this shutdown until it happens as it seems a deal is always struck at midnight to continue government operations.

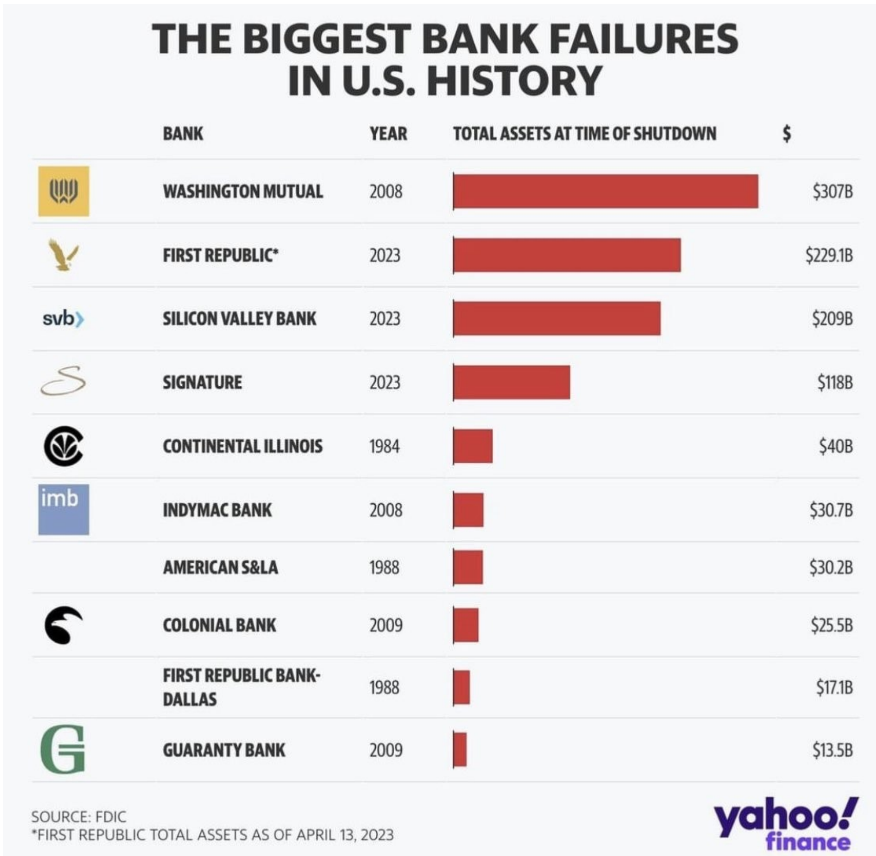
We will however talk about an implication that could stall a recently hot IPO market that has been sputtering for most of the last 18-24 months. That's right a government shutdown could negatively impact the IPO market.

The SEC says it will suspend processing of IPOs along with other filings if Congress cannot pass an appropriations bill by September's end. If the SEC goes on hiatus, it would be another hurdle for anticipated deals including shoemaker Birkenstock, home builder Smith Douglas Homes, or computer game maker VNG Ltd.

Federal securities law has a provision allowing firms to go ahead with an IPO without the SEC's sign-off but many analysts doubt companies would pursue this route due to shortcomings stemming from it.

Flashback

This week, 15 years ago the largest U.S. bank to ever fail, defaulted. Washington Mutual, which failed in 2008, was larger than any bank in history to fail in the U.S. It was larger than the failures of 2023 when First Republic, Silicon Valley, and Signature Banks failed.



For now, it looks like the 2023 bank failures are over and contained but looking back at past crises reflects how small 2023's issues were relative to 2008.

MacNicol & Associates Asset Management
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