THE WEEKLY BEACON NOVEMBER 17, 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.

Chania Lighthouse

Chania, Greece

Chania Lighthouse, is a lighthouse located at the entry of the port of Chania, on the island of Crete, Greece. It was built in 1864 on the location of the original lighthouse by the Venetians. The lighthouse has a height of 26 meters.

Lighthouse of Cap de Formentor, *Cap de Formentor; Majorca; Spain*

The Formentor is an active lighthouse on the island of Majorca. The lighthouse has a focal height of 210 meters tall and is the highest lighthouse in the Balearic Islands. The lighthouse was built in 1863 and has a range of 24 nautical miles.

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

Prices hit the brakes.

October's inflation numbers were released on Tuesday morning by the U.S. Bureau of Labor Statistics and the release reflected flat prices in October.

October's CPI came in at 0.0% versus an estimate of 0.1% pointing to incremental progress in the Federal Reserve's effort to get prices under control. Cheaper gasoline prices took the edge off U.S. inflation slowing the annual rate of inflation down to 3.2% from 3.7% in September. However, the core inflation rate rose 0.2% in October falling to 4% over the last year. This suggests some stickiness to inflation as the core inflation rate has remained near 4% for the last few months well above the FEDs 2% target. Many economists use the core inflation rate rather than the headline rate as they believe it is a predictor of future inflation trends.

This soft headline inflation data could push the FED to leave rates alone at their December meeting. The FED's next decision and last of the year is due December 13th. The FED has raised interest rates 4 times in 2023 but has not changed its policy rate over the last 2 meetings.

Markets took this announcement quite positively on Tuesday as investors piled back into equities:

Dow	34,827.70	489.83	1.43%	▲
S&P 500	4,495.70	84.15	1.91%	▲
Nasdaq	14,094.38	326.64	2.37%	▲

Small caps even got in on the action as the Russell 2000 had its best day in over a year.

We are not huge, small-cap investors but ask the question, has the tide changed on small caps after 2 years of beatdowns? We will have to see.

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Xi in China

As tempers boil between the West and China, many fear the relationship could completely sour and more trade sanctions could be put in place. Despite this geopolitical rift, President Xi made his first visit to American soil in over six years. Xi met with President Biden at the APEC Summit in San Francisco this week. APEC is the Asia-Pacific Economic Cooperation which is a regional economic forum established in 1989 with the following 21 members:

Member Economies

Australia	Japan	Philippines
Brunei Darussalam	Republic of Korea	Russian Federation
Canada	Malaysia	Singapore
Chile	Mexico	Chinese Taipei
People's Republic of China	New Zealand	Thailand
Hong Kong, China	Papua New Guinea	United States of America
Indonesia	Peru	Viêt Nam

As San Francisco was set to host the summit, Governor Gavin Newsom cleaned up the city to hide the city's homelessness problem (among others) from other world leaders. Newsom flat-out admitted that he only cleaned the city up for the visiting leaders. Here is Newsom's quote where he directly admits to this:

> "I know folks say, 'Oh, they're just cleaning up this place because all those fancy leaders are coming into town.' That's true because it's true," Newsom said.

The Governor has arguably destroyed San Francisco over his 4 years in office, once a hotbed for innovation and technology now has become a crime-ridden city that has a major homelessness problem. Our point main point: the Governor cares more about global leaders like President Xi than he does about the people of San Francisco. The ironic part of Newsom and his cronies cuddling up to China and President Xi is the American public has completely turned on China over the last 6 years.

Back to China and President Xi.

Many hope the in-person meeting between Xi and Biden will ease tensions between the world's two most powerful countries. The leaders are expected to talk about Taiwan, Israel and Hamas, Russia invading Ukraine, fentanyl, AI, and more.

Xi and Biden are expected to meet far from the conference location at Filoli Estate, miles outside of San Francisco and carefully chosen for its security, serenity, and remoteness.

However, many close to the two leaders are less optimistic about easing tensions between the two countries. The Biden Administration has publicly stated that they want to help the struggling Chinese economy which has undergone turbulent times over the last few years. Many believe this economic assistance could push Xi and China to be more cooperative with Biden and the U.S.

We will have to see if both sides are serious about easing tensions when there is so much that divides them.

In a show of unity before their meeting on Wednesday, Xi and Biden pledged to fight the global climate crisis together. In a joint statement after climate talks in the U.S., they pledged to make a success of a crucial UN climate summit starting at the end of this month in Dubai and recommitted to the 2015 Paris climate accord goals of holding global heating to “well below” 2C, while pursuing efforts to limit the increase to 1.5C.

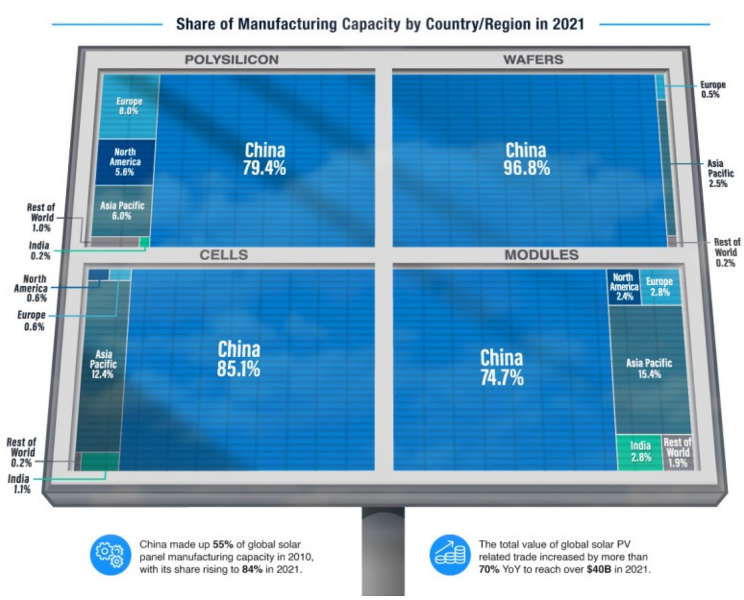
China and the U.S. are the world's two biggest greenhouse gas emitters. The countries mentioned energy transition, and methane and deforestation as major issues that need to be addressed. China cut off climate relations over a year ago amid rising tensions over Taiwan. In the joint statement, the countries mentioned that they will ramp up the use of renewables as they rush to accelerate the substitution for coal, gas, and oil. However, there was no mention of phasing out certain fossil fuels like coal which China is extremely reliant on.

10 Countries with the Highest Total Coal Consumption in the World (million cubic feet)

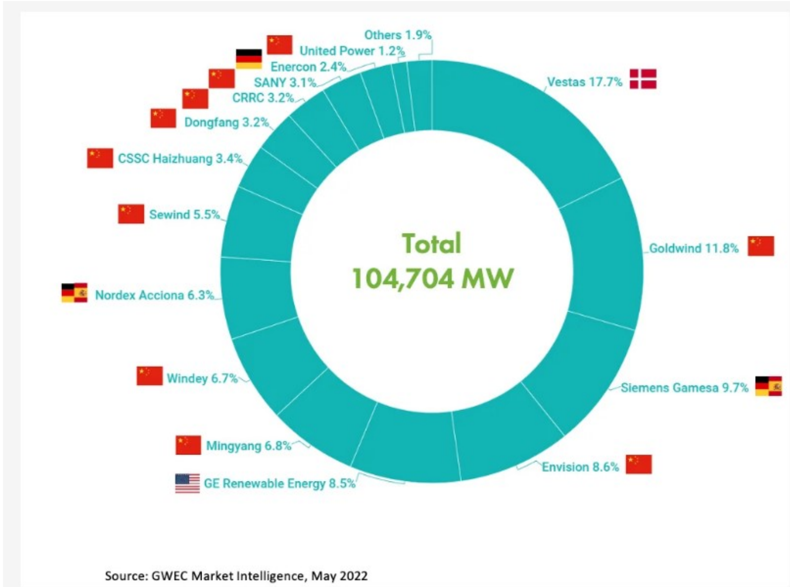
1. China — 4,320 trillion MMcf
2. India — 966 trillion MMcf
3. United States — 731 trillion MMcf
4. Germany — 257 trillion MMcf
5. Russia — 230 trillion MMcf
6. Japan — 210 trillion MMcf
7. South Africa — 202 trillion MMcf
8. South Korea — 157 trillion MMcf
9. Poland — 149 trillion MMcf
10. Australia — 130 trillion MMcf

China consumed six times more coal than the U.S. did last year, and they continue to build more coal plants. China continues to invest in coal as a cheap energy option despite their climate promises. Who is to say this week's promise from China means anything if they do not make any changes of substance?

After all, China benefits from the West's climate promises as they dominate the solar panel industry and are large players in other renewable energy areas. China's dominance in the solar panel industry is real as they have monopolized every channel within the industry:



Here are the world's largest wind turbine suppliers as of 2021, note many are Chinese-based companies:

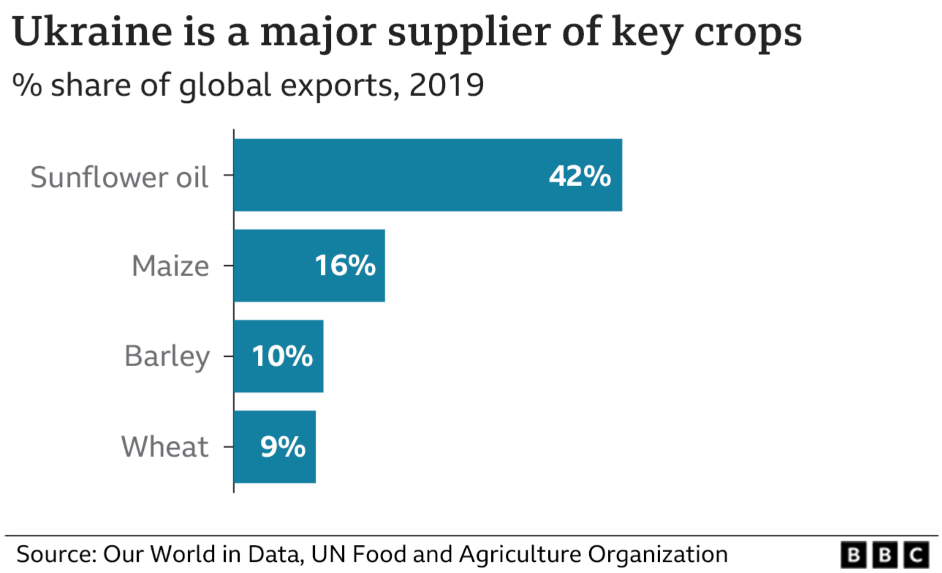


We will simply say that the West is too reliant on China in these areas and tensions between the two could present some serious risks moving forward. Geopolitical risk in energy, unlocked. Look what happened last year in Europe regarding Russian natural gas, something quite similar could happen in this space down the line.

We are not as optimistic about China's promises regarding climate change as their actions say something else. We will have to wait and see what China and the rest of the world do when they realize we still need oil and natural gas to keep the lights on and wind turbines and solar panels are not the only energy solutions moving forward.

Fertilizer's time?

When Russia invaded Ukraine energy prices went parabolic in early 2022 before pulling back to end the year (we all know this). The same trend happened with various foods as well as fertilizer prices last year. Russia is the world's third largest producer of fertilizer (behind the U.S. and India) and Ukraine is the world's 9th largest producer. Ukraine is also a major exporter of various agricultural goods which have slowed down due to the conflict occurring in Ukraine. This caused surging food prices all across the world due to supply disruptions.



This sent the stock prices of the limited amount of listed fertilizer producers on exchanges soaring as well as the spot prices for various agricultural commodities. Many investors ignored this sector for years and did not follow the supply chains in this sector or the potential issues the industry could face. These issues bubbled over when Russia invaded Ukraine.

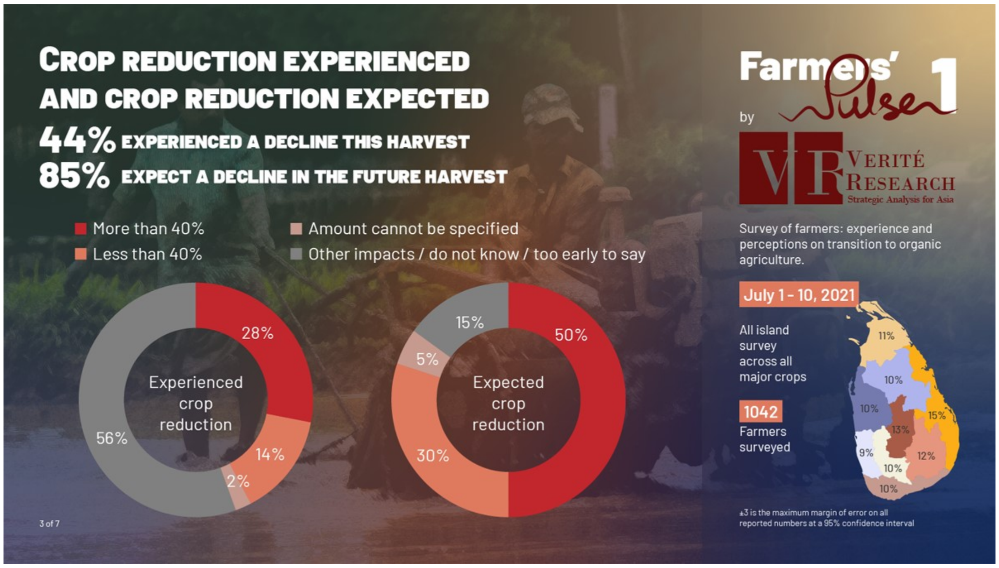
We do not think 2022's run-up will be the only run-up that food producers and fertilizer companies will have over the next decade. We think prices will move higher moving forward for several reasons which include regulation from governments, trade sanctions (caused by geopolitical rifts), and global supply issues caused by higher prices, drought, and disaster.

We think the best way to play this trend is through fertilizer producers whose stock prices have a high correlation with the prices of various agricultural commodities.

First, we will explain how government regulation in the fertilizer sector is impacting the global supply of food and boosting fertilizer prices. As governments move to reach climate goals, they have not only increased regulation in energy, but they have also done the same in the fertilizer space. Various governments around the world have outright banned certain fertilizers which have historically been used by farmers. These fertilizers that are in short supply around the world help keep crops productive, guarantee plants are getting proper nutrition, protect plants, and increase crop yield.

Regulation over the last decade in this space has ramped up tremendously as the world looks to meet its climate goals. Here are just a few examples of how government regulation is impacting food and fertilizer prices:

Sri Lankan farmers who faced fertilizer bans just a few years ago have been surveyed and many have seen reduced crop output and almost all expect a decline moving forward due to these fertilizer bans.



Farms are even being closed across the world to comply with emission reduction acts. Just a year ago the Netherlands announced that they will be closing up to 3000 farms.

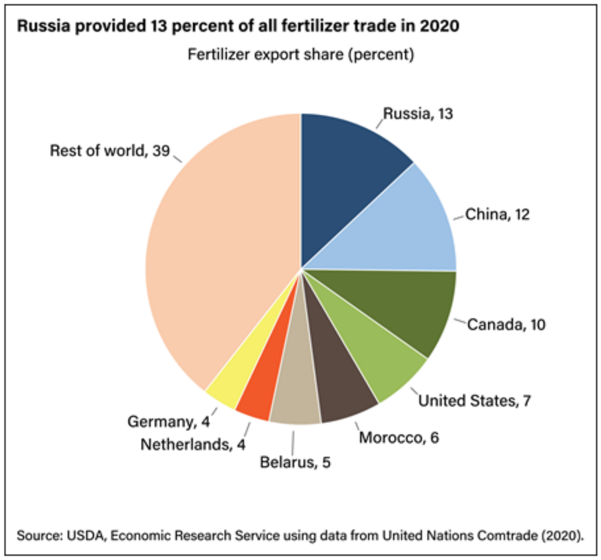
Netherlands to close up to 3,000 farms to comply with EU rules

Government tries to cut down on nitrogen pollution in a move set to reignite tensions with farmers who say the industry is unfairly targeted

By James Crisp, EUROPE EDITOR
28 November 2022 • 4:02pm

This over-regulation will continue. The energy crisis that we have long talked about will lead to a food crisis as well and fertilizer prices have a high correlation with certain energy commodity prices.

Trade sanctions are also something to look at in the fertilizer space and came to the forefront when Russia invaded Ukraine. Trade sanctions by countries on Russia have led to higher fertilizer prices as supply has shrunk and transportation volume of the products has decreased. Potash access decreased after Russia's invasion as Belarus, a Russian ally and Russia are major producers of the product needed in fertilizer. Rising natural gas prices also led to surging fertilizer prices last year. The fertilizer market is not extremely concentrated, but the world's two largest players are not allies of the West which could lead to more supply problems across the world moving forward especially if tensions rise between certain parts of the world and China and Russia.



We are not saying this is a guarantee but if something were to happen geopolitically, fertilizer prices could explode.

Higher fertilizer prices in 2022 caused supply issues globally which has led to even more food shortages in the poorest parts of the world.

Finally supply issues in the fertilizer space. Fertilizer shortages spread across the world last year and we are feeling the effects this year. As energy prices surged last year, prices rose for producers. Nitrogen fertilizers are made through a chemical process that consumes energy, typically natural gas. As gas prices rose, fertilizer companies increased prices. Other factors including access and global trade led to shrinking supply. Fertilizer shortages have continued to be an issue in 2023 despite prices falling, many forecast this issue to accelerate moving forward.


AGRICULTURE, FOOD AND BEVERAGE

This is how war in Europe is disrupting fertilizer supplies and threatening global food security

Mar 1, 2023

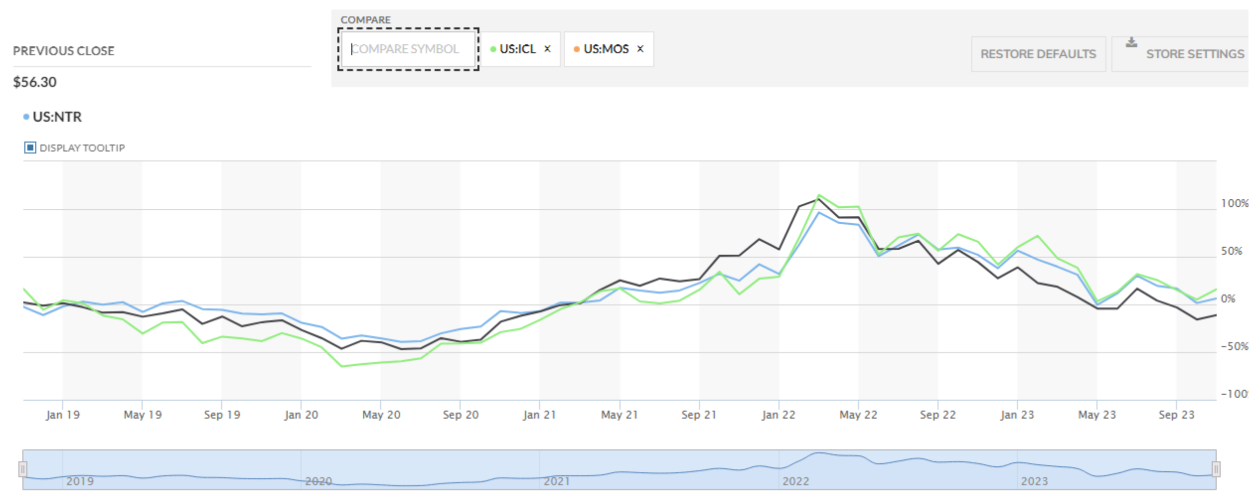
We think this is an issue down the road and are looking to position ourselves accordingly.

There are several publicly North American listed producers of fertilizers that you can look at.

The largest being Nutrien, Mosaic, and Israel Chemicals which are all listed on the NYSE.

Nutrien is headquartered in Saskatchewan, Mosaic in Tampa Bay, Florida, and Israel Chemicals in Tel Aviv. In terms of market capitalizations Nutrien is the largest at $28 billion, Mosaic $12 billion, and ICL $6.6 billion.

In terms of historical stock prices, the 3 producers are relatively flat over the last 5 years and are down over the last 1.5 years. As the companies are tied to commodity prices, they trade with higher volatility, but we think now could be a great opportunity to buy these companies if you haven't already. All are trading near 52-week lows and seem to have found their bottoms on this downswing in fertilizer prices.



We like these companies due to the fertilizer narrative that we described above but also their valuations which are extremely attractive to us. All three companies trade-in value territory, produce consistent earnings and even pay a dividend.

COMPANY	NUTRIEN	MOSAIC	ISRAEL CHEMICALS
PRICE TO BOOK	1.11	0.97	1.16
PRICE TO EARNINGS	11	11.06	6.27
PRICE TO SALES	0.92	0.81	0.83
STABILITY RATIO	1.52	1.53	N/A
EV / REVENUE	1.36	1.00	1.06

We see tremendous upside in the fair market value in several of these companies moving forward. The companies all relatively have clean balance sheets and are well-capitalized moving forward. The companies are all producing positive cash flows and positive earnings.

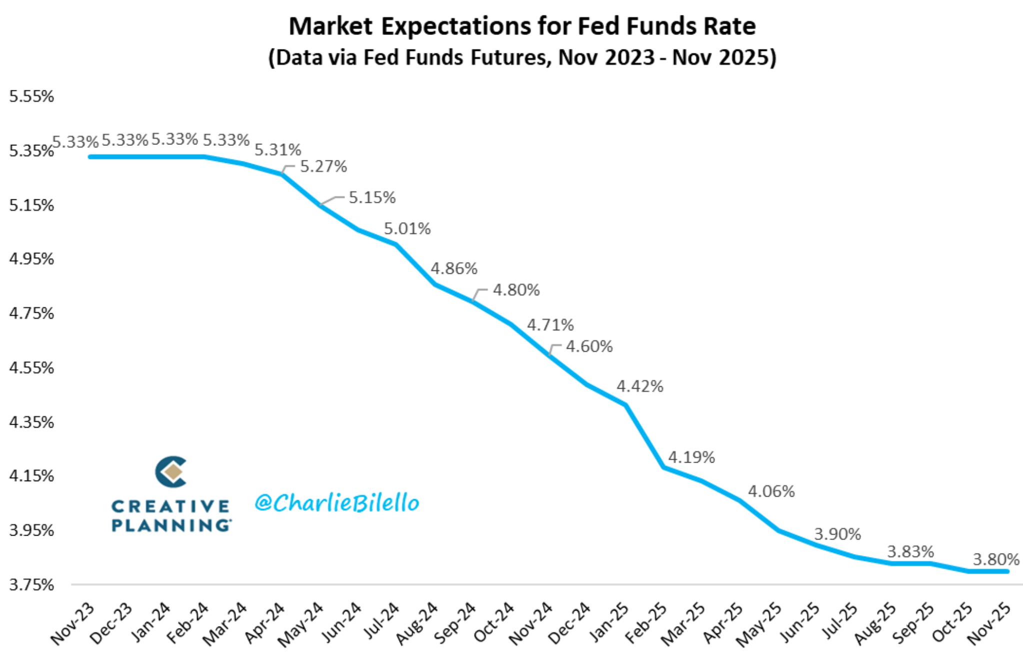
We think share prices in this industry could move higher quite quickly moving forward. The companies also produce fertilizers which are volatile in price making their stock prices highly volatile, but they produce necessity goods for humanity that are needed in any economic environment. Act as you will.

Fertilizer stocks are another diversified way of expressing a bullish view on traditional fossil fuel prices.

Disclaimer: MacNicol & Associates Asset Management clients have exposure to companies operating in the fertilizer industry including companies mentioned in the write up above.

To cut rates or to not cut rates?

After Tuesday's soft inflation print, market participants now believe interest rates have peaked and that they will only head down from here. The CME Group's FED Funds Rate Watch Tool believes there is a 100% chance that rates will stay the same at the next two FED meetings. The next two meetings are on Dec 13th and January 31st. Beyond that market expectations believe that interest rates will almost be slashed by 1% by the end of 2024 and will be close to 3.8% in 18 months.

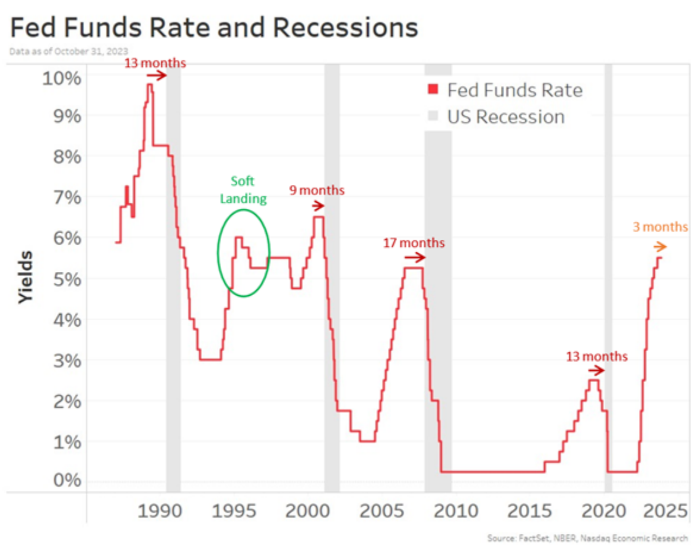


We understand that inflation rates have changed and there are major recession fears, but we think the FED will keep rates a bit higher than many expect for longer. We are not saying more hikes, we are saying more pauses unless something warrants a major policy change (ie. Slashing rates and slashing quickly).

After all that Powell and the FED have said, it seems many market participants are trying to be as optimistic as possible and positioning themselves for a massive rally.

However, if the U.S. economy does tip into a serious recession, our minds will change on interest rate policy.

Looking back on history and applying that to today has resulted in our belief that a recession is coming – although that recession might be mild. Historically, recession lags interest rate increases, and of the 5 periods where rates were hiked since the mid-1980s, 4 resulted in recessions and those recessions began on average 13 months after the last rate hike occurred. We are only 3 months into the last rate hike which would mean a recession could occur sometime next year.



However, as you read our thoughts on economics, understand that we are financial analysts and portfolio managers not economists. We are best setting up our client portfolios for any economic backdrop moving forward and believe we can limit investor downside without discounting investor upside through our diversified approach across asset classes and sectors as well as our portfolio insurance that we call fire insurance.

MacNicol & Associates Asset Management
November 17, 2023