THE WEEKLY BEACON **NOVEMBER 3, 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.

Lindesnes Lighthouse,

Lindesnes, Norway

Lindesnes lighthouse is a coastal lighthouse at the southernmost tip of Norway. The lighthouse was originally opened in 1655 and was automated in 2003. The lighthouse stands at 16 meters tall and set atop rugged rocks.

Cape Espichel Lighthouse,

Cabo Espichel, Portuga

This lighthouse is situated on the western coast of Castelo. The lighthouse was built in 1790 and was automated in 1989. The lighthouse stands at 32 meters tall and is a photographer's dream.

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

A recession up north…

The Great White North looks to have a big problem on their hands……a recession.

The Canadian economy is contracting, and Justin Trudeau's government looks like it has yet another problem on its hands. Statistics Canada released its August GDP numbers on Tuesday along with preliminary third-quarter numbers and the data appears to show the Canadian economy in a recession. The three straight months of flat output since July point to a decline of 0.1% annualized for the quarter, following a decrease of 0.2% over the period from April to June. Although third-quarter data will likely be revised, the economic growth is much slower than the expected 0.8% growth rate forecast made by the Bank of Canada just a few months ago.

Statistics Canada also reported that GDP was unchanged in August, missing the median street estimate of 0.1%. Bloomberg surveyed several economists in this study.

Tuesday's GDP data supports the Bank of Canada's view that interest rate increases are working through the economy, slowing consumer demand and inflation down.

Governor Tiff Macklem and his officials held borrowing costs at 5% for the second straight meeting last week.

Gensler scared of artificial intelligence

The head of the Securities Exchange Commission, Gary Gensler, argued in an interview this week that AI could negatively impact financial markets. Gensler noted AI as revolutionary but noted the major risks that could impact equity markets moving forward.

He noted that many financial actors could rely on the same 2-3 financial models, thus creating a monoculture and herding. This could lead to underlying risks across the system.

This herding effect could not be accounted for in these AI financial models which could cause large unpredictable changes in markets during times of financial stress according to Gensler. Gensler pointed to the examples of cloud computing and search engines as markets for tech products that have quickly become dominated by one or two major players, and he said he worries about similar concentration in the market for AI technology.

Even though Gensler has been a harsh critic of the cryptocurrency industry for quite some time, he has only recently rung alarms on the AI industry. Gensler said in his interview that his agency is already contemplating new rules to regulate AI in finance. For example, the SEC proposed a rule this summer to address conflicts of interest associated with stockbrokers and investment advisors that leverage algorithms to predict and guide investor decisions through their smartphone applications or web interfaces.

We are not sure if any of these rules will be put into place or if this is just smoke from an interview that follows a major trend. However, we would warn Mr. Gensler for the time being that he should worry about current issues in financial markets and investors who have been harmed over the last few years rather than hypotheticals. The entire cryptocurrency industry has been littered with fraud and bad actors who have not been punished. The SPAC industry also has had its fair share of controversy over the last 2-3 years and maybe Gensler's agency should take a closer look at the SPAC sponsors who ripped off retail traders. This all in our humble opinion.

WeStink

The office-sharing company WeWork rose to prominence before COVID-19 filed for bankruptcy this week in what looks like the end to a roller coaster ride for investors, consumers, and executives at the company.

Reports from numerous sources on Tuesday night and Wednesday morning of this week point to WeWork's bankruptcy filings as imminent. In response to these reports, shares plunged over 50% to a new all-time low on Wednesday.

Shares are down 98% year to date and 99.7% since WeWork went public. WeWork's market capitalization has crashed to $59 million as of this writing versus $326 million two months ago, $9 billion at its public market debut (March 2021), and $47 billion at its peak valuation (January 2020). WeWork has raised over $22 billion in funding (including debt) from investors such as SoftBank, BlackRock, and Goldman Sachs since its founding in 2010.

WeWork remains a huge black spot for SoftBank who sunk billions into a business many doubted. WeWork never turned a profit in its history.

WeWork withheld interest payments on a note due in 2025 that was due on November 1st, even though they had the cash to cover this payment.

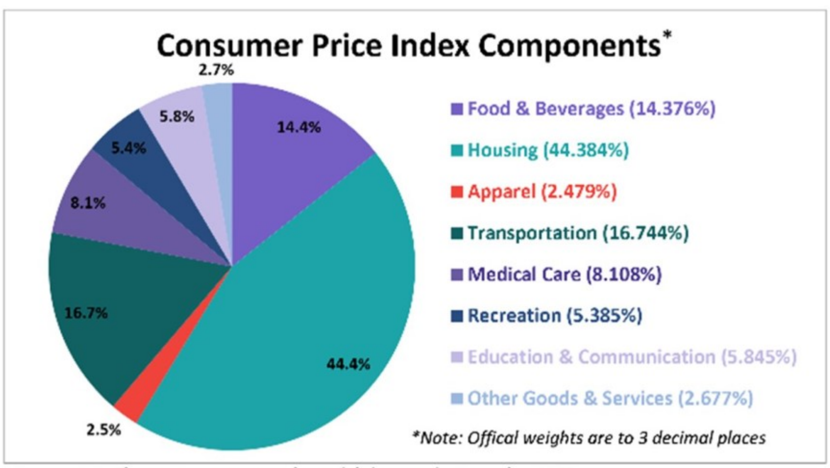
WeWork remains a significant tenant in many large office markets and its failure or restriction could further weigh on industry fundamentals. Office real estate has yet to recover since COVID-19 began and companies are trimming office space which has impacted the entire market. Office real estate has been the worst-performing real estate asset over the last 3-4 years as demand has disappeared.

WeWork made a $694 million loss in the first half of this year, an improvement on the $1.1 billion loss it reported for the first six months of 2022. In August, WeWork said substantial doubt exists about its abilities to continue operations, if you piled in on that warning, we would recommend an advisor or two or would even recommend roulette in Vegas as a better alternative than WeWork stock.

CPI basket

How do governments calculate inflation? The equation is ever-changing, and investors and consumers deserve to know. Governments have changed the weightings of certain inputs over time to manipulate the rate of inflation. It has happened numerous times in history, so the headline number does not seem extreme to consumers. After all, both the Canadian and American governments (along with others around the world) have been getting creamed over the last 18+ months for high inflation rates.

We ran by an image this week that graphically shows how the CPI in the U.S. is calculated currently. We wanted to share that image with our readers who are still focused on inflation like we are.

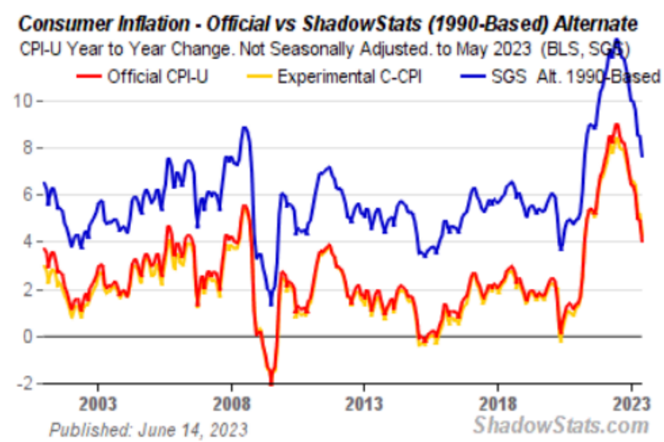


Source: BLS; The most recent annual reweighting was in December 2022

The weightings are a tad stale as they are as of December 2022 but are accurate, nonetheless. The largest weightings are housing, food, and transportation (all no surprises). However, every consumer has different monthly spending habits thus resulting in millions of different inflation rates. Just because inflation is reported at 6% does not mean that is accurate for Joe Smith from Toronto, his rate could be 12% depending on his monthly budget.

We think inflation rates could remain sticky to the end of 2023 and start of 2024 which will push back rate cuts. We also think we may see inflation waves like the 1970s when inflation rebounded after decreasing quite substantially. Dealing with inflation could become the new norm for investors and consumers for quite some time.

On the inflation front, we will leave you with one chart from an economist that we regularly consult with. The economist has been tracking CPI in the U.S. using the 1990s-based calculation (before large changes were made) and the numbers jump off the page:



He is tracking inflation at just under 8% and had it peaking well above 11% at the end of last year. For comparison, the red line trend is the official CPI that the U.S. government is currently reporting.

Corporate America's "China warning"

Three North American consumer-focused firms reported poor revenue and earnings this week and all of them blamed soft demand from China. Estee Lauder missed revenue forecasts and cut its 2023 outlook on Wednesday. Canada Goose Holdings revenue fell short of expectations, and Yum China Holdings missed Q3 revenue estimates. All three firms blamed Chinese demand and slow growth in China. Yum China Holdings reported extremely soft numbers, missing Wall Street expectations for the third quarter in a row.

Estee Lauder shares plunged 17% on Wednesday after the news, Canada Goose shares dropped 9% on Wednesday and are down 42% year-to-date, and Yum China shares are down 25% year-to-date.

The Chinese consumer has not shifted into hyper buy in 2023 like Western consumers did after their lockdowns ended.

Yum China Holding's CEO said in a call this week that demand has remained slow in October like it has been this year.

The Chinese market is souring on firms across the world even as products are available. Imagine what will happen to these companies and their sales when more trade sanctions are put in place (if China's U.S. geopolitical issues continue to accelerate).

We continue to have our doubts about the Chinese economy and will not be buying any Chinese securities moving forward.

A success story

Alimentation Couche Tard Inc. is a Canadian multinational operator of convenience stores and is wildly successful at what it does.

The company which was founded in 1980 and boasts a $74 billion market cap, operates 14,302 stores worldwide, and had $72 billion in revenue in its last fiscal year (ending April 30, 2023).

Shares are up 27% year-to-date and 139% over the last 5 years.

The consumer staple has withstood all types of market conditions and continues to move higher. Even with the market turbulence we have seen in September and October, ATD continues to hold strong.

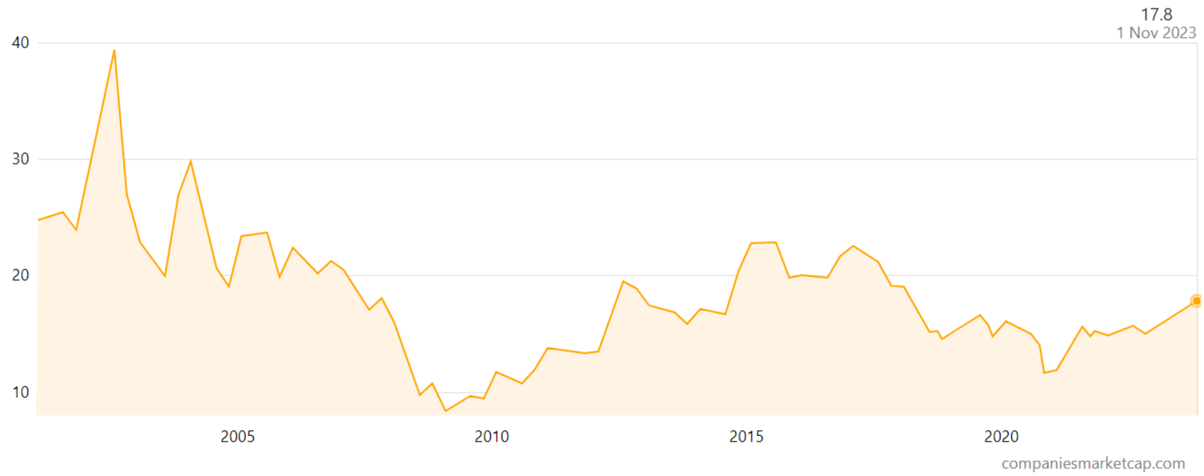
Before we get into the weeds, what does ATD do?

The company operates convenience stores in Canada, the U.S., Mexico, Ireland, Norway, Sweden, Denmark, Poland, Russia, China, Japan, Indonesia, and the Baltics. The company operates its stores mainly under the brands Circle K, On the Run, Couche-Tard, and many more. The company has been wildly successful through expansion and acquisitions, and they do not look like it will be stopping anytime soon.

The company's outlook is positive, and it arguably trades with great value still. ATD trades at 17.7x trailing 12 months earnings, and 18x forward earnings.

The upward ride that ATD shareholders have gone on is not due to multiple expansions but due to earnings growth. ATD's P/E ratio is below the level it was at in 2019.

P/E ratio history for Alimentation Couche-Tard from 2001 to 2022



ATD is free cash flow positive and has been for quite some time. The company also boasts a strong balance sheet with limited debt – important with rising rates. ATD's weighted average coupon rate on outstanding debt is 3.34% and the weighted average term to maturity is 11.7 years.

The company's insiders own approximately 24% of shares outstanding.

ATD presented at its investor day earlier this month and highlighted a road map for the 5 years mentioning forecasted growth in its private brand sales, thirst stop, and fresh food. The company has also begun to adopt EV charging stations at its locations to expand consumer fueling needs. The company has forecasted EBITDA to reach $10 billion in fiscal year 2028, growing at a CAGR of 11.7% over the next 5 years. The company also plans to buy back shares until its comfort zone for a leverage ratio is reached.

Yes, ATD could have a pullback in the short term especially if markets continue to wobble but the company and its shareholders have brushed off those worries for now and continued to look forward. We know this company is not sexy and is certainly not going to be the lead on the five o'clock news but we think it could continue to reward shareholders moving forward.

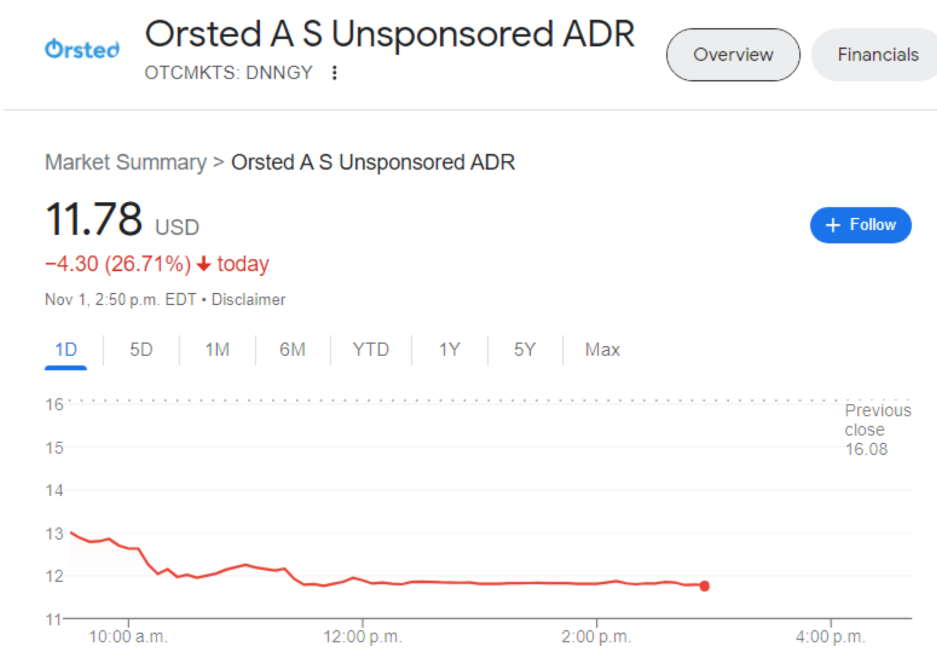
Disclaimer: MacNicol & Associates Asset Management has been a longtime holder of this company.

Offshore setback

Orsted, the world's largest offshore wind developer said it will stop working on two projects in New Jersey due to rising costs. The Danish firm was expected to provide power for one million homes with the two projects. The firm cited high-interest rates, supply chain issues, and delays as reasons for abandoning the projects.

Orsted will realize $4 billion in impairments related to its wind projects.

Orsted ADR shares trade OTC in the U.S. and were down 26% due to this announcement as of this writing. Orsted shares are down 61% year-to-date.



Offshore wind is a key part of America's decarbonization plans. President Biden has had ambitious targets for offshore wind as a whole, projecting 110 gigawatts of offshore wind by 2050, up from 1 gigawatt installed today.

Orsted's CEO highlighted the macroeconomic environment as the reason for his firm's decision.

Orsted was not alone on this front in the offshore wind industry. Both BP and Equinor announced this week that they were also writing down a project in New York for a collective $840 million. BP and Equinor have not decided if they will outright abandon the project altogether. They had previously petitioned the state of New York for better day rates but have been rejected.

Orsted did announce one piece of positive news for its U.S. wind portfolio. It plans to move ahead with a project in Rhode Island called Revolution Wind. Still, that project is expected to produce less than half as much power as the ones that Orsted is walking away from.

For now, it's a tale of two sides and we are glad we backed the winning side.

There will be money to be made on the green energy front but there will also be money that is lost. For now, we are sticking with the energy that we all need and that consumers still demand. Consumers may demand wind and solar energy but in today's market would prefer something reliable rather than something unreliable.

MacNicol & Associates Asset Management
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