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.

Cape Byron Lighthouse, Byron Bay, Australia

This lighthouse also known as Cape Bryton Light station stands at 23 meters tall and opened in 1901. The lighthouse is an active heritage listed lighthouse and is home to a museum, retail space, and tourist attractions.

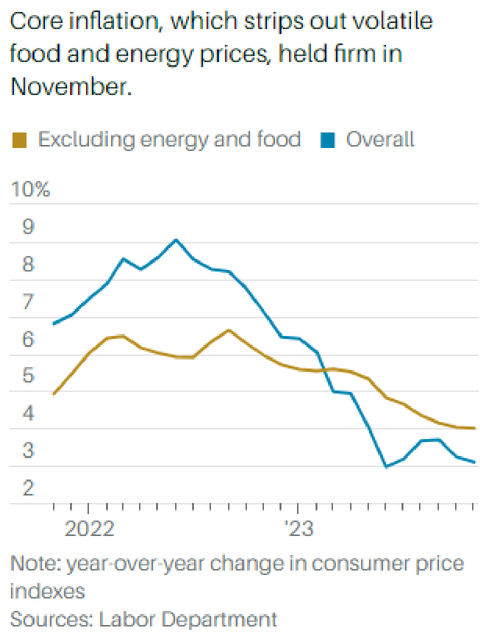
Caribou Island Lighthouse, Caribou Island, Lake Superior, Ontario, Canada

This lighthouse was opened in 1886 and stands at 31.5 meters tall. The lighthouse was automated in 1970 and has a hexagonal shape. It lies entirely within the territorial waters of Canada although only about three miles from the international border between Canada and the United States.

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

FED versus inflation

The Federal Reserve's battle against inflation looks to live on after Tuesday's data release. Consumer inflation dipped slightly to 2.1% for the year ended November 30, 2023, as energy and gasoline prices retreated. However, core inflation which strips out volatile items like food and energy accelerated by 0.3% in November up from a 0.2% rise in October. The annual core inflation rate held firm at 4%, well above the Central Bank's 2% target.



This persistent strength in price growth stems from rent, medical care, and car insurance which are all rising quite substantially. This reading may delay rate cuts which many believed would begin at one of the FED's first meetings of 2024. FED officials are more than likely going to hold rates in place on Wednesday at their last rate announcement of 2023 (they did). The sticky core reading could push interest rate cuts to the end of next year and impact those who had been positioned for aggressive rate hikes at the start of 2024.

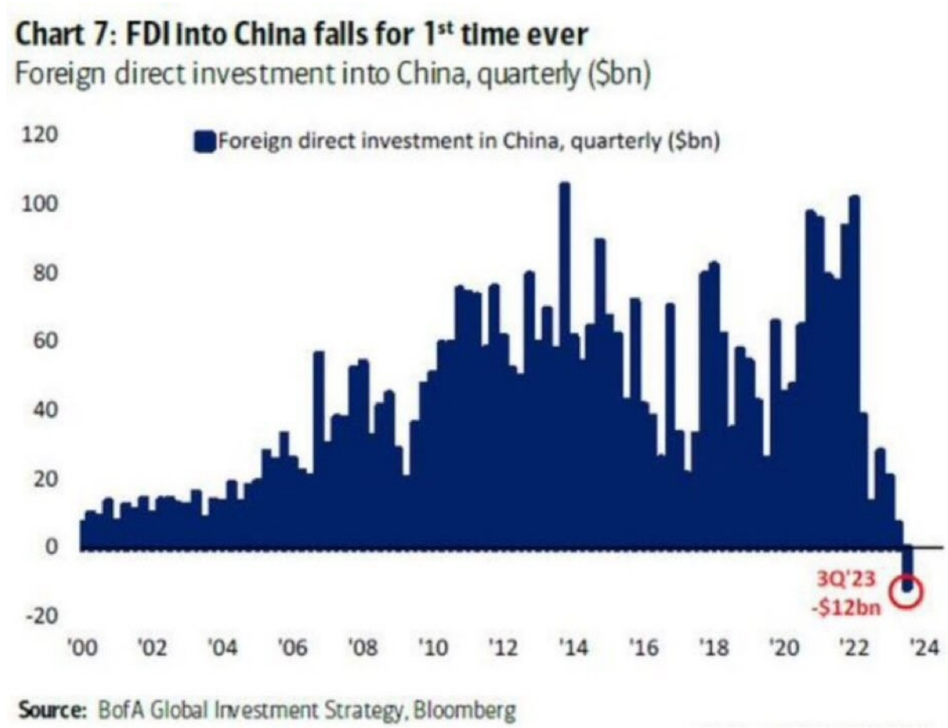
Tuesday's reading is the second-lowest headline CPI reading since March 2021. The annual rate of headline inflation hit 3% in June of this year but has since inched upwards.

After this CPI release, the Federal Reserve made its final policy decision on Wednesday as they held interest rates in place yet again. Chairman Powell mentioned that most members of the FED see rate cuts next year. The news was music to the ears of investors who got a nice Christmas present from Powell.

Powell mentioned that the FED's policy decisions have slowed inflation as they focus on affordability for all Americans. Powell said the FED is still focusing on bringing prices down without stalling the economy – something known as a soft landing. Powell mentioned that rate cuts will be a topic of discussion going forward. After the meeting, markets were pricing in 1.5% of interest rate cuts next year. That would take the benchmark funds rate down to a target range of 3.75%-4%. However, the FED's dot plot says interest rates will not get to that level until 2025. In the FED's dot plot, they expect to slash interest rates 3 times next year – notably more than their last dot plot release.

Rotation of capital

The third quarter of 2023 was a major milestone for China and one they are more than likely not happy about. Foreign direct investment in China fell for the first time as international investors pulled billions from China.



According to Bank of America, China saw a withdrawal of $12 billion during the 3rd quarter. This withdrawal was China's first on record (data going back to 1998). The world's second-largest economy is feeling the impact of global investors hitting the exit as the risk associated with China is too high for the return offered. We believe that the risks associated with China have been high for quite some time and have avoided investing in the country. We believe that other emerging markets will offer better returns moving forward with lower risk. China is home to numerous risk factors now including a potential conflict with Western countries including the U.S., an authoritarian government, a real estate crisis, a stagnant economy, and a potentially shrinking population.

We think that capital will rotate into other areas of the world from China including other southeastern Asian nations, India, Mexico, and other Latin American countries.

This divestment certainly will not be the last as large institutions will begin to pull money from China as more trade restrictions are put into place. According to Yusuke Miura, a senior researcher at NLI Research Institute, many companies will be very cautious in China moving forward, "foreign companies are becoming increasingly concerned about authorities' emphasis on security, and it is unlikely that their cautious stance toward China will change quickly."

Frowning technology

SmileDirectClub, a popular tele-dentistry company officially shut down operations this week after filing for bankruptcy protection just 3 months ago. The announcement has left some of their customers in the dark and investors holding huge losses. The announcement comes after a month-long search by the company to find a partner to assist them in continuing their operations.

SmileDirectClub advertised everywhere over the last few years. You more than likely saw their advertisements on your smartphone, laptop, or television over the last 5-7 years. The company offered 3D-printed clear aligners that attempted to compete with traditional braces and Invisalign. SmileDirectClub did most operations virtually but had 300 retail locations globally.

SmileDirectClub was founded in 2014 and in 2018 raised $380 million in a private round led by Clayton, Dubilier & Rice. The 2018 raise valued the company at $3.2 billion according to Bloomberg. SmileDirectClub partnered with numerous celebrities who could promote their product to millions of followers online. The company went public in 2019 and shares lost 28% on their first day of trading. The company's 2019 IPO value was $8.9 billion.

So, what went wrong?

The company has averaged quarterly net losses of $60 million since 2020 and revenue has been on the decline since 2019. SmileDirectClub's revenue peaked in 2019 at $750 million and has declined to $414 million over the last 12 months. The company has burned through investor capital and is extremely leveraged.

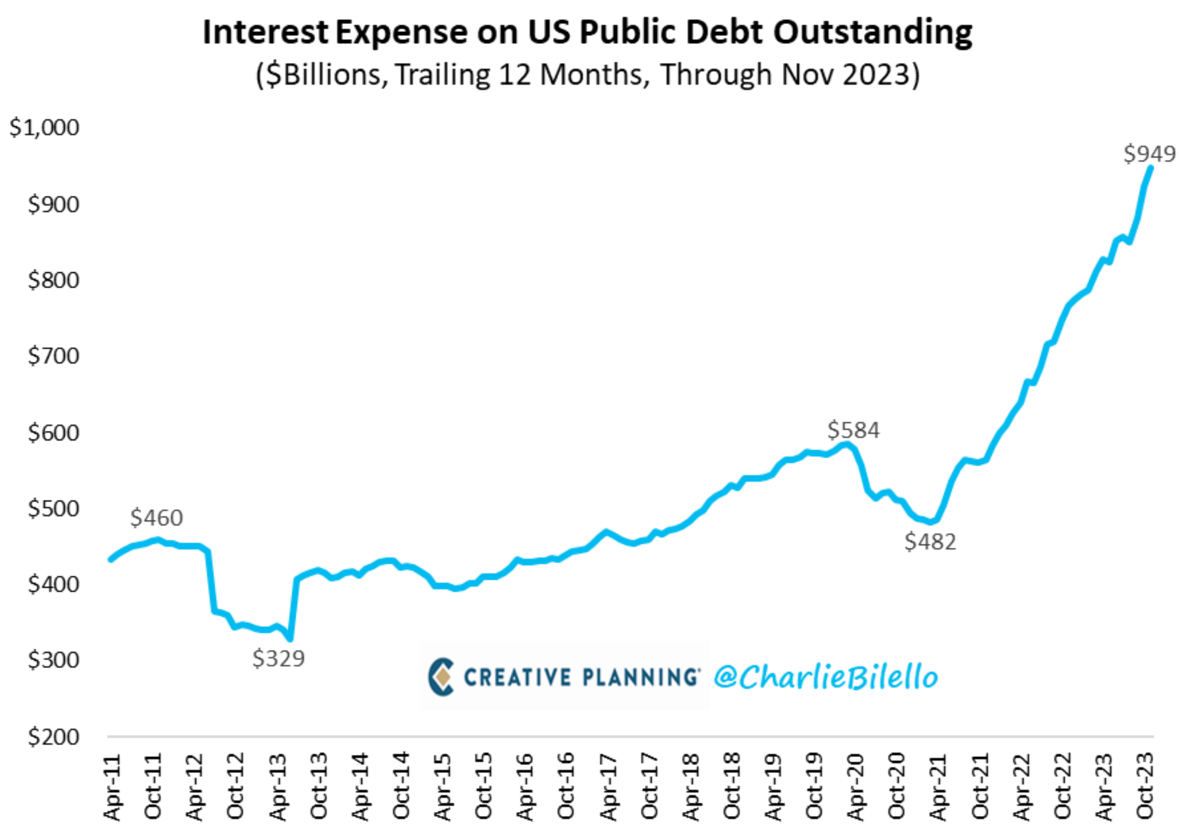
SmileDirectClub offered extremely low prices for their products relative to competitors which impacted their ability to create a profit. The company also faced numerous legal battles throughout its short history. The District of Columbia attorney general sued SmileDirectClub last year for manipulating online reviews and preventing customers from reporting negative reviews.

SmileDirectClub seized its operations over the weekend and announced it would stop customer shipments immediately. This has left hundreds of customers in the dark who have recently paid for their products.

We were not investors in this company and have never looked at it before due to its consistent losses, negative free cash flows, and flawed business model. A reminder to all, if it is too good to be true, then avoid the investment.

Closing in on a trillion

We have reported in recent editions of this publication that the U.S. Federal expense for interest is surging to record levels and it will soon reach $1 trillion over the last 12 months. This week we got new data from the federal government which indicates that they have spent $949 billion over the last 12 months on interest payments.



Interest payments have doubled over the last 2.5 years as interest rates have jumped at their fastest pace in decades.

If this trend continues, interest paid on the debt will become the federal government's largest expense passing social security.

Here are the U.S.'s largest expenses for 2022:

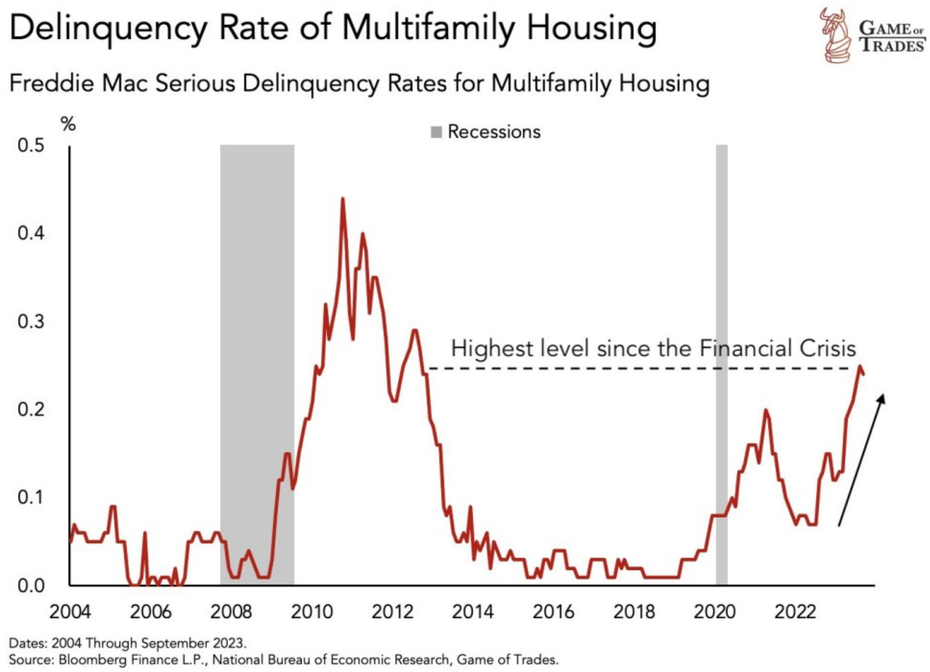
Name	Obligated Amount
Medicare	$1,484,160,985,812
Social Security	$1,296,047,055,351
National Defense	$1,160,975,500,606
Health	$1,075,778,623,838
Income Security	$878,498,463,890
Net Interest	$735,945,839,855
Education, Training, Employment, and Social Services	$656,975,570,228
General Government	$438,692,326,927
Transportation	$293,835,384,757
Veterans Benefits and Services	$284,351,825,607

Source: USAspending.gov

Something will have to give in the future as the U.S. government cannot continue to sustain its spending growth as interest rate payments also balloon. Watch for this to be a huge issue in next year's election and watch for the Biden Administration to seriously pressure the Federal Reserve to decrease rates as we head into November 2024.

Worth noting

U.S. multifamily delinquencies have hit their highest rate in over a decade as consumers feel the stress of rising rates.

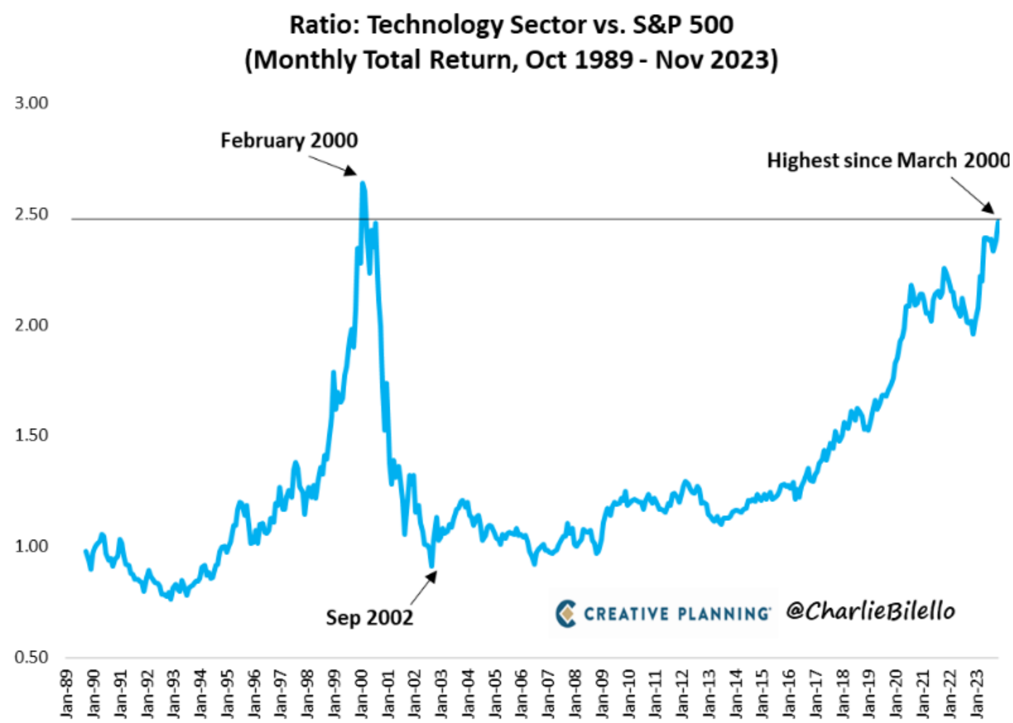


The chart which has jumped over the last 18 months has moved from a 0.1% delinquency rate to a 0.25% rate. The jump is very small but a trend we wanted to highlight this week as it's something that we have not seen in over a decade.

Pricey tech stocks

Technology stocks have led the equity market in 2023. After a horrible 2022, these stocks have bounced back and hit all-time highs. The Magnificent Seven has enjoyed a massive year. The seven mega-cap technology stocks have been piled into by retail investors. These investors are piling in due to FOMO (fear of missing out), artificial intelligence developments, and new product development.

This has led to these seven companies contributing most of the market returns this year. However, the entire tech sector is completely outperforming the rest of the market. On a relative basis, technology stocks are producing over double the monthly return of the S&P 500, something we have not seen since the Internet bubble in the early 2000s.

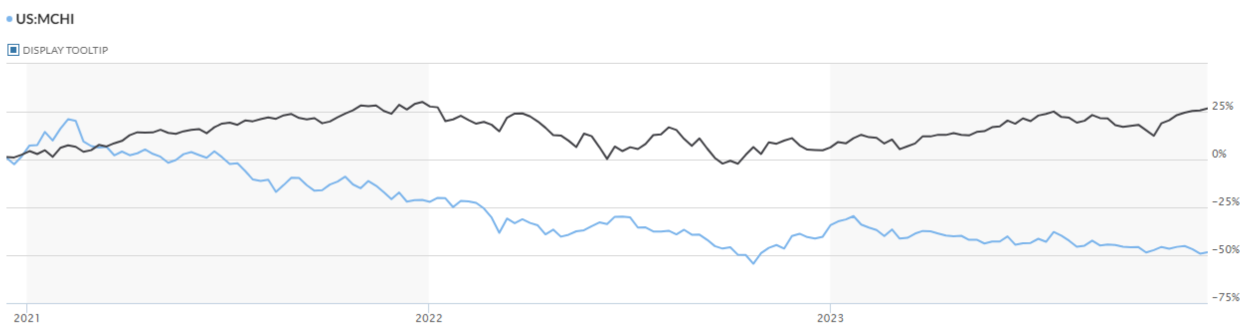


Perhaps this is a new dynamic for markets, and we are overreacting, but we think the chart could begin to correct and the rest of the market could relatively outperform technology stocks for quite some time. Some of these tech names are already displaying issues as revenue growth dries up, and consumers spend less money. These companies will be forced to innovate yet again and expand their operations from what they are today if they want to continue to outperform their peers and the overall market.

Chinese stocks set to continue to underperform

Chinese leaders wrapped up a two-day economic policy meeting this week and made no major surprise announcements. The meeting's purpose was meant to set next year's forecast and course. The world's second-largest economy has struggled this year and their equity markets have severely underperformed relative to global equities.

However, the underperformance is not purely a 2023 thing. Over the last 3 years, the iShares China ETF is down close to 50%, while the S&P 500 (black line below) is up over 25%:



The Chinese underperformance can be linked to several factors, geopolitical risk, an authoritarian government, and a real estate crisis.

Many believed that Chinese leaders would announce a plan at this week's meetings to stimulate their domestic economy and announce a solution for their real estate crisis, but they did not. This is an ominous signal to investors and a likely signal that Chinese stocks will extend their underperformance. A JP Morgan analyst wrote in a research report on Wednesday that the probability of economic fiscal stimulus in China is extremely unlikely after this week's meetings.

Most China observers, including Bloomberg Economics, expect Beijing to stick with its 5% GDP target set for 2023. There could, however, be major disappointments when the actual growth objective is unveiled in the first quarter.

The status quo policy decision by China's leaders and a lack of stimulus do favor Chinese government bonds. Many are forecasting further drops in yields into 2024 amid weak economic fundamentals and loose liquidity conditions.

Investors turn on "climate" ETF's

The green investing facade is having some major hurdles. We have mentioned the issues with ESG investing and green investing throughout this publication's history. Investors do not want to sacrifice returns for strong arbitrary ESG companies. This week another climate ETF closed its doors. The Goldman Sachs ActiveBeta Paris-Aligned Climate U.S. Large Cap Equity ETF (GPAL) shut down its operations. We had never heard of this fund and you probably have not either, but it is a growing trend that we want to highlight.

Goldman Sachs Asset Management has approved a plan to liquidate the fund and the fund will immediately begin unwinding its assets. A Bloomberg ETF expert had stated that the fund had only taken in $7 million over 2 years. The fund had extremely low demand even with its low management fee of 20 basis points. The fund is also up year-to-date.

The reality is that supply greatly outstrips demand in the ESG and Green investing area. Every company has launched numerous funds and there is not enough investor interest. Expect this trend to continue moving forward as ESG funds begin to unwind.

Part of the issue recently might be the hype fading as clean energy stocks have underperformed this year. Approximately $30 billion has been lost by clean energy stocks over the last 6 months. The S&P 500's two worst-performing stocks in 2023 both operate in solar energy, SolarEdge Technologies is down 72% year-to-date, and Enphase Energy is down 61% year-to-date. The spread between the hope of this sector and reality is as wide as it's almost ever been.

The iShares Global Clean Energy ETF is down 29% year-to-date. Clean energy has a long way to go, and most investors know that.

Copper shortages re-enter the headlines

After a year of consolidation, copper is back in the news this week. Copper has been forecasted to be in increased demand moving forward as it's a major input in numerous green technologies. The realities of the tight copper market will push prices higher as supply cannot meet the market's demand.

This week numerous outlets wrote articles on the copper markets deficit including Bloomberg.

INVESTING | Commodities | Company News | News Wire   Dec 11, 2023

The World's Copper Supply Is Suddenly Looking Scarce

Thomas Biesheuvel, Bloomberg News

We own some large-cap copper miners and have stuck it out in 2023 despite their underperformance. We have stuck it out because this is a long-term play that we think will pay off nicely for our investors.

Earlier this year there were whispers that there would be a copper surplus in 2024, but that surplus has disappeared. The thesis was numerous new projects, increased production, and massive investment in the sector would temporarily allow supply to meet demand.

In the past 2 weeks, one of the world's largest copper mines was forced to shut down due to massive public protests. Another large miner has also faced recent setbacks which has made them slash their production forecasts. Panama’s government shut the doors on a $10 billion copper mine run by First Quantum. At the same time, Anglo American slashed production forecasts for next year due to operational issues in their South American mine.

The result has been a removal of 600,000 tons of expected supply in 2024. The surplus has turned into a balanced market that many believe could run into a deficit next year. As more countries and companies demand green technology, more copper will be in demand.

BMO Capital Markets, which was forecasting a large surplus of refined copper next year, now sees a small deficit instead. Goldman Sachs Group Inc. — which has been much more bullish on copper and already forecast a deficit of refined metal for 2024, now sees that shortfall ballooning to more than half a million tons. Jefferies also now expects a major deficit next year.

The short-term supply glut could be a thing of the past and deficits could be the new norm in the copper market. Take a look at some large-cap copper producers. Many trade at reasonable multiples, and are cash-printing enterprises. These companies (for the most part) have also cleaned up their balance sheets over the last few years.

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