THE WEEKLY BEACON JANUARY 19, 2024

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.

Tillamook Rock Light, Tillamook Head, Clatsop County

Tillamook Rock Light is a deactivated lighthouse on the northern Oregon Coast of the United States. The lighthouse was first lit on January 21, 1881, and was deactivated in 1957. The lighthouse stands at 133 feet tall and had a range of 33 kilometers. The lighthouse was added to the U.S. National Register of Historic Places in December 1981.

Nauset Lighthouse, Cape Cod

The Nauset Lighthouse is the iconic red-and-white symbol of Cape Cod. It is listed on the National Register of Historic Places. The lighthouse originally was built in 1838 and was erected in 1923. The lighthouse stands at 15 meters tall.

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

FED members are not in a rush

FED Governor, Christopher Waller spoke at the Brookings Institution, a DC-based think tank that specializes in economics, and foreign policy on Tuesday and shed some light on what the FED's next move might be.

Waller said that the FED is likely to cut interest rates this year but there is no need for policy to be rushed. He went on to say that the FED will be careful, and methodical with interest rate cuts. He said the FED will not cut rates like they have in the past, as there is no reason to move as quickly as they have in past cycles. Waller went on to say that the timing and number of rate cuts this year will be driven by upcoming data releases.

Markets have priced in seven rate cuts this year beginning with one in March. However, last week numerous FED officials tried to push back on the expectations of rapid cuts to start 2024.

Waller claimed that economic data from 2023 was "almost as good as it gets" for the situation the economy was in to start the year. Waller's outlook on inflation is like most FED board members believing inflation is on a path to 2% and will eventually get there.

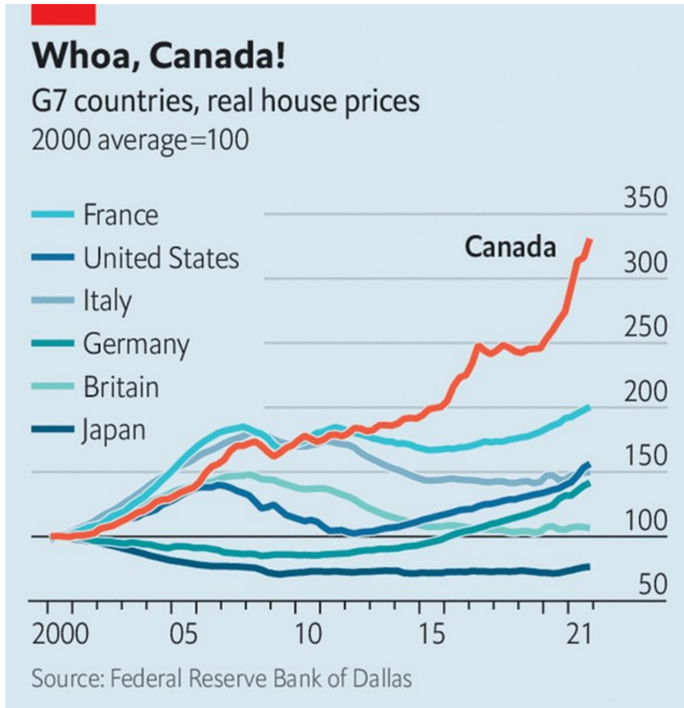
These comments by Waller are nothing new but reconfirm our thoughts that the FED will be hesitant to cut rates immediately (barring something major happening) leaving rates higher for longer. We think optimism is a great trait in certain areas of life but false hope and ignoring reality has negative consequences, especially in financial markets. Ultra-bulls want numerous rate cuts immediately to feed their bull market thesis and justify the valuations of the stocks they own.

Do not be surprised if the FED drags its feet with rate cuts.

G7 outlier

The G7 includes some of the world's most powerful countries, both economically, and militarily. These developed nations have enjoyed tremendous economic development over the last few centuries and are what emerging nations hope to one day be. These countries and their economies differ in some ways and have had different business cycles, but for the most part, they share many similarities as Western powerhouses.

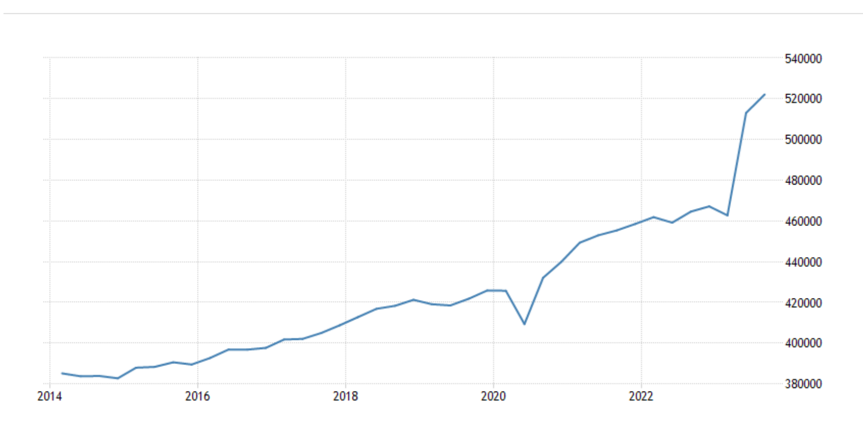
However, over the last 12-15 years something has happened in one real estate market in these G7 countries that differs from the other six real estate markets. Canada's real estate market has ballooned in comparison to the rest of the G7.



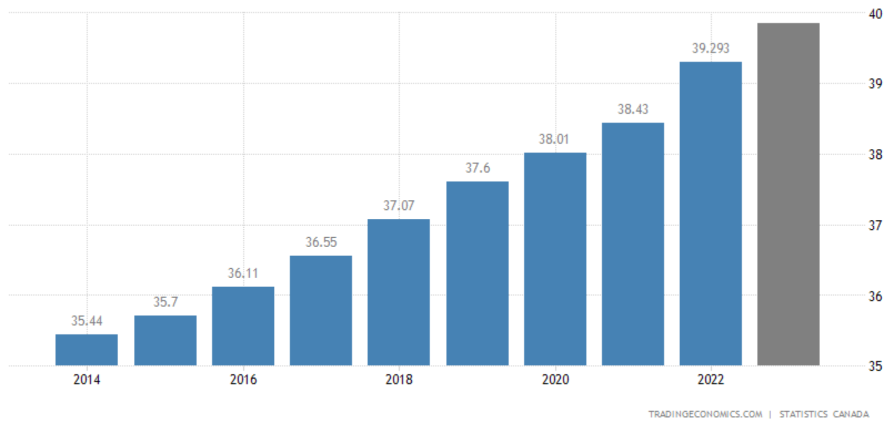
The Economist

So why has Canada’s real estate market more than tripled since 2000 while every other G7’s real estate market has not even doubled? First off, most of Canada’s growth and divergence begins in the 2011-2012 timeframe according to the chart above. Since then, the Canadian market has close to doubled in just over 10 years while the 6 other markets have been stagnant or have had small growth. So, what the hell happened in Canada over the last 10 years? Government spending surged, the country's population exploded, and housing starts have remained close to stagnant.

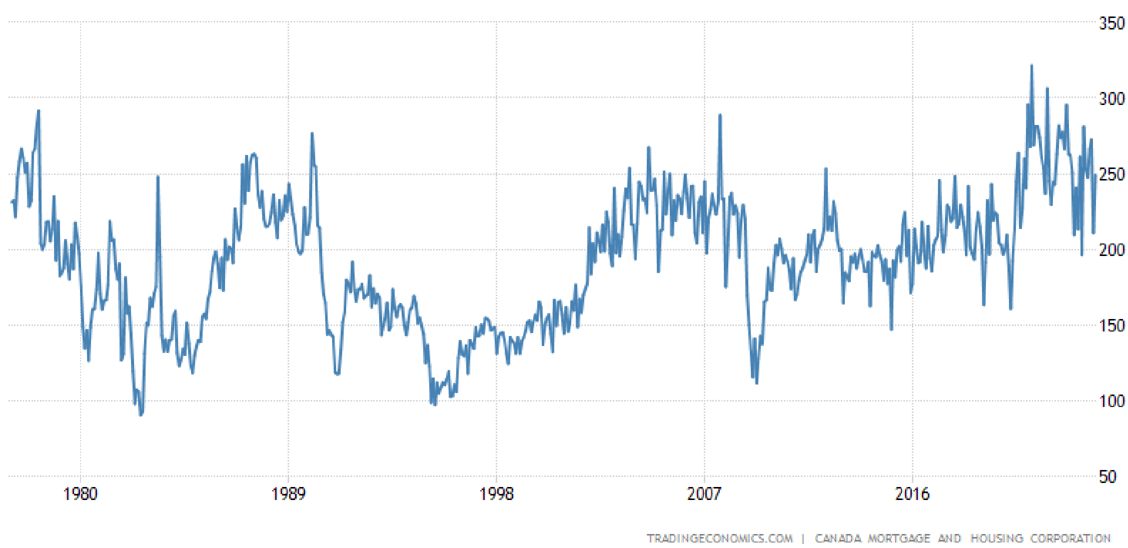
Here is Canada’s government spending over that period:



Here is Canada's population (in millions) over the same period:



Here is a chart that tracks Canadian housing starts (in thousands) over the last 45 years:



Inflation, a deteriorating Canadian dollar, record immigration of unskilled workers, a lack of housing supply, and increased regulation in the housing sector have all contributed to this bubble in the Canadian real estate market. Home builders still face lengthy approval periods for new projects despite this supply issue in Canada. Many builders have voiced their concerns with the lengthy permit periods that exist in Canada.

For now, Canadian home prices will remain elevated as there is no short-term solution to this issue. Hopefully, moving forward both provincial and federal governments never let this happen again. These governments have made home buying impossible for some young professionals due to affordability.

The other thing to keep an eye on in Canada is the country's (lack of) economic growth. Real GDP per capita in Canada is close to flat over the last 10 years. The country's overall economic growth is purely due to a population boom of unskilled workers. This increase in population has decreased productivity and artificially increased our country's GDP.
Canada cannot continue ignoring these economic issues and the country's next federal government will have to do its best to address these issues head on.

Spirit plunges

So much for merger arbitrage.

Spirit Airlines shares plunged this week after a federal judge blocked a deal that would see JetBlue Airways buy Spirit for $3.8 billion. The judge sided with the federal government in a courthouse in Massachusetts claiming that the deal would stifle competition and raise fares for consumers. The deal would have eliminated the U.S.'s dominant deep-fare discount airline.

Spirit shares lost 60% in the next two trading sessions after the block of this deal.

Spirit shares tanked as JetBlue was paying a premium in this deal. As of January 17th, 2024, Spirit Airlines had a market capitalization of just $703 million.

On the other hand, JetBlue shareholders were happy this deal fell through as shares jumped 11% on the day of the blockage. Shares retreated the following day.

The deal would have produced the country's 5th largest airline and would help JetBlue grow and compete with larger rivals like Delta and United. Both companies voiced their displeasure with the decision and reaffirmed that they believe this deal is the best situation for both companies moving forward as it will allow them to compete with dominant carriers.

The deal falling through in the 11th hour due to a lawsuit from the government is a perfect example of merger arbitrage having flaws. Some market participants say “merger arb” has limited downside, but we disagree, and Spirit Airlines would agree with us. This strategy comes with tremendous risk and should not be done by retail investors, especially with the use of leverage.

The airline industry is one of the few industries that has yet to recover from Covid-19.

Travel volume is still recovering, fuel costs have decreased, and most airline stocks trade at extremely low multiples. We think the setup for select airlines with low leverage is quite bullish currently and expect many to outperform over the next year.

Election results

Unless you deeply follow the global economy and global politics you probably missed an important election over the weekend. Taiwan held a Presidential election and elected a new leader, Lai Ching-te, a candidate that leans towards Taiwan's independence from China. Lai Ching-te was previously Taiwan’s Vice President.

The election of Lai Ching-te brought forth the tension between the West and China. President Biden congratulated the new President of Taiwan earlier this week before Beijing rebuked the U.S. leader. Although the Taiwan leader has not said anything about independence from China since being elected, it remains a major risk in global markets. China had been painting him as a dangerous separatist in the lead-up to the election. China claimed that the leader would threaten peace in the region if he won and painted the race as a “war versus peace” decision. Lai Ching-te took a swipe at China in his victory speech claiming, “the Taiwanese people have successfully resisted efforts from external forces to influence this election”.

This independence issue will more than likely (hopefully!) bubble under the surface for a long time ahead. Expect the U.S. to cuddle up to the new leader and China to be even more firm against an independent Taiwan.

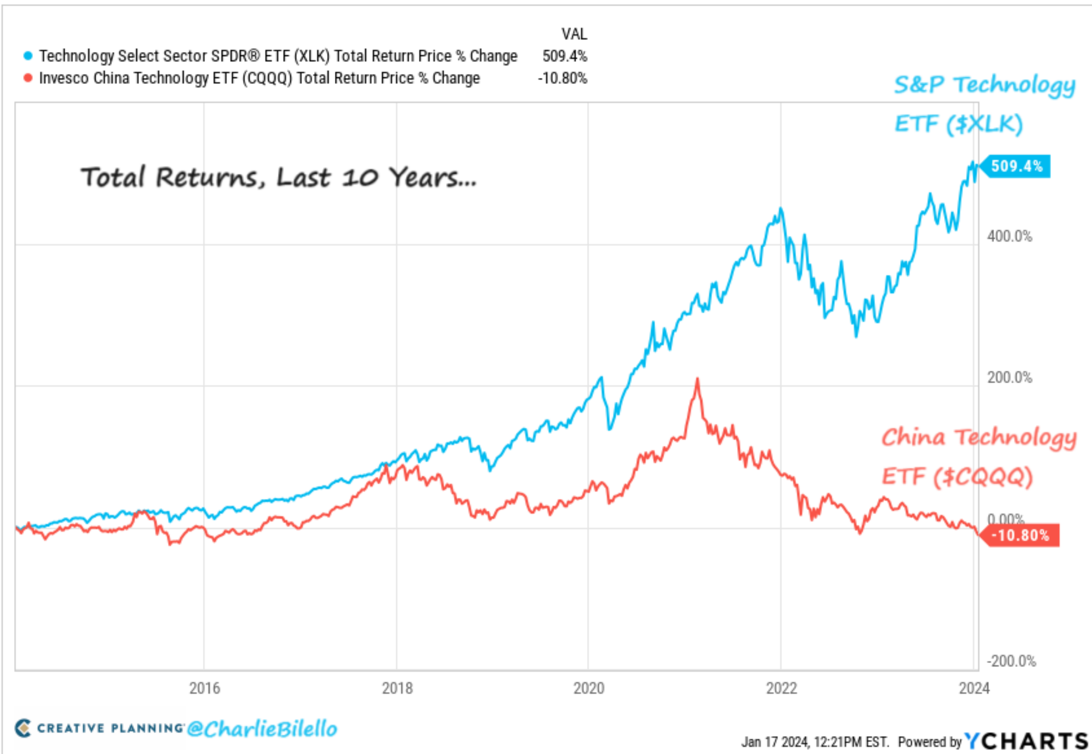
These issues could accelerate with a pending U.S. Presidential election in November where it looks like former President Trump will be facing off against President Biden. Trump won the first caucus in the Republican nomination race in Iowa on Tuesday. He won by over 30% over Governor Ron DeSantis. Trump was very firm against China and began the trade wars that are still occurring today between China and the U.S. His rhetoric has not changed and continues to believe Taiwan should be independent of China.

Expect China-U.S. relations to have a rocky year as both candidates will more than likely be firm against China.

Not all technology stocks are created equally

10 years is quite the sample size. Over the last 10 years, China has cracked down against the West. Western nations have installed sanctions against China. China's government has become more authoritarian, and the Chinese economy has slowed its growth. These occurrences have accelerated over the last 3-5 years which has significantly impacted the performance of all Chinese securities.

We knew on a relative basis compared to U.S. equities that Chinese stocks (especially technology companies) have struggled recently but the chart below illustrates just how bad the situation has been for Chinese investors.



Over the last 10 years, investors in Chinese technology stocks are down almost 11%, while U.S. technology stocks are up 509%. Not only on a relative basis have Chinese stocks underperformed but they have also underperformed on an absolute basis.

Government overreach, increased regulation from the Chinese Communist Party, trade sanctions, and geopolitical issues have negatively impacted Chinese stocks over the last decade. These issues look to be worsening the longer President Xi is in control of China. A major hurdle that Chinese companies continue to face is that they are alternatives to Western technology companies. What do we mean by that? Alibaba is an alternative to Amazon. DiDi Global is an alternative to Uber. BYD is an alternative to Tesla. Countries around the world (for the most part) trust Western enterprises over Chinese enterprises as there is a fine line between state and private enterprise in China. For the most part, Western enterprises have also been the earlier mover in their fields.

The gist is Chinese tech stocks serve China while U.S. technology companies serve the world. For now, China remains uninvestible moving forward for many managers including us. First to market and NOT copiers of technologies should rule the day.

Continuing with China this week….

Chinese Premier Li Qiang, the country's second in command spoke in Davos this week at the World Economic Forum on China's economy, trade sanctions, and much more. His speech did not calm investors in China. Chinese stocks have been in free fall over the last year despite markets rebounding across the globe. In his closely watched speech, he spoke about the resilience of the Chinese economy and its future growth prospects.

The Premier spoke about soon-to-be-released economic data which disappointed economists and investors. Data showed persistent challenges from deflationary pressures. GDP growth came in lower than expected for the 4th quarter and was the lowest annual growth rate since 1990 (outside of 2020-2022 – Covid-19). The data also displayed China's continued property crisis which has been unfolding for a few years now. All the data suggests that China's economy needs stimulus, but Chinese leadership has not made any indication that will happen anytime soon. On Wednesday, the Hang Seng index dropped 3.7% to a 15-month low. Foreigners sold $1.8 billion worth of stocks - the most in more than a year.

Further issues could be coming for China later this year as former President Trump announced that his stance on China will be a key part of his 2024 campaign. A strategist from Bloomberg Intelligence claimed, "Trump's claim on Chinese markets highlights the geopolitical risks and volatility in a US election year, where China could be a main talking point for both parties". Expect the Western rhetoric on China to continue to heat up and expect more investors to wake up to the fact that China currently is uninvestable.

Burger King's big move

The parent company for Burger King, Tim Hortons, Popeyes Louisiana Kitchen, and Firehouse Subs made a huge move this week. Restaurant Brands International (RBI) announced a $1 billion purchase of its biggest U.S. Burger King franchisee, Carrols Restaurant Group. Carrols ran approximately 15% of all U.S. Burger King's across 23 States. The move by RBI brings over 1,000 Burger King locations under RBI control. As of December 31, 2022, RBI only had control of 50 Burger King locations while franchises controlled 19,739 locations.

Restaurants Brands International wants to revamp older domestic restaurants and said it will pump $500 million into remodeling Carrols's Burger King locations by 2028. They claimed that their remodeling would be much quicker than that of Carrols Restaurant Group.

RBI shares slipped slightly on the announcement but are up 15.37% over the last year.

Carrols's Restaurant Group shares jumped significantly after the deal was announced. Carrols shares are up 337.7% over the last year but are only up 9.2% over the last 5 years.

RBI will pay $9.55 a share for Carrols Restaurant Group shares not held by RBI or its affiliates already. This is a 23% premium to Carrols' 30-day volume weighted average price. The deal is expected to be completed during the second quarter of this year.

RBI said they would use cash generated from Carrols locations to help finance renovations. After improving the over 1,000 locations, RBI will seek out new owners to buy blocks of roughly 50 stores or less, a process they forecast will take 5-7 years.

Uranium update

For those of you who are long-time readers of this publication, you know our stance on Uranium and the Nuclear energy industry.

As we crossed the $100 mark recently for the spot price of Uranium, we wanted to highlight a few notable items in the space to keep you updated.

We are still bullish on the industry and believe there will be more upside. There also could be small pullbacks on the way up.

One of the Economists who we talk to regularly and that you all know is quite bullish on Uranium despite his overall views of markets and the economy right now. David Rosenberg was on BNN this week and highlighted the fundamental bull market that will continue in Uranium due to supply and demand factors. He then went on to say that the bullish case for Uranium has nothing to do with the economic cycle. Quite the remarks from one of our favorites.

In other news, France announced plans to build 8 new Nuclear plants on top of six new plants they announced in 2022. The French energy minister said these new reactors are critical and are needed for France to hit carbon reduction targets.

On the producer side, Kazatomprom announced a warning on Friday of a production shortfall over the next 2 years. Kazatomprom is the world's largest Uranium miner owned by the Kazakhstan sovereign wealth fund. The company is listed on the London Stock Exchange. The company went on to explain that shortages of sulfuric acid and construction delays at new development deposits would create major production challenges over the next 24 months.

Other countries around the world have also committed to expanding their Nuclear energy capabilities.

As the world wakes up to the realities of carbon zero, and the supply-demand factors in the Nuclear energy industry, prices will continue to move higher. We believe this trade is still in its early days.

Watch for Kazatomprom’s trading release in February for exact production forecasts. If Cameco also announces forecasted production misses, the spot price of Uranium *could* surge in the months ahead.

Disclaimer: MacNicol & Associates Asset Management clients hold various securities in the Uranium industry.

MacNicol & Associates Asset Management
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