

The Weekly Beacon

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 any questions regarding any observations.

*The two main purposes of a Lighthouse are **to serve as a navigational aid and to warn boats (Investors) of dangerous areas.** It is like a traffic sign on the sea.*



Flowerpot Island. Tobermory, Ontario



Split Rock Lighthouse, Silver Bay, Minnesota

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



Robinhood (HOOD) receives mixed signals from Wall Street

The quiet period for underwriters on Robinhood's IPO ended Monday. The quiet period references a period where investment banks cannot release forecasts or projections on deals, they underwrote. The SEC has mandated this short embargo period for all types of listings. As most sell side reports by large banks serve as a version of marketing, the SEC has intelligently banned this.

Robinhood's quiet period ended Monday allowing investment banks involved in underwriting to initiate their coverage. JP Morgan and Goldman Sachs led the deal with Barclays, Citi and Wells Fargo acting as secondary book runners. Interesting enough Goldman Sachs and Barclays released their first report for Robinhood and rated the stock as neutral or a hold. JP Morgan was the only investment bank to rate Robinhood a sell or underweight.

The signals were mixed from Wall Street, a few banks remain bullish on Robinhood. Citi Group was one of the most bullish, projecting Robinhood will grow its customer base from 22.5 million at the end of the second quarter to 32.5 million by 2023. In the August 6th edition of *The Weekly Beacon*, we mentioned Robinhood had 2 million users in 2017 which would project a 15x increase in just over 6 years, quite the lofty goal especially if Robinhood only continues to serve US customers. Citi has valued these customers at \$620 of revenue per customer. This is a high estimate when Bazinet has estimated Robinhood makes about \$29 per customer per quarter. Even a lot of other brokers have cut commissions to zero, Robinhood is still lagging in terms of revenue per customer. The same research at Bazinet, estimates Charles-Schwab makes \$367 per account per quarter.

Even though Goldman remains neutral, they estimate Robinhood will grow to 53 million accounts by 2025. Robinhood is huge with young investors and revenue per account will remain below industry standards until these investors get older and grow their account size. A major challenge for Robinhood is dependency on one type of revenue, 80% of their revenue comes from payment for order flow, which is only made when people trade. Day trading amongst young investors has become quite popular during Covid-19 and people have been more active due to the euphoric rise of equity markets over the past 16 months. If that dries up or slows down due to a full reopening (people will have less free time) or a market correction, Robinhood's revenue would decrease further. Another reason analysts remain cautious is the potential for Congress and the SEC to change or outright ban the payment for order flow system due to conflicts of interest.



Carl Quintanilla ✓
@carlquintanilla

...

"This was a devastating initiation," says @jimcramer.
(JPM was one of Robinhood's lead underwriters.)



Carl Quintanilla ✓ @carlquintanilla · 5h

JPMORGAN: "... we see a number of risks including regulation, pricing, and market saturation, and challenges to the business including its focus on smaller accounts that we think limit \$HOOD's ability to reach competitive margins and profitability"

Initiate Underweight, \$35 tgt

9:18 AM · Aug 23, 2021 · TweetDeck



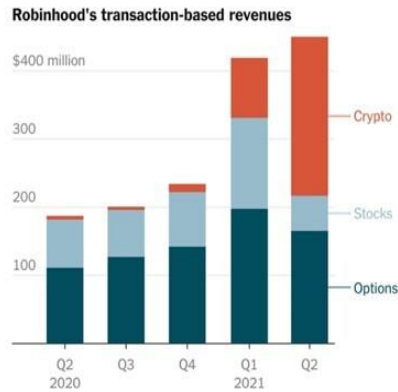
A CNBC analyst summarized JP Morgan’s sell rating on Robinhood quite well. Even though the investment bank underwrote the deal and turned the company public, they do not seem to be long term believers. JP cited regulation, pricing, and market saturation as major hurdles that Robinhood will face. The analyst who wrote the report highlighted the SEC being a major problem for Robinhood “a highly engaged SEC that has fined and has continued to call out Robinhood specifically for activities and actions that it is investigating.”

This day trading phenomenon will more than likely slow down that Robinhood depends on for revenue. The major issue that Robinhood will continue to face, their average account is tiny versus competitors. This will create a massive hurdle on the way to profitability. Even with the massive surge in customers over the past year, Robinhood has remained not profitable.



Last week, we talked about Cathie Wood or “Queen Cathie”. We talked about how she is the leader in disruptive innovation but is heavily invested into unprofitable companies. Ark Investments has bought approximately 6,375,429 of Robinhood shares as of close on August 23rd. She never seems to shy away from new and viral ideas. We would remind everyone, not every new idea is disruptive, innovative, and sustainable in the long run.

Another interesting graphic, Robinhood’s revenue breakdown by type of security. The real growth in revenue they have recently seen is due to cryptocurrency. They also rely heavily on option trading. Mentioned before, most Robinhood users are young and are inexperienced, option trading is being used by them like a stock market casino. We have also explained the risks that comes with investing in cryptocurrencies. Charlie Munger labeled financial markets as a “gambling parlor” fueled by Robinhood which he describes as “beneath contempt”. He described Robinhood’s tactics as unethical and who’s actions are regrettable. Any loss of consumer confidence in cryptocurrency alone could plummet Robinhood’s revenue.



Source: Robinhood • By The New York Times

Even though Robinhood created an innovative product that popularized investing with a new generation, the technology does not give it a significant advantage over competitors and investing in the company comes with numerous risks. Shares have been on a roller coaster from the start and right now the risks in the long run outweighs the reward.

Mass renewable energy use: A pipe dream?

The push for net zero emissions by government leaders and large corporations has significantly increased throughout the last couple of years.

[Governor Newsom's Zero-Emission by 2035 Executive Order \(N-79-20\)](#)

Executive Order calls for elimination of new internal combustion passenger vehicles by 2035



EU urges all major economies to raise climate goals by November summit

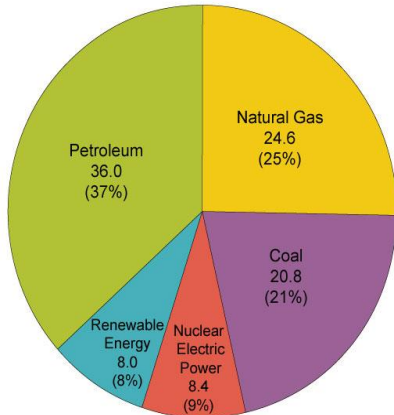
We have mentioned how some of these goals are almost impossible to achieve with the limited supply of inputs used to build these renewable sources. The electric vehicle goals set by Federal and State governments seem extremely unlikely, but we have already mentioned that in previous issues. We are going to look at renewable energy sources this week, if countries want to reach net zero, renewable energy use will have to significantly increase.

Throughout the US, renewable usage has increased by 4% over the last 10 years. Natural gas, a cleaner burning hydrocarbon has also increased in usage. The transition has already begun, coal as a primary source of energy has been decreasing in usage since approximately 2000 in the US.

Primary Energy Use by Source, 2010

Quadrillion Btu and Percent

Total U.S. = 98.0 Quadrillion Btu

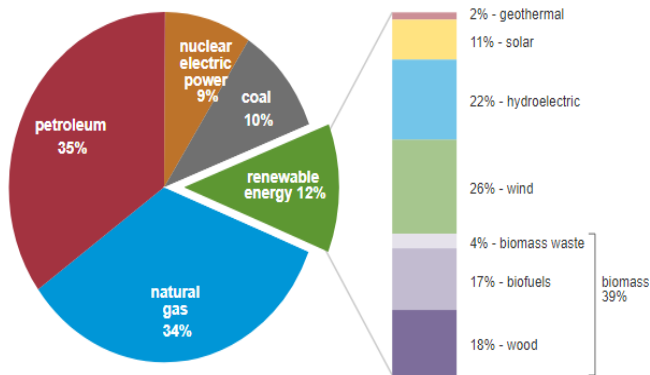


Source: U.S. Energy Information Administration, *Annual Energy Review 2010*, Table 1.3 (October 2011).

U.S. primary energy consumption by energy source, 2020

total = 92.94 quadrillion British thermal units (Btu)

total = 11.59 quadrillion Btu



Source: U.S. Energy Information Administration, *Monthly Energy Review*, Table 1.3 and 10.1, April 2021, preliminary data
 Note: Sum of components may not equal 100% because of independent rounding.

The International Energy Agency has devoted an entire website to this Net Zero Goal. Its quite the complicated website but highlighted in it:

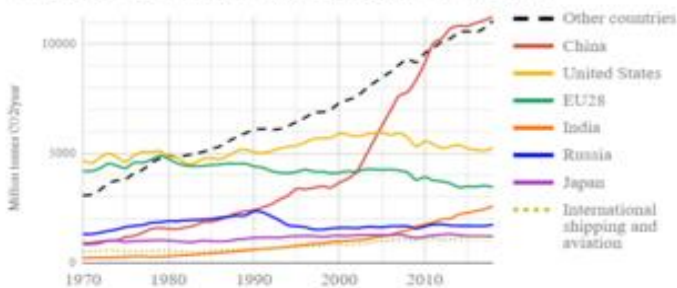
Achieving net-zero emissions by 2050 will require nothing short of the complete transformation of the global energy system.

This is a true point; the economy will change to fit this net zero goal and individuals will even need to change habits to help reach this goal.

However, the world will not reach any of these goals if its just the western developed countries who commit to this goal. China has significantly been increasing its CO2 emissions over the last 20 years.



World fossil carbon dioxide emission 1970-2018



And in 2020, China set somewhat of a record, it emitted more than every developed country combined....

Report: China emissions exceed all developed nations combined

© 7 May

China has also pushed its net zero goal all the way back until 2060 and has set a peak emissions year of 2030, they can increase their record setting carbon emissions for another 10 years.

Despite Pledges to Cut Emissions, China Goes on a Coal Spree

China is building large numbers of coal-fired power plants to drive its post-pandemic economy. The government has promised a CO₂ emissions peak by 2030, but the new coal binge jeopardizes both China's decarbonization plans and global efforts to tackle climate change.

BY MICHAEL STANDAERT · MARCH 24, 2021

As of 2020, 350 coal-fired power plants are under construction. They include seven in South Korea, 13 in Japan, 52 in India, and 184 in China with the rest underway in other parts of the world.

Seems like an interesting move as the world pushes to evolve from “dirty” sources of energy.

The west will not be able to solve climate change on their own. India and China as well as the rest of the developing world will need to commit to some sort of evolution. This seems unlikely at least in the next 10 years.

Just looking at the western world now, and the role renewables like solar and wind will need to play in tomorrow's economy, there are a few problems that arise with mass dependency on these sources of energy.

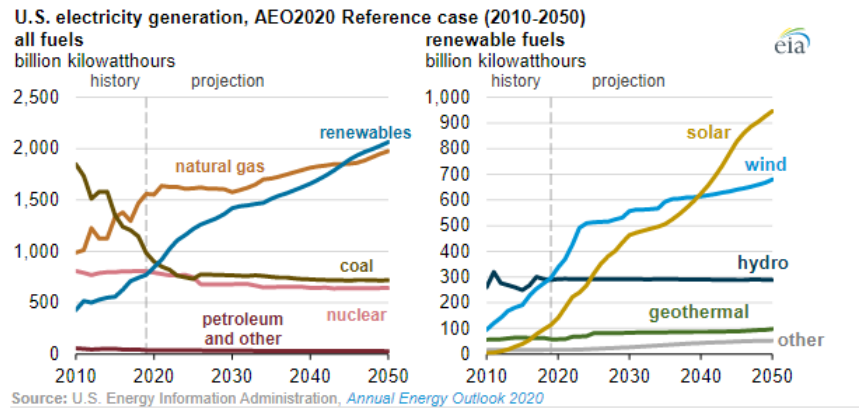
The sources of US electricity will completely need to change by 2050, a study done by the US Energy Information Association breaks down total electricity generation and the renewables by type.



Renewables will also have to be the largest source of electricity by 2050. This is not total energy usage, this study just looked at the generation of electricity which is why petroleum and fossil fuels is scarcely used.

The study preaches the exponential increase of solar and wind energy over the next 30 years. That may not be entirely possible...

EIA expects U.S. electricity generation from renewables to soon surpass nuclear and coal

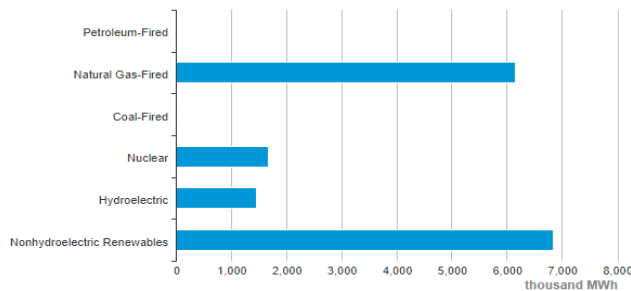


California, the most populated US state has been long applauded for its use of renewables which have been increasing for years.

- In 2019, California was the nation's top producer of electricity from solar, geothermal, and biomass energy, and the state was second in the nation in conventional hydroelectric power generation.

Its electric grid has become extremely reliant on renewables which many would say is great for the future of our world.

California Net Electricity Generation by Source, May, 2021 [DOWNLOAD](#)



Source: Energy Information Administration, *Electric Power Monthly*

Articles are frequently written celebrating the success of renewable energy:



California just hit 95% renewable energy. Will other states come along for the ride?

However, hidden in that L.A. Times article:

There are several caveats. For one thing, Saturday's 94.5% figure — a record, as confirmed to me by the California Independent System Operator — was fleeting, lasting just four seconds. It was specific to the state's main power grid, which covers four-fifths of California but doesn't include Los Angeles, Sacramento and several other regions. It came at a time of year defined by abundant sunshine and relatively cool weather, meaning it's easier for renewable power to do the job traditionally done by fossil fuels.

This is a great start in terms of mass use of renewables. However, 95% of the power grid in California was only powered by renewables for exactly 4 seconds. This also did not include the States, most populated city, Los Angeles and the State capital, Sacramento. The article also mentions weather conditions were perfect for this feat to happen.

But at what cost does this green push have on society.

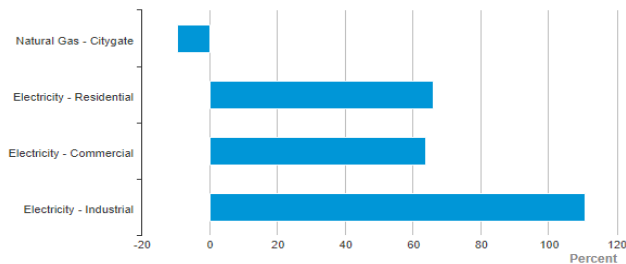
The High Cost of California Electricity Is Increasing Poverty

California's poverty rate is the highest in the nation. New restrictions on natural gas will increase electricity costs, making the problem worse.



California is becoming extremely unaffordable; they already are home to the highest home prices in the US but now sport the highest electricity prices which is making their homeless problem much worst.

California Price Differences from U.S. Average, Most Recent Monthly ↓ DOWNLOAD



Source: Energy Information Administration, Petroleum Marketing Monthly; Natural Gas Monthly; Electric Power Monthly

There is also the recent rise of blackouts across California.

Blackouts Loom in California as Electricity Prices Are 'Absolutely Exploding'

By Robert Bryce
June 24, 2021

EDITORS' PICK | Apr 20, 2021, 02:22am EDT | 13,082 views

Renewable Energy Boom Risks More Blackouts Without Adequate Investment In Grid Reliability



Michael Shellenberger Contributor @
Energy
I write about energy and the environment.



California Orders State of Emergency to Avert Blackouts

By Mark Chedlek and Joe Ryan
July 30, 2021 6:15 PM Updated on July 30, 2021 7:16 PM

California should serve as a warning for states and countries looking to ramp up renewable energy usage. They have shown the transition is not going to be as simple as some hoped.

There is also this that was released a few weeks ago, even the green energy state of California will lean on fossil fuels to avoid more blackouts.

August 11, 2021
7:21 PM EDT
Last Updated 14 days ago

Energy

California's clean grid may lean on oil, gas to avoid summer blackouts

[An article in the MIT Technology Review](#) does a great job explaining the fundamental challenges solar energy faces.

A few lonely academics have been warning for years that solar power faces a fundamental challenge that could halt the industry's breakneck growth. Simply put: the more solar you add to the grid, the less valuable it becomes.

The article highlights, on perfect days solar plants produce more energy than what is required, driving down prices. The major issues arise when weather is not ideal for solar plants, which happens more than you'd think. This devaluation of solar energy on good weather days is good for consumers as they are paying less but makes investors and producers less likely to build or expand solar plants. Government subsidies for solar energy companies can only get you so far.

Solar energy will also face obstacles as time moves on due to changing weather patterns arising from climate change.

There are also obstacles that wind will face as a source of energy.

The [Insider Weekly](#) did a great job highlighting in last weeks issue, the challenges wind sourced energy is already facing.



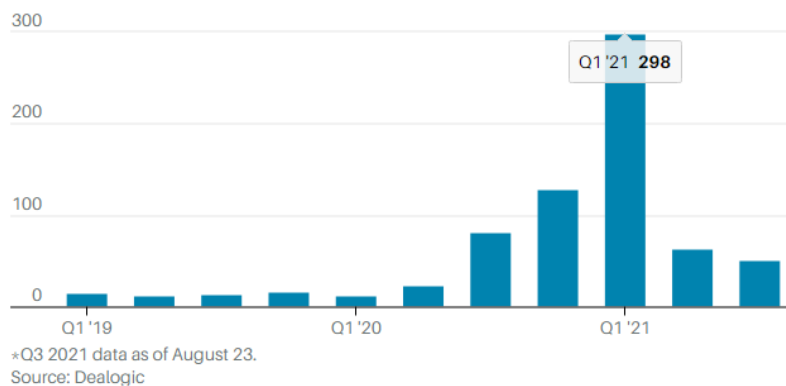
Orsted a Danish energy producer focused entirely on renewables announced its revenue and profits would be down this year due to extraordinarily poor weather and low wind speeds.

Unless these major issues are solved, energy grids will not be able to survive with heavy reliance on wind and solar. This is without mentioning the high prices consumers will face with increased renewable usage. Climate change will be a major obstacle in the scaling out process of renewable energy which is supposed to solve climate change. Seems like a circular problem, we will see how this turns out.

SPACs hit the brakes

In the [July 23rd edition of *The Weekly Beacon*](#), we talked about SPACs and their growing popularity. After a massive increase in listings throughout 2020 and in the first quarter of 2021, SPAC listings fell by 79% in the second quarter of this year. Mergers and definitive agreements also fell in the second quarter by 23%. Some industry professionals mention the decrease will be temporary but will not grow like it did this past year.

Number of SPAC deals, quarterly



The decrease in deals and SPAC companies could be temporary but the slow down is also being fueled by a decrease in demand by investors. There are also numerous SPAC companies that have fallen completely flat due to massive valuations. Some private companies may look at some of the recent SPAC mergers that have failed as a lesson. Rushing to public markets is sometimes not the best way forward.

The IPOX SPAC Index is down 28% from its February high. Numerous SPAC listings sit below their redemption level and many SPAC companies take a dip on the announcement of a deal.

Retail investors who piled into SPACs last year doubled their money on numerous deals, the ride this year has not been so great....

With a slow down in deals and agreements, there will probably be a growing number of SPAC companies that reach their holding period limit. This will cause the companies to return money to investors.

MacNicol & Associates Asset Management Inc.
August 27, 2021