

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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ASSET MANAGEMENT

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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.*



#### **Lighthouse Pointe Apartment Project, Corpus Christi, Texas**

*The lighthouse will be the tallest lighthouse in Texas, and the tallest stone lighthouse in the entire western hemisphere. The Lighthouse was completed in 2021 and the development is home to 159 luxury apartments.*



#### **Gannet Rock Lighthouse, New Brunswick**

*It was first lit in 1831 and was staffed until 1996. The lighthouse was solarized in 2002 and remains operational. It was declared "surplus to requirements" by the Canadian Coast Guard in 2010 and is no longer being maintained. It stands at 75 feet tall.*

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



## Buffett goes abroad

Warren Buffett is in Japan this week. Buffett and Berkshire Hathaway announced that they had raised their stakes in five major Japanese trading houses.

Japanese trading houses known as "sōgō shōsha", trade in a wide variety of materials, products, and food, often serving as intermediaries and providing logistical support. These trading houses are also deeply involved in the real economy in such areas as commodities, shipping, and steel. Japanese trading companies are known to be extremely diversified in terms of their separate business units and have a heavy focus on risk management. These trading houses played a huge role in Japan's modern-day economic development. These trading houses are like a conglomerate with different business units, eerily similar to Berkshire Hathaway.

According to the announcement, Berkshire Hathaway has raised its stakes in all five trading houses (it previously owned) to 7.4%. That's up from positions of 6.6% in Mitsubishi Corp., 6.6% in Mitsui & Co., 6.2% in Itochu Corp., 6.8% in Marubeni Corp., and 6.6% in Sumitomo Corp, according to November filings.

Here are the seven major trading houses in Japan:

Seven major *sōgō shōsha* (billions of yen)

Name	Earnings (FY 2021)	Total assets (Mar. 2021)	Net assets (Mar. 2021)
Mitsubishi	172.55	18,634.97	5,613.65
Mitsui	391.5	11,806.3	3,817.7
Itochu	401.43	11,178.43	3,316.28
Sumitomo	-134.48	8,079.98	2,527.95
Marubeni	225.34	6,938.96	1,819.06
Toyota Tsusho	134.6	5,228	1,469.6
Sojitz	60.82	2,230.29	579.12

Buffett told the Nikkei that he would be meeting with each of the trading houses later in the week to discuss his investments and the support each trading house has from Berkshire.

"We feel that these five companies are a cross-section of not only Japan but of the world", Buffett explained to Nikkei in Tokyo. "They are really so much similar to Berkshire. They own a lot of different things." High dividend yields, share buybacks, and extremely low valuations are other reasons Berkshire likes these investment vehicles.



Name	Dividend Yield	Price / Book	Price / Earnings	ROE(%)
Mitsubishi Corporation (8058.T)	4.33%	0.86	5.6	16.42
Mitsui & Co., Ltd. (8031.T)	3.54%	0.99	5.57	19.87
ITOCHU Corporation (8001.T)	3.64%	1.27	7.35	17.57
Marubeni Corporation (8002.T)	4.58%	1.09	5.42	23.17
Sumitomo Corporation (8053.T)	4.99%	0.78	4.83	18
<b>Average</b>	<b>4.22%</b>	<b>1.00</b>	<b>5.75</b>	<b>19.01</b>
iShares MSCI Japan ETF (EWJ)	1.14%	1.33	12.82	

As of April 11, 2023.

Japanese stocks are inexpensive compared to U.S. stocks but these trading companies trade at a deeper discount than broader Japanese markets. These trading houses also produce consistent cash flows and believe in optimizing shareholder value.

Buffett first bought these Japanese trading houses in August 2020 and increased his stakes in November 2022. He has previously commented that it's a possibility that he increases his holdings of these trading houses up to 9.9% of shares.

Before this week's visit, Buffett was last in Japan in August 2011 when he visited Tungaloy, a company that specializes in the production of metal cutting tools. Berkshire Hathaway purchased Tungaloy in 2008 through its subsidiary IMC Group, the second largest company for metal working products. The IMC Group is comprised of 14 companies in 60 countries across the world.



Whether you like it or not, Warren Buffett, Charlie Munger and Berkshire Hathaway can find industries that have tremendous value and upside potential.

Many believe Japan's economy is on the cusp of emerging from decades of too-low inflation. Last year's global price increases could be the juice that kickstarts the Japanese economy which could be helpful for companies to expand and reverse Japan's relative economic decline.

### A rug pull for the ages

We have talked about WeWork and its founder Adam Neumann multiple times in this publication's history. This week we will not dive into what happened, we will just show you three images that show the magnitude of this rug pull.

WeWork's valuation peak (from a Bloomberg article):

Masayoshi Son, the founder of SoftBank, became one of them in 2017 with an initial outlay of \$4.4 billion in a deal valuing WeWork at \$20 billion. In January 2019, SoftBank pushed the valuation to \$47 billion. Oct 20, 2021

WeWork's market cap (as of April 11, 2023, close):



And finally, Adam Neumann's net worth:

Adam Neumann / Net worth

**2.2 billion USD**

2023



A rug pull historians will study; Neumann is now worth quadruple what the company he founded is worth.

We hope you were not one of the retail investors who bought this dumpster fire.

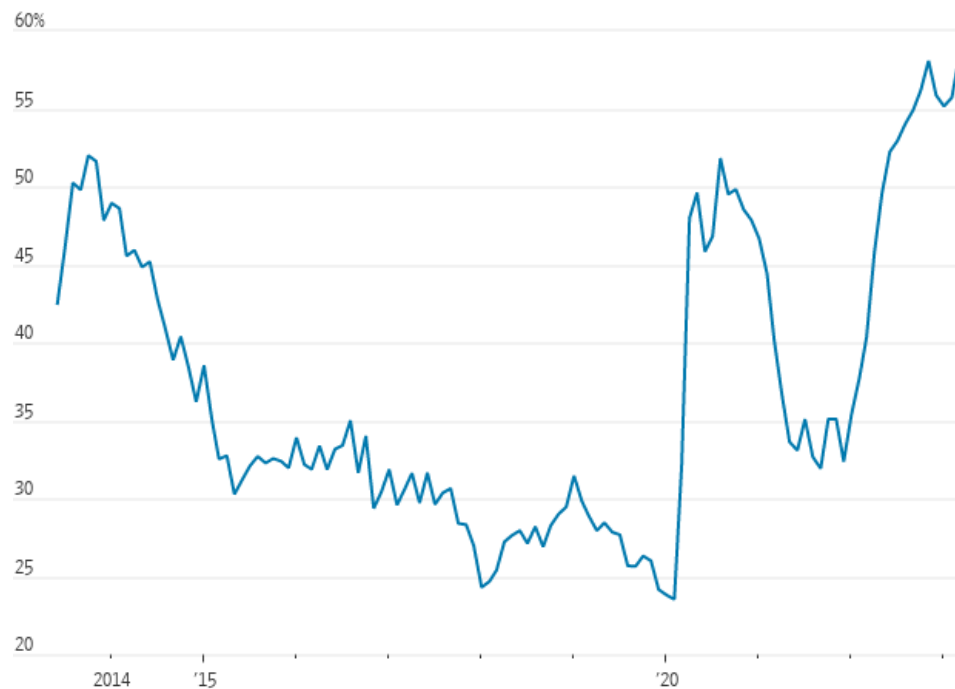
### Tighter credit conditions

Consumers are feeling the squeeze right now.

Almost 60% of U.S. households say it's hard to obtain a credit card.



Share of households reporting it is harder to obtain credit than one year ago



Source: Federal Reserve Bank of New York

Personal balance sheets have deteriorated, and people are beginning to dip into their savings.

Banks have also made it harder for consumers to get a credit card by tightening their standards. This has hurt consumers who have been impacted the most by rising prices.

High credit card approval was a symptom of easy money and cheap credit. Do not expect approval rates to return to their 2019 highs anytime soon.

### **Word of the week**

Inflation.

Perhaps we are understating our point by saying it's the word of the week. Inflation might be the word of the year. Everyone talks about it. Traders, wealth advisors, restaurant owners, retail workers, university students, and many more have rising prices at the front of their minds.

This past week was inflation week as the Consumer Price Index was released on Wednesday. This was a highly anticipated data point that investors were looking to for guidance on where markets would go from here. If the number came in higher than expected, then the FED would likely need to raise rates yet again.

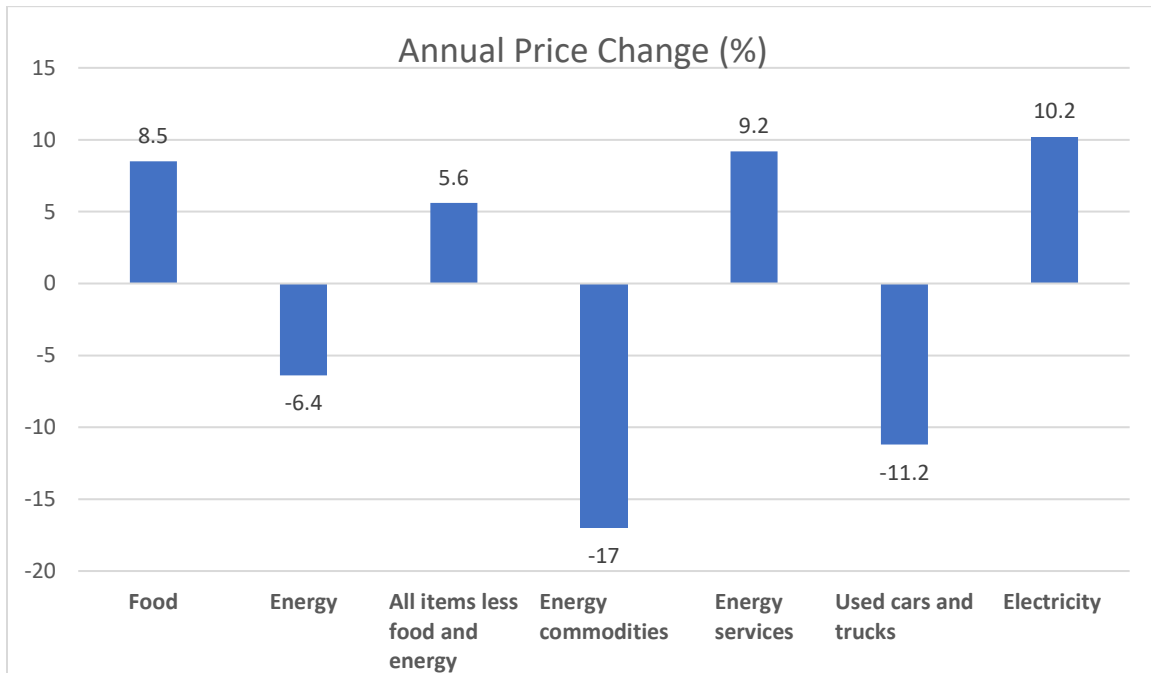


On Wednesday morning the U.S. BLS released that prices rose 0.1% in March. Economists polled by the Wall Street Journal were forecasting a price increase of 0.2% for March. The CPI (yearly rate) came in at 5% for March 2023. This was down substantially from the month prior when the CPI was 6%. March 2023 was the 9th month in a row that the CPI decreased.



The yearly rate of inflation slowed to 5% - the lowest level since May 2021. What helped decrease the annual inflation rate was a large increase in March 2022 dropping out of the annual rate.

Here are the annual price changes for major categories in the CPI:





Energy prices retreating is a major reason that the CPI has decreased since June of last year. The price of oil peaked in June 2022 at over \$120/bb before retreating over the next 6-7 months. The price of natural gas has also decreased quite substantially since last summer. This has decreased the price for consumers on several fronts since.

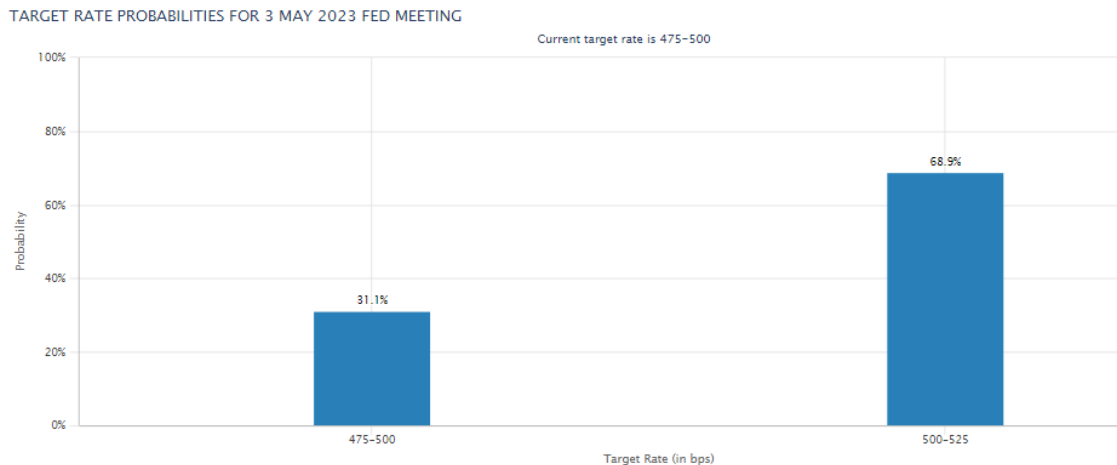
However, energy prices have moved up quite significantly in recent months and could help lead the CPI higher moving forward.

The increase in the core rate of inflation over the past 12 months moved up to 5.6% from 5.5%. These prices have fallen slower than the broader CPI and point to inflation remaining high through most of 2023.

Core CPI strips out energy and food prices which tend to be more volatile than the price of other goods. Service prices continue to increase as consumers continue their rotation from goods to services. Hotel prices jumped 2.7% in March and Transportation services jumped by 13.9% over the last year. We expect consumers to continue to sacrifice spending in certain areas to afford certain services, especially as the weather gets warmer.

The March CPI report is one of the last major data releases before the FED meets on May 2-3 to raise interest rates for what would be the tenth consecutive time in this tightening cycle.

For now, here are the probabilities of what will happen at that meeting:



Most are projecting a 0.25% increase to be announced by the FED at May's meeting.

The FED's remaining interest rate decisions for 2023 are scheduled for May 3, June 14, July 26, September 20, November 1, and December 13.





## Buffett doubles down on an old take

During Warren Buffett's trip to Japan, he sat down with CNBC to conduct a long interview where he answered several questions on financial markets.

Buffett, a long-time critique of Bitcoin and cryptocurrencies doubled down on his crypto opinions. He compared crypto to a casino and buyers as gamblers.

The most memorable part of the interview came when Buffett was talking about Bitcoin:

*"I've seen people do stupid things all my life."*

— Warren Buffet, Berkshire Hathaway CEO

Buffett compared crypto to witnessing people gambling when he was on his honeymoon in the 1950s in Las Vegas. Buffett went on to say that smart people have become involved in this area out of fear of missing out.

Buffett's comments come as Bitcoin surged in 2023.



Even though Bitcoin has enjoyed a great start to 2023, it is well below its all-time high price of \$65,000 which it reached in November 2021.

We are not endorsing Buffett's comments and understand the utility across certain cryptocurrencies but with an unlimited supply of coins, and limited regulation, the entire industry has issues to solve moving

forward. The issue Buffett and other investors have against Bitcoin and its peer group are the coins have no fundamental value and are not backed by anything.



### Hiccups in the green transition

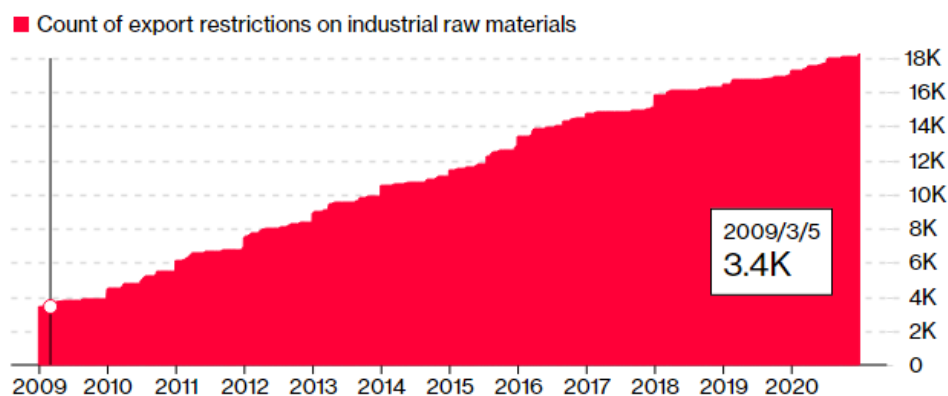
Nationalism and green energy. Two terms green energy activists never thought would be muttered in the same sentence.

Green energy activists believe we need to transition away from fossil fuels immediately. This has led to numerous countries creating plans that will help reduce emissions and decrease the world's dependence on fossil fuels. When green energy activists set forward these plans, they do consider raw material supply, production capabilities, and costs. They simply set forth a high-level plan and let others figure out the details.

As we all know, green energy requires several raw materials including copper, other industrial metals, and several Rare Earth metals. This technology will increase the demand for these metals substantially. As there is a finite supply of these metals across the world and every country (for the most part) wants to be a leader in green technology, numerous export restrictions have been put in place by countries so that they can secure the supply (of various metals) they need moving forward.

The OECD (Organisation for Economic Co-operation and Development) put out a report that highlights these issues. The report says export restrictions from several countries including India and China could make it much harder for the world to reach its climate goals. The restrictions include anything from additional taxes to quantitative limits. These restrictions have increased more than five-fold over the last 10-12 years:

### **Critical Raw Materials Are Getting Harder to Export**



Source: Organization for Economic Cooperation and Development

From: Bloomberg

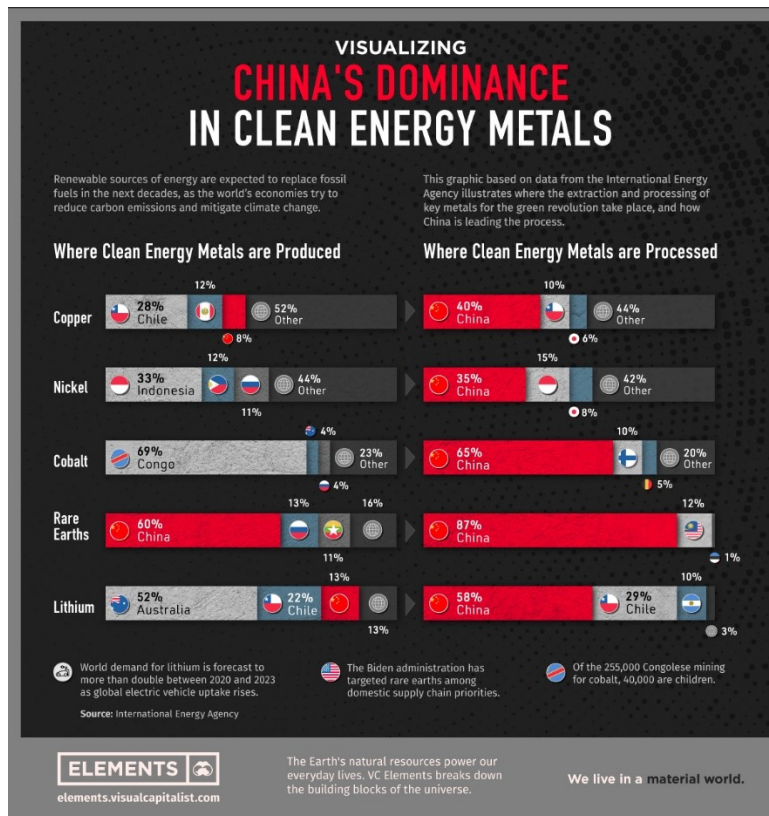
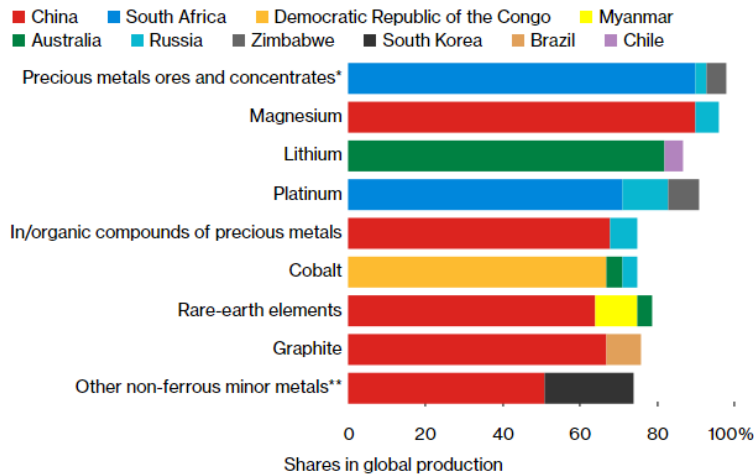
China, India, Argentina, Russia, Vietnam, and Kazakhstan are the top six countries that have put in export restrictions over the last decade.



Mining and production for many of the metals required in green technology are dominated by a select number of countries.

### A Few Countries Dominate Production of Critical Raw Materials

Top producers of the most production-concentrated critical raw materials



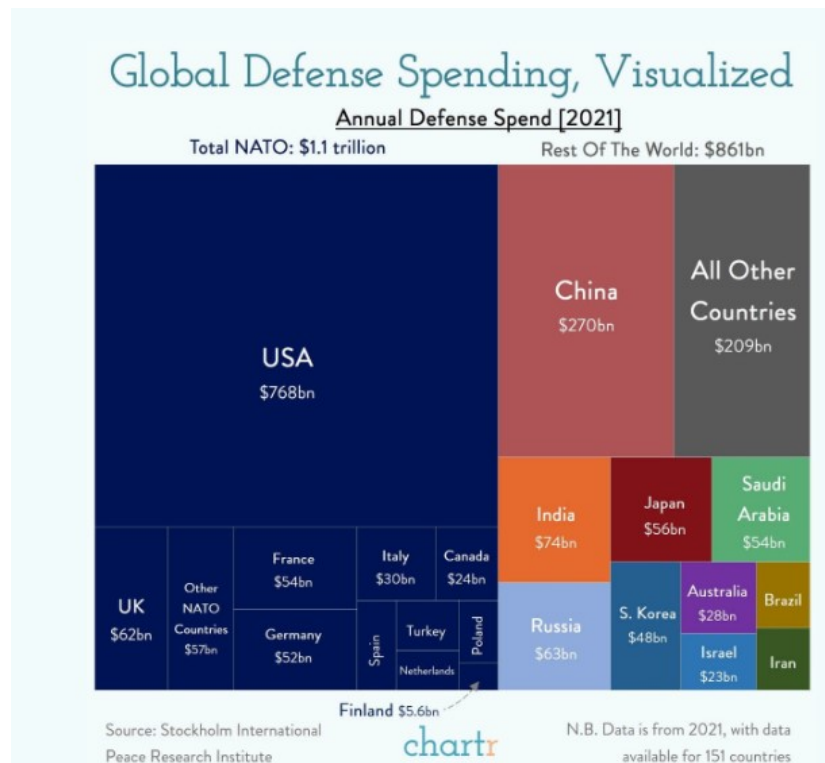
Until the world begins to play nice, climate goals might be harder to achieve than the greens thought. However, we do not see China and its allies removing restrictions so Western nations can increase their presence in this industry.

We remind you to buy the metals (at good valuations) and not the companies consumers use like electric vehicle producers or solar energy companies!

### How much?

The world spent over \$2 trillion on defense in 2021, over half of which was spent by NATO members. Geopolitical tensions between the world's leading powers have led to an increase in spending by almost all countries. Many fear that we are one event away from a catastrophic World War 3 between the U.S. and its Western allies and an alliance led by China and Russia.

The image below uses scale and illustrates how much the U.S. spends on defense relative to every other nation. They are responsible for more than 75% of NATO members' total defense spending yet according to World Data the U.S. only makes up approximately a third of NATO's total population.

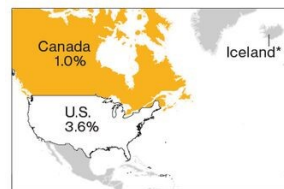


This chart has slightly improved over the last 5 years. In 2017, President Trump demanded that his allies spend at proportionate levels to the U.S. on defense. Trump and his team wanted NATO members to match the U.S. in defense spending as a total percentage of a country's GDP.

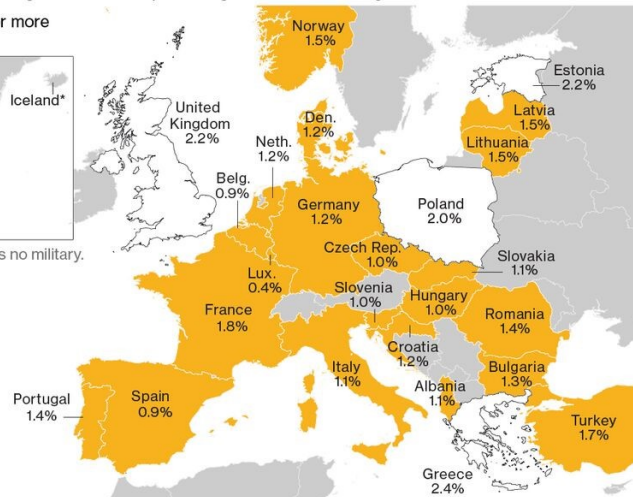
### Paying Their Fair Share?

2016 national defense spending estimates as a percentage of GDP. NATO target is 2%

■ less than 2% □ 2% or more



\*Iceland, a NATO member, has no military.



Source: NATO data based on 2010 prices and exchange rates

Bloomberg

Although these percentages are not equal today, Trump made defense spending by allies an issue Americans are aware of. We think moving forward allies of the U.S. will begin to increase their defense spending especially with some geopolitical uncertainty occurring across the world.

We bring military spending by governments up this week because we do not expect it to slow down. We think it will accelerate both in the public and private marketplaces. There will be breakthroughs in the private sector that could be a game changer during the world's next war. Whether you like it or not, there are ways to profit from this expansion in defense spending through public markets.

Like many of our other macro ideas, it is important to thoroughly research this sector (and companies in the sector) as geopolitics presents added risks for investors.

### Lighter news

Fyre Festival, the infamous music festival that never happened filled with celebrities, socialites, and influencers is back in the news this week. The festival which never happened originally went viral due to a Netflix documentary released in 2019. It is back in the news for the first time in years this week. The man behind Fyre has been released from prison and is already making headways.

Billy McFarland, the co-Founder of Fyre Festival tweeted that Fyre Festival II will happen.



McFarland defrauded investors of \$27.4 million and was sentenced to six years in prison, he served four years behind bars.

We truly are in a time when anything can happen. If you pay McFarland and his company any money to go to this festival, you more than likely need some help.

“Faking it until you make it.” – one step (festival) at a time.



**MacNicol & Associates Asset Management**  
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