THE WEEKLY BEACON APRIL 7, 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.

MacNicol & Associates Asset Management

Contact us today if you would like to meet about your investment future. info@macnicolasset.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.

Hudson–Athens Lighthouse,

Hudson River, New York

This lighthouse is located between Hudson and Athens in New York state. The lighthouse was first constructed in 1874 and was automated in 1949. The lighthouse stands at 46 feet tall. As of 2002, the lighthouse offers tours to the public through the Lighthouse Preservation Society.

Cape Romain Lighthouses,

Charleston County, South Carolina

The Cape Romain Lighthouses are a pair of brick lighthouses constructed in 1827 and 1857. The lighthouses stand at 161 feet, and 65 feet tall. Both lighthouses are decommissioned. The lighthouses were repaired in the 1980s and now are available to tour.

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

Big move for oil

OPEC and Russia made a huge announcement last weekend. The organization and its members will decrease oil production by over 1.6 million barrels per day. As prices have fallen, many energy investors have looked for OPEC to do something to stabilize the market. However, many market participants were caught off guard by this move made by OPEC and Russia. The move was a positive sign for energy investors, especially with recession fears looming over the economy.

Saudi Arabia's Ministry of Energy said the production cuts were precautionary and were meant to stabilize global prices. Many analysts and insiders also believe that Saudi Arabia green-lighted this plan due to recent comments made by U.S. Energy Secretary Jennifer Granholm. Secretary Granholm spoke last week and said it would take years for the U.S. to replenish its strategic petroleum reserves, and that they probably would not begin refilling it this year due to production issues.

Trigger for Saudi oil production move was comment that U.S. would not refill SPR this year, report says

Last Updated: April 3, 2023 at 9:30 a.m. ET
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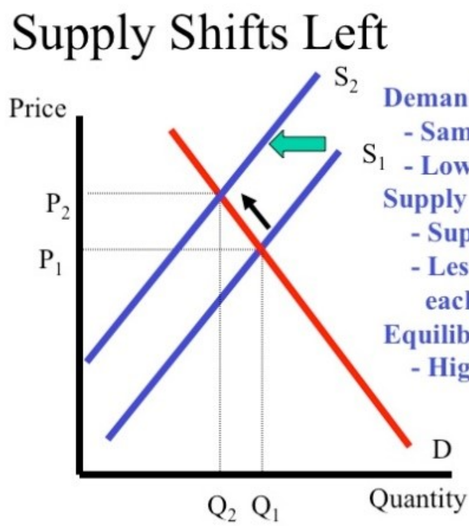
Here are the countries that have agreed to decrease their oil production:

Country	Size of cut (b/d)
Saudi Arabia	500,000
Russia	500,000
Iraq	211,000
UAE	144,000
Kuwait	128,000
Kazakhstan	78,000
Algeria	48,000
Oman	40,000

These production cuts account for approximately 2% of global oil production.

Oil prices jumped on Monday morning on this news. Basic economics tells us less supply equates to higher prices.



Supply constraints could also become a problem as we head into the driving season. Prices were up 6% as of 3:30 PM on Monday.

Crude oil trading above $80 a barrel is huge. Just a few weeks ago crude oil was trading at a 12-month low near $65. Many traders believed it was the end of the energy cycle and cut their losses. We assume if they did sell, they are probably quite mad this week. However, we warn our readers yet again that the energy sector is extremely volatile and large, short-term swings to the downside and upside must be expected. We are not short-term traders; we are investors predicting on a long-term trend.

This move by OPEC could reignite inflationary pressures in the energy space. Consumers will face higher energy costs when powering their homes, and offices, and will face higher fuel costs at gas stations.

This move is also the last thing the Trudeau and Biden governments wanted on a short-term basis.

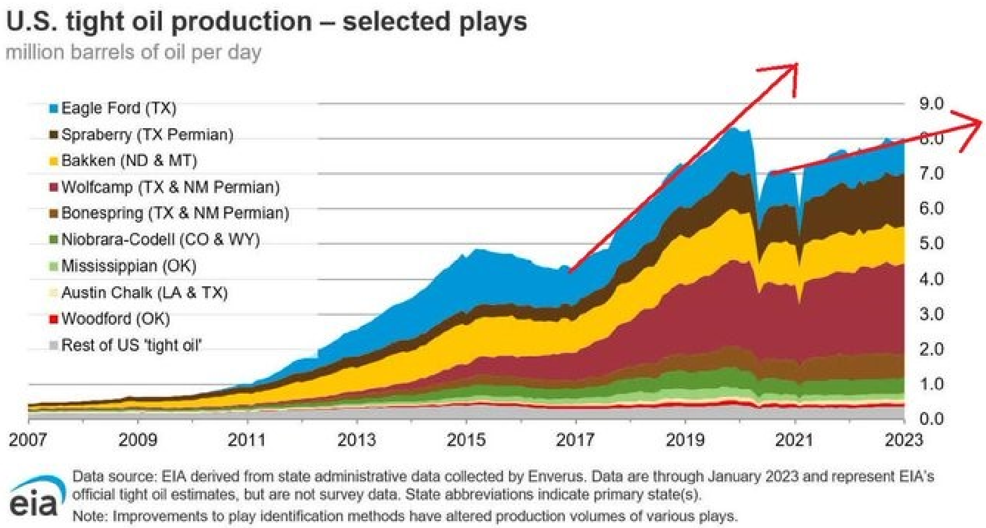
Rising prices are bad for governments, especially when heading toward an election (US November 2024 – Canada 2025). The Biden administration has drained its strategic petroleum reserves (SPR) over the last 6+ months to depress oil prices through added supply. Their move has left the SPR at its lowest capacity in over 40 years. Prime Minister Trudeau and his government suspended certain fuel taxes to lower energy prices for most of 2022. This led to lower consumer prices even as underlying energy prices increased. The suspension of these fuel taxes ended on April 1st, 2023.

> The federal carbon tax will increase to 14 cents per litre of gasoline and 12 cents per cubic metre of natural gas on April 1. First passed in the 2017 federal budget, the alcohol escalator tax automatically increases excise taxes on beer, wine and spirits every year by the rate of inflation. Mar 1, 2023
>
> Canadian Taxpayers Federation
> https://www.taxpayer.com › newsroom › major-tax-hikes...

This added fuel charge jumped by 30% overnight. Canadian consumers see some of the highest oil prices in the world due to added carbon taxes. Consumers blinked and prices surged overnight.

Even though Canada and the U.S. produce the cleanest oil and gas in the world and have the reserves to increase production, the countries decided not to for environmental reasons. The overregulation of the energy industry has also led producers to underinvest in increasing production. Companies have focused on cleaning up their balance sheets and optimizing shareholder value in recent years rather than exponentially growing production through capital expenditure investment. Energy companies have also been vilified by both governments and many Westerners in recent years due to climate change.

Surprisingly, the move by OPEC and Russia was essentially supported by the U.S. oil sector. The U.S. oil sector has been unwilling or unable to increase oil production at the same rate it did from 2016-2020 over the last few years. This has led to less supply elasticity and has essentially given a green light to OPEC and Russia to defend higher oil prices without sacrificing market share.



U.S. production looks like it is not able to fill the void left by OPEC and Russia's oil production reduction.

A CIBC Private wealth analyst said there is "a limited threat to market share" when referencing OPEC's decision to decrease production.

Many have projected this move could be very bullish for oil especially in the short term, citing prices around $90-100 per barrel by the end of the year.

PRO Crude oil at $100 could soon become the new normal, top energy analyst Paul Sankey predicts

18 MIN AGO • Natalie Zhang

The inflation angle

OPEC's decision to cut oil production will increase energy prices overnight. Go check your local gas station, it's already started.

This will lead to higher energy prices leading to higher inflation rates. Inflation rates have decreased over the last 6 months. Over that same period, energy prices have decreased. A resurgence in energy prices could lead to a resurgence in the CPI.

We are not projecting that wave to begin in next week's CPI report for March 2023 as these price increases will begin in April.

The FED has increased interest rates to decrease inflation rates. One policy decision by OPEC and Russia could set them back quite substantially.

Higher energy prices hurt both consumers and producers. This will lead to higher prices across the board for consumers.

For now, we will have to wait on the sidelines to see who will come out on top:

Changing the rules

Silicon Valley Bank (SVB) is the bank in the news for all the wrong reasons over the last month. We have written about SVB and its downfall for a month straight so do not worry, this will be quick. We will not go into any depth but wanted to share one thing regarding SVB that we read this week.

> In buying longer-term investments that paid more interest, SVB had fallen out of compliance with a key risk metric. An internal model showed that higher interest rates could have a devastating impact on the bank's future earnings, according to two former employees familiar with the modeling who spoke on the condition of anonymity to describe confidential deliberations.
>
> Instead of heeding that warning — and over the concerns of some staffers — SVB executives simply changed the model's assumptions, according to the former employees and securities filings. The tweaks, which have not been previously reported, initially predicted that rising interest rates would have minimal impact.

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From a CNBC article

According to former employees, SVB executives knew their trades were higher risk than they should have been, instead of changing their philosophy they changed the model to fit their mindset. The company manipulated its financial models to suit its preferred outcome completely ignoring the massive downside risks associated with the long-term debt securities that they had bought with customer deposits.

The ironic part of this story is one week before its failure, SVB praised its top executives for an area of achievement: managing risk in their annual report to shareholders.

Trillion-dollar company cuts costs

Today's economic backdrop is a lot different than the one we faced in 2021. This is especially true for the technology sector.

In 2021 stocks only went up, technology stocks led the way, technology companies were hiring at record rates, and technology workers had huge compensation packages.

Since then, tech executives have been faced with some harsh realities which have been led by rising interest rates. This rate hiking cycle is arguably the first we have ever seen during the Internet age. Analysts for tech stocks and tech company CEOs seemingly did not know how to react to rising rates.

In recent months, tech companies have laid off workers by the thousands, as they attempt to increase profitability by cutting costs without sacrificing efficiency. This trend in the tech industry arguably began when Elon Musk bought Twitter and decided to slash the company's employees by close to 80%. The company reportedly has under 1,500 employees currently. That number was over 7,500 in December 2021. As avid users of Twitter, we have not seen a decrease in performance, or features for the application, you could even argue more has changed in recent months (with Musk at the helm) than in the previous few years on Twitter.

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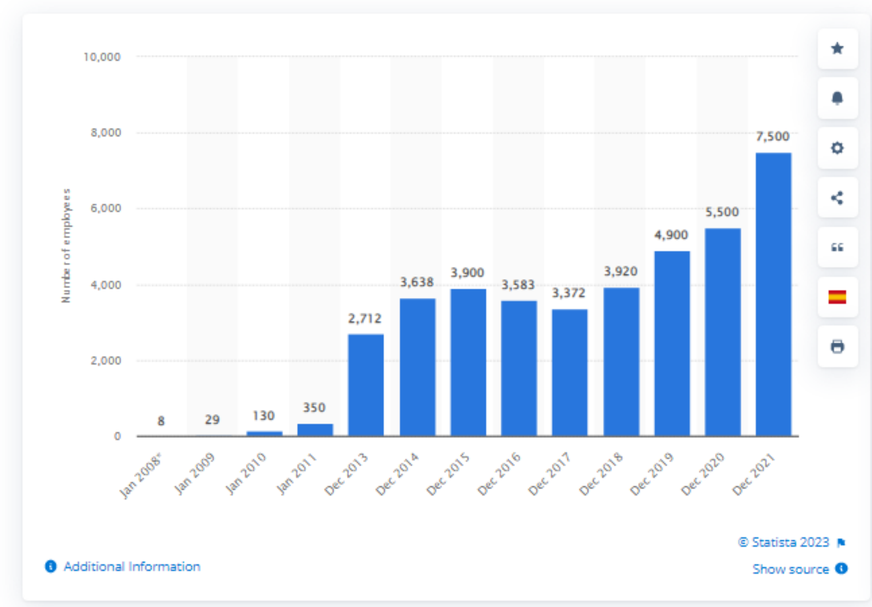
Number of Twitter employees from 2008 to 2021



As other tech companies follow Musk, they are doing more than firing employees to cut costs.

Google announced it would be cutting employee services like fitness classes and the frequency of laptop replacements. Google also announced it would be cutting back on in-office products like tape, staplers, and other stationary items.

An internal email also indicates that Google will shut down its internal cafes on Mondays and Fridays. The email also indicates the company will scale back food purchases, as well as massage and transportation initiatives.

Tech workers have had it better than even we thought! Frequent laptop upgrades, free meals, free ubers, fitness classes, massages, and unlimited staplers. How did they expect these workers to be productive?

These moves by Google are just the latest by the company to cut costs. Google laid off 12,000 employees in January.

10,000,000 less of these and Alphabet shareholders might notice!

Munger links speculation to addiction

Charlie Munger has been steadfast in recent years that most retail traders were essentially gambling. The investing legend recently described investors who he sees as gamblers as addicted. He described the rush they get from investing like heroin.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Billionaire investor Charlie Munger says stock market 'gambling' is as addictive as 'heroin'—but he sees no way to fix it

Berkshire Hathaway's Munger criticized investors who trade like they're "gambling" and said it causes harm like the Great Depression.

BY **PRARTHANA PRAKASH**

April 03, 2023 5:01 PM EDT

He believes they are gambling as they are speculating on prices rather than finding value. If this trend continues, we could have a generation of consumers on the brink of retirement making high-risk trades and getting wiped out. It is important to understand the timeline of your investment portfolio so risk levels can be managed.

As a titan of the industry, we had to share this front-page quote from Munger.

Gold prices nearing all-time highs

The price of Gold has surged in recent months and is closing in on an all-time high. Gold set its all-time high in 2020 when the price of gold reached $2,069.40. As of 2:00 PM on Tuesday, the price of gold was sitting at $2,040 up 1.8% on the day and 11.28% on the year.

The price of gold has increased by 25% ($400) since early November 2022.

This price movement is music to the ears of gold bulls. Before this move gold prices slightly decreased in 2022 even though inflation was at 40-year highs. Gold is an inflation hedge and has historically performed well during inflationary periods.

So, what’s with this recent move?

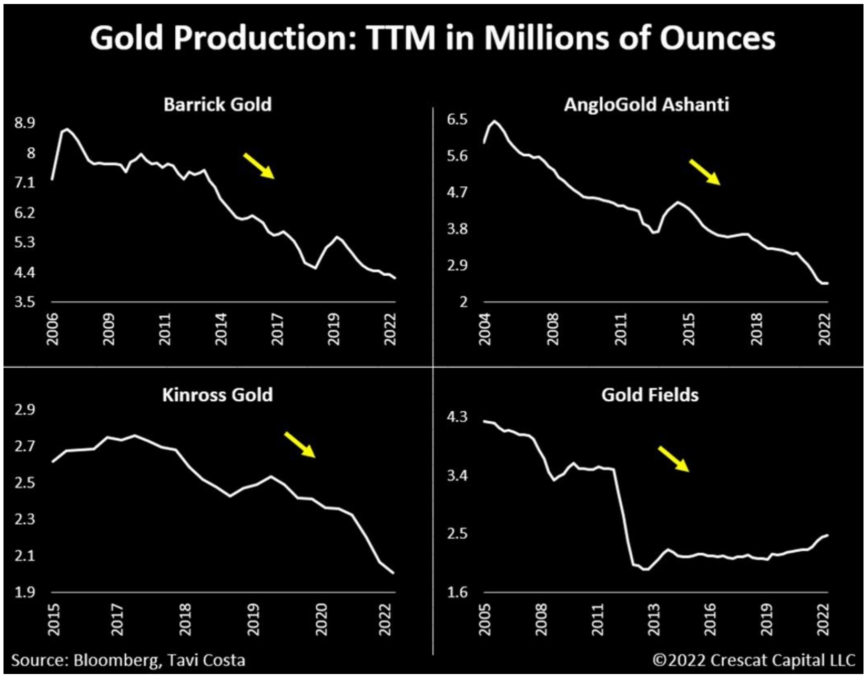
One reason is the U.S. dollar has declined in recent months.

Another comes from uncertainty. The uncertainty in the U.S. and global economies along with FED policy (and interest rates) has seemingly turned investors toward the physical metal in recent months rather than fiat money or U.S. Treasuries.

Jamie Dimon also warned investors that the banking crisis is not over and that there could be more hurt. Dimon was referencing what has happened over the last month across the banking industry. Dimon went on to say the failure of Silicon Valley Bank and the UBS rescue of Credit Suisse is increasing the odds of a recession. He went on to say that this crisis is nowhere near as bad as in 2008. Dimon signaled higher inflation rates moving forward are likely.

Sky-high inflation over the last year as well as under-reported inflation numbers for the last 10-20 years has destroyed the purchasing power of all major currencies including the U.S. and Canadian Dollars. Consumers look to be changing their tune as they exit the U.S. Dollar and U.S. Treasuries and enter tangible assets like Gold.

Depressed precious metal prices have also led to years of underinvestment in the industry (which could create some added upside).



The other bullish tailwind for gold prices comes from Central Banks around the world. Central Banks have been on a gold-buying spree. China increased its gold holdings by 24.9 tons in February, the 4th month in a row that China has been a net buyer of gold. At the same time, China has cut its holdings of U.S. Treasuries to their lowest level since the financial crisis. Global gold demand last year also hit its highest point since 2011. Emerging markets led the way as their Central Banks loaded up on the physical metal. Central banks have been net buyers of gold for the last decade. Central Banks also set a record in 2022 as they bought the most gold they had ever bought in a calendar year.

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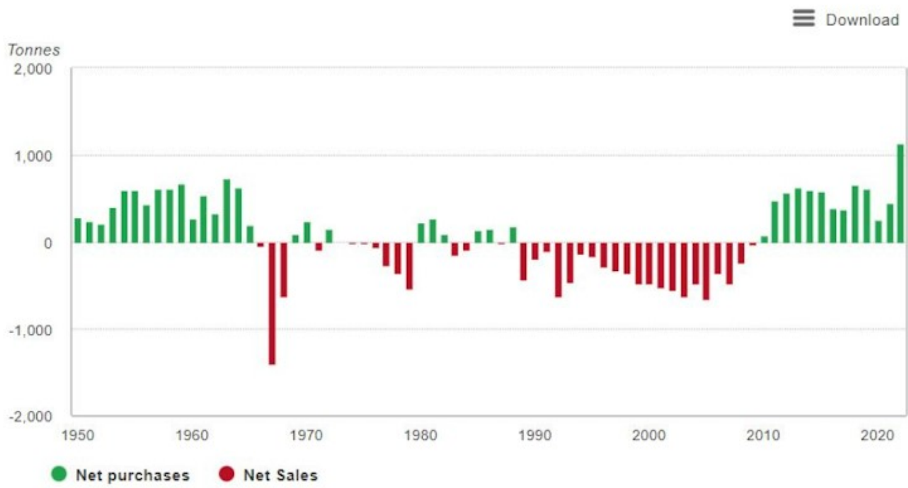
Central bank buying in 2022 was the highest on record*[4]



Sources: Metals Focus, Refinitiv GFMS, World Gold Council; Disclaimer

We are glad we did not waver when gold prices dropped. Some investors are probably regretting their panic. It is important to update your thesis and continue researching your holdings. It is also important to not get spooked by short-term reactions across markets.

It also helps that gold producers have cleaned up their balance sheets in recent years and are extremely undervalued relative to historic values.

If yields continue to drop, expect gold prices to be a beneficiary as investors exit Treasuries and park their money elsewhere.

Cracks in the armor

Gold prices have also moved up for a few other reasons. Other countries are slowly rotating away from the USD. The USD has been the world's reserve currency since the Bretton Woods agreement and is the currency in which most global trade is settled. This gives the U.S. government and U.S. FED tremendous economic power.

Numerous countries are rotating away from the USD for various reasons.

In Africa, numerous nations are moving towards de-dollarization. Sudan has signified its willingness to work closer with Russia, and possibly ditch the USD. Iran is looking to deepen its ties with Africa in trade and will look to ditch the USD to settle a trade by creating a joint bank with settlements in local currencies. Kenya also announced it would be buying oil from Saudi Arabia not in USD but in Kenyan Shillings.

Most recently the Indian Ministry of Foreign Affairs announced that India and Malaysia had agreed to settle trade in Indian Rupees rather than the USD.

On March 29th, Brazil announced that it had reached an agreement with China to no longer use the dollar as an intermediate currency, but to settle trades in local currencies. China is now Brazil's largest trade partner and Brazil receives the largest investment from China in the Latin American region.

FINANCE

De-dollarization is gaining momentum

Published 3 days ago on April 1, 2023
By Newsroom

China recently completed a test trade with France for natural gas where the trade was settled in Chinese Yuan.

It seems countries are slowly positioning themselves away from the U.S. and other Western nations and closer to China (and even Russia).

If you do not believe us, then look at this map which shows who sanctioned Russia when they invaded Ukraine.

The largest emerging markets in the world looked the other way when it comes to Russia invading Ukraine. Most of the world is still conducting trade with Russia while also trading with the U.S. Countries and buying what benefits themselves (and their populations) first and worrying about geopolitics second (We are not in any way condoning the Russian invasion, simply looking at how global trade has changed since it began).

Even Japan, one of the U.S.'s closest allies has broken the sanctions they agreed to. Just last week it was announced that they had been buying Russian oil for more than the Western price cap.

MARKETS | COMMODITIES

Japan Breaks With U.S. Allies, Buys Russian Oil at Prices Above Cap

Citing energy needs, Tokyo won exception to rules binding G-7 nations

Countries are both economically and militarily pushing themselves away from the United States. Most countries now conduct more trade with China than the U.S. and cannot be held hostage by the U.S. and its allies. Look for more nations to become neutral in global conflicts. We also expect more countries to begin to side with China and Russia rather than the U.S. out of pure necessity and economic upside.

The de-dollarization will not happen over night, it will be a slow and painful process. It took approximately 30 years for the world to move off the Pound to the U.S. Dollar during the last transition between global reserve currencies.

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