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.

Rubicon Point Light,
Rubicon Point, Lake Tahoe, California

The Rubicon Point Light is a small lighthouse on Lake Tahoe. The lighthouse sits at 12 feet tall and was originally constructed in 1916. The Rubicon Point Light was added to the Lighthouse Digest Doomsday List in 1997.

Cedar Island Light, *Sag Harbor, Gardiners Bay, Long Island*

Cedar Island Light is a lighthouse in Cedar Point County Park in East Hampton, New York. The 40-foot lighthouse was decommissioned in 1934 and was replaced by an automatic light on a steel skeleton at breakwater. The lighthouse stands at 30 feet tall.

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

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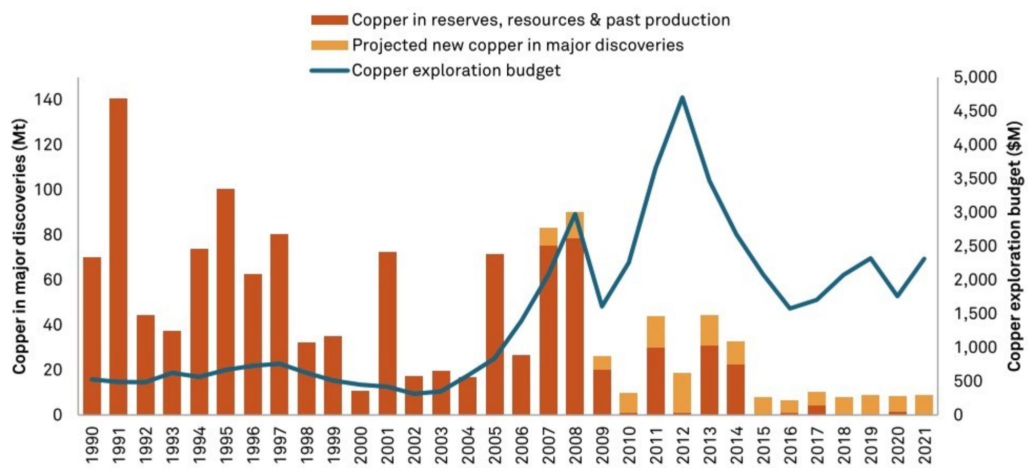
Copper's drought

The world is in the middle of a major copper discovery drought. The world has not found a major new copper discovery since 2014.

Major copper discovery drought continues



As of May 10, 2022.
A major copper discovery includes any deposit containing at least 500,000 tonnes of copper in reserves, resources and past production, with the year of discovery corresponding to the year of the initial drill program that identified potentially economic mineralization.
Source: S&P Global Market Intelligence.
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Even though many believe copper demand could decrease in the short term due to a potential global recession led by China (which consumes the most copper in the world), we believe the supply issues are still overlooked. This drought has been occurring for 10 years and the longer this discovery drought persists, the more there will be a supply imbalance.

We have talked about copper in recent months extensively in this publication so we will not dive further into this subject, we will simply say that we believe demand will grow substantially in the copper market.

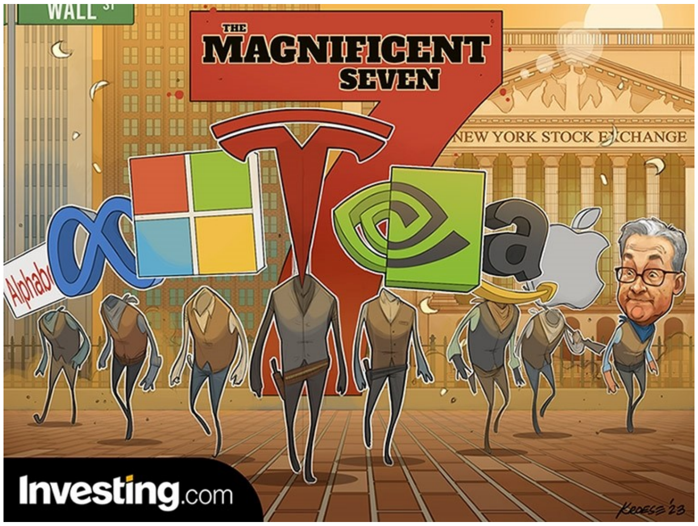
Regardless of what you think, you have seemingly missed out on some outsized returns in 2023 with many copper producers trading at all-time highs:

We will have to see what happens next, but we continue to believe that this is one of the best ways to invest in the green energy wave that will continue to blanket society for the foreseeable future.

The Magnificent Seven

We have talked about the market's consolidation throughout this year. Mega-cap stocks have led the charge and have accounted for most of the returns across major indices. These mega-cap stocks that have surged are all technology names and are known in finance as the "Magnificent Seven".

The Magnificent Seven include:



These companies have three major things in common.

1. They are all considered technology companies (yes, we include electric-vehicle Tesla in this as many justify the company's valuation by saying it's a tech company, not an auto producer).
2. They are all betting on AI. These companies are all developing and integrating artificial intelligence into their platforms or services. These companies made sure to mention the term AI in recent earnings calls as much as possible.
3. They trade at ridiculous multiples.

We will not jump into the first two points, but we will look at the third. Just how expensive do these seven stocks trade at, how expensive are they relative to the rest of the S&P 500, and how expensive are they compared to historical averages? When we say expensive, we are talking valuation – specifically the multiples that these stocks, and indices trade at. Today we will look at price-to-earnings ratios to get our point across.

The Magnificent Seven trades at 32 times earnings, while the S&P 500 trades at 20 times earnings, a huge spread in terms of valuation. Yes, we know it's not apples to apples as these are not all technology stocks, but they are all large capitalization stocks. When you take the Magnificent Seven out of the S&P 500, the index trades at 17 times earnings, almost half of what the Magnificent Seven trades at.

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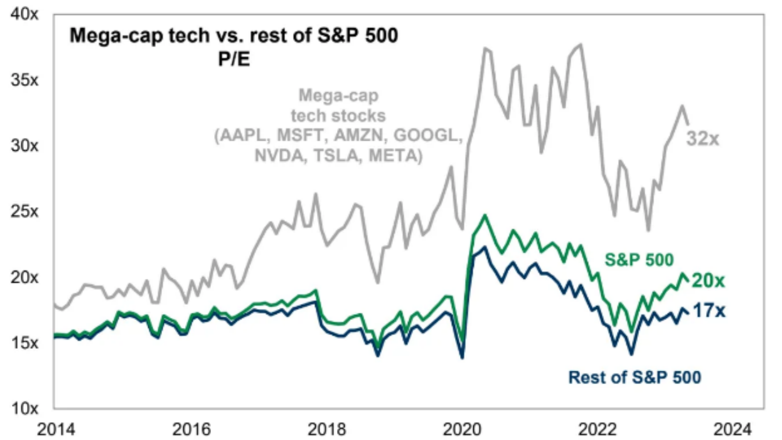
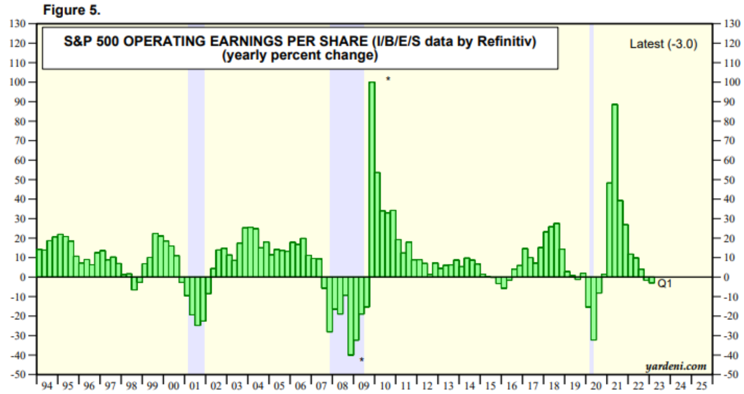
Exhibit 6: S&P 500 trades at a 20x P/E in aggregate, but 17x ex. the top 7 stocks
as of July 20, 2023



Source: Compustat, Goldman Sachs Global Investment Research

The only period over the last 10 years where these stocks traded at a higher valuation (in terms of P/E ratios) was during Covid-19 when corporate earnings shrunk due to global economic shutdowns recommended by public health agencies. S&P 500 earnings shrunk at the onset of Covid-19 three quarters in a row, the longest retraction since the Financial Crisis in 2008-2009.

Figure 5.



* Due to extreme values, Q4-2008's -65.2% is capped at -40%, Q4-2009's +198.9% is capped at 90%.
Note: Shaded areas are recessions according to the National Bureau of Economic Research.
Source: I/B/E/S data by Refinitiv.

The P/E ratios for both the S&P 500 and the Magnificent Seven are well above their 10-year averages. When we mention that the S&P 500 and mega-cap technology stocks are expensive, this is what we mean. Before you say, "so then what do you think we should buy if everything (including the index) is expensive right now", the rest of the S&P 500 is fractionally more expensive than the 10-year average. No matter where you are in the cycle, stocks trade in a reasonable price range that still has great growth prospects, it's just on investors to find them.

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British billionaire dinged with insider trading

It's not often you hear a billionaire getting in trouble over white-collar crimes, after all, they are extremely insulated, well-connected, and very smart. They rarely get caught with insider trading even though you could argue that it happens every day.

This week, the U.S. attorney's office in Manhattan charged a British billionaire with insider trading. Federal prosecutors claim that Joe Lewis, who owns the majority stake in the Tottenham Hotspur (English Premier League), orchestrated a "brazen" insider trading scheme, claiming that Lewis used insider information to help friends, family members, and employees. Two of Lewis's pilots were also charged with insider trading. Both men reaped millions of $ from Lewis' tips.

The events that got Lewis and his associates in trouble reportedly occurred between 2013 and 2021. Lewis founded the investment firm Tavistock Group. Lewis is reportedly worth north of $6 billion. U.S. Attorney Damian Williams said in a statement that Lewis' actions were unnecessary, and the moves did not help to enrich himself substantially.

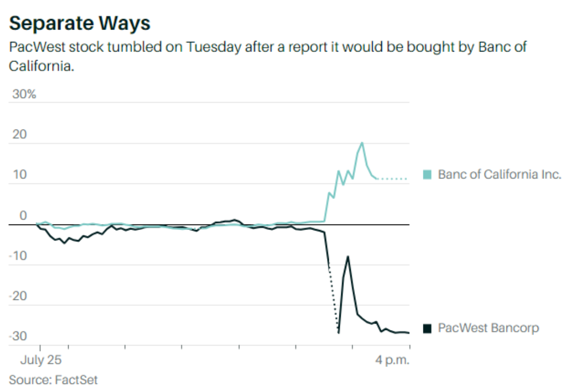
We will continue to watch this to see what happens. The one thing that caught our eye is why a man worth north of $6 billion risked a lot to help his circle make a few million, perhaps he could have skipped these issues and just wired them some money.

Regional banking news

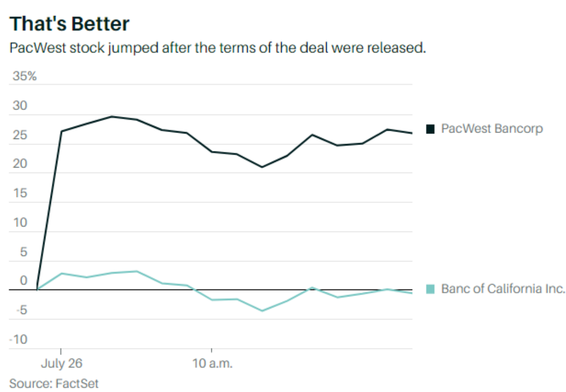
It's been a few months since we got any major U.S. Regional Banking news. For a few months, the sub-industry was front and center across capital markets. Loan portfolio losses, liquidity crunches, and a loss of confidence by consumers led to massive outflows which eventually sunk two large regional banks, Silicon Valley and Signature. The turmoil continued across the industry as investors and consumers turned their backs on regionals and piled into the big banks.

This week, it was announced that there would be more consolidation in the regional industry. On Tuesday, Banc of California announced that it would be buying out PacWest Bancorp.

After the announcement of the deal, PacWest shares tanked while the acquirer Banc of California saw their shares surge.



After details of the deal were released, PacWest shares bounced back:



After all the turmoil PacWest shares are only down 7%. As part of the deal, PacWest shareholders will get 0.6569 shares of Banc of California which equates to $9.60 – the current market price of PacWest shares (as of this writing). The deal also includes Warburg Pincus and Centerbridge Partners injecting $400 million in equity into the combined company. The transaction makes the two companies stronger as a whole than they were before the transaction. Under the terms of this deal, the new company would be called Pacific Western Bank.

"The combined company will have the strength and market position to support the banking needs of small and medium-sized businesses in California and to capitalize on the opportunities created for stronger financial institutions in the wake of the recent banking industry turmoil," said Jared Wolff, president and CEO of Banc of California, in a statement.

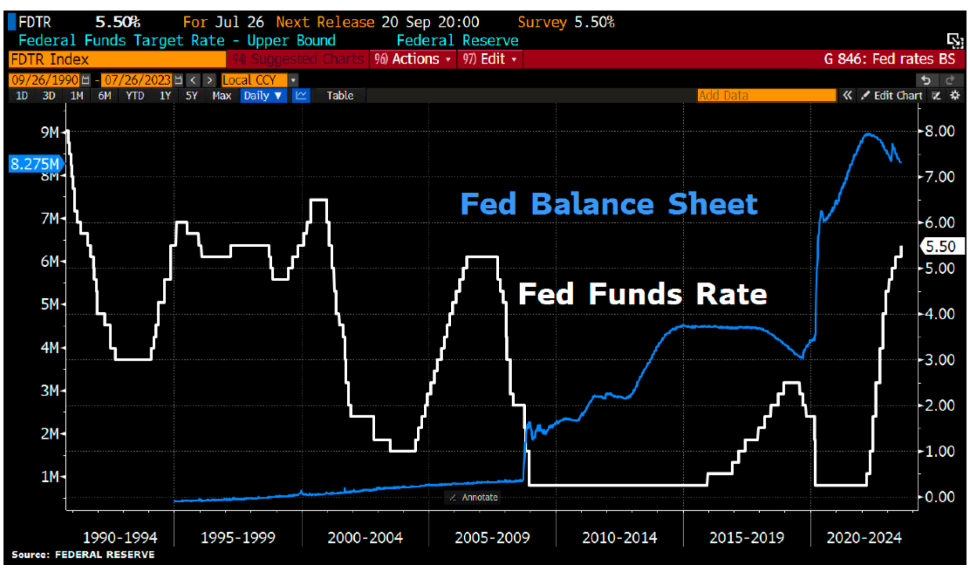
PacWest shares have struggled since the original banking crisis earlier this year and had yet to recover.

As of July 26th PacWest's market capitalization sits at $1.1 billion while the Banc of California has a market capitalization of $853 million.

Many believe that this move will continue to bolster consumer, investor, and regulator confidence in the regional banking industry which continues to struggle as a whole.

Rate hike

On Wednesday, the Federal Reserve announced that they would be raising the FED Funds Rate by another 25 basis points (0.25%). This brings the FED Funds Rate to 5.5%. This brings the FED Funds Rate to its highest point in 22 years.



David Rosenberg of Rosenberg Research released some thoughts after the FED's decision was made. Rosenberg said the FED not mentioning one word on the progress made fighting inflation lined up on the hawkish side, concluding that he thinks there is likely more work to be done.

In Powell's press conference on Wednesday, he announced that the FED no longer forecasts a recession and that the FED will not begin cutting rates during 2023. In terms of the FED's next policy decision,

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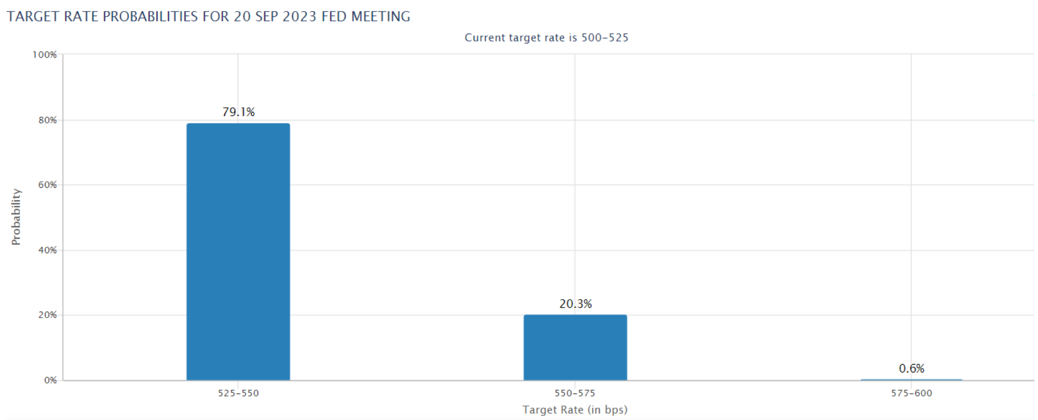
Powell said after more data is digested a decision will be made in September, claiming a raise or hold is possible.

We think the ultra bulls that were forecasting what they wanted to hear (rate cuts) rather than what is likely to happen are probably quite mad. However, we do think some metrics are pointing to a recession despite Powell and the FEDs announcements.

The one thing that could start pushing the CPI upward is energy prices in the fall which have moved up quite substantially in recent months after falling at the end of last year and the start of this year. Energy prices are an added cost for producers in numerous industries which will lead to higher consumer prices.

After Wednesday's press conference, the FOMC rate tracker was forecasting no rate hike in September at the next FED meeting.



A note on wind power

Barron's published a report on wind energy last week and we need to share it with our readers. We are heavily invested in energy so this story was a must-read for our Investment Team.

Before we jump into the article, we will give you its title.

"America's Bet on Wind Power Is Running Into a Big Problem"

The article highlights the dark things going on behind the scenes in the wind energy industry. Higher costs and serious delays are plaguing the industry and new projects.

Even though governments and renewable energy groups are applauding the adoption of wind energy, the reality is quite different. The industry is teetering, companies are planning to renegotiate contracts or pull out of their contracts due to profitability issues. The major issue with this move is these contacts were supposed to supply electricity to millions of homes. Cities like Boston and New York have become dependent on this energy source as the cities push to go green. Inflation has eroded the profits of these companies which has caused companies to back out of the industry. After all who wants to lose money?

Shell CEO said in a statement last month that returns on offshore wind are becoming more and more challenged. Shell pulled out of a joint venture off the coast of Massachusetts last month citing low return potential as a reason for pulling out of the contract.

Shell is not the only large company to pull out of deals in recent month. BP, Orsted (Denmark), Equinor, Iberdrola (Spain), Energias (Portugal), and Engie (France) have also pulled out or asked to renegotiate various offshore wind projects in recent months. These companies are attempting to renegotiate in ways that will pass more costs onto consumers.

Barron's mentioned that this trend could also put the U.S.'s plan to decarbonize at risk. President Biden announced a 2030 goal of 30 gigawatts of offshore wind power which could power over 10 million homes. This goal, which was unlikely to be accomplished, to begin with, seems impossible at this point. A Credit Suisse analyst mentioned that installing 15 gigawatts could be possible but 30 seems unattainable.

Installing these offshore wind projects has skyrocketed in recent years – as costs increase. Analysts cited land being purchased by energy producers in the ocean as a major driver for rising costs, the analyst linked the rise in prices to a bubble. Traditional fossil fuel producers jumped into renewable energy industries in recent years to decarbonize their energy mix in the face of government and shareholder pressure. The analyst highlighted a parcel of land at the bottom of the ocean that Shell bought for $700 million last year compared to a similar-sized piece of land that sold years prior for $10 million. We do not know ocean real estate but that seems like a bubble to us. Steel prices have also skyrocketed in the last few years which have added extra variable costs for producers.

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Offshore wind is the key for large urban coastal areas to go green as there are limited alternatives in renewable energy for these cities. This has resulted in a wave of projects off the coasts of States in the Northeast.

The producers who are threatening to pull out or have pulled out of negotiated contracts are pushing for electricity prices to be linked to inflation rates. The Chairman of the Rhode Island Public Utilities Commission said in a recent statement that developers can essentially hold regulators hostage for higher rates and more advantageous terms due to government energy goals.

The industry may be in the early stages of a bad-news cycle, with more impairments to come at various companies, these holdouts could continue moving forward. Perhaps some of these issues can be resolved but we think the eventual solution will result in higher prices for consumers.

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