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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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.

Boat Bluff Lighthouse,

British Columbia, Canada

The original building was established in 1907. The lighthouse has been kept since 1932 by a resident keeper. The lighthouse currently stands at 28 feet tall and is operated by the Canadian Coast Guard.

CAPE MAY LIGHTHOUSE, Cape May Point, New Jersey

Built in 1859, the Cape May Lighthouse is still an aid to navigation. The lighthouse stands at 160 feet tall and was added to the National Registry of Historical Places in 1973.

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

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The second quarter seemed to fly by. Before we get into this week's issue. We want to wish all our Canadian and American readers a happy belated Canada and Independence Day(s), we hope you had a restful start to the summer.

China fires back

Tensions have continued to boil over between the world's two largest economies, China, and the U.S. We are not talking physical conflict, or activating warships, we are talking economic conflict.

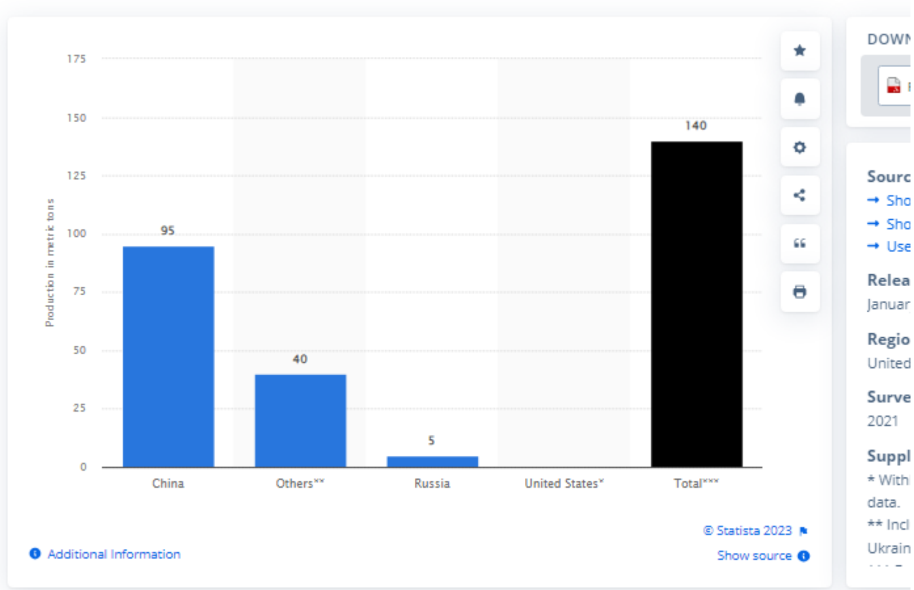
That economic conflict has been increasing over the last few years, beginning with the Trump presidency, and continuing through the Biden presidency. On Monday, China seemed to hit back with trade sanctions of their own. As the U.S. announced they may halt exports of semiconductor chips to China two weeks ago, China did not hesitate to retaliate. China announced export restrictions for two key metals required in the manufacturing of semiconductors. The new regulations will require Chinese exporters to seek approval to ship gallium and germanium compounds beginning August 1st. Many believe the restrictions are targeted at the U.S. and its European allies.

China announced that export restrictions are being put in place to protect national security interests.

Germanium and gallium are Germanium ores are rare and most germanium is a by-product of zinc production and from coal fly ash. Gallium is found in trace amounts in zinc ores and bauxite, and gallium metal is produced when processing bauxite to make aluminum.

China produces approximately 60% of the world's germanium and 80% of the world's gallium according to the Critical Raw Materials Alliance.

Refinery production of germanium worldwide in 2021, by country
(in metric tons)



So, is this a big deal? Yes and no.

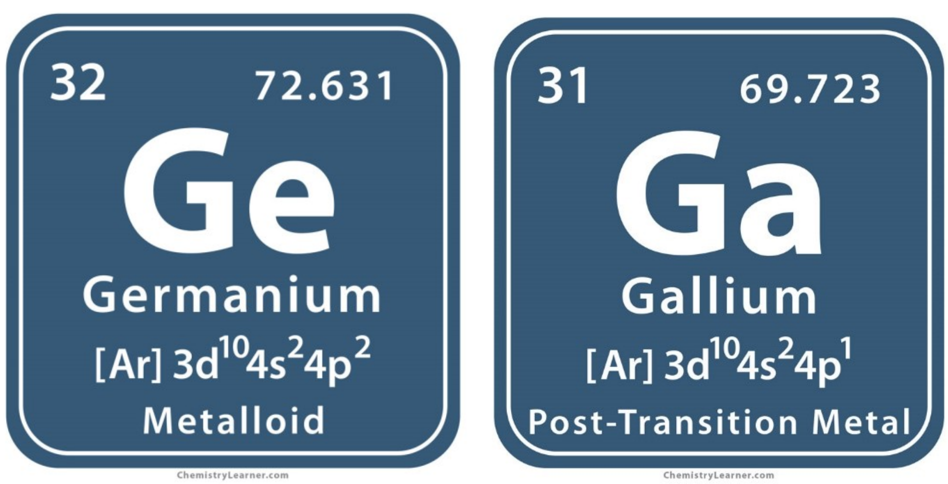
Germanium is used in solar products and fiber optics; it is also used in night vision goggles. Gallium is used in radio frequency chips for mobile phones and satellite communication. However, even though China dominates these markets, a few organizations believe these restrictions are a warning and are nothing near a death blow.

The U.S. and Europe don't import huge amounts of these materials nullifying the impact of these new restrictions. The U.S. received $5 million of gallium metal and $220 million of gallium arsenide in 2022, according to government figures. The U.S. and Europe Union imported $190 million of Germanium in 2022.

Many believe substitute countries will step into China's place with these restrictions. Belgium, Canada, Germany, Japan, and Ukraine can manufacture germanium. Japan, South Korea, Ukraine, Russia, and Germany meanwhile produce gallium. Several research groups also highlighted substitute metals that could be used in manufacturing the two metals that China will begin exporting. According to USGS, in some applications gallium wafers can be replaced by silicon or indium and zinc selenide can replace germanium metal.

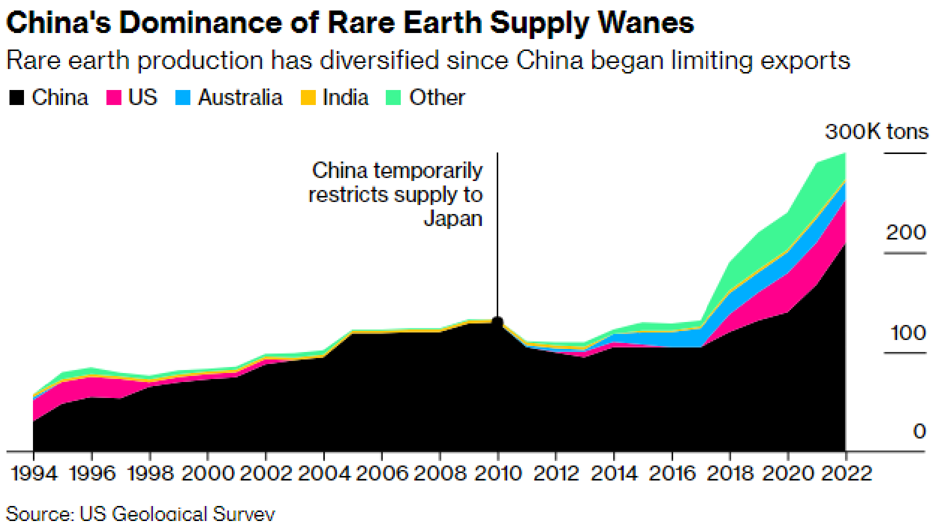
Canada's Teck Resources is the biggest germanium producer in North America, extracting the material in British Columbia.

For our science friends, here are germanium and gallium and the periodic table:



China's previous efforts to restrict the sale of rare earth metals have only diminished its market share as other countries work to secure supplies of the metals that aren't controlled by China. In 2010, Western nations made a concentrated effort to increase their production of these metals to decrease their reliance on China. At the time, China temporarily halted exports to Japan due to a boating collision. A simple accident led to export restrictions highlighting the issue of depending on China. Expect something similar to happen with gallium and germanium moving forward.

130 Bloor St. West, Suite 905, Toronto, ON M5S 1N5
Tel: 416-367-3040 Toll free: 1-866-367-3040 Fax: 1-877-215-4044
Email: info@macnicolasset.com URL: www.macnicolasset.com



What recession?

It seems Americans completely overlooked their finances this past long weekend. Even though many believe we are in a recession or are on the cusp of entering one, Americans gleefully did what they wanted this past weekend.

This past weekend, 10.7 million people passed through airport security Thursday through Sunday, a record according to the Transportation Security Administration. An additional 2.3 million people passed through security on Monday and 2 million on Tuesday. This trend is further confirmation of our theory on services and experiences over goods. It also follows Memorial Day travel trends which set multi-year highs this past May.

In addition to the weekend record, Friday was the busiest travel day since Thanksgiving 2019 according to TSA.

Even though personal finances continue to worsen, Americans did not blink and continued their summer celebrations. This was also the first July 4th since 2019 that had no restrictions on a national level.

Airline stocks have bounced back in 2023 as revenue and earnings estimates improve.

However, numerous airline stocks have not seen a price recovery from their pre-pandemic highs.

Even if you believe airline stocks were slightly overvalued in late 2019/early 2020, they still have tremendous upside. The recovery is occurring in front of our eyes and consumers are continuing to pile onto planes to travel. We expect this summer and early fall to set multi-year records in terms of airline passengers. If you do not believe us, talk to your friends or coworkers and ask when their next trip is.

Airline stocks are trading at discounts to their historical averages (in terms of price multiples) and continue to improve forward guidance. Do not be surprised if numerous airlines report better-than-expected earnings and revenue for the second quarter.

Here is an earnings schedule for major North American airlines over the next month:

Company	Earnings Date
Delta Air Lines	July 13
United Airlines Holdings	July 19
American Airlines	July 20
Alaska Air	July 20
Ryanair ADR	July 24
Spirit Airlines	July 26
Southwest Airlines	July 27
Air Canada	July 31

FED minutes

The Federal Reserves June meeting minutes were released on Wednesday and they signal further rate hikes at a slower pace (nothing we did not already know).

Policymakers decided against a rate hike at their last meeting over economic growth concerns. The main reason they skipped a rate hike in June was the lagged impact of their previous policy decisions.

The unanimous decision not to raise rates came in "consideration of the significant cumulative tightening in the stance of monetary policy and the lags with which policy affects economic activity and inflation."

The minutes also highlighted some disagreements amongst FED members. All but two members expect at least one more rate hike would be appropriate and 12 of 18 members expect two more rate hikes.

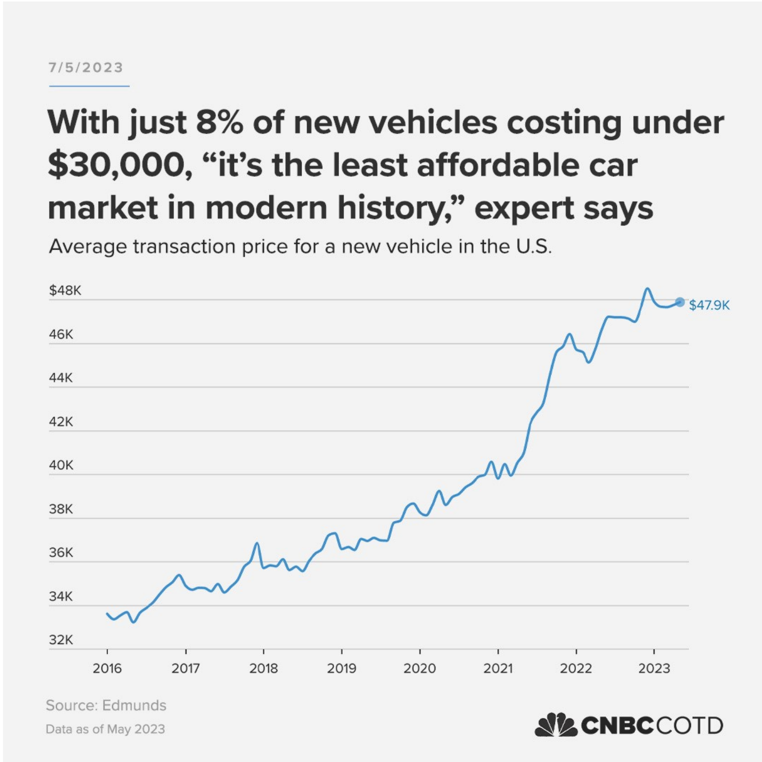
Since June's meeting, most policymakers have stuck to a consistent narrative that they do not want to give in too quickly on the inflation fight.

The next data dump that the FED will have its eyes on will be July 12th when the Bureau of Labour Statistics releases June's inflation numbers. June will more than likely reflect a continued slow down in the inflation rate which will predominantly be fueled by a decrease in energy prices which peaked in June 2022, during this cycle.

Unaffordable market

The average new car in the U.S. is now selling for $47,900, a $10,000 jump from 3 years ago. It seems cars both traditional and electric are becoming more and more unaffordable to consumers.

Beyond the issue of average price, only 8% of cars being sold across the U.S. are below $30,000. It seems there are almost no cheap options for consumers.



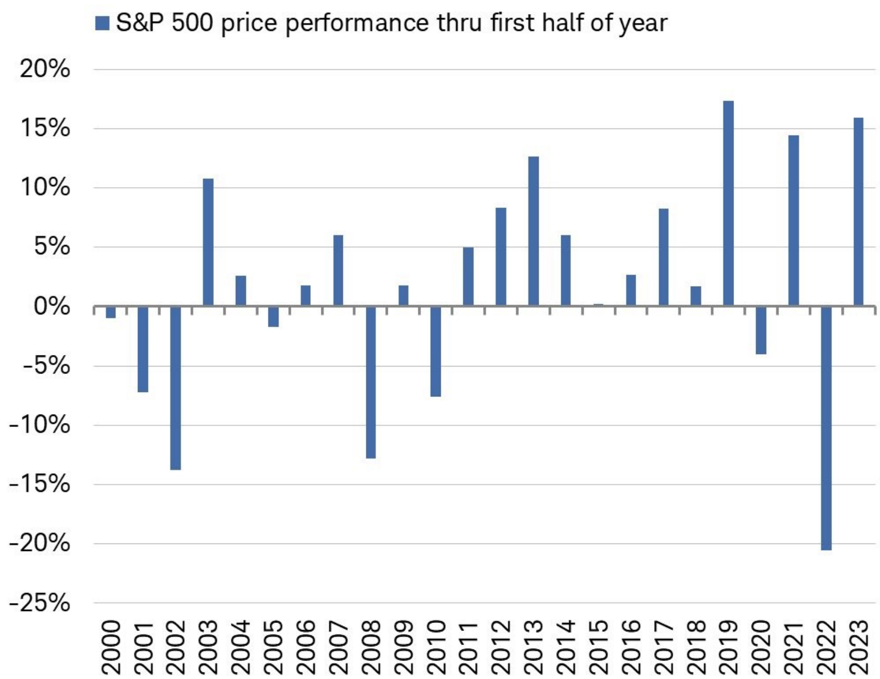
CNBC interviewed an expert on this phenomenon and claimed that features and preferences for SUVs and trucks over sedans have dramatically changed over the last 3-5 years. This led to retailers stocking more models with all the features and fewer base-level (in terms of options) vehicles.

Cars have also become much more expensive at the top end, 10% of all vehicles now cost over $70,000, and five years ago only 3% of cars cost that much. This has led to many drivers and new drivers being priced out of the market.

This trend will more than likely continue especially as more consumers adopt electric vehicles which are holistically more expensive than traditional automobiles. We do not expect EVs to dramatically drop in price anytime soon as input costs continue to rise due to global supply constraints.

Market marches on

Inflation, rising interest rates, and recession projections have not slowed down the S&P 500 in 2023. The first half of 2023 produced the second-best 6-month start to a year since 2000.

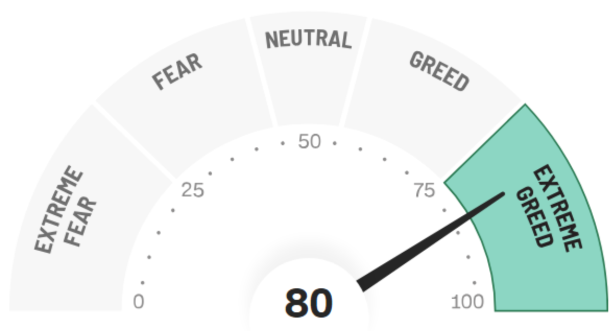


Source: Charles Schwab, Bloomberg, as of 6/30/2023. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. Past performance is no guarantee of future results.

We know returns have been led by mega-cap stocks but indices and growth stocks continue to march forward.

The S&P 500 was up almost 16% during the first half of this year after taking over the same period just a year prior. It seems artificial intelligence, technology, and fear of missing out are pushing markets in the right direction.

Investors have piled into equities over the last few months as they rush to benefit from this momentum. This has led to a complete reversal in CNN's Investor Fear and Greed Monitor. The scale now sits at 80, indicating extreme greed from investors as they pile into expensive stocks that are surging despite poor economic conditions.



Just one year ago the scale sat at 22, indicating extreme fear. The scale started 2023 at a 37 and bottomed in March in the low twenties, despite all that fear and poor economic data, investors continued to jump into equities and have completely flipped the narrative.

Chinese recovery fading

The Chinese economic recovery that we have seen start this year is beginning to crack.

Activity in the services industry and construction sector dropped to its weakest level since December according to official data released on June 30th.

Following the weak numbers, the Chinese Yuan weakened. The Yuan has fallen 5% relative to the U.S. Dollar this year as investor sentiment soured on China as its growth prospects fell. Chinese interest rates are also well below many major economies' interest rates across the world. Non-manufacturing PMI also retreated in the most recent data dump, showing a crack in the armour in China's economic recovery.

Remember China's recovery lags much of the world due to their harsh and rigorous approach to containing Covid-19.

The data to start the year reflected pent-up demand from consumers from China's lockdowns, but that demand has not continued at all according to multiple Asian market strategists.

Many are pointing to the Chinese government to seek guidance on future growth as policy support will be essential to prevent further growth deceleration.

China most recently cut interest rates to spur growth, the first rate cut in 10 months. However, many believe the policy decision will need to be paired with a stimulus package that will drive growth, and spending, and promote consumption.

Despite the weakness, China's leaders continue to beat the drum that they will meet their 5% growth target by the end of this year.

Weakness in China could be a sustained theme moving forward especially as the west and east decouple for security reasons and China's population continues to age.

MacNicol & Associates Asset Management
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