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.

Plymouth Light, *Plymouth, Massachusetts*

This lighthouse was established in 1768, and its current structure was built in 1843. The wooden lighthouse stands at 102 feet tall. The lighthouse is still in operation.

New London Harbor Light, *New London, Connecticut*

This 89 foot lighthouse was originally built in 1760 and was replaced in 1801 due to structural cracks in the original building. The original New London Harbor Lighthouse was the fourth lighthouse ever built in North America.

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

Chinese debt issues

Is China facing a Lehman moment? Maybe. Was the Evergrande real estate problem ever resolved? Not really. Were these questions slightly hyperbolic? Yes, but China is facing a serious debt problem that deserves to be looked at. The debt problems they face could stunted the country's economic growth and could throw a serious wrench into the forecasts of many who believe(d) the Chinese economy will one day be larger than the American economy.

It seems China has some of the makings of an economic disaster. Their property developers remain under duress after over-leveraging themselves, and their economy seems to be in free fall with huge manufacturing, export, and employment misses.

We have talked about the Evergrande real estate crisis in depth in this publication but if you need a quick refresher:

The 2020–2023 Chinese real estate sector crisis is a current financial crisis sparked by the difficulties of the Evergrande Group and other property developers in China in the wake of new Chinese regulations on company debt limits.

In other words, some believe this could be a major Lehman moment for China. The funny thing is the event has kind of flown under the radar for some investors over the last 18 months as our domestic difficulties have usurpingly dominated the news. Many Western investors (including us) have also avoided investing in China in recent years due to the unpredictability of their authoritarian government.

Back to the current crisis.

The Chinese economy is struggling and so is its real estate market. Existing home prices fell by 9% in July. The steepest decline in a decade. The real estate market is extremely important to the Chinese population, as the property sector holds 70% of household wealth, well above the percentage for Western nations.

On top of issues in the real estate market, Chinese exports are down, unemployment is high, and there is growing concern amongst the Chinese population and their confidence in their economy.

The only real way out (for China) is for economic conditions to improve and productivity to increase – both of which seem unlikely in the coming months. If Chinese developers continue to miss debt payments, it could cause Chinese investors to pull their money from all kinds of investment products due to a lack of confidence in the system. This would lead to a snowball effect which accelerates the current issues China is facing.

Even though the Chinese economy has rapidly grown in recent decades, so has debt. Debt growing while an economy growing is healthy but when economic growth slows down and debt grows rapidly, a serious economic disaster is possible.

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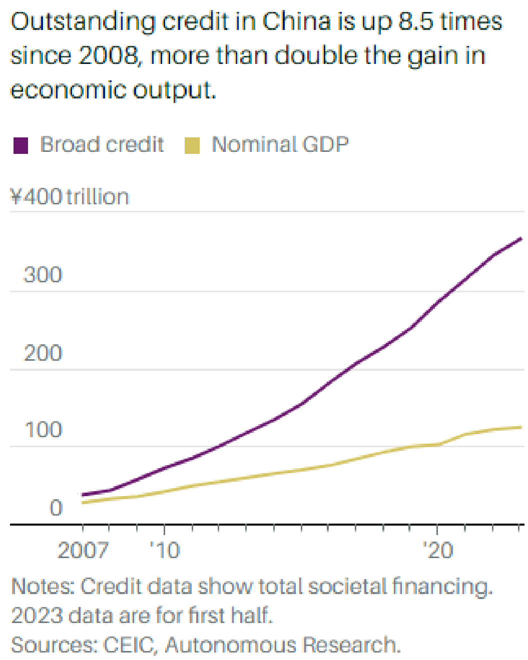


We are not sure what will happen next, but we are certainly watching as the second-order effects of this crisis will certainly impact the global economy. Who knows if this will lead to a Lehman moment or if it will lead to something like Japan's lost decades, either way, it is interesting to watch.

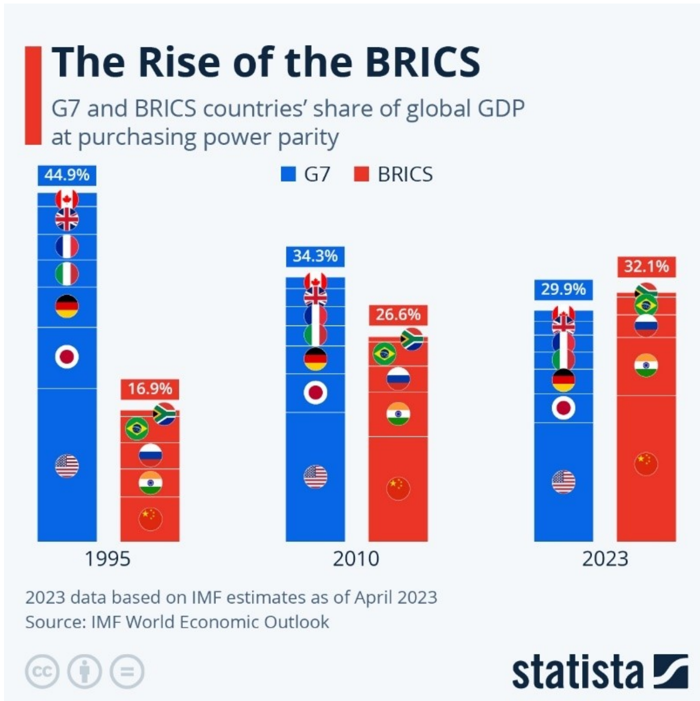
One thing is for certain, a stable economy does not hide basic pieces of data from the rest of the world.

China stops releasing youth unemployment rates amid economic gloom

Release of figures suspended in order to 'optimise labour force survey statistics', says bureau, after youth jobless figure hit record 21.3% in June

BRICS additions

BRICS is a geopolitical group that was originally formed in 2006. The group was given this name by a Goldman Sachs economist in 2001 to describe a group of fast-growing economies that he predicted would dominate the global economy by 2050. The geopolitical bloc has a focus on economic growth and the mutual benefit of all member states. The countries that originally formed BRICS included Brazil, Russia, India, China, and South Africa. The five countries account for 26.7% of the world's land surface and 42% of the global population. The five member states are all considered emerging superpowers and have surpassed the G7's share of global GDP at purchasing power parity.



The total gross domestic product of BRICS countries in 2022 was $26.03 trillion (U.S. Dollars). Many economists believe BRICS will surpass the GDP of the G7 by 2030.

Many Western nations and investors have been weary of a dominant global economic partnership in which they are not involved. BRICS wants to compete with the G7 and beat them at their own game which could weaken the G7 economically. This economic partnership has also trickled into how countries around the world deal with conflict. BRICS nations are taking a hands-off approach when their ally is in a dispute which is quite different than how Western nations have dealt with global conflict over the last 50-60 years. Russia is invading and at war with Ukraine, yet none of its fellow BRICS members are directly assisting them. The only way BRICS nations have assisted Russia is by not placing Western sanctions on them. China and India have filled the void that European nations have left Russia in their trade imbalance.

However, what these BRICS nations are doing to Russia is no different than the rest of the world (minus developed Western nations). Most countries across the world have followed the lead of BRICS and not the G7 during the Russian invasion of Ukraine. Perhaps this is one of those massive historical events that is unfolding in front of our eyes. We think it's something worth watching. The influence of BRICS across the world is growing and differs from the influence of the G7 / West, while G7 nations participated in several wars, peacekeeping missions, and other conflicts. China helped build up countries around the world, assisting them with technology, infrastructure, and money.

China donates mobile hospital to Argentina

16th February 2021 - 13:56 GMT | by The Shephard News Team RSS

May 03, 2023 6:57 PM
Kate Bartlett

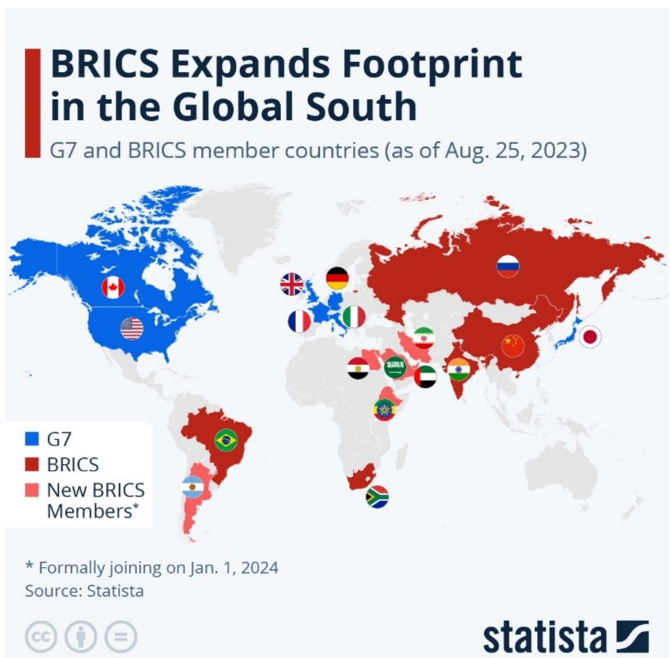
Why China Is Investing in Africa's Green Energy Future

This has led to more trust from countries around the world and China. China might have ulterior motives but, on the surface, looks like they are trying to build up third-world nations.

The influence of BRICS is much larger than many Western citizens understand. The geopolitical bloc has tremendous global influence and has been extremely successful.

We bring this all up not because we are explaining BRICS (we have done that in the past), but because the geopolitical bloc voted to add six new members at its August summit in Johannesburg. The influence of BRICS that we mentioned earlier is seemingly growing at a rapid pace.

BRICS approved the membership applications of Argentina, Egypt, Saud Arabia, Ethiopia, Iran, and the UAE.



On top of the 5 member states, and 6 new members, were over 50 countries who sent delegates to attend the August summit in South Africa.

The six new members represent 400 million people.

BRICS has also expanded its influence on global energy markets - six of the largest nine oil producers are now BRICS members. BRICS countries now account for approximately 44.5% of global oil production (2022 production numbers), versus the G7 which accounts for approximately 21.5%. BRICS look like they will expand their pricing power in global energy markets. China and India are already amongst the largest consumers of oil around the world and are expected to increase their consumption over the next decade.

Countries in Asia, South America, Central America, Africa, and the Middle East have also applied for membership in BRICS but are still pending. BRICS seems strategic with how and when they add countries to their partnership.

There have also been rumors swirling of a BRICS currency that could eventually rival the U.S. dollar.

However, do not write off the G7 and anoint BRICS as the future leaders of the world. Cooperation in this geopolitical bloc is key and members have already had disputes and major disagreements. India has been keen to limit its dependence on China. They have onshored supply chains and looked for investment domestically to produce certain products. India is also growing at a faster pace and could surpass China if their issues persist over the next few decades. India has also historically been a much closer ally to the U.S. than it has been with China. India also refused to join the Chinese trade organization RCEP. China has also used BRICS as an anti-American organization which could cause issues with countries that maintain strong partnerships with the U.S. and the West (India, Brazil). The addition of Iran to BRICS was reportedly promoted by China. Iran is the 43rd largest economy and is hardly an economic titan. The addition of them looks to have deeper meaning. All in all, BRICS seems like a good idea for these large emerging markets, but underlying conflicts, disputes, and disagreements could cause serious issues amongst the now 11 members moving forward.

Mortgage rates

As mortgage rates increase, consumers are being priced out of certain parts of the market. Consumers cannot afford the same mortgage that they could just a few years ago. As U.S. mortgage rates approach 7.5%, consumers will be forced to do one of two things (if they want to pay the same monthly), buy a cheaper home, or make a much larger down payment.

Redfin illustrated this relationship on the chart below showing how interest rates have changed since September 2020 (2.65%) and what that means for consumers and affordability.

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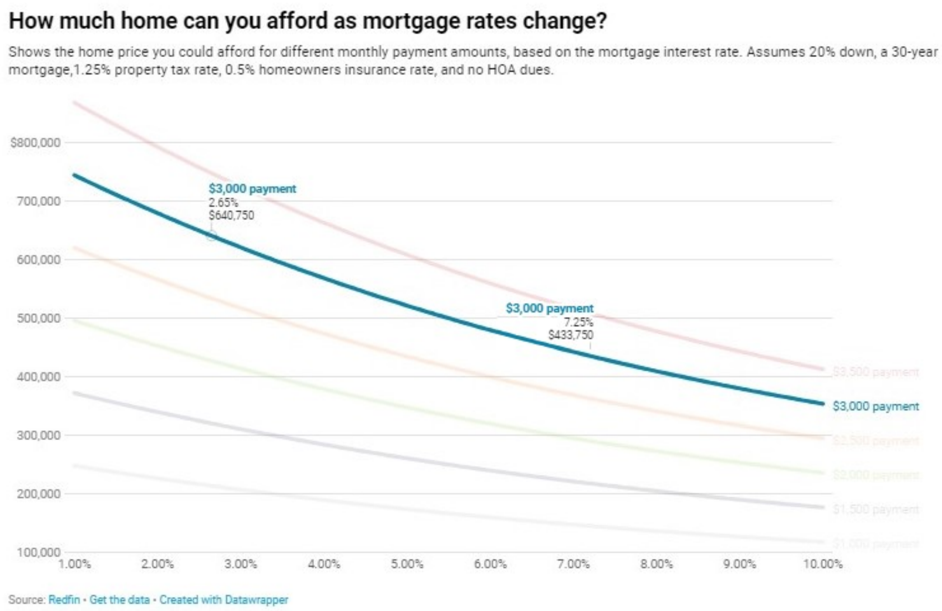

Surging mortgage rates are crushing affordability, and in turn, crushing demand. Mortgage purchase applications in the US have fallen to their lowest levels since 1995.

Despite all this, the S&P CoreLogic Case Shiller 20-city house-price index rose 0.9% in June. A broader measure of home prices, the national index, rose on a month-over-month basis in June by 0.7%, but it was flat over the past year. All numbers are seasonally adjusted.

<u>What's up with Disney?</u>

The Walt Disney, commonly known as Disney is an entertainment conglomerate headquartered in California. The company has been a staple for children since it was founded in 1923. The company offers a television channel, amusement parks, a motion picture studio, streaming platform, and it has even recently bought ESPN (U.S. leading sports channel).

The company has been uber successful since its infancy. Disney hit its stride starting in the mid-1980s when revenue grew exponentially, leading to its eventual IPO. Returns were exceptional for shareholders for decades, but something has happened over the last 10 years that has investors and Disney shareholders scratching their heads. The company which boasts a $154 billion market cap is trading at the same price it was trading at 9 years ago. Today's price is a 9-year low, even lower than during Covid-19. Shares are down 5% year to date, 25% over the last year, 25% over the last 5 years, and 59% from its peak in March 2021.

The 59% drawdown in Disney's share price is larger than its max drawdown from 2007-2009. So what has happened?

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The issues that have plagued Disney recently include declining profitability. Disney’s revenue has grown from $30 billion to $88 billion since 2004, but its net income is essentially flat over that period. Net profit margin is down to 2.6% from 7.4%, 20 years ago. Disney has loaded up its income statement with costs that have exponentially grown over the last 20 years.

On top of all that, Disney is being sued by its shareholders for deceiving investors about the financial health of its streaming service. The lawsuit states that Disney's leadership misled investors beginning in December 2020. The suit names both Bob Iger (current CEO), and Robert Chapek (former CEO), as well as its former CFO and several other executives. The basis of the lawsuit argues that Disney hid the true costs of the platform and that their forecasts were lies. In 2021, Disney forecasted that they would have 240-260 million subscribers in 2024 and that they would turn a profit. The most recent numbers reported in June reflect 146 million subscribers and a loss of $512 million (for its streaming platform).

Disney, Bob Iger, Bob Chapek Hit With Another Investors Suit Over “Fraudulent” Streaming Costs

By Dominic Patten
August 29, 2023 1:39pm

The Disney+ suit is the latest headache Disney leadership faces, having staved off a proxy fight from billionaire activist investor Nelson Peltz earlier this year. Peltz stated that Disney’s streaming platform was flawed and that the strategy implemented by the company lacked cost discipline. Peltz claimed these added costs were eating away at Disney’s share price.

We do not know anything about financial law or forecasting law, so we do not know if this lawsuit has any real merit. We will say that Disney shareholders should have looked at Netflix to see the real cost of creating a streaming platform. Netflix burned billions of $ for over a decade as they looked to grow their platform - this included creating and acquiring content. Disney already owned numerous movies, and series from their past but acquiring and producing more comes at a cost, especially when the marketplace is ultra-competitive.

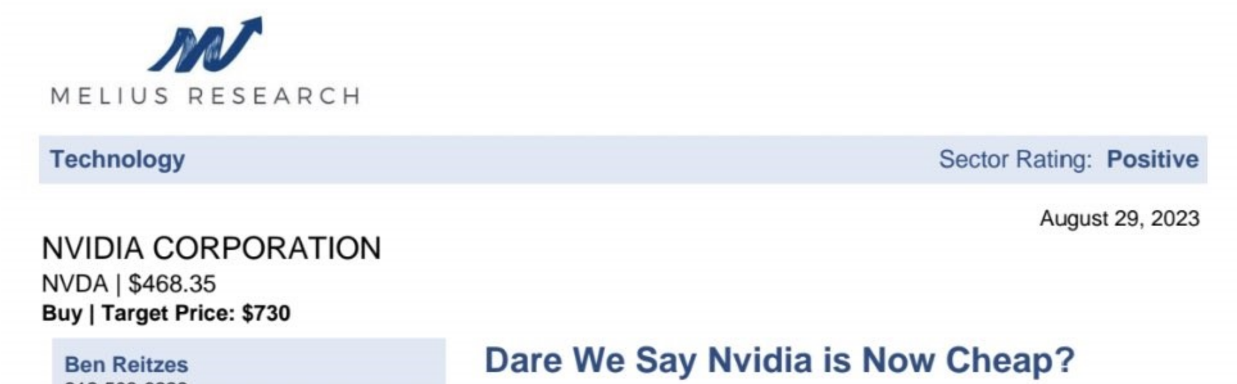
Moving forward it has been rumored that Bob Iger would like to offload linear television assets - Disney owns ABC and ESPN. Cutting these assets and focusing on its core business – entertainment could be what Disney needs to spark its stock price. Another business unit that has lagged in recent years for Disney is the amusement parks which are seeing low attendance. The low attendance that Disney parks are seeing is being driven by high costs and greater competition.

We will have to wait and see what Bob Iger and Disney do next. For now, we will sit on the sidelines and wait for more clarity on what Disney will do next.

Sell side analysts: back at it again

Sell side analysts like to sell investors, both retail and institutional a bill of goods. They create their discounted cash flow (DCF), and relative models and choose inputs they like to project the future value of a company. We read information from a select few in the space but believe many working in this space have alternate motives when grading a stock that might correlate with their overall employers' goals.

With that being said, Melius Research put out some coverage on Nvidia this week after their earnings and well we will let the picture speak for itself.


MELIUS RESEARCH

Technology	Sector Rating: **Positive**

August 29, 2023

NVIDIA CORPORATION
NVDA | $468.35
Buy | Target Price: $730

Ben Reitzes

Dare We Say Nvidia is Now Cheap?

We are so back, euphoric returns led by no fundamentals. Nvidia might be the biggest company in the world one day but how someone could argue the stock is cheap is beyond us.

A company trading at 114 times earnings and 36 times sales is the farthest thing from cheap that we have seen but investors seem to still be diving in. Investors have lofty expectations in Nvidia due to recent earnings and revenue beats, as well as the growth in popularity of artificial intelligence (AI) from consumers and investors.

Even though we think Nvidia is expensive, we would certainly not short the stock in today's environment.

MacNicol & Associates Asset Management
September 1, 2023