THE WEEKLY BEACON **OCTOBER 6, 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.

Tower of Hercules, *Galicia, Spain*

The exact date of the tower's construction is unknown, but records show that it has existed since at least the 2nd century CE. It may have been built or rebuilt by the Roman Emperor Trajan and modeled after the Lighthouse of Alexandria.

Pharos of Alexandria, *Pharos, Alexandria, Egypt*

The Pharos of Alexandria, commonly called the Lighthouse of Alexandria, is the often considered the oldest lighthouse in the world. It was built by the Ptolemaic Kingdom of Ancient Greece sometime between 280 – 247 BCE.

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

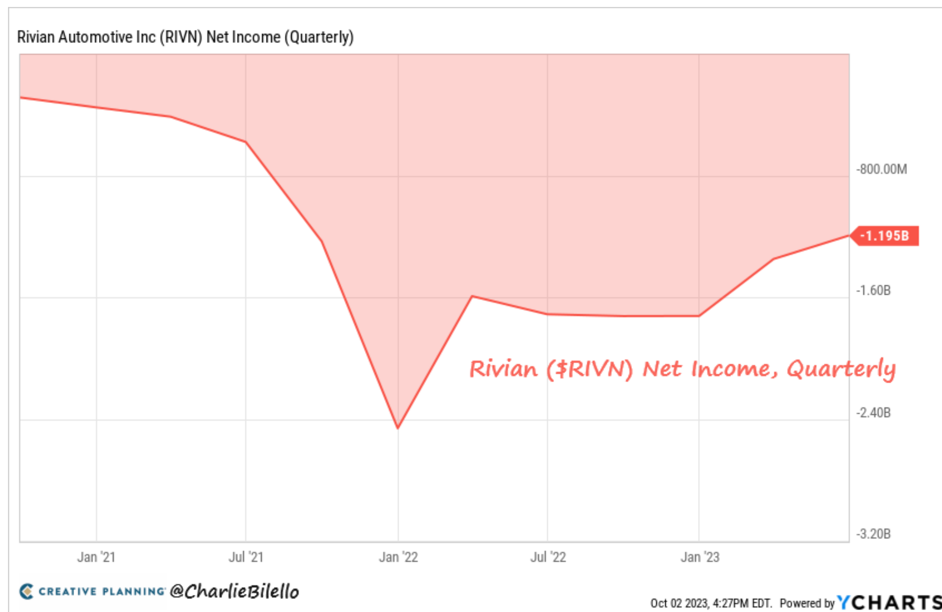
Tough business

The business of producing and selling vehicles has evolved since the early 1900s. Companies have increased efficiency and optimized the assembly line. Successful companies like Ford have survived many cycles. Despite this track record of success and evolution, many green activists believe traditional vehicle producers will disappear and all we will eventually be left with are new-aged renewable vehicle producers like Tesla, Rivian, and Lucid Motors. We all know Tesla has been a massive success and will continue to lead the green vehicle revolution, but we do not think its competitors will all do the same. We think the marketplace will be very competitive and will include most traditional vehicle producers who have adopted electric vehicles and are producing cheap renewable options. Although the process might be slow and will have issues, we believe the assembly lines, supply chains, and technology that traditional automakers already have give them a large advantage over up-and-coming EV companies who are in their infancy.

Larger traditional automakers have the advantage of economies of scale as they have already invested in developing supply chains, and assembly lines, and are also already well-known to consumers. This cuts some of the costs that will be incurred. These companies are also mature, and their shareholders do not want to see large negative cash flows and unprofitability versus new-stage developers who are expected to be unprofitable and to be burning through cash.

Even though we all know most of this, we were surprised when we ran by an article that looked at Rivian. Rivian is one of the large electric vehicle producers that launched within the last few years and has begun producing vehicles. The article highlights that in the second quarter of this year, Rivian vehicles sold for $80,000 on average, quite a high price tag for the luxury EV producer, yet they lost on average $33,000 per vehicle sold due to the high costs required to build their vehicles.

In the second quarter, Rivian reported a net loss of $1.2 billion. Over the last 12 months, Rivian has reported a net loss of $5.9 billion and has a free cash flow of - $6.8 billion. Rivian needs to begin to turn the corner to show the market it will eventually be ready for profitability instead of burning through new shareholder capital to produce a few thousand vehicles. Rivian shares are up 29% year to date but down 29% over the last 12 months. Rivian shares have fallen over 80% since their debut price in November 2021.



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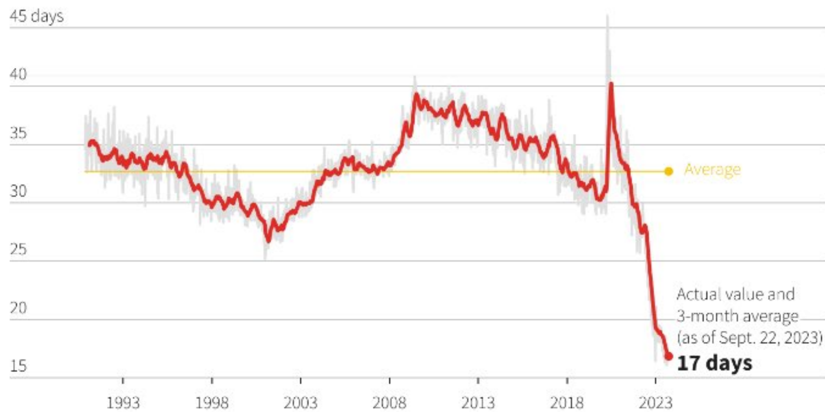
Draining the well

As oil spiked in price in 2022, the Biden administration's response to worried consumers was to drain the Strategic Petroleum Reserves. The Biden administration has drained the reserves which are meant to be used in emergencies to give consumers some price relief. Certain policies the Biden administration enacted in their time have led to higher oil prices. Even though many look to high oil prices as the fault of Russia, there are many other drivers of this trend. Russia's invasion of Ukraine certainly accelerated the issues within the oil market, but even without the invasion the market was becoming increasingly tight due to heavy regulation, under-investment in the industry, and governments vilifying the companies who produce the oil we rely on. The result has led to oil prices returning to a 12-month high even after the Biden administration has drained the SPR.

The SPR is at its lowest level in 40 years and is almost 50% of what it was just 3 years ago.

Currently, there are only 17 days worth of oil left in the SPR versus the average of the last 30 years which was nearly double at 33 days.



The issue with draining the SPR is it's a desperation move that is very short-sighted. It does not address the fundamental issues in the oil market and does not increase supply in the long run. Investors and oil producers know the SPR can only do so much as it will eventually reach a level of capacity where it cannot be drained. Draws in the SPR have slowed down in recent months just as oil prices have accelerated. We hope Biden and the Secretary of Energy have learned their lesson and understand their solution solves nothing.

Two-year project

This entry will be brief and blunt.

Meta Platforms has begun laying off employees in their Metaverse business unit.

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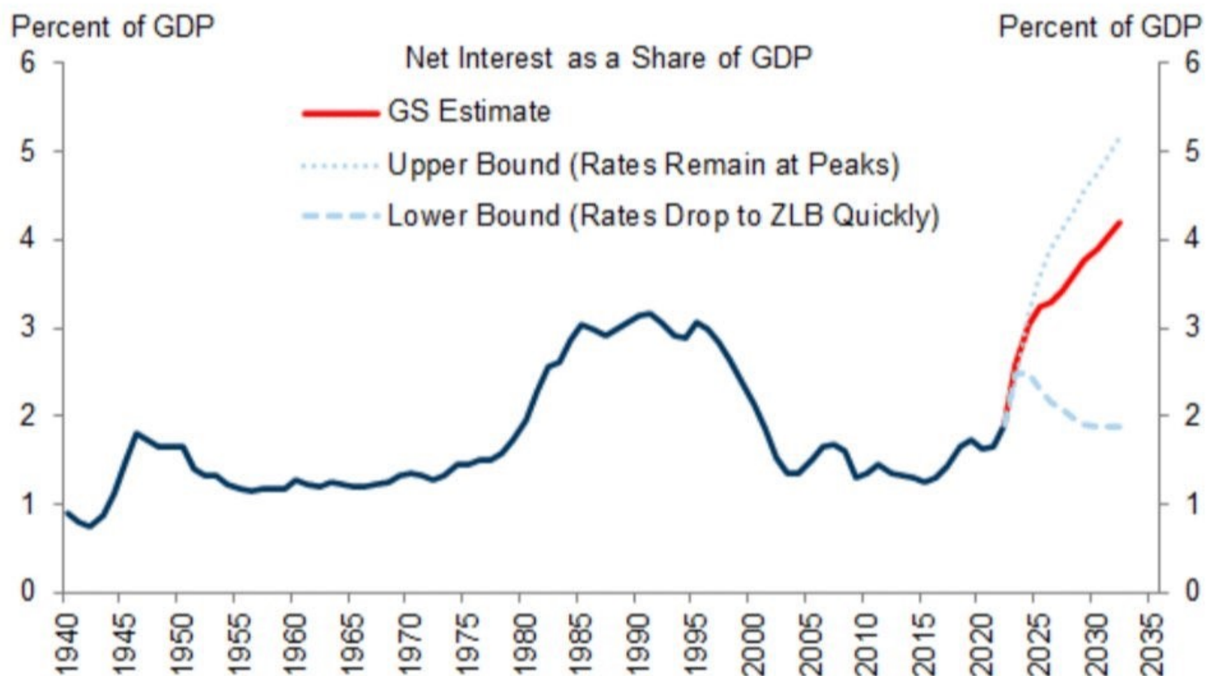
Who would have thought that online real estate would fail? Zuckerberg and Meta threw billions of dollars into a growing trend during a historic bull market and ended up wasting almost all that money. When markets turned over and everything was not going straight up, analysts realized that Meta's cash burn on the Metaverse was unsustainable and was hampering the company. This has resulted in a pullback on spending in the business unit and now layoffs.

Meta releases its third-quarter earnings later this month on October 25th.

Servicing debt is not cheap

We have talked about the implications of higher rates for quite some time now. This means higher borrowing costs for consumers, investors, home buyers, and companies. However, the biggest borrower is the Federal government which owes more than $33 trillion. The outstanding debt owed by the U.S. federal government climbs every week as the government continues to spend above its means. This debt that they have added on has become quite costly to service as interest rates have risen. Interest payments have increased quite substantially for the U.S. government since the FED has begun to increase the FED Funds Rate. Goldman Sachs estimates that by 2025 interest payments will make up over 4% of the U.S. GDP.



The U.S. GDP was forecasted by the Congressional Budget Office in the 2023 fiscal Budget to be $28.6 trillion. That means that interest payments will account for over $1 trillion by 2025 if interest rates remain elevated. Goldman Sachs also included a lower and upper bound estimate on the chart displaying what the percentage would be if the FED slashed rates quicker or if rates remained higher for much longer than many think.

So, what can be done to address this worry?

Congress seems like no help right now with a dead split House and Senate who cannot stop tripping over themselves. Just this week 8 Republicans were joined by all Democrats in ousting the Speaker of the House, Kevin McCarthy. McCarthy will not rerun for Speaker. Candidates rumored to fill the position include Jim Jordan, Steve Scalise, Liz Cheney, and Donald Trump. Without a Speaker, the U.S. cannot pass legislation, and they will run out of money in 45 days. This puts a leadership race for Speaker into hyperdrive as Congress races to elect a new Speaker and ink a new funding bill. Getting back to the issue at hand, perhaps some fiscal responsibility can solve this issue in the next election with a change of leadership.

The only ways we see things moving forward with the current situation we have are:

1. Cut current and future spending (by a lot). The last time the U.S. government had a budget surplus was in 2001. Large portions of the U.S. budget include spending on health care, pension entitlements, and the military.
2. Drastically increase taxes and create other government revenue channels.
3. Slash rates and continue to print, kicking the can down the road causing inflation to get hot again.
4. Yield curve control (ie. Japanese style fiscal repression).

We are not sure what will happen next and what will be implemented to solve our current issues. We do think it could be a combination of these ideas that will more than likely be used. Spending should be a huge topic in the next election for every major country as government spending helped lead us to where we are today.

Electing the same leaders repeatedly and expecting a different result is wishful thinking that will more than likely fail again. Regardless of how you feel or how you vote, the spending that the U.S. government has done recently should scare you. The government recently added on $275 billion in debt in one day, a record amount for them. Total outstanding debt by the U.S. government has increased by $442 billion in just over 2 weeks. Somebody needs to take Congress and the Biden administration's credit cards away from them.

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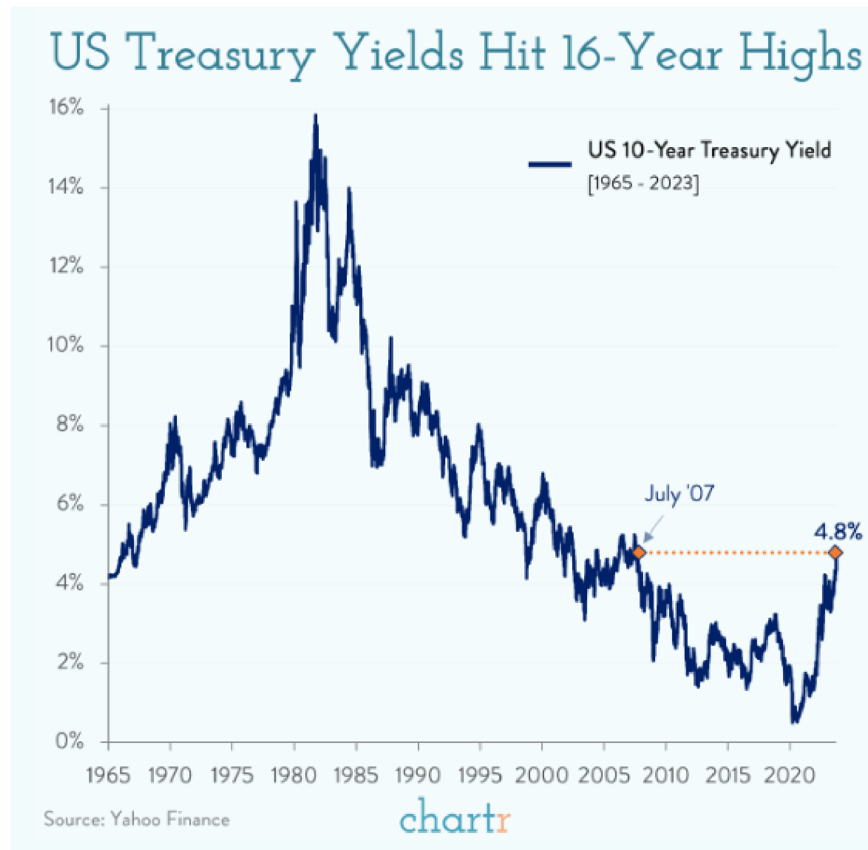
Yields rocketing

Over the last week, long-term interest rates have rapidly increased causing equity prices to dip. The U.S. 10-year yield hit a 16-year high on Tuesday, briefly touching 4.8%. U.S. job numbers released earlier this week showed a tight labour market, possibly giving the FED the green light for more interest rate hikes.



The 30-year treasury also hit a 16-year high. The 30-year yield moved up by as much as 16 basis points, the largest daily increase in over a year.

Long-term yields moving up highlighted the resilience in the U.S. economy and investors are finally waking up to the fact that interest rates could remain elevated indefinitely.

The rapid pace of the moves in recent weeks has taken investors and strategists by surprise. Across Wall Street, analysts are rethinking their forecasts for just how high yields can go, with those at Goldman Sachs Group Inc. and JPMorgan Chase & Co. among the latest to set higher targets.

Investors who have piled into long-term bonds anticipating some interest rate relief have had a tough few months as the third quarter erased most of their yearly gains. The 60/40 portfolio that many investors and advisors live by continues to struggle. The BlackRock 60/40 Target Allocation Fund

Institutional Shares is down 22% from its November 2021 highs and has erased most of its 2023 gains over the last 2 months.

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