

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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ASSET MANAGEMENT

Contact us today if you would like to meet about your investment future. [info@macnicolasasset.com](mailto:info@macnicolasasset.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.*



### ***Cape Flattery, Neah Bay, Washington***

This 65 foot tall lighthouse is a must visit lighthouse in the pacific northwest. The lighthouse sits on the Makah Indian Reservation. The lighthouse was opened in 1854 and was automated in 1977.



### ***Patos Island Lighthouse, Patos Island, Washington***

Patos Island Lighthouse is an active aid to navigation overlooking the Strait of Georgia at Alden Point on the western tip of Patos Island in the San Juan Islands, San Juan County, Washington. The lighthouse was opened in 1893 and sits at 12 meters tall. The lighthouse was automated in 1974 and is on the National Register of Historic Places.

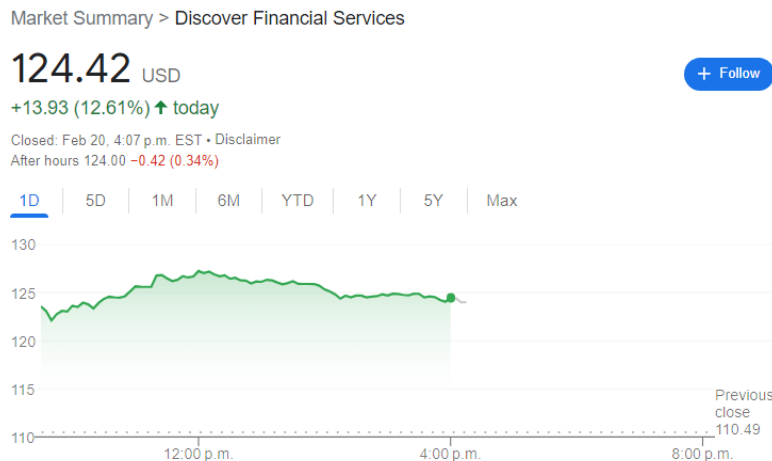
*\*Feel free to send us your photos of Lighthouses to be featured in our weekly market observations.\**



## **Huge 'potential' deal in the financial sector**

Over the long weekend, Capital One and Discover Financial agreed on a \$35 billion deal that would see Capital One acquire Discover Financial in an all-stock deal. The deal will see Discover shareholders receiving 1.0192 Capital One shares for each Discover share, a 26.6% premium over Discover's closing price on Friday. The deal will reportedly create \$2.7 billion in pre-tax synergies in 2027. The deal is expected to be completed at the end of this year or early next year.

Discover's stock jumped on Tuesday on this news:



Capital One, the U.S. consumer bank backed by Warren Buffett plans to acquire a major U.S. credit card issuer which they hope will help them create a global payment giant, something that they hope could potentially compete with Mastercard and Visa. The deal would create the sixth-largest U.S. bank by assets. The deal will cut overall costs, add scale, and utilize the benefits of Capital One credit cards with Discover's network.

The deal is 2024's largest in the M&A world. However, for those who expect a quick and easy completion of this deal, we would warn that regulators might have something to say that could impede the deal. Antitrust regulators will likely have concerns about one of the country's largest card issuers buying one of its largest payment networks. The deal will have to be approved by the Federal Reserve and the Office of the Comptroller of the Currency. The DOJ's antitrust division could also raise anticompetitive concerns while the Consumer Financial Protection Bureau could sound the alarm over how this new company could impact consumer costs.

Many believe that the Biden Administration could push for regulators to reject the deal and that a potential Trump administration could be easier to work with from a regulation perspective. President Joe Biden's administration has focused on boosting competition in all areas of the economy, including a 2021 executive order aimed at bank deals which could stall this deal.

One factor that could work in Capital One's favor in terms of regulation would be that this new enterprise could be a more powerful rival to Visa and Mastercard which dominate the credit card



industry. Senate Majority Whip Dick Durbin and other lawmakers have tried to push a bill that would force credit-card issuing banks to offer a choice of at least two payment networks, one of which is not Visa or Mastercard, to process transactions. The idea is that greater competition would force the networks to lower fees.

Capital One's CEO said he kept regulators in the loop in this process and believes the company is in a good position to get approval.

Discover has a broad network that spans 200 countries and territories; however, it is much smaller than its rivals, Visa, Mastercard, and American Express. This deal with Capital One will allow the company to scale and enable the Discover network to be more competitive globally with the world's largest payment networks.

By acquiring Discover, which also issues its credit cards, Capital One would have a leg up against competing credit card-issuing banks such as JPMorgan Chase, Bank of America, and Citigroup, which don't process transactions themselves.

However, one of our major inverse signals flashed after this deal was announced. Jim Cramer of CNBC said Capital One shares are a screaming buy due to this deal. We try and avoid Cramer and his clubs' holdings as he has mistimed many of his trades.

### **The new world**

The Russian invasion of Ukraine shined a light on how dependent Europe and the rest of the West were on Russia for various goods including food and energy commodities. This dependence is what we would call an Achilles heel for a nation as they have major dependence not on an ally but an adversary. When things go wrong, shortages arise, trade wars begin, and prices surge.

This Russian reality has not only changed how we deal with Russia from an economic or trade standpoint but also how we (the West) deal with all our adversaries.

Yes, we know that sanctions are not new and are aware the West has been harsh on North Korea, Iran, Venezuela, Syria, and other major nations in the past (from a trade and military standpoint).

We are simply saying that this Russian invasion is changing how we deal with all our adversaries as well as the minds of many Western governments as well as their populations. The major adversary that we have been implicitly referencing is one of Russia's biggest allies, China. The world's second-largest economy and the second-most populated nation has turned from a success story that the West cheered on to an adversary that needs to be dealt with.

We all know that Trump was the first major Western politician to be outspoken against China. He ran his 2016 campaign on 'Make America Great Again' a slogan that took shots at many emerging markets that benefited from U.S. companies moving production abroad. The biggest winner is China.



However, China has slowly revealed its true colours and its true plans; to become the world's most powerful country and to replace the U.S. as the world's largest economy and financial market.

The U.S. has put numerous trade sanctions into place since Trump began his Presidency that target China. This has resulted in protectionism across various industries, nearshoring of many U.S. companies, and a decoupling of the East and West which seem to be engaging in a new form of a 'Cold War'.

We mention all this due to several topics circulating in the news this week regarding China and the U.S.

Dr. Phil went on the Joe Rogan Experience this week to discuss a variety of topics including China. He mentioned that there has been a surge of Chinese migrants entering the U.S. from its southern border illegally and that those migrants could potentially be connected to the CCP or some other Chinese government organization. Due to the lax border restrictions almost anybody can enter the U.S. through its southern border.

The other topic Dr. Phil and the world's largest podcaster talked about regarding China was the recent surge in farmland purchases from Chinese nationals around U.S. military installations. The seemingly strategic move could be very forward-looking and pose a grave risk to the U.S. if a conflict arises.

Beyond the conversation between Dr. Phil and Joe Rogan (check out the full episode on Spotify), the Biden administration announced a plan this week to invest billions in the domestic manufacturing of cargo cranes. This might not seem like something that relates to China, but it does. This investment by the government is to counter fears that the use of China-built cranes at many U.S. ports poses a potential national security risk.

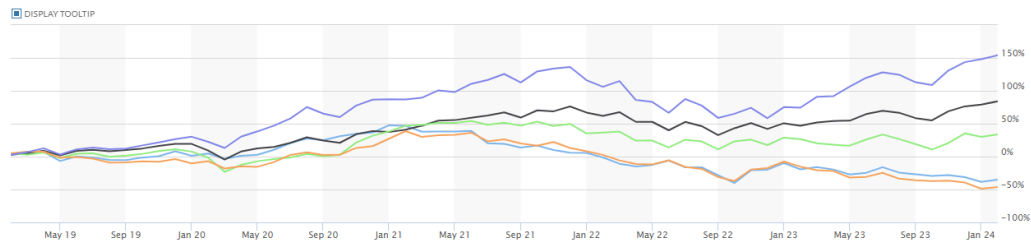
This move was part of a broad announcement on Wednesday to improve U.S. maritime security. The Biden administration said more than \$20 billion would be invested in port security over the next 5 years. The funds come from the 2021 bipartisan infrastructure deal that totaled more than \$1 trillion. The money tapped would help support a U.S. subsidiary of a Japanese crane producer, producing port cranes in the U.S. for the first time in approximately 35 years.

Currently, China-based ZPMC is the largest producer of ship-to-shore cranes in use at U.S. ports.

The fears with these cranes stem from their underlying technology and software which Washington believes could be hacked or susceptible to a Beijing cyber attack.

Either way, a complete decoupling of the East and West is continuing. We expect many companies from the West to continue to exit China and bring their operations, including manufacturing, closer to home or other countries in South-East Asia.

While the U.S. and China's economies decouple so have their equity markets:



Index	5 Year Return
iShares MSCI China ETF	-36%
iShares MSCI China Small-Cap ETF	-48%
S&P 500	78%
Nasdaq-100	146%
Russell 2000	25%

Be careful not to catch a falling knife.

### Speaking of China

The Chinese government made yet another interesting move on Wednesday regarding their capital markets.

They banned selling at market open and close across their equity markets. The move comes one day after the CCP said it would suspend one of China's biggest quant funds of aggressive selling. The new move that bans selling at open and close, looks to limit short selling in the Chinese equity market. This is a notable tightening by the CCP on markets that risks upending popular strategies used by large institutions and hedge funds. The move will not allow investors to sell more shares than they buy during the first and last 30 minutes of trading.

However, Bloomberg and many other sources are unsure if this move will impact individual investors. Individuals account for a large portion of the trading volume in China. The banning of this practice for large institutions could make it easier for government-backed funds to influence Chinese equity markets.

Besides the trading curbs, Bloomberg also notes that China is actively preparing to ban short selling as some brokerages have been asked to recall stock loans to clients for shorting purposes.

Capital markets in China continue to show their true colors, major geopolitical risk, and a desperate government that wants to stop the bleeding. This move will more than likely have a positive effect on Chinese markets, but we warn our readers and investors to not buy this short-term news.



## **Berkshire Q4 updates**

Berkshire Hathaway filed its 13F for the fourth quarter of 2023 and it revealed a few things that we find very interesting. Warren Buffett increased his stakes in only 3 companies during the quarter. The most notable was his increases in the energy sector, Buffett added 14.37% more shares of Chevron and 8.74% more shares of Occidental Petroleum. He now owns 126.09 million shares of Chevron and 243.72 million shares of Occidental. Berkshire owns 6.66% of the outstanding Chevron shares and 27.7% of the outstanding Occidental shares.

Buffett seemingly bought the dip in energy that we saw and still sees tremendous value in the energy sector. We are happy that he has not wavered from this recent trade of his and continues forward. We have been quite bullish on oil and have remained firm on our view of shortages moving forward, clean balance sheets, and cheap valuations in the industry.

At last year's annual Berkshire meeting in May, Buffett said he would add to his Occidental holdings, but he would not take control of the company. In August 2022, he received regulatory approval to buy up to 50% of Occidental. This filing could reflect more purchases by Berkshire and shows just how serious Buffett is about the energy sector.

Berkshire's other transactions include exiting D.R. Horton, and Markel Group as well as reducing his holdings in HP Inc., and Apple. Apple remains the largest holding in Berkshire's portfolio, representing 50.19% of the portfolio, followed by 10% in Bank of America, 8.18% in American Express, 6.79% in Coca-Cola and 5.41% in Chevron.

We will be staying tuned to Berkshire this week as they release their annual shareholder letter on Saturday. We will report back in next week's issue.

Berkshire shares are up 35% over the last year, significantly outperforming the S&P 500 which is up 24%. Berkshire Hathaway has also quietly closed in on a \$1 trillion market capitalization and would be the only non-technology based U.S. company to do so.

Disclaimer: MacNicol & Associates Asset Management owns equities in the energy industry, including various oil industries and Berkshire Hathaway in some accounts.


## **Nvidia earnings**

Nvidia reported its earnings on Wednesday at market close in what many dubbed the most important earnings report in quite some time including Goldman Sachs. Many believe overall market performance for the rest of the year or at least for the next few months depends on Nvidia's Q4 earnings. We are not trying to be hyperbolic or overreacting, we are simply sharing information that we ran by this week.



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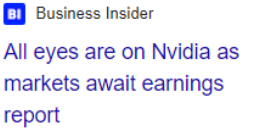
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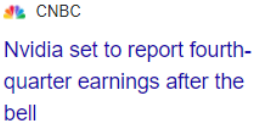
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Investors were already bracing for a letdown in the earnings release to start this week, markets moved lower on Tuesday, and Wednesday, as did Nvidia shares. Nvidia shares were down 4.35% on Tuesday, the largest drop since October 2023, and another 3.8% as of 3:00 pm EST on Wednesday.

Nvidia's market cap before earnings is \$1.65 trillion and over the last 12 months have only generated \$45 billion in revenue and \$19 billion in earnings. To say this is a bubble is an understatement, yet many investors continue to chase returns.

Forecasts have pegged Nvidia revenue to total \$20.6 billion over the 3 months ended January 31, 2024 (Nvidia uses a Jan 31 year-end), 240% above last year and 25% higher than their Q3 revenue. Net income is expected to surge close to sevenfold - \$10.4 billion, up from \$1.41 billion last year.

Nvidia will need to continue delivering huge earning beats, as well as large growth numbers to sustain its stock price.

Many decided to sell their Nvidia shares in the days leading up to this earnings release as they believed Nvidia's beat would not beat consensus estimates by a large margin. The buy-side whisper estimate for revenue and earnings was much higher than the sell side which may have caused some buy-side firms to partake in some profit-taking.

The above was written pre-earnings. Below we will talk about what was reported and the ramifications of the report.

Nvidia beat Wall Street estimates for revenue, earnings, gross margin, and data center revenue. Revenue came in at \$22.1 billion for the quarter, and EPS came in at \$5.16, versus estimates of \$20.6 billion and \$4.63. Nvidia shares surged on the company's forward-looking statements where they see revenue growing to \$24 billion for the first quarter, versus an expected \$21.9 billion. Shares originally dropped another 4% after earnings were released but rebounded to be up over 7% in after-hours trading.

Investors closely watched Nvidia's Data Center business, which includes the company's H100 graphics cards that are widely used to power generative AI apps such as OpenAI's ChatGPT. Data center revenue jumped by more than 400% from Nvidia reported during the same period last year. Data center revenue came in at \$18.4 billion for the quarter, making up the majority of the top line for Nvidia.



Nvidia also mentioned in their shareholder letter that sales to China significantly declined over the quarter due to U.S. government licensing requirements. These requirements were sanctions installed by the Biden Administration for national security reasons. The fact that Nvidia beat estimates with low sales from China shows the overall demand in this space. Nvidia has historically heavily relied on China as a market for sales.

Even though earnings were strong and are forecasted to grow more than expected, we still think Nvidia shares trade at a ridiculous valuation that we as conservative wealth managers cannot justify buying for our investors.

We read some rumblings that they could announce a stock split but that never came to fruition. Perhaps that will come in their next earnings report in 3 months.

**MacNicol & Associates Asset Management**  
**February 23, 2024**