THE WEEKLY BEACON **June 28, 2024**

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 our 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.

Nosy Alañaña Light, Prunes, Toamasina Province, Madagascar.

This lighthouse is an active lighthouse that stands at 197 feet tall. It is the 24th tallest traditional lighthouse in the world as well as the highest in Africa. The tower is closed to the public but by accessible by boat.

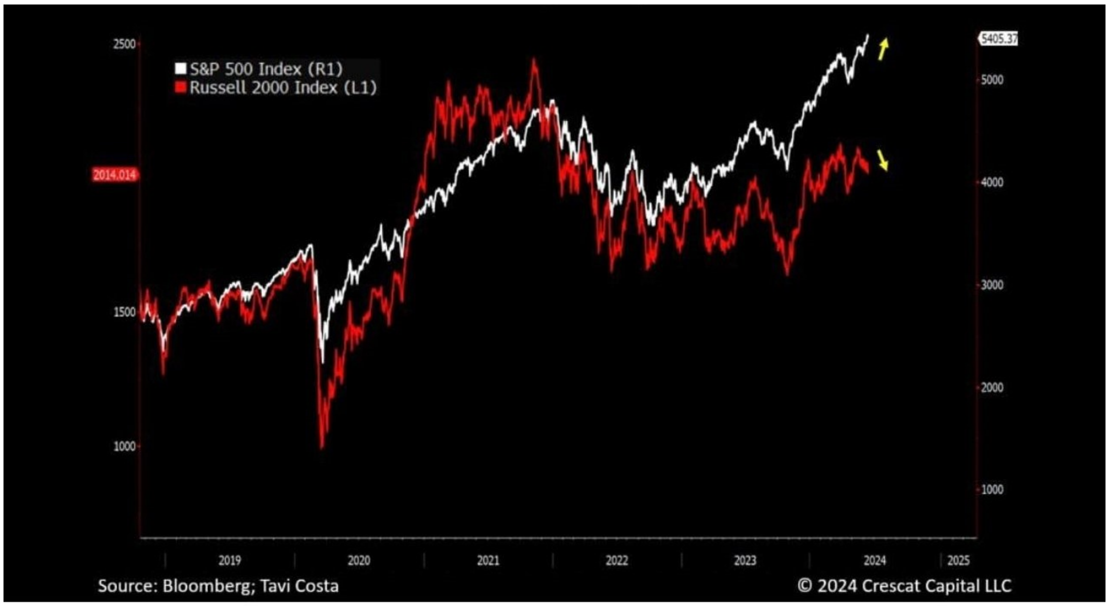
Waipapa Point Lighthouse, Waipapa Point, Southland, New Zealand

This lighthouse was built in January 1884 and was automated in 1975. The 43-foot-tall lighthouse is operated by the Maritime of New Zealand. The lighthouse has a range of 9 nautical miles.

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

Small and large cap divergence

For those who avidly follow equity markets, we are sure that you are aware that small caps have significantly underperformed large caps in recent years and by quite a large margin. That divergence has accelerated recently. The chart below which tracks the S&P 500 (large caps) and Russell 2000 (small caps) highlights this.



Small caps continue to negate the rally from large and mega-cap stocks. Historically, many investors ignore these types of divergences as they only focus on one area of the market (the biggest) or pile into the large caps due to them being familiar. These dynamics are also why there are more exploitable deficiencies in small caps. However, we along with a few investors believe that it could be a leading indicator for everything across equity markets. Small-cap stocks represent most of the labor market, and their underperformance is likely indicating that the overall market is far ahead of itself.

We do not think it will be a straight line down or nothing will work if large caps turnover. Certain corners of the market will outperform and managers who rotate rather than index (or closet index) will be rewarded.

We purely think the correlation of these two trend lines will revert to their mean and will become more correlated once again. We are certainly not recommending small-cap stocks for all investors or small caps at all right now, we are purely sharing our thoughts on the state of global equity markets.

Risk assets drop

Bitcoin and Nvidia slid on Monday marking a potential slip in the momentum of speculative assets which have surged over the last 18-24 months.

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Nvidia shares were down 6% as of 2:30 on Monday and 11% over the last 5 days. After a huge boost over the previous few months after a stock split where Nvidia became the world's largest company, investors have been a little weary of the chip maker. More and more questions have come out on what justifies the elevated valuation of Nvidia. Investors have also noticed that Nvidia insiders have cashed out of their shares over the last 2 weeks as the stock melted up. Over the last month, insiders have sold close to half a billion in stock, perhaps cashing in some gains before the share price has a pullback.

At the same time, the price of Bitcoin has pulled back. Over the last month, Bitcoin has pulled back by more than 12% despite the launch of numerous investment products which is increasing the cryptocurrency's demand.

Perhaps these two assets struggling over a week is a coincidence or perhaps it is a sign that investors are realizing speculation is not a good way to invest and now is a good time to lock in some gains.

Another sign of this speculative bubble deflating was the pullback of meme stocks like GameStop and AMC which surged last month on retail and short squeeze interest but have since pulled back significantly.

We are not comparing Nvidia to Bitcoin or meme stocks, we are simply stating that buying Nvidia at these levels comes with increased risks due to the levels at which the company trades at.

Canadian foreshadowing

The pain in Canada is being felt and voters are letting Trudeau and his Liberal government know. On Monday, there was an off-year federal election in 1 riding across Canada in a small town named Toronto. The riding was a Liberal stronghold, located on the edges of downtown Toronto, and had been won 10 elections in a row by the Liberals. You have to go back to 1988 to see a Conservative win in this riding.

In 2021, the Liberals won 50% of the vote and the Conservatives won only 27%.

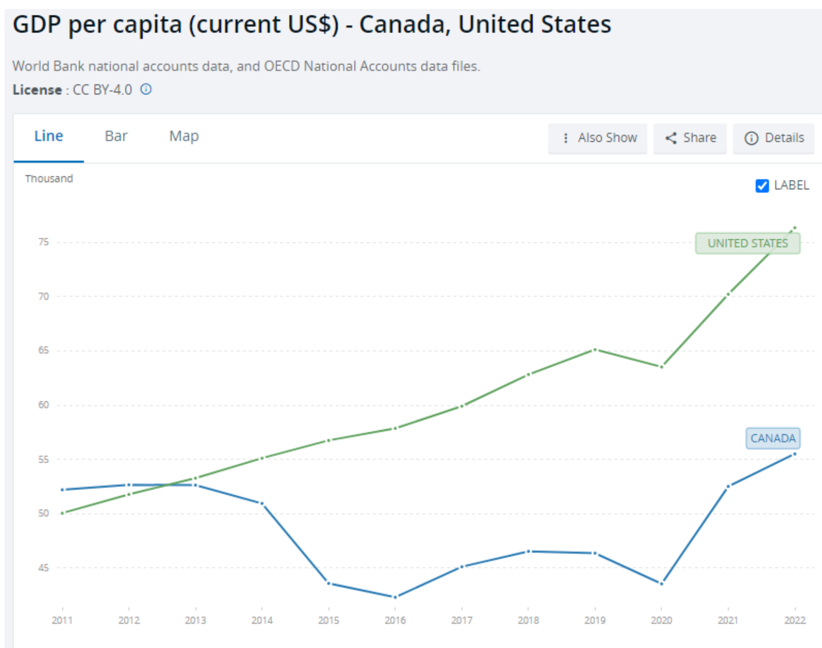
Fast forward to Monday night and ripples are being felt across Canada. The Conservatives won the riding and gained 17% of the vote. After this result, it seems like no seat is safe in the next general election for the Liberals. If they cannot hold onto seats in downtown Toronto, where will they win?

Voters voiced their concerns which have been raised over the last few years. Concerns over the cost of living, housing prices, economic growth, education policies, energy policies, and immigration led voters in the opposite direction of the incumbent government.

This is just one riding, and it's not like the Conservatives run the country but it is something that we along with many think could foreshadow mass change in Canada. There was even speculation on Tuesday morning that Trudeau could step down after being what many have described as embarrassed.

On the same morning this election result was released, Canadians were hit with another piece of news. Inflation accelerating once again. The inflation report for May was released and surprised many as it came in much hotter than street expectations. The annual inflation rate came in at 2.9% well above the 2.6% forecast. Inflation in the month prior was 2.7%, this stickiness in the inflation rate immediately cast doubt on a July rate cut from the Bank of Canada. The BOC already has cut interest rates by 25 basis points and was forecasted to do so once again in July. This piece of data will more than likely pause that effort.

Canada cut rates before the U.S. due to cracks in the economy and some weak data that could suggest a recession north of the border. Canada has trailed the growth rates seen south of the border tremendously over the last 15 years. GDP per capita in Canada increased by 6.3% from 2011 to 2022 while the U.S. number grew by 53% (according to the World Bank Group). Canada has artificially grown its overall GDP through mass immigration while productivity has severely slipped.



Back to the inflation report. Many Canadians were counting on another rate cut in July and a few more to end the year but if inflation remains a problem the Bank of Canada could be forced to keep rates higher for longer. While a rate cut in July remains on the table, the latest inflation data "won't instill any added confidence for the Bank of Canada," TD economist James Orlando wrote in a research note.

The main reason inflation accelerated in May was due to services led by cellular services, travel tours, rent, and air transportation. Rent prices continue to increase in Canada, with the national rent index rising 8.9% in May, compared to 8.2% in April. Mortgage interest rate costs were up 22.3% on an annual basis in May.

We will see what the BOC chooses to do next month. Before this inflation announcement, there was a 70% probability that rates would be cut in July, after this data was released, the probability dropped to approximately 40%.

Time for a Tokyo adventure

The Japanese Yen dropped to its lowest level relative to the U.S. Dollar since 1986 on Wednesday morning. The Yen also hit its all-time low relative to the Euro on Wednesday.

As the Yen deteriorates, now may be the best time in years to book that Japanese getaway.

The increase above the 160 level has prompted concern from investors and consumers in Japan. Japan's vice minister of finance said on Wednesday that they are watching foreign exchange markets with a high level of urgency and will take appropriate steps as needed.

The deterioration in the Yen has led to cost-of-living concerns in Japan, something the incumbent President needs to address before his party's leadership election in September.

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The Yen has lost 12% versus the U.S. Dollar this year. Analysts believe Japanese officials will wait till Friday to make a policy change. On Friday the U.S. PCE is released, the PCE is the FED's preferred gauge of inflation versus the traditional CPI. A decrease in the PCE could allow the FED to slash interest rates before the election.

Japanese officials are watching U.S. data releases due to the vast spread between the two countries' policy interest rates. In Japan, the policy rate is close to 0% versus nearly 5% in the U.S. This spread is a major reason the Yen has lost so much value this year.

We do not have any international exposure to Japan but recommend to our investors interested in the country, that now should be the time to pull the trigger and visit Japan.

Carnival's strong earnings

Carnival Corp reported earnings on Tuesday and the street loved what they heard. Shares jumped by almost $2 between Tuesday and Wednesday sending the stock up 12%. Shares are up 18% over the last 5 days and are close to a 52-week high. Over the last year, shares are up 26% as the cruise industry bounces back and companies like Carnival beat earnings expectations and raise forward expectations.

The company reported a quarterly profit of $0.11 per share versus a street estimate loss of $0.02. Revenue for the quarter also beat expectations by approximately $100 million. This marks the 7th straight quarter that Carnival has beat earnings expectations and 6th straight quarter they have beaten revenue forecasts. Cruise operators had rough 2020, 2021, and 2022 fiscal years due to rotating lockdowns stemming from Covid-19. Since then, most cruise operators have turned it around. 2024 has been a record year for cruise operators as booking volumes hit all-time highs as consumers look for new experiences at affordable prices.

Carnival CEO, Josh Weinstein said on the company's earnings call that the company continues to see strong bookings volume driven by record volumes for 2025 sailings. Total customer deposits during the second quarter hit a new all-time high, surpassing the previous number by over a billion.

We forecasted strong earnings for the sector as we exited COVID-19 citing the consumer's interest in experiences and services rather than goods. Even we did not foresee this strong of earnings for these cruise operators.

The one issue that we along with many investors see with Carnival is their debt levels which remain quite high. The same can be said for basically the entire industry. The cruise industry requires a lot of capital and leverage. The company paid down $1.6 billion in debt during the quarter, putting its net debt at $27.7 billion.

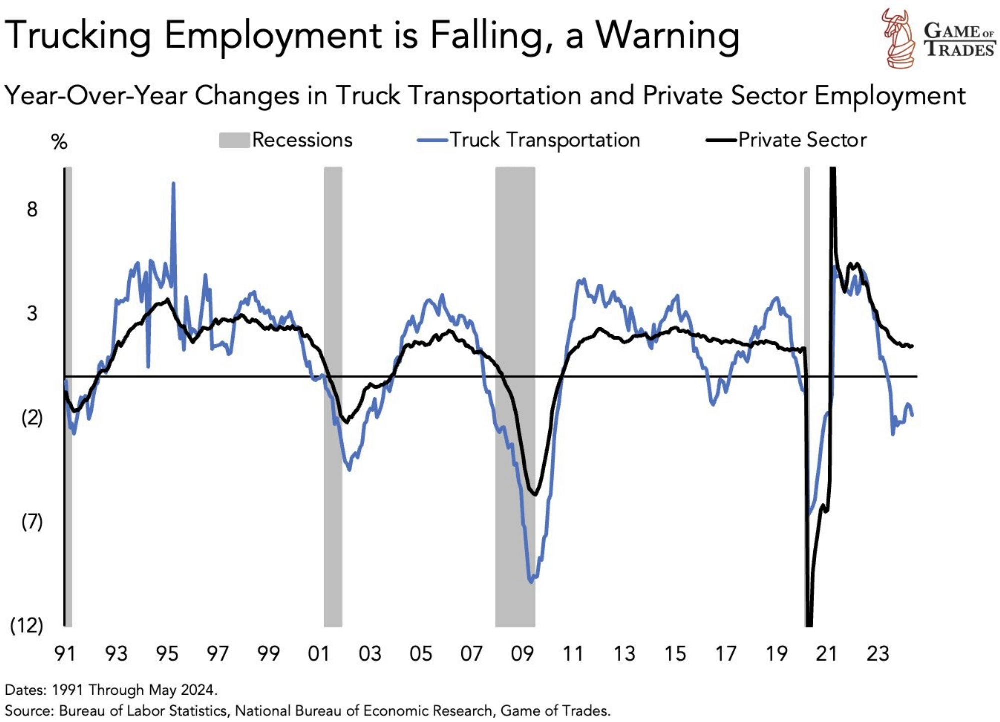
Along with strong earnings during Q2, Carnival raised its earnings forecast for the 2024 fiscal year as well as its revenue, operating profits, and booking volumes.

We continue to see more upside in this cruise operator as it continues its accession post-Covid-19 after being severely beaten down. We think this is a long-term play that could pay off well down the road.

Disclaimer: MacNicol & Associates Asset Management hold Carnival Corp across various client accounts.

A warning?

Trucking employment fell year-over-year in the most recent jobs report. Trucking employment falling has been something that has been a pre-cursor to every recession since 1991.



We understand the importance of trucking as when employment is increasing, it's due to demand and more spending from consumers, corporations, and even governments. It reflects an increased level in commerce when increasing and a slow down, sometimes a recession when it's on the decline especially when the trend turns negative like it has recently.

The other way to look at this is the market is reverting to the mean and is going through a small correction. By market, we mean the trucking market and by reverting to the mean, we mean employment count. During Covid-19 and after Covid-19 employment in trucking surged due to consumers buying everything online. This led to increased employment in trucking to satisfy consumer demand. Fast forward a few years and consumers are buying less online and less goods which has caused layoffs in the trucking and logistics industries. Look at FedEx and UPS, they have both announced layoffs across their workforces in a move to cut costs.

FedEx anticipates it will lay off 1,700 to 2,000 employees, reportedly costing the company between $250 million and $375 million through the 2026 fiscal year. Jun 12, 2024

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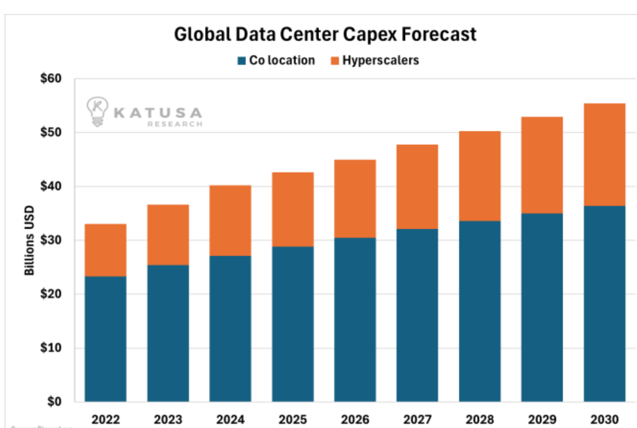
Although in the past this may have been a good gauge of a coming recession, we think this time's occurrence is also a factor of COVID-19 and the over-employment that we saw in the trucking industry correcting itself.

Do we think some signs are pointing to a potential recession? Yes. Do we think a recession is guaranteed? No. Does this trucking data mean a recession is coming? Potentially but you must look at why these layoffs are happening. It’s a correction. Consumers are still spending, they just moved on from goods to services as the global economy has re-opened over the last 24 months.

AI energy demand

Is the energy industry set for a huge AI boost? It looks like it. According to the Boston Consulting Group, AI data center electricity needs are set to exceed the energy usage of 40 million U.S. homes. Demand for electricity and energy in the AI space has been surging and is forecasted to continue to do so.

Global data center capex by year is expected to jump quite significantly through the end of this decade.



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The AI revolution will take decades of work which will demand more and more energy.

Expect energy consumption to only increase from here. We hope you still have exposure to some energy and electricity names.

An alternative way to play the AI space.

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