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.

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.

West Point Lighthouse, West Point, PEI

This 21-meter-tall lighthouse was constructed in 1875. The lighthouse was first of the second-generation lighthouses in PEI.

Cape Bear Lighthouse, Murray Harbour, Prince Edward Island

This PEI lighthouse was established in 1881. It stands on PEI's southeast coast and is still operational today. The lighthouse has a nautical range of 22 kilometers.

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

Home buyers hit the exit

A record number of U.S. homebuyers backed out of deals in July. 60,000 Americans backed out of real estate deals in July over numerous concerns according to Redfin.

Despite falling mortgage rates, over 59,000 home purchase agreements in July were canceled, representing 16% of the homes nationwide that went under contract last month. July's share of cancellations was the highest since 2017 when Redfin began tracking this data set.

According to Redfin, the major drivers of this July trend are election-year uncertainty and high home prices.

A lack of interest from buyers and a glut of supply has also cut the prices of homes across some real estate markets. The number of homes for sale across the country was up 14% year over year as of last month. This glut and a lack of buyers have led to 26% of homes listed on Zillow receiving a price cut last month. This is the highest percentage for one month since July 2018.

This news is not good for sellers. However, it is good news for buyers who are in the right financial situation. As supply increases, buyers have more room to negotiate. Buyers also benefit from the drop in mortgage rates.

Despite prices pulling back, the average home price in the U.S. is up 4.1% from last summer. Other buyers are uncertain where the country will be in six months and are holding off on their purchase. However, according to industry experts' real estate prices have little correlation to ONE political party winning. In nine of the last eleven presidential elections, home sales rose in the year following the election. At the end of the day, the real estate market is impacted by the macro environment and how consumers are spending. We think rates will decrease in the short to midterm but could bounce back higher down the line.

Ark investors paying for Wood's mistakes

We all know Cathie Wood and Ark Investments. We have talked about the brash CEO and the asset manager throughout this publication's history. We will not rehash old news and reshare our opinions on her investing style. We encourage you to read old editions of this publication if you want more information on Wood and Ark.

We brought Wood and Ark up this week because of a report that came by our desks. This week we read a report in Barron's that explores the losses that ARKK (Ark's flagship fund) investors ate and the gains they missed out on.

At one point, ARKK was the largest U.S.-listed active ETF, with close to $30 billion in assets. Today the fund has one-sixth of that number in assets. That is because Wood's early pandemic-era bets have

busted since. The fund which more than doubled in 2020 has seen extremely poor results in recent years. ARKK was down 67% in 2022 and is down 14% so far this year.

The annual return for ARKK has been 9.7% since its 2014 inception. However, the average investor in ARKK has seen far worse results than the fund itself. According to Morningstar, the average investor's annual return is -17% for ARKK. Morningstar calculates the investor return by tracking money moving into and out of a fund to see what share of the fund's annual return is captured by fundholders.

While it's common for investor returns to lag actual returns for ETFs, the average difference for actual returns versus investor returns for funds larger than $1 billion in the U.S. is approximately 1%, not 27% like ARKK's spread.

A big reason for this phenomenon is many ARKK investors missed out on the 2020 and 2021 runs, and bought at the top in 2022, before many ARKK holdings collapsed like Zoom, Roku, and Roblox.

Wood shared with her investors in her July shareholder letter that she understands volatility can be unsettling and frustrating. However, she went on to recommit to her investment philosophy that looks for disruptive companies in new areas of the economy. Do not expect this volatility to go anywhere anytime soon.

Morningstar analyst Jeffrey Ptak called the wild ride that ARKK has taken its investors on an epic failure. He cited the huge losses that the average investor in ARKK has realized and the positive results for the S&P 500 over the same reason as an obvious reason to avoid these high-volatility ETFs.

Walmart sells China

According to filings on Tuesday, Walmart dumped its entire stake in JD.com raising $3.6 billion in cash. JD.com is a Chinese-based e-commerce company that Walmart has owned stock in for approximately 8 years. The company said in a statement to Barron's that they look forward to their future commercial relationship with JD.com.

This stock sale pulled JD.com shares down in China on Wednesday as well as many other Chinese ADRs on Tuesday. The China risk continues to remain in play even with the bounce back that we have seen this year.

Walmart cited focusing on Walmart China and Sam's Club as reasons for their divesture, noting that they now can deploy capital towards other priorities.

JD.com shares jumped heavily last week on a strong earnings report. Perhaps, Walmart saw these earnings beat as a time to collect some profits and move on. Walmart's stake was reportedly worth $2 billion as of March 31st. Walmart sold its stake for over $3.6 billion this week showing how strong some Chinese stocks have performed in recent months. However, JD.com shares are down over 70% from their 2021 peak, and prices are little changed from the levels in 2016 when Walmart became a major shareholder.

Walmart shares rose to a record high on Tuesday after this news was released. Walmart shares are up 41% this year on strong earnings as well as strong numbers from China. We think their strong reporting from China made their divestment from JD.com an easy decision. Walmart reported an 18% year-over-year increase in revenue in China as well as a 26% increase in membership income from Sam's Club China over the last year. Despite weakness in the Chinese economy, Walmart is not struggling and continues to grow its influence in the world's second-largest economy. Walmart's leadership team knows they specialize and are successful in operations, not minority investments. Walmart essentially believed Chinese equities like JD.com would underperform moving forward and become a non-core asset.

Mythical number

The U.S. Bureau of Labour Statistics made a HUGE revision to U.S. payrolls data on Wednesday. The revision is not positive. The Federal government announced that there were **818,000 fewer jobs created than reported** over the last year ended March 2024. Zerohedge, an alternative media outlet was reporting on this huge revision a few days before it was released.

Wednesday's revision was the largest downward revision in 15 years. This revision was the largest since 2009 when the world was undergoing a financial crisis.

This indicates that job growth was overstated by 70,000 per month in the U.S. and indicates that the economy and job market are weaker than many thought.

The preliminary estimates for the payroll revisions were 306,000, the actual number was 2.5x greater than that.

This is not the first time the government has overstated job creation. It also sets the table for an interest rate cut next month from the Federal Reserve. The other event that this revision could impact is the Presidential election in November where the strong economy that Biden and Harris have led is not as strong as they and their government have reported.

The largest sector revisions were seen in professional services which saw 358,000 fewer than reported jobs created, followed by leisure at 150,000 and manufacturing at 115,000.

This data confirms that most of the jobs reports that beat in 2023 never existed as the average monthly payroll change in 2023 was reduced by 31% after this 1-year revision.

We think this data could push the FED as far as cutting interest rates by 50 basis points at September's FED meeting. According to the CME Group's FED Watch Tool, the probability for a 50-basis point cut at September's meeting increased by 4% after this data release and has increased by 28% over the last month (from 4% on July 19th to 33% as of Wednesday).

The economy is much weaker than reports suggest especially as the unemployment rate has been rising. The notable downward revision to payroll numbers is confirmation that the rise in the unemployment rate is an accurate signal that the labor market is deteriorating.

We will see how this data impacts the FED's path forward next month. However, we will receive some guidance from the FED this Friday at Chairman Powell's speech at Jackson Hole.

Aggressive budget

Saudi Arabia has aggressive plans to economically develop and become a world leader in numerous industries. The country is looking to diversify its economy and not rely on oil as much moving forward. In order to accomplish this, they are investing heavily in infrastructure, foreign enterprises, and tourism. The country also has eyes on becoming a major global leader in finance.

These initiatives will (and have) cost(ed) a lot of money and thus have increased Saudia Arabia's expenses. In order to run a balanced budget Saudi Arabia now needs oil to sell for $95/barrel, $112 if you include the spending from the Public Investment Fund.

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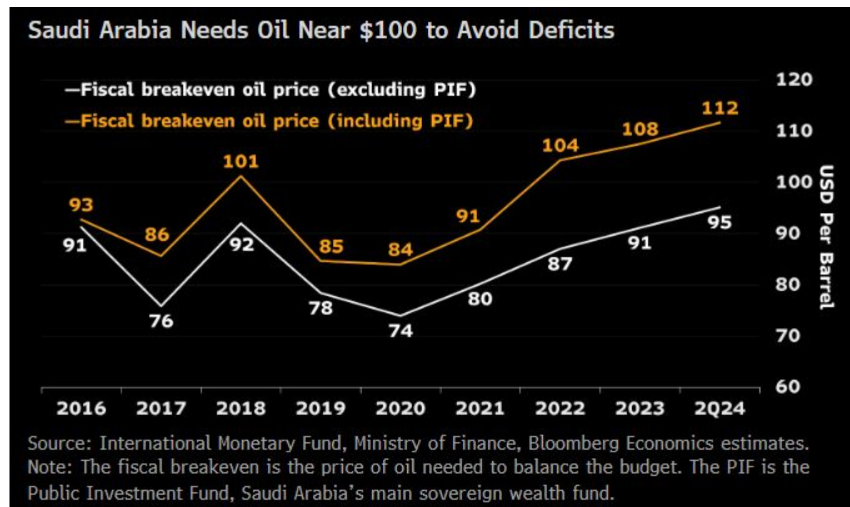
The estimates done by the IMF and Bloomberg reflect a dramatic increase in the fiscal breakeven oil price for Saudi Arabia in recent years. The chart below includes government spending and domestic investments by the sovereign wealth fund.



Source: International Monetary Fund, Ministry of Finance, Bloomberg Economics estimates.
Note: The fiscal breakeven is the price of oil needed to balance the budget. The PIF is the Public Investment Fund, Saudi Arabia's main sovereign wealth fund.

The Saudi government can run a deficit to push their spending forward. However, they historically have preferred to run a relatively balanced budget.

The Saudi government released its 2024 first-half budget data last week and their deficit is going to be much larger than initially expected in 2024. With oil trading in the high $70s, below their breakeven budget price, they will be reluctant to expand output.

This data and the Saudi government's expectation of continued oil exports for 20+ years are more than likely going to lead to a slowdown in spending from the Saudis. Saudi Arabia does not want to finance a huge deficit so they will have to pull back on spending. The spending will not slow domestically, we think it will internationally. The almost $1 trillion Public Investment Fund will shift focus to domestic spending to spur domestic growth and the era of Saudi Arabia being perceived as a source of easy money will come to a close. According to London-based investment bankers, the Saudi government wants institutions and corporations to have skin in the game in Saudi Arabia and not just the country as a cash cow.

The country which has aggressively invested globally for the last 8-10 years will pivot to domestic projects.

We think these events will lead to Saudi Arabia continuing to pressure OPEC+ to not expand supply and support the global oil market.

We think the price of oil will continue to remain elevated moving forward and continue to remain bullish on numerous North American oil producers, transports, and refining companies. We understand there is some volatility in this trade in the short term but continue to remain steadfast in our long-term thesis on the industry.

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Alimentation Couche Tard's next target

In surprising news, one of our long-time and core holdings, Alimentation Couche-Tard reportedly has initiated talks with the parent company of 7-Eleven over an acquisition. According to reports on Monday, the Canadian-based convenience store operator made a preliminary takeover bid to acquire 7-Eleven through its Japanese parent company Seven & I Holdings.

The proposed takeover would be the largest foreign takeover of a Japanese company ever. The potential merger would create the largest convenience store operator across the globe with over 100,000 stores.

The offer is nonbinding and is in its preliminary stages. The biggest hurdle if an agreement between the companies is finalized will be U.S. regulators who will more than likely heavily scrutinize the deal. Approximately 31% of Alimentation Couche-Tard stores have a 7-Eleven or Speedway (owned by Seven & I Holdings) within 1 mile. Under the Biden Administration, the FTC has blocked deals at a record pace and has scrutinized mergers and acquisitions heavily. Currently, they are fighting the Kroger – Albertsons grocery merger, Nippon Steel – U.S. Steel acquisition, as well as numerous other corporate deals. Historically Japanese regulators have been very weary of foreign acquisitions of businesses but have recently relaxed their grip.

Alimentation is familiar to Regulators; in 2021 they were forced to abandon a $20 billion bid for French retailer Carrefour SA due to government opposition.

Back to the deal itself.

Seven & I Holdings operates 85,000 convenience stores; the company also operates numerous other retail stores in Japan. The 85,000 convenience stores are scattered across 18 countries. On the other hand, Alimentation operates in 31 countries but only operates approximately 16,000 stores. However, Alimentation Couche-Tard enjoys a much larger valuation at $56 billion than Seven & I Holdings' valuation of $37 billion (both figures in U.S. Dollars).

So how did a U.S. convenience staple get into the hands of a Japanese conglomerate? In 1991, a Japanese supermarket chain bought 70% of 7-Eleven.

Alimentation Couche-Tard has been one of the strongest-performing stocks across the globe over the last two decades. Alimentation has done this through consistent acquisitions over the years. Over the same period, Seven & I Holdings has arguably underperformed. The stock has drawn in activist investors in recent years who pushed for increased efficiency and for management to focus on the core business and sell off other assets. For the most part, they resisted these efforts. Alimentation trades at 12.5x 2025 EBITDA while Seven & I Holdings trades at 9x.

This would be a strong strategic move by Alimentation Couche-Tard as it would give itself more pricing power over suppliers, reduce costs, and grow its U.S. footprint as 7-Eleven is the largest player in the U.S. convenience market with a 15% share of the market. Sell-side desks believe there could be up to

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20% in accretion in a potential deal. Alimentation would more than likely sell off Seven & I Holdings noncore assets if a deal gets done like activists have been asking of Seven & I Holdings management for years.

The timing of this deal comes on strong cash flows, and growing margins from Alimentation, a weak Yen, volatility in Japanese markets, and rising interest rates in Japan.

Seven & I Holdings saw its share price jump on the Japanese exchange by 23% on the day of this report while Alimentation Couche-Tard shares were relatively flat.

According to industry experts, 7 trillion Yen would be tough for Seven & I Holdings management to say no to. This would be approximately $48 billion (U.S.) which is close to the rumored offer price by Alimentation. These numbers are speculation as of now.

According to BMO's research team, Alimentation would need approximately $13 billion in debt and $29 billion in equity to get a deal done. This would represent a 50% equity dilution for current shareholders with the addition of some serious leverage.

We would have to see the details of the deal to express our opinion on a potential deal but we like the continued aggressiveness from Alimentation's veteran leadership team.

Seven & I Holdings is reviewing the offer through its board and a special committee.

We will report back when the particulars of the deal are announced.

MacNicol & Associates Asset Management
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