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.

Boat Bluff Lighthouse, Sarah Island, British Columbia

This lighthouse was established in 1897 and was first lit 10 years later. The lighthouse sits 38 feet above sea level. The other buildings are where staff and keepers of the light have lived.

Triple Island Lighthouse, Triple Island, British Columbia

This lighthouse was built in 1920 and sits at 72 feet tall. The lighthouse is off the west coast of BC and is operated by the Canadian Coast Guard. The lighthouse is recognized as a federal heritage building of Canada.

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

More insider selling

Insider selling has put some downward pressure on the stock price for Cava Group this week. After a remarkable 8-month performance, insiders have been dumping stock. Cava Group shares started 2024 trading at $40 a share, last week shares were above $125. This led insiders to sell off some of their holdings and led to the stock dropping 7% on Tuesday morning.

Cava Group is a Mediterranean fast-food chain that has 309 locations and currently boasts a market capitalization of $14 billion.

Filings with the SEC on Monday after hours revealed that the CEO had sold $25 million in shares, the co-founder had sold $12 million, and the CFO had sold close to $1 million in shares. This triggered investor fear that Cava Group shares could be hitting a ceiling.

Cava Group has reported extremely strong same-store sales growth throughout this year despite various restaurants and fast-food chains missing earning and revenue targets. Cava Group most recently saw a huge boost to its stock price on Friday when its latest quarterly results were released. Revenue and earnings beat Wall Street expectations and Cava Group reported a 9.5% boost in traffic. This strong report and internal forecasting led Cava Group to boost its 2024 guidance.

The recent rally last week in Cava Group's stock price lifted its valuation to 250x forward earnings and 12x forward sales. For reference, the industry leader, Chipotle trades at 45x forward earnings and 6x forward sales.

The boosted valuation and conservative expansion plans taken by Cava Group could lead to a pullback in the stock price moving forward. JP Morgan's analyst that covers Cava Group changed his rating on the company from overweight to neutral after this huge run-up citing, "we are not chasing stock performance here, and instead would revisit lower".

Cava Group trades with a massive valuation and the risk completely outweighs the reward currently. We think this insider selling is management front running a pullback in the stock. Even management sometimes knows when it's time to take some profits.

We are certainly not saying Cava Group is flawed and that it will not expand, we simply are talking about valuation. We expect the number of Cava Group locations to increase in the coming years and perhaps with a pullback, we can find an attractive entry point for our investors.

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Canada takes a swipe at Chinese companies

Canada is following its allies, the U.S. and Western European in slapping import tariffs on Chinese electric vehicles. This will raise the price for Canadians looking at buying Chinese EVs.

The Finance Minister of Canada announced a 100% tariff on Chinese EVs on Monday, a similar policy to the U.S. which was proposed in May by President Biden. The Minister cited unfair trade practices as the reason for this new tariff.

In Europe, the import tariffs vary from 20-40% even though the issue of cheap Chinese vehicles is more pressing. Currently, there are no Chinese EVs on sale in North America, the Canadian and American governments are essentially front running the issue so domestic producers do not lose any market share.

Chinese automakers have a huge price advantage over Western producers due to massive government support and significantly lower wages. This does not make Chinese automakers more profitable than their U.S. competitors, but it allows them to be profitable on vehicles selling for as low as $10,000. This low price reflects what some Chinese consumers want, a bare-bone, low-quality vehicle only meant for personal transportation.

Western countries hope these tariffs keep manufacturing jobs at home and weaken the demand for Chinese EVs. However, there is a risk for Western governments where China could retaliate and implement tariffs on Western products which could decrease the employment in other sectors of Western economies.

In theory, Tesla vehicles produced at Tesla's Chinese manufacturing plant would not be exempt from this tariff. Tesla has historically shipped Chinese vehicles to Canada. However, the company would just reroute deliveries to Canada through the company's two American manufacturing plants, so we expect this announcement to not impact Tesla whatsoever.

A value play in tech

You do not always find value plays in tech. Technology companies usually trade at premiums due to rapid earnings growth expectations, and innovation. However, this phenomenon often leads to investors buying overvalued companies as they believe the company will always see growth. Sure, the strategy of not worrying about valuation has worked for investors in many well-known tech names, but it has failed in many names you probably have not heard of. That is why we historically look for value plays in the technology industry.

The company that we ran across recently that we are talking about is Hewlett Packard Enterprise Company (HPE). HPE is a Houston-based multinational technology company that was founded in 2015 after Hewlett-Packard split apart. HPE focuses on business solutions for global enterprises. The company

offers enterprise security, analytics and data management, applications, data center care, cloud consulting as well as numerous other services. Its business segments include servers, hybrid cloud, intelligent edge, financial services, corporate investments, and others. The company employs approximately 62,000 employees.

So why do we like HPE? It has flashed buy signals through our technical screening and fundamentally we think it's undervalued. HPE trades below industry averages in terms of price to forward earnings, price to sales, enterprise value to sales, and enterprise value to EBITDA. The company has seen its balance sheet expand in recent years as well as its sales. Despite beating Wall Street estimates for earnings almost every quarter over the last 3-4 years, earnings-per-share have not substantially increased over that period. We think the AI revolution will allow HPE to increase its sales, and earnings moving forward and give the company its next catalyst.

HPE provides customers with AI servers (hardware) but is also a complete AI solutions provider (software tools, security solutions, etc.). HPE currently lags behind its competitors in AI server sales. However, HPE also provides liquid cooling which is required across the AI industry. HPE has been a leader in data center design and direct cooling for decades, we expect that to continue. Liquid cooling is required for AI servers and is seeing its demand rise as AI chips and data center demand grows. Lower powered chips have previously not required this technology and have utilized air cooling. On HPE's last earnings call, its CEO highlighted this opportunity and how HPE is positioned to capitalize on it, "As accelerated computing, silicon innovation advances, higher power density demands direct cooling technologies building direct liquid cooling AI systems is complex and requires manufacturing expertise and infrastructure, including power, cooling, and water. With more than 300 HPE patents in direct cooling, proven expertise, and significant manufacturing capacity for this kind of system, HPE is well positioned to help customers meet the power demands of current and future accelerated compute silicon designs."

HPE shares lag its competitors and the market over the last 1- and 5-year periods. The stock is up 11% year-to-date.

HPE's most recent earnings presentation highlighted these AI catalysts. AI revenue more than doubled during its last quarter, allowing net revenue to jump year over year. HPE tripled its number of AI customers over the previous year. AI revenue is growing at a rapid pace for HPE and currently AI revenue accounts for 12.5% of total revenue for HPE last quarter. Some analysts expect AI revenue to grow throughout its 2024 fiscal year and reach $5 billion, last year it was $1.5 billion. This growth will be fueled by strong demands for server, storage, and HPE's segment GreenLake cloud.

GreenLake cloud is HPE's edge-to-cloud platform which allows customers to perform AI workloads. Customers grew by 9% for GreenLake last quarter and numerous industry experts expect to see double-digit growth moving forward.

HPE has also made some exciting announcements in recent months that are giving the company some tailwinds. In June, they announced NVIDIA AI by HPE, a portfolio of new services co-developed by HPE and Nvidia specifically designed to address a range of workloads. The offering will be turnkey and is

reportedly enterprise-ready. The offering is targeting customers who want simplicity. HPE is working to maintain its 11-13% operating margin on this product.

HPE also announced an acquisition a few months back which they expect to close at the end of this year. HPE will acquire Juniper Networks for $14 billion. Juniper Networks makes networking devices like router switches. This acquisition will further cement HPE's position in the AI market. Juniper Networks will bolster HPE's network security and AI enterprise networking operations. Earlier this month, the EU's European Commission gave unconditional approval to HPE for its Juniper Networks acquisition. A week later, the deal was given the green light by the UK's antitrust watchdog. However, there are several risk factors that we will mention when it comes to HPE. The first risk is the Juniper Networks deal. The street likes the deal for both companies but if it does not get to the finish line, there could be some slippage. The second risk is China. HPE is divesting from a Chinese company but needs Chinese regulators to approve the deal. These regulatory approvals represent some uncertainty. The final risk factor for HPE is competition, Dell, and Super Micro* sell more AI servers and serve as stiff competition in the server industry. Both companies have partnerships with all major GPU providers, Nvidia, Intel, and AMD, while HPE as of now only has a partnership with Nvidia. *Activist short seller Hindenburg Research put out a report on Super Micro accusing the company of accounting fraud prompting the company to delay its annual filings on Wednesday morning.

Despite these risk factors existing we think the overall risk level for this position is quite low, especially for a technology company. We think the technical lineup and the fundamentals scream value. When a technology company is forecasted to grow and is trading at 9x forward earnings and below 15x current earnings, we see tremendous value and opportunity. We think there is a nice upside for HPE given its current stock price. However, the position is best suited to a well-diversified portfolio of equities with broad sector exposure, cash equivalents, and alternatives.

Disclaimer: MacNicol & Associates Asset Management hold shares of HPE across various client accounts.

Super Micro disaster

We mentioned Super Micro Computer Inc. in the entry above. It's a server provider that is positioning itself to capitalize on the AI revolution like HPE. SMCI has been at the forefront of the AI revolution and has benefited more than any company since it began. At one-point SMCI shares were outperforming Nvidia shares.

However, the company does not interest us as the stock is much more volatile than HPE and its other competitors. Shares surged to as high as $1,200 this past March, currently trading at $400, and are still up 40% year-to-date, despite a 27% pullback on Wednesday morning. Just look at the 2024 chart and talk about volatility and a roller coaster ride.

if you read this after October 4th, shares underwent a 10 for 1 split

We do not own shares of SMCI and are not interested in the company right now. For one, it is quite a bit more expensive than HPE. If you had to choose one, the choice is easy, we highlighted the bullish case for HPE above. For another reason, SMCI just had a short report released on the company by Hindenburg Research. This short report accused SMCI of accounting fraud and led them to delay their annual filing report which was due Wednesday morning.

First off, for some background, Hindenburg Research is an active short seller that publishes short reports on companies. The company was founded in 2017 and has notably gone after Nikola, Clover Health, Lordstown Motors, Adani Group (India), Icahn Enterprises, and Block Inc.

Let's get into the allegations about SMCI. Hindenburg is accusing the company of accounting fraud. Hindenburg claimed they found accounting red flags, evidence of undisclosed related party transactions, sanctions, export control failures, and numerous customer issues. Hindenburg disclosed it had done a three-month investigation where it talked to industry experts and former employees at SMCI.

The company is on track for its worst stock performance in a month since 2018.

These accounting issues are nothing new to SMCI. In 2018, they were temporarily removed from the Nasdaq for failing to file financial statements, and in 2020, SMCI was charged by the SEC for "widespread accounting violations". The company paid a fine for artificially elevating revenue, and profit margins. According to Hindenburg, SMCI started rehiring most executives involved in this accounting violation just a few months after the fine was paid, and most of the executives still work at SMCI. Hindenburg accuses the company of doing all sorts of shady business practices including undisclosed related party transactions by senior executives including the CEO, violating U.S. trade sanctions, and insider information on the failure of certain SMCI investments and initiatives.

We will not get into the weeds of the Hindenburg report as it is very detailed. We will provide a link to the report below, happy reading:

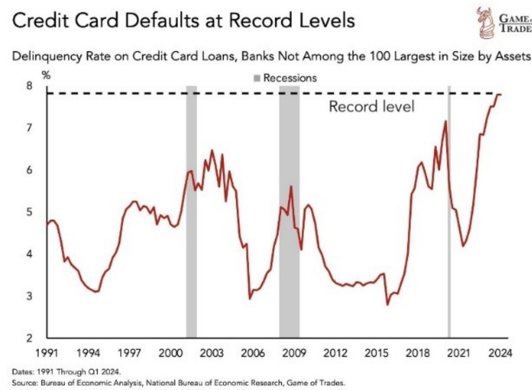
https://hindenburgresearch.com/smci/

We will not give our opinion on these accusations, as they are simply accusations. The only thing we will say is timing is everything. A short report followed by a delay in financial filings one day apart cannot be coincidental. Something is up.

Chugging along

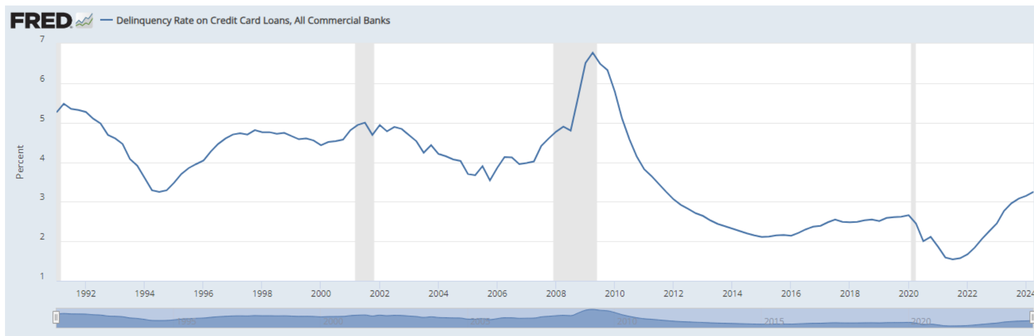
Credit card delinquencies continue to chug higher as consumers feel the pain of higher interest rates, and a year and a half of high inflation.

According to Game of Trades, the delinquency rate on credit cards issued by subprime banks is close to 8%, the highest on record.



Americans are pushing off their credit card bills, stomaching the interest they will have to pay so that they can afford their daily living.

However, when you include all banks in the U.S. as issuers, the chart is at a multi-year high (and increasing) but well below all-time high levels.



These two charts tell us all Americans are hurting but those with poorer credit ratings are hurting even more during this cycle.

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Applause for Buffett (& Munger)

On Wednesday, Berkshire Hathaway became the 8th U.S. company ever to reach a market capitalization of $1 trillion. The financial services company was the first non-technology American company to hit the milestone. Warren Buffett and his late partner, Charlie Munger, have steered the ship for decades and have been as successful as anyone in modern-day history and have remained humble all the way through. Other than 7 U.S. technology companies, and Berkshire, Saudi Aramco is the only company in history to ever surpass the $1 trillion milestone.

We also wanted to highlight Buffett and Berkshire this week as they raised even more cash this past week, selling more Bank of America stock in recent filings. After selling hundreds of billions in stock in recent quarters, what do you think Buffett's next target will be, or do you think that he will diversify a bit and not swing for the fences late in his career?

At the end of the second quarter, Berkshire was sitting on $276 billion in cash and cash equivalents, after a few more stock sales this quarter, that number is marginally higher according to analysts.

Here is Berkshire's current exposure breakdown according to Chartr:

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