THE WEEKLY BEACON	September 20, 2024

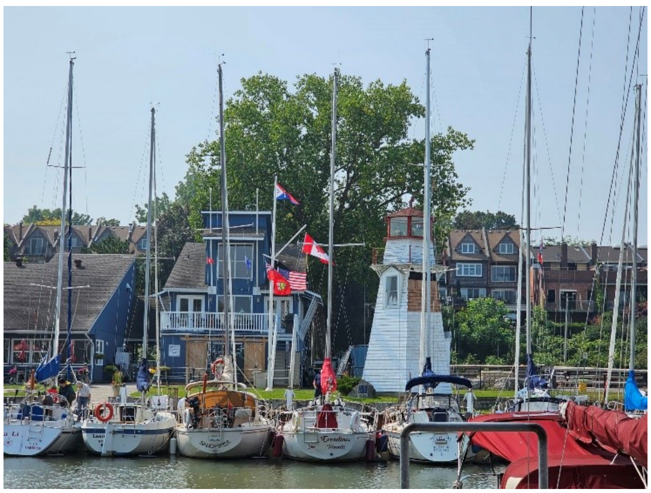
This commentary was written by our team and NOT outsourced to a third party. We will be giving some macro economic market updates on a weekly basis. No equity recommendations will be given in this commentary, and we encourage you to contact us if you have questions regarding

MacNicol & Associates Asset Management

Contact us today if you would like to meet about your investment future. *info@macnicolasset.com*

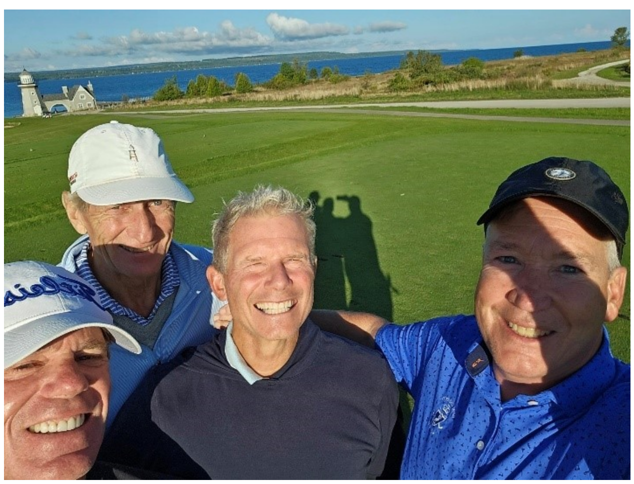
BEACONS OF THE WEEK

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.



The Oakville Yacht Squadron Lighthouse, Oakville, Ontario, across from The Oakville Club submitted by David M.

This lighthouse was first built in 1836 and cost $852 to construct. The original lighthouse was destroyed in 1886 by a storm. In 1960, the lighthouse was replaced with a modern steel structure. In 1991 it was declared a heritage structure.



Cobble Beach Lighthouse, Kemble, Ontario submitted by David M.

This iconic lighthouse is located near the 17th green at Cobble Beach Golf Club. The lighthouse is a testament to the historic and old world nature of the property which dates back to 1803 when the British military used various spots along the Georgian Bay shoreline as survey points.

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

Our AI favourite

In a recent edition of this commentary, we discussed Hewlett-Packard Enterprise and our decision to initiate a position in this technology company. The company plays on AI and trades cheaply, which interests us.

The stock pulled back after recent earnings as some investors overreacted to margin numbers despite HPE beating most estimates. We hope you did not get spooked, we sure did not. Shares have recouped all those losses in just a few weeks.

On Tuesday, HPE shares performed the best across the S&P 500, jumping close to 6% after a Bank of America analyst published new research that paints a bullish picture for the company.

Wasmi Mohan upgraded his rating on HPE from a hold to a buy. He placed a price target on the company of $24, implying a 39% jump from its recent close price.

Mohan highlighted HPE's focus on costs and capitalizing on the expanding market for artificial intelligence infrastructure. He highlighted cost savings from Juniper Networks and the company's focus on decreasing costs and boosting margins. He also highlighted how inexpensively HPE trades relative to peers and historical averages. Perhaps these bullish research reports can increase interest and volume in HPE. We think HPE will be a winner down the line.

Disclaimer: MacNicol & Associates Asset Management holds HPE across various client accounts.

The end of state-run capitalism

Those who support the Chinese Communist Party often label their economic beliefs as state-run capitalism, and not socialism or communism. While this may have been true in the past, the CCP currently has as large of an iron grip on the economy as Mao. President Xi and his allies consolidated power and decreased the ability of private enterprises.

This trend has led to a major consolidation in China. Many private enterprises are now in the hands of the government or are controlled by state-run enterprises. This trend has eroded the entrepreneurial spirit across China as consumers do not think it's worth the risk of starting a company or they simply are not being allowed to. Check out the chart below from the Financial Times which tracks the number of companies founded in China by year.

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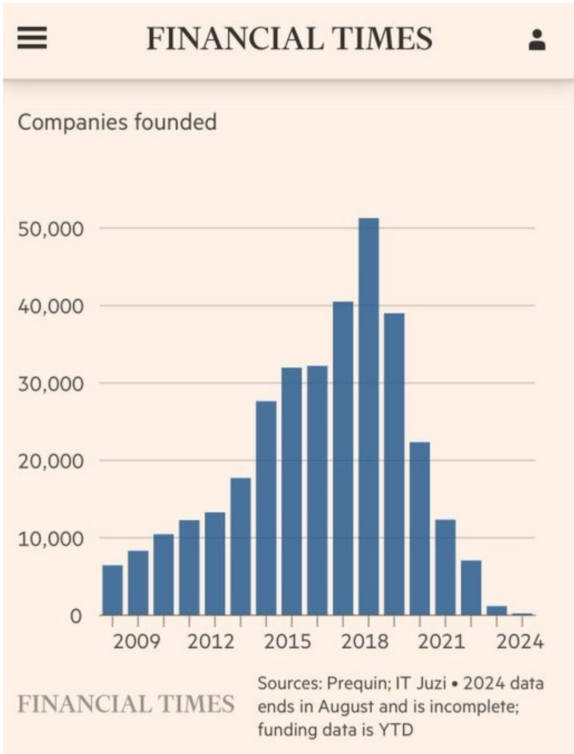

2018 saw the most companies founded ever in China and a few years later, basically no new companies are being started. The trend above correlates with the prices of Chinese equities. When the CCP began cracking down on companies and decreasing transparency, investors ran. This geopolitical risk is why we say China is currently not investable despite its deep value.

The chart above is slightly misleading as it does not account for companies that have not registered certain paperwork as China altered its reporting criteria in recent years. Despite the inaccuracy of the data set above, we think the chart explains the overarching trend in China quite well. There is major consolidation occurring, power concentration is increasing, and more companies are becoming state-run or controlled. The major drop off on the chart above since 2018 can reportedly be explained by the natural founder-seed-angel venture capital cycle according to industry experts. However, many note that the official trend would still be decreasing in recent years.

Buyer beware.

Coffee fanatics

Have you noticed the rising prices at Starbucks lately? Chances are you have. Did you know this is not just to do with rising costs like labor and materials but also to do with a commodity price?

The price of coffee hit an all-time high on Monday according to futures prices. Robusta coffee is the cheaper bean relative to arabica, it is often the bean used in instant coffee.

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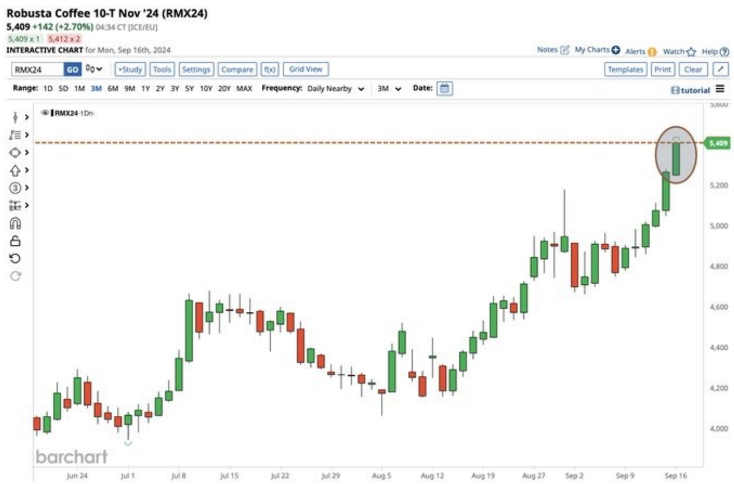


Prices have risen all year for robusta coffee according to data from the London-based ICE Futures Market. Rising demand and supply disruptions have led to these high prices. Vietnam, a global leader in robusta coffee exports, saw their total exports decline by 11% in the first half of 2024 versus a year prior. The International Coffee Organization this month estimated a rise of 2.2% in global coffee consumption in the 2023/24 season.

The rise in the price of the cheaper robusta coffee beans paired with Vietnam's struggles to increase production, has led Brazilian producers to increase exports and exposure to the commodity.

Expect coffee prices to remain high for the foreseeable future, even for coffee bought at grocery stores.

Bell creates some liquidity

Canada's largest telecommunications provider Bell (BCE) sold off an asset on Wednesday which caught the eyes of many including the financial world.

BCE announced they are selling off their stake in Maple Leaf Sports & Entertainment to Rogers Communications, the second largest telecommunication provider in Canada. BCE owns 37.5% of MLSE which owns the Toronto Maple Leafs, Toronto Raptors, Toronto FC, Toronto Argonauts, Scotiabank Arena, and several other teams and pieces of real estate. Before this deal, Rogers was an equal owner with BCE in MLSE, now Rogers will own 75% and hold the controlling interest in MLSE. The remaining 25% of MLSE is owned by Chairman Larry Tanenbaum via his holding company, Kilmer Sports Inc.

Rogers is paying $4.7 billion for BCE's stake, which values MLSE at $12.5 billion. The deal will reportedly close in 2025. Rogers also owns the Toronto Blue Jays and has officially cornered the professional sports market in one of North America's largest cities.

Bell says it plans to reduce debt with proceeds and that the deal will continue to support its ongoing transformation from telco to techno with a focus on core growth drivers. In the announcement, Bell confirmed that they will continue to air select Leafs and Raptors games through TSN their sports network for the next 20 years. The deal could reduce BCE's debt by 10% (after accounting for taxes on this deal) and will ensure there will be no short-term dividend cuts to shareholders. However, the BCE balance sheet will remain heavily leveraged as the company has added on $8 billion in long-term debt over the last 3.5 years. It seems management is focused on reducing debt and selling off a high-quality asset to not be forced to cut its dividend.

Canadians who focus on income in equity markets breathed a sigh of relief after this announcement.

The reduced debt load and lower interest rates will also help BCE earnings as the company's interest expense has ballooned in recent years.

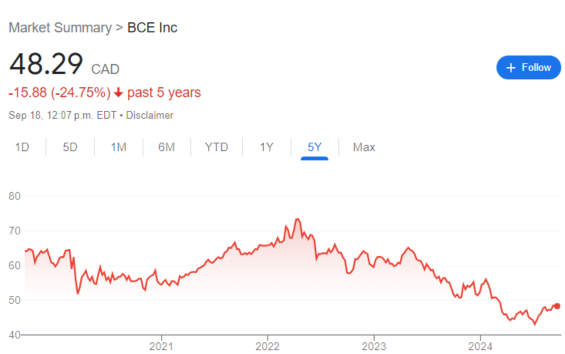
The deal is subject to league approvals as well as regulatory bodies.

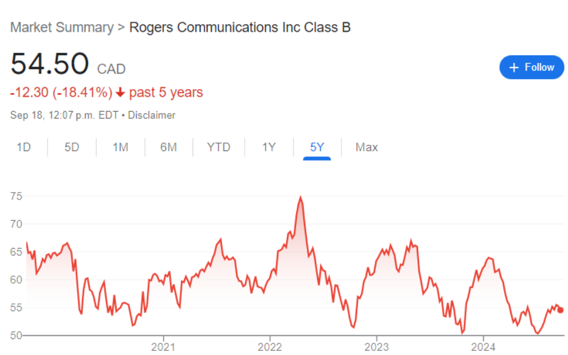
In the deal announcement, Rogers claimed that this purchase would not affect their debt leverage and that financing would include some private investors.

Rogers and Bell jointly purchased MLSE in December 2011 from the Ontario Teachers Pension Plan for $1.07 billion. Since that 2011 deal, Tanenbaum, the Chairman of MLSE increased his ownership from 20.5% to 25%.

We will have to see what happens with our beloved Maple Leafs and Raptors with this deal. One thing sports fans are probably happy about is decision making as it can now be streamlined with one majority owner, not two competitors with equal voting rights.

The deal had opposite effects on the immediate stock price of Rogers and BCE. BCE shares jumped 2.75% while Rogers shares slumped 2% (as of noon on Wednesday). Both Rogers and BCE have had poor stock price performance over the last 5-10 years. However, the issues that the two companies have faced have plagued the entire Canadian telecommunications industry. U.S. providers have also faced similar issues over the last 5-10 years but have seen major turnarounds and outperformance in 2024.





We think this deal could be positive for both BCE and Rogers as BCE slightly cleans up its balance sheet without reducing its dividend and sells a high-quality asset at a time when sports franchises are in extreme demand. Rogers acquires the majority stake in a high-quality asset which will help their ability to raise third-party funding for these assets moving forward.

We do not own positions in either of these companies. We will evaluate the transaction for both companies over the next few weeks to see if our position has changed. However, for now, we would remain weary of both names. We are not saying these will be losing stocks, we are just simply stating that on a relative basis, we like other companies and sectors at this current moment.

Mega AI infrastructure fund

BlackRock announced they are launching a $30 billion artificial intelligence fund alongside Microsoft that will look to build data centers and energy projects. The Global Artificial Intelligence Infrastructure Investment Partnership will bring together financial and industry leaders to build the infrastructure of the future and power it in a sustainable way.

The AI partnership will feed the growing hunger for computing capacity, as well as fund infrastructure to create new sources of energy for these facilities which as we all know consume massive amounts of energy.

Alongside BlackRock, and Microsoft in this partnership is MGX, an AI and advanced technology investor based in Abu Dhabi. The group hopes the launch of this fund with debt financing will eventually reach $100 billion.

In the announcement letter, the companies stated that the investments will be mainly in the U.S. Reportedly, Nvidia will advise the group on the design and integration of AI factories.

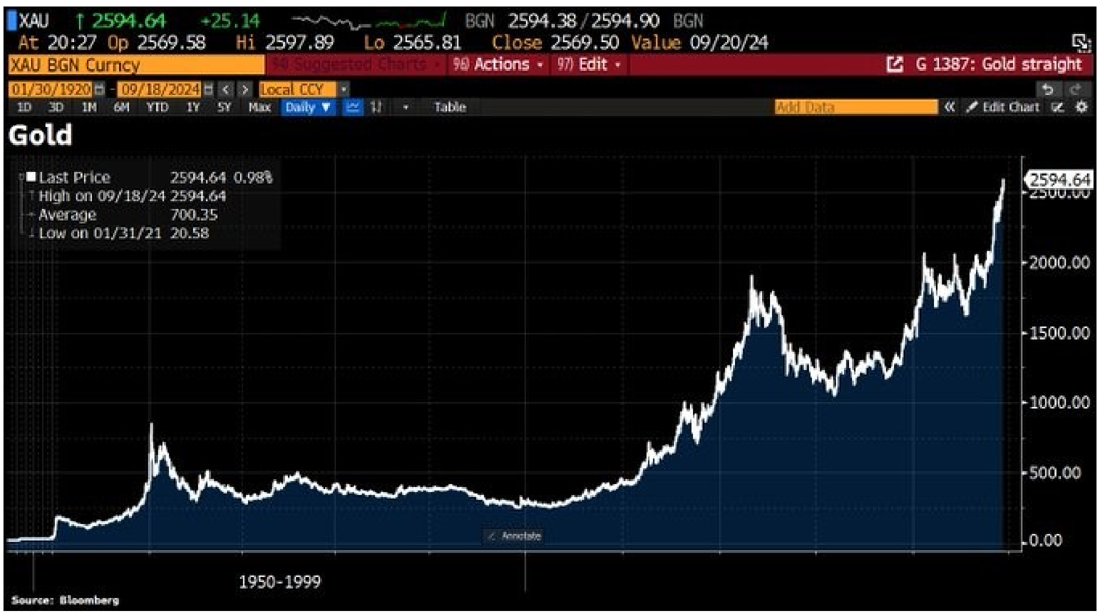
FED slashes hard

The Federal Reserve announced they will cut interest rates by 50 basis points on Wednesday. This slightly surprised us but was mostly priced into the market. Most futures were pointing to a 50-basis point cut rather than a 25-basis point cut due to weak economic data and job numbers recently released which show some serious cracks in the U.S. economy.

This interest rate cut is the first one since 2020. This was the first policy change from the FED since July 2023 - they had kept rates the same for 14 months. The U.S. was the last major Western economy to begin slashing rates this cycle. According to FED projections, the FED expects 50 basis points of additional cuts in 2024, 100 basis points of cuts in 2025, and 50 basis points in cuts in 2026. According to these projections, the FED Funds Rate will be 250 basis points lower at the end of 2026 versus a few days ago. This made investors extremely happy as the low-interest rate environment they have become accustomed to looks like it will be returning.

However, we believe rates will not plunge as many expect and rates will not return to the 0-2% levels like seen a few years ago. We expect interest rates to remain higher for longer like we predicted 18 months ago with inflation and interest rate hikes.

For now, this news is extremely bullish for investors. A lower discount rate to justify their financial models. It also lowers interest rates for consumers, corporations, and variable-rate homeowners. After the announcement from the FED, gold surged to another all-time high as investors fled high-yielding assets for a store of value that provides inflation protection. Small caps also spiked on this announcement as many small caps are heavily leveraged, they are volatile and a torque play on the market.

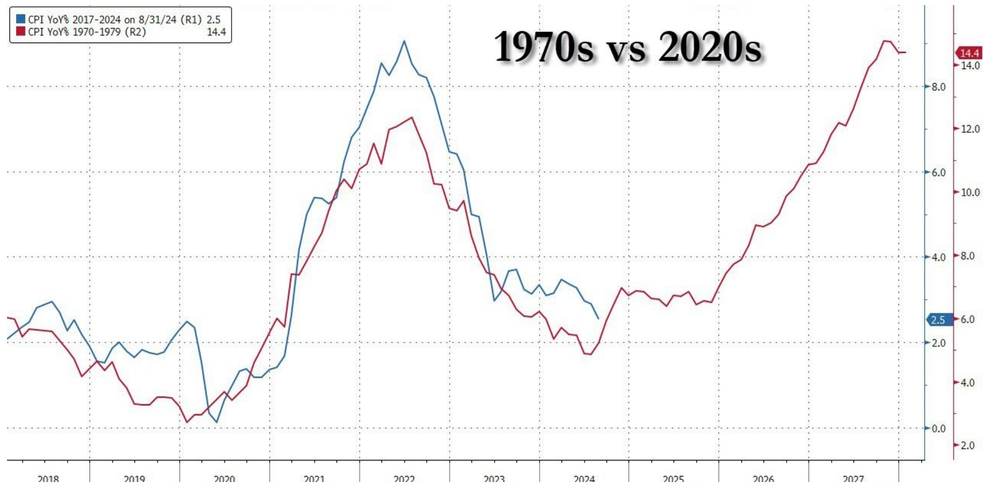


In Chairman Powell's press conference, he stated the FED is pivoting into a neutral policy where the FED does not want inflation to reaccelerate with lower rates but at the same time does not want the labor market to deteriorate. He went on to say that the FED will continue to evaluate data on an ongoing basis and make changes as they see fit. By the end of Powell's press conference markets gave up much of their gains as he stated that the FED is not on a predetermined path and things could change with their forecasts.

We will continue to watch the economic data as interest rate cuts in the forecasted volume are often associated with an economic slowdown and are done to increase economic activity.

Inflation trend

With the most recent U.S. inflation numbers pointing to even lower price increases, many believe the fight against inflation is over. Politicians have even championed themselves for decreasing the rate of inflation, forgetting to mention that prices are still way up over the last few years. Before you go all in on the inflation is over camp, look at the chart below which tracks inflation in the 1970s and inflation over the last few years. Do you notice anything?



Is a second wave of inflation on its way? How would the global economy handle this if it were to happen? We think it would be quite messy and many investors would be caught off guard. We think real assets are a must-have in today's economic environment as the U.S. Dollar weakens, rates move lower, and uncertainty increases. We also like real assets if the inflation rate above starts to perk up again. We want to protect our investors from all types of uncertainty and risks. Our goal is to mitigate various types of risk and navigate choppy waters. We think a blend of real assets, alternatives, high-quality stocks and portfolio insurance is the best way to do this.

If you have any questions regarding the state of your portfolio, feel free to reply to us with an email and we can set up a quick 15-minute call.

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