

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 our observations.



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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.



Gibraltar Point Lighthouse, Toronto Islands, Ontario, Canada

The Gibraltar Point Lighthouse is a lighthouse located on Hanlan's Point, the most westerly of the Toronto Islands in Toronto. The Lighthouse is the oldest existing lighthouse in the Great Lakes. The lighthouse was first lit in 1809.



Cap-des-Rosiers Lighthouse, Gaspé, Quebec, Canada

This lighthouse is Canada's tallest lighthouse standing at 112 feet tall. The lighthouse is located along the St Lawrence River and was constructed in 1858. The lighthouse was automated in 1981.

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



A value AI play

Our favorite artificial intelligence play had a big jump to the end last week as it reported earnings. We have outlined our reasons for liking Hewlett Packard Enterprises (HPE) in a few issues of this publication in recent months. On Thursday, we were very pleased when we dove into their recent earnings report. HPE jumped 11% on Friday after beating revenue and earnings estimates. HPE's revenue set a quarterly record for the company. Shares pulled back on Monday due to some overall market weakness. Despite this weakness, HPE shares are up 37% year-to-date.

Diving into HPE's numbers. HPE reported strong demand for their AI server. Server revenue jumped by 32% year-over-year and beat Wall Street expectations. Despite its stock price jump, HPE remains in value territory and trades cheaper in terms of forward earnings estimates compared to its competitors which include Dell and Super Micro Computers. Adjusted earnings for HPE were up 12% year-over-year and revenue came in 15% higher than last year. HPE also beat free cash flow estimates during the quarter. HPE kept its 2025 forecast in line with expectations. Gross margins have also increased throughout the year. The company expects mid-teens growth in its revenue for Q1 2025.

A major driver of the jump in HPE's stock price came from comments made by the company's CEO. He said HPE is participating in AI in a disciplined way. We like the company's approach to this high-growth sector as they remain disciplined and patient and continue expanding their market share.

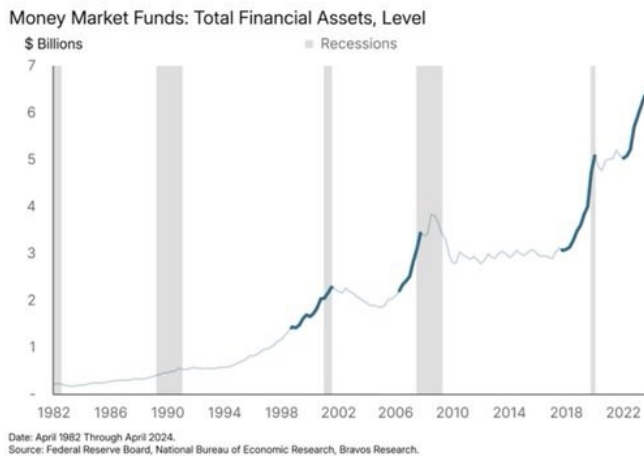
According to company management, HPE's Juniper acquisition continues to progress and is still expected to close during the first quarter of 2025. We have commented on this accretive acquisition in past editions of this commentary.

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

Money market flows

Money market inflows continue to pour in. Not only is Warren Buffett raising his cash exposure to record levels, but so are other investors. However, the last 3 times we saw huge surges in money market inflows, a recession followed. Is this an indicator that investors should be watching more closely? We certainly are.

Money Market Funds



Money market funds now have close to \$7 trillion in assets under management in the U.S. This number has doubled since 2008/2009. The increase in the money supply is partially driving this. However, we also think investors are rotating capital out of other assets into money market funds for safety and foregoing immediate returns to preserve some capital.

We are not saying now is the time to sell, we are simply sharing a chart that leads us to certain conclusions. We are protecting our investor's capital through diversification and downside protection. Our investors are exposed to low correlating alternative assets, physical precious metals, and downside protection through portfolio insurance (MAAM's Safe Harbour Fund). The portfolio insurance that we provide our investors looks to capitalize on adverse movements in the S&P 500 and spikes in the Volatility Index. Our Safe Harbour Fund invests in the leading hedge fund in this industry. The principles of the fund have been in the industry for decades and have led their clients through numerous market downturns including the dot com bubble, financial credit crisis, and Covid-19.

Nvidia's China problem

Semiconductor giant, Nvidia is facing the full force of the Chinese Communist Party according to reports. A report on Monday was released that suggests China's regulators are investigating Nvidia over antitrust concerns. The report suggests that China is accusing Nvidia of violating antimonopoly laws. The investigation accuses Nvidia of violating a commitment it made in a 2020 acquisition.

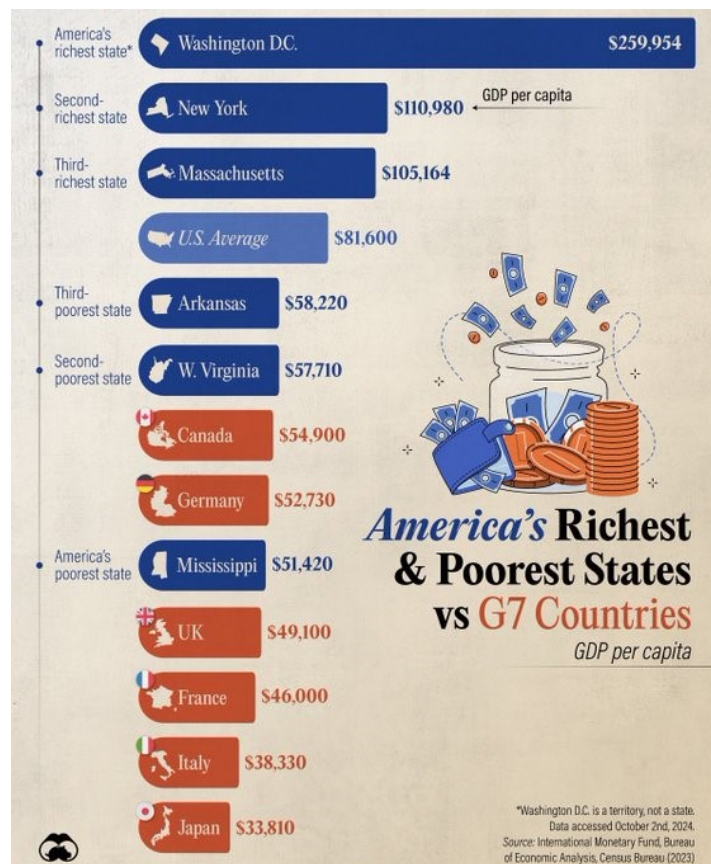
This investigation is worrying investors as Nvidia still produces a significant amount of revenue from China despite U.S. export restrictions imposed over the last few years. During its third quarter, 15.4% of revenue for Nvidia came from China (including Hong Kong) valued at \$5.42 billion. \$20 billion in revenue annually is significant no matter what company you are. Sales in China for Nvidia have slipped since the U.S. government began placing export restrictions on their products. Nvidia has not been impacted by these restrictions due to the rapid growth in demand their semiconductor chips have seen in this AI revolution.

We will have to see what comes of this as China and the CCP truly act as they wish and can be very unpredictable. We will say the timing of this report seems retaliatory. Just a day ago, Trump threatened or warned China not to play games to retaliate against the U.S. for imposing tariff increases and a week before the U.S. placed restrictions on sales to 140 companies including numerous Chinese technology firms. An investigation into one of the biggest companies in the world (and the U.S.) seems retaliatory from our point of view. Either way, the chip war is seemingly heating up.

Nvidia shares are up 192% this year, however, a majority of that boost came in the first few months of the year.

GDP per capita north of the border

We ran by a chart this week that explores the GDP per capita of various geographic areas in North America. What we found shocked us.



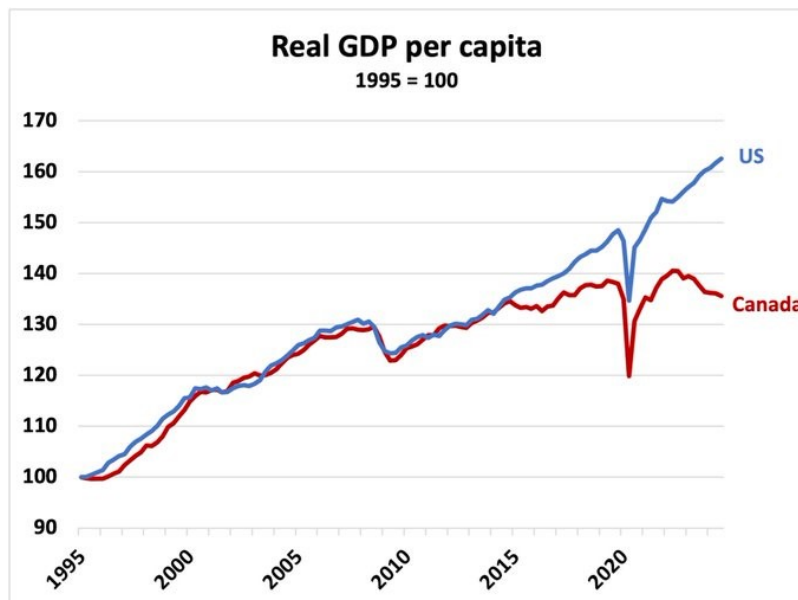
Canada's GDP per capita is below West Virginia's. West Virginia has the second lowest GDP per capita for a U.S. state. Canada's GDP per capita is only above Mississippi in terms of states. Even more surprising, the UK, France, Italy, and Japan all have lower GDP per capita's than every U.S. state.



Canadians have seen their relative wealth decrease in recent years. The Canadian Dollar has also deteriorated over the same period. Productivity has also become an issue north of the border as productivity has not increased in Canada at the same rate as in other developed nations. We also think the focus on the redistribution of wealth and overregulation are drivers of this divide. The U.S. on a relative basis has the loosest regulations, low taxes, and rewards for success, something other Western nations may want to copy.

As we have said in past editions of this publication, Canada continues to mask its economic woes with mass immigration. This issue has become very divisive in Canada and will more than likely be a hot issue when Canada heads to the polls next year.

If you still do not think Canada has an economic problem, take a look at this chart which tracks Real GDP per capita since 1995:



Highly correlated numbers, then boom a divergence in 2015. We hope our country can figure it out.

Energy outlook reversal

The International Energy Agency revised its 2025 outlook for the oil market. They are revising their outlook from a surplus to a deficit. Last month they proclaimed the oil market would have a 300,000 barrel a day surplus citing low demand and an increase in demand for other energy sources. A few months earlier they were forecasting an even larger surplus for 2025. Not even one month later they have changed their tune. The IEA and other energy agencies are waking up to the macro realities we are in.



Global energy demand will continue to increase, and supply is not keeping up. Most nations prefer less expensive energy sources despite the push for green energy. 2022 is also a lesson for many countries as their reliance on renewables and Russian energy led to oil prices surging. We think prices will remain in an attractive area next year. Producers will continue to report strong numbers and deliver cash flow to shareholders. Prices will not reach levels that will impact global demand in a negative way.

The IEA reversed their forecast due to OPEC+ extending their production cuts, something we had forecasted a few months back. OPEC+ nations need oil prices to remain high to finance their other initiatives and help operate their governments.

We will warn our readers that this news does not mean prices will surge. We think the price of oil will remain in its current range in the short term and move higher down the road.

We continue to monitor our oil positions and have not exited the sector or trade. However, we will remind you that owning quality matters in this market. Quality names have produced strong returns this year despite the spot price of oil while non-quality names have lagged.

November CPI

The Bureau of Labour Statistics released inflation data for November. The U.S. CPI rose 0.3% in November in line with economist expectations and 2.7% over the year, 0.1% above expectations. The Core CPI rose 0.3% in November, also in line with expectations, and 3.3% over the last year. The monthly jump in the CPI was the highest number since April. The CPI every year has accelerated 3 months in a row. Perhaps, this is a short-term move, or perhaps, it's the start of inflation reaccelerating and the start of the 'second wave'.

Most of the monthly results came in line with expectations and essentially confirmed yet another FED rate cut at the FED's next meeting (Thursday, December 19th). The data suggests a small cut is on the horizon. According to the CME Group's FED Watch Tool, there is a 98.1% probability that we see a 25-basis point (0.25%) cut. On a positive note, rent inflation came in at its lowest level since July 2021. Shelter costs have been the largest driver of inflation over the last few years.

Many expect inflation to decelerate in 2025 but believe the CPI could remain elevated and force the FED to dial back interest rate cuts through the year. We have said inflation will remain higher for longer for quite some time and the trend in 2024 confirmed our thought process. We think this will continue next year.

Inflation has been a real problem for the better part of the last 5 years. Most consumers continue to feel these price increases despite lower inflation rates. In the previous 4 years, the CPI of auto insurance is up 61%, U.S. home prices are up 43.2%, the CPI for electricity is up 29.1%, the CPI for new cars is up 19.9%, the CPI for medical care is up 9.3%, and the CPI for food at home is up 22.9%. These rapid price increases are hurting the middle and lower classes the most and neither political party seems to have a

solution for these economic issues. We will have to see what Trump and his administration do in the new year. We are just over a month from inauguration.



Traditional tech company rejects crypto

Microsoft shareholders voted no on a resolution that would initiate a Bitcoin reserve for the company on its balance sheet. The plan was backed by the National Center for Public Policy Research and Michael Saylor*. It aimed to allocate 1-5% of Microsoft's profits into Bitcoin as a hedge against inflation and a step toward embracing the next big tech wave. Saylor spoke on behalf of the Free Enterprise Project at a virtual Microsoft board meeting earlier this week, the organization sent a similar proposal to Amazon and may target other large corporations.

*Michael Saylor founded business analytics software firm MicroStrategy and ran it as CEO until early August 2022, when he moved into the chairman's role. One of the best-known executives of the Internet bubble, Saylor was a multibillionaire in the late 1990s thanks to his stake in MicroStrategy.

Michael Saylor is a Bitcoin ultra-bull and the executive chairman of MicroStrategy. He said it's a no-brainer for Microsoft to go forward with this plan. Saylor is a huge advocate of Bitcoin and has leveraged his company's balance sheet and stock price to Bitcoin. MicroStrategy now holds 2% of all the Bitcoin that exists.

Microsoft's board rejected the proposal citing Bitcoin's volatility, the board recommended that its shareholders vote against the proposal. The Free Enterprise Project told Microsoft before the vote it would withdraw the motion if it could meet with the Microsoft CEO for an hour. Microsoft rejected the meeting. The move by these organizations and Saylor comes a month before Trump takes the White House. Trump will reportedly be pro-Bitcoin and crypto and is reportedly considering a government reserve of Bitcoin.

A few companies have begun to venture into crypto and follow the lead of MicroStrategy. However, after the Bitcoin rally over the last year or so, many believe now is not the time to buy Bitcoin on balance sheets as a pullback in the price of Bitcoin could lead to some negative quarterly reports.

We continue to explore crypto as a whole and how we can gain exposure while limiting the downside in our investor portfolios. We have previously invested in crypto through the Alternative Asset Trust where we invested in a private exchange and saw a positive exit price.

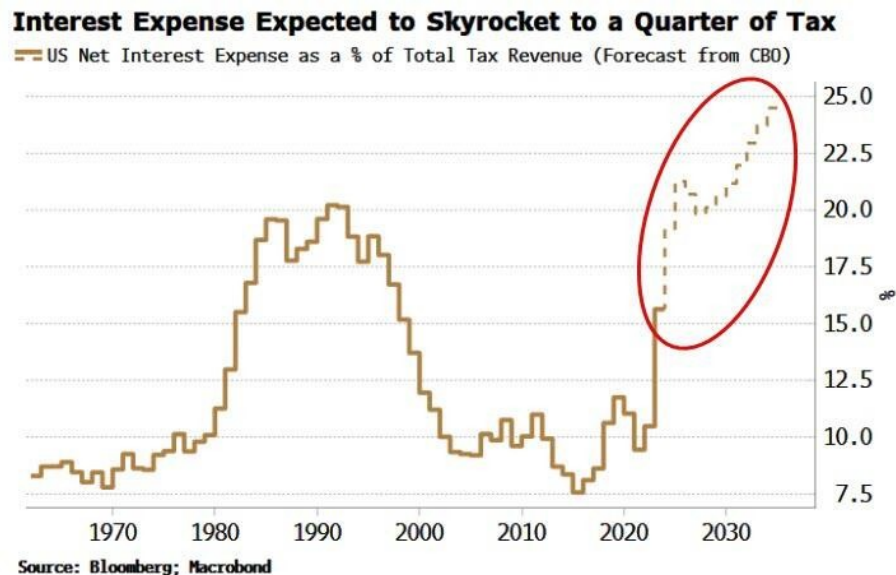
The impact of higher rates

For consumers, higher interest rates mean higher mortgage rates, higher financing costs, and higher credit card interest rates. For corporations, it has higher interest expenses, and foregoing debt issuance due to higher rates. For the government, it also means a higher interest expense. The FED raising rates negatively impact the government the most as they are the world's largest borrower.



Higher rates and a rapidly growing national debt are leading to an expansion of the government's interest expense. The national interest expense is expected to surpass \$1 trillion per year and will become the government's second-largest expense.

Currently, the interest expense accounts for 15% of the U.S. government's total revenue, a 20-year high. Over the next decade, the number is expected to reach 25% according to Bloomberg. This current rate of debt additions and higher rates are unsustainable.



The government will be forced to cut other expenses to service its massive debt pile. We hope the Department of Government Efficiency (DOGE) can do something about decreasing the annual deficit for the government and eventually decrease the outstanding debt. Perhaps, they can follow Argentina which just reported its first fiscal surplus, free of default in 123 years.

We will say it's early in President Milei's reign, so it might be an early call, but he is making positive change in numerous ways. Inflation has cooled, spending is down, and Argentina seems like a place many want to invest to capitalize on its growth prospects.

MacNicol & Associates Asset Management
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