

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.



Cape Reinga Lighthouse, New Zealand

This lighthouse sits on the northern tip of New Zealand. It was built in 1941 to replace an old lighthouse located on a small island near the coast. The lighthouse has not been manned since 1987.



Heceta Head Lighthouse, Oregon, USA

This lighthouse looks out over a rocky cove. The lighthouse was built in 1894 and was more recently restored. It is the strongest light on the Oregon Coast. A bed and breakfast operates out of the former Assistant Lighthouse Keeper's house nearby.

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



Sovereign wealth fund?

On Monday morning, Prime Minister Carney of Canada announced that, under his leadership, the country would launch a sovereign wealth fund.

Sovereign wealth funds are state-run investment vehicles that invest a country's surplus revenues for long-term financial returns. They are commonly found in energy-rich countries that run large surpluses and are looking to diversify their economies. These investment vehicles also look to preserve wealth for future generations when natural resources are depleted. Countries like Saudi Arabia, Kuwait, Norway, and the UAE have these investment vehicles.

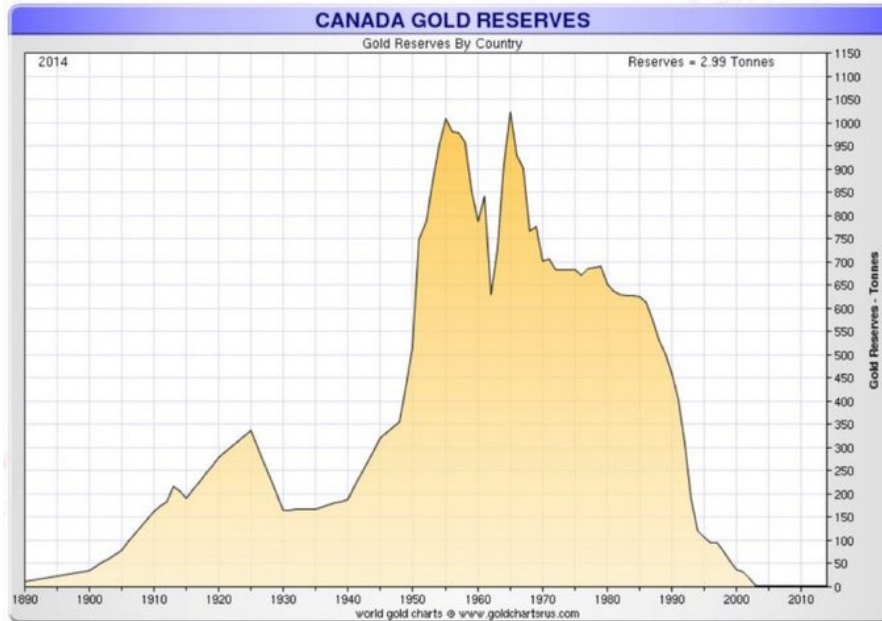
The \$25 billion Canadian fund, dubbed the "Canada Strong Fund," will help propel already-identified infrastructure projects and allow Canadians to have a stake in the fund. The fund will reportedly be professionally managed and operate at arm's length from the government. According to Carney, the structure will allow for profits to be shared between private and public sector participants. In Carney's announcement he stated Canadians would be able to invest alongside the government in this fund structure. All the investments in this fund will be in nation-building projects that serve the interests of Canada. There was also language in this announcement that makes us assume that companies that work with the government and that are funded by this wealth fund will be given faster regulatory approval (something every project should be given).

In order to allow people to contribute to the fund, the federal government will launch a "retail investment product" like a mutual fund or pension scheme, where Canadians can buy into the fund and earn a dividend.

In theory, this is a great idea for Canada, as our economy heavily relies on natural resources, which have a finite supply. However, theory is not reality, as Canada does not run a surplus; we run a massive deficit that continues to grow. In our eyes, Carney launched a fund that he will seed with debt and is pushing for Canadians to help fund it and invest in the select projects that his committee will pick alongside the government's money. Currently, Canada is running a \$78 billion deficit and has more than \$1 trillion in debt. This idea is not a sovereign wealth fund; it's a debt fund that will surely benefit insiders and the inner circle leading these projects. Canada's Minister of Finance stated that the country would be using its "AAA credit rating" to fund this initiative.

Another issue with this fund is that it will invest in projects inside Canada; many sovereign wealth funds avoid domestic investment to increase diversification and to not disrupt the domestic economy. Canada will not be doing that.

I will also say our government does not have a great history with investing. Beyond all of the failed and delayed construction projects comes the country's gold reserves, which sit at 0. An all-time blunder by these Canadian Politician's, who are the only G7 country with zero gold reserves:



In 1965, Canada held north of 1,000 tonnes of gold worth nearly \$200 billion (CAD) in today's prices. Six Prime Ministers in a row sold gold in Canada until the last ounce was sold by Trudeau Jr. in 2016. The government stated that holding high-quality foreign interest-bearing securities is better than gold as a reason for their sales. In other words, they would rather hold foreign bonds that are also losing their value to inflation than hold an inflation hedge, gold. Canada's gold sales began in the early 1970s when the U.S. exited the gold standard, to which Canada responded by selling everything.

Oil M&A

Arc Resources (ARX), the Canadian energy firm, jumped on Monday by more than 30% for its largest gain since 2020 after Shell agreed to acquire the energy producer in a \$22 billion (CAD) deal.

Under the terms of the agreement, ARX shareholders will receive \$8.20 in cash and 0.40247 ordinary shares of Shell for each ARX share. The translated consideration equates to \$32.8/share, a 27% premium to its closing price last Friday. The board of both companies has unanimously supported the transaction. The deal will close in late 2026 pending approvals.

This transaction is highly attractive for Canadian energy investors. It is highly encouraging for Western Canadian energy peers. Shell is making its move to add reserves and growth through a Canadian expansion and acquiring high-quality assets. It comes at a time when natural gas is seeing heightened structural demand, and supply in the Middle East is unstable. Expect more and more of these deals to occur if geopolitical instability continues. Another reason we think Shell made a Canadian acquisition is due to Canadian hydrocarbons having a lower carbon intensity, which fits the transition narrative. Shell is a company that supports the Paris Climate Agreement and has made numerous pledges to decrease their emissions.



The deal is a win-win for both companies. Shell secures profitable oil and gas and increases its presence in Canadian energy. Shell's reserve lives have significantly depleted, resulting in many rumors that the British energy firm was interested in an acquisition. The deal strengthens Shell's integrated gas business and creates a new engine of growth. Last year, ARX produced a record 374,336 barrels of oil equivalent per day (14-15% of what Shell produced), and many industry experts believe that Shell will look to add another 100,000 as a result of this acquisition. ARX is a diversified producer; last year, 59% of its volume was natural gas, and 41% was crude oil and liquid products. From an ARX shareholder perspective, the takeout price comes at a premium as shares have been under pressure due to the rollout of Attachie, which has underperformed, and execution has been uncertain. Other than Attachie, ARX shares were highly attractive from a valuation perspective as broader company fundamentals have remained strong. The deal also gives ARX shareholders some liquidity and upside exposure to a global integrated energy platform.

We like this deal for ARX as it unlocks more for shareholders, including some of our investors.

Beyond the deal, ARX reported its quarterly earnings on Tuesday and reported strong figures. The company beat street estimates for EPS by 48% and revenue estimates by 36%. ARX also reported record production during the first quarter, eclipsing 415,000 barrels of oil equivalent per day. All in all, a strong week for ARX. ARX forecasts a 10% CAGR over the next five years in production and a 16% CAGR in free funds flow per share growth. The numbers continue to improve, and Shell looks to be acquiring a high-quality asset.

Disclaimer: MacNicol & Associates Asset Management holds shares of Arc Resources (ARX: TSX) across various client accounts.

Huge news

With an ongoing conflict in the Middle East, traffic in the Strait of Hormuz grinding to a halt, and energy prices trading well above multi-year averages, a huge news piece hit on Tuesday. The news piece comes as oil is trading above \$100 per barrel once again. So much for lower prices with a ceasefire.

The news piece that we are talking about is not regarding the conflict that we have talked in-depth about in recent editions of this publication. On Tuesday, the UAE announced that as of May 1st, the country would be officially leaving OPEC. It also announced it would be leaving the broader, looser global organization OPEC+. The country ends its 59-year membership, and according to the UAE, it will help the country focus on its "national interests, and its commitment to its investment and importing partners".

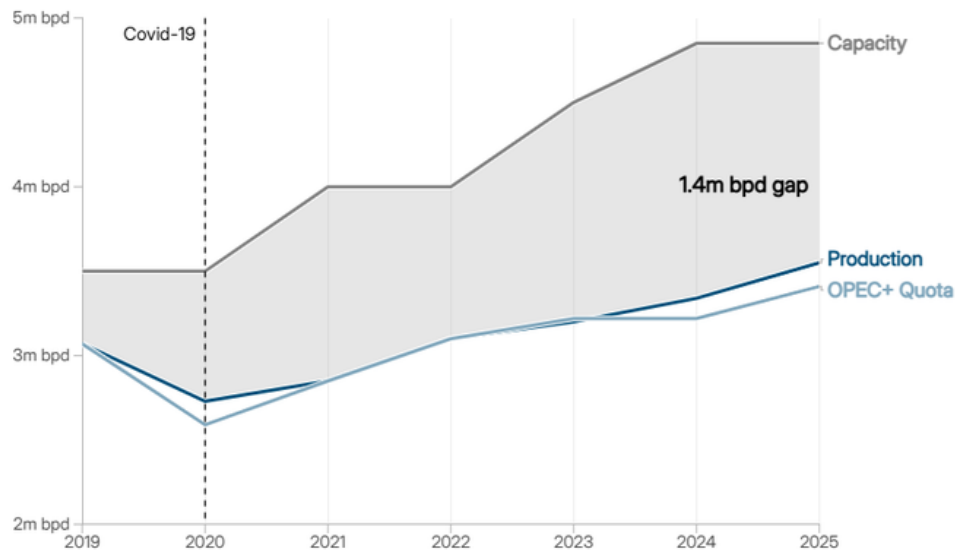
This announcement comes as the UAE has looked to increase its production from 3.4 million barrels per day to 5 million barrels per day by 2027. The UAE has spent years building extra capacity while OPEC has kept its production quota near 3.3 million barrels per day. This is a strategic move by the UAE while oil prices remain very elevated and supply remains tight. Rumors of the UAE leaving OPEC have swirled for

years as leadership has disagreed with the organization that has prevented an increase in their production. The UAE has also been critical of its fellow members in recent weeks after a slew of Iranian attacks.



UAE's oil production capacity vs Opec+ quota (2019-2025)

The UAE's production capacity is set to reach 5 million bpd by 2027



Source: Opec secondary sources, S&P Global



This exit from OPEC echoes Qatar's leaving the organization in 2019.

Why is this a big deal on a macro level? OPEC produces 40% of the oil supply globally. The cartel organization dictates production and thus prices globally. The UAE is OPEC's third-largest producer, and its leaving redefines the global energy industry. The stunning loss of the UAE could create disarray and weaken OPEC, which has usually sought to show a united front despite internal disagreements over a range of issues from geopolitics to production quotas.

The UAE's leaving OPEC will impact oil markets as the UAE has significantly ramped up its extra capacity. This departure comes as global spare capacity hovers at historically low levels (leaving the oil market extremely tight). The UAE will be free to produce at its discretion, which will decrease OPEC's influence on the oil market. (OPEC's power has decreased in recent years with the U.S. ramping their production and Qatar leaving the organization. This is another blow.

The UAE is one of the most efficient producers in the world and can help global oil markets in the long term react to geopolitical events like the conflict in Iran and increase production. The UAE will be able to fully leverage its position in global energy markets outside of OPEC. The UAE produces some of the world's lowest-cost and lowest-carbon barrels in the world. The UAE is also one of OPEC's few members that has the ability to quickly increase production, according to Rystad Energy. In the short term, expect prices to be volatile as traders digest the extra UAE production. "This opens the door for the UAE to gain

global market share when the geopolitical situation normalises," said Monica Malik, chief economist at ADCB.



This is a huge win for Trump, who has long criticized OPEC. In 2018, he stated that "OPEC was ripping off the rest of the world". It comes just a few weeks after UAE leaders visited Washington. The UAE is one of the U.S.'s closest allies in the region, and this move brings the two even closer together. The UAE has doubled down on its ties to Washington in recent years. It views its relationship with Israel as a critical lever for influence and a unique channel to U.S. leadership.

This move by the UAE will be bullish for consumers in the long run in terms of lower prices, but do not expect a significant decrease in oil prices in the short term without a resolution in Iran. The Strait closure will continue to restrict vessel traffic even with the UAE leaving OPEC.

Tech buzz fades

On Tuesday morning, the AI trade was under pressure after the Wall Street Journal published an article that reported on OpenAI missing some key financial targets. According to the article, OpenAI missed several revenue milestones earlier this year. The report also stated that ChatGPT fell short of reaching 1 billion weekly active users by the end of last year. The report weighed on shares of Oracle, Nvidia, and SoftBank Group due to their exposure to OpenAI. Other AI-related companies, including semiconductor manufacturers, also declined.

The report said Google's Gemini had taken market share from OpenAI while Anthropic gained ground in coding and enterprise markets. The company's CFO stated that OpenAI may struggle to meet future compute commitments if revenue does not grow fast enough. OpenAI has signed \$600 billion in future computing and chip contracts with hyperscalers and chip producers. If they are unable to grow fast enough, the circular AI trade and spend completely crumbles. The CFO and select other executives are even now seeking to cut costs and instill more financial discipline in the business, which has reportedly created tension with the CEO.

The target misses, and market share losses have led investors to question OpenAI's leadership and the company's ultimate strategy. OpenAI is attempting to grow through scale by adding users. The company has grown through its major partnerships, which have helped the company increase its spending. Despite an increase in revenue, OpenAI is still in a heavy cash-burning phase with multiple reports pointing to large negative free cash flow and delayed profitability.

These challenges emerged just weeks after OpenAI raised \$122 billion to fund its next phase of growth.

They also coincide with early preparations for a potential IPO, despite reported concerns from the company's CFO that OpenAI may not yet meet public reporting standards. Combined with signs of moderating operating momentum, these developments could complicate the company's path to the public markets. In order to justify a premium valuation, OpenAI needs to reflect sustained hypergrowth. If their growth slows, targets miss, and market share shrinks, where is the appetite for this behemoth IPO?

While Sam Altman continues to push for OpenAI to rapidly grow at all costs and looks to go public, we think OpenAI will face severe stress due to the competitive landscape in the industry and its burn rate. We also think some of OpenAI's largest partners could face pressure as OpenAI does not fulfill its financial commitments, which justifies their elevated valuation.



What we are looking at next week

Markets enter the week of May 4th with investors focused less on the Fed itself (and the fallout from the FOMC Meeting), and more on whether the incoming data can confirm that the economy remains strong enough to support current valuations. The key releases will be ISM services, trade balance, ADP employment, productivity, consumer sentiment, and, most importantly, the April employment report which comes out Friday before markets open. The trend in US employment has been slowing recently despite a positive reading last month; investors will likely be looking to see if that positive reading was simply an aberration and an ongoing downward trend, or whether the economy really can get some more juice via a stronger labour sector. With the next CPI release not until the following week, labour market data will likely be the main macro input shaping near-term rate expectations.

Earnings will remain a major focus, with Q1 results still coming through across technology, consumer, energy, and Canadian cyclicals. Key names investors will be watching include Palantir on May 4th, AMD on May 5th, Disney on May 6th, and Canadian reports such as Shopify, Suncor, Cameco, and Kinross. The main themes will be whether AI-related capital spending is still being rewarded, whether software valuations can hold up, and whether energy and commodity companies are benefiting from geopolitical tension and higher resource prices. Taken together, next week will be about whether earnings and labour data can validate the market's bullish momentum, or whether investors begin to question how much optimism is already priced in.

MacNicol & Associates Asset Management

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