

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.



Tangasseri Lighthouse, Tangasseri, Kollam, India

This lighthouse is located in southern India. The lighthouse stands at 41 meters tall and was originally constructed in 1902. Prior to the lighthouse being constructed, the British East India company built a tower with an oil lamp at the sight.



Cannanore lighthouse, Kerala, India

This lighthouse is located off the west coast of southern India. The lighthouse station was established in 1903 and the current structure was first lit in 1976. The lighthouse overlooks the Arabian Sea in a town that was considered an important seaport beginning in the late 15th century.

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

Flares in the Strait



On Monday morning, we got more news from the Middle East. Over the weekend Iranian state news had reported that a U.S. warship was hit with missiles as it tried to enter the Strait of Hormuz. The U.S. denied these claims. Energy prices rose on Monday as tensions between the U.S. and Iran appeared to be rising. On Sunday, the U.S. also stated that it would begin guiding commercial vessels stuck in the Strait out of the waterway. Iran's leadership took this statement as a threat and stated that any foreign armed force approaching or entering the Strait would be attacked. It seems both sides are doing as they please, and tensions could potentially boil over as soon as this week.

Reports that Iran had struck a U.S. warship appear to have been false. According to multiple sources, the vessel involved was affiliated with Abu Dhabi National Oil Company, not the U.S. Navy. Separately, the United States said its forces destroyed six Iranian attack boats that were threatening commercial shipping, while Iran denied the incident occurred.

Concerns are also mounting regarding the lack of progress in diplomatic efforts, raising the risk of prolonged disruptions to global shipping flows through the Strait of Hormuz. In response to Iranian leadership turning up the temperature, U.S. forces have begun providing escorts to commercial vessels in the region. Notably, a Danish containership operated by AP Moller-Maersk said a vehicle carrier it operates crossed through the Strait with help from the U.S. military. This protection underscores the increasing securitization of this critical trade corridor.

After all of this uncertainty, another conflicting report was released on Wednesday morning, which stated that the U.S. and Iran were nearing a permanent peace deal that would permanently end the Iran War. This news caused oil prices to drop into the low \$90s, and equities to rally. The report came from U.S. officials and states that Tehran and Washington officials have agreed on a one-page memorandum of understanding to end the war. After a flare-up in tensions earlier this week in the region, investors are welcoming this progress and potential momentum in creating a peace deal. We will warn our readers that a peace deal is not yet certain, and investors should remain highly vigilant even with this news.



(Photo by Frederic J. Brown / AFP via Getty Images)



Government AI deals

Last Friday, the Department of Defense announced deals with seven major tech companies to integrate AI into its classified networks. The Pentagon will aim to establish the U.S. military as an AI fighting force to enhance data analysis and decision-making.

NVIDIA, Microsoft, Alphabet, SpaceX, OpenAI, Amazon, and AI start-up reflection will serve as the DoD's AI vendors. Omissions from the list included Meta and Anthropic. Anthropic being left on the list was no surprise as the company has been sparring with the Trump administration over the use of AI-trained weapons. Anthropic was blacklisted by the U.S. government a few months ago and remains on that list due to "supply chain risk".

The companies that were included on the DoD's vendor list will provide various products and services to the agency. The deal signals procurement at scale and deeper integration of AI at one of the most secure agencies in the world. The announcement arguably broadens the market for AI as it validates use in regulated environments. The deal also further validates the case that AI spending will remain a multi-year theme.

Shares of most of the companies that will serve as AI vendors for the DoD moved slightly higher on Monday.

Earnings in full swing

Earnings season is in full swing, and companies continue to report strong results, beating estimates at a high rate and blended earnings growth running well above previous forecasts. According to FactSet, approximately 84% of the companies that had reported earnings as of last week had posted a positive EPS surprise. This trend has helped drive the rebound of certain company share prices after a volatile start to the year. On Tuesday, indices in the U.S. hit fresh highs as investors turned their backs on the Iran conflict and returned to earnings season.

Positive earnings surprises have been broad-based across the economy, even with certain economic conditions deteriorating. That is especially true for cyclical sectors like industrials. Industrial earnings have improved and reflect stabilizing demand and improving margins after a long downturn. Industrials usually turn with the business cycle as their order books, backlog, factory utilization, and capex budgets move before reported earnings, alongside the movement of the economy.

We preface everything above to highlight this season's earnings trend and how it is impacting some of our industrial holdings that reported this week.



Eaton Corporation, a multinational power management company, reported its Q1 earnings on Tuesday morning. Eaton is an intelligent power management company that supplies electrical systems, aerospace companies, and vehicle technologies. The company topped estimates but provided a softer outlook, which caused shares to pull back. Eaton revenue grew 17% YoY and beat analyst expectations by 5.6%. EPS came in 3% higher than FactSet estimates. Eaton's strong quarter was driven by demand from data centers. These positive numbers were strong headlines for investors, but investors came in a bit disappointed with the guidance. Eaton expects comparable sales growth of about 10% YoY (up from prior guidance of 8%), and a fiscal year EPS range of \$13.05 to \$13.50 (up from \$13 to \$13.5). On top of that, EPS guidance for Q2 came in lower than FactSet projections. Margin forecasts for 2026 also came in lower than previous estimates.

Eaton's reported sales backlog came in strong this quarter, with organic sales growth expected to improve in the coming quarters. Eaton's overall sales growth is not translating into boosted earnings due to needed investments for growth. Eaton simply needs to build capacity to drive growth, which in the short term will impact profitability. This increase in spending has increased Eaton's leverage and interest payments.

Eaton has benefited from robust demand tied to electrification and digital infrastructure. This trend has been reflected in Eaton's share price, which is up 32% over the last year (as of Tuesday morning). Shares pulled back after the company's earnings release.

Our investment thesis for Eaton remains intact despite the share price melt-up over the last year, which has raised the valuation of the company alongside the valuations for its peer group. Eaton remains a high-quality industrial company with a growing order backlog and robust data center demand. The company sits at the intersection of secular electrification, grid upgrading, AI expansion, and aerospace recovery. While Eaton's bull case is clear to us, we are mindful of major risk factors that could impact the company. These risk factors include an elevated valuation, cost inflation, a macroeconomic slowdown (which will slow demand), and data center revenue concentration.

Disclaimer: MacNicol & Associates Asset Management holds shares of Eaton Corporation (ETN) across several client accounts.

Meme is back

Popular meme stock GameStop announced its plans to buy eBay this week in an unsolicited offer. GameStop is worth about \$11 billion, and its offer price values eBay at \$56 billion. According to GameStop's CEO, the company has a \$20 billion debt financing commitment from TD that would help pay for the deal. The rest of the deal's funding would come from GameStop's \$9.4 billion cash pile as well as new stock. GameStop hopes to turn the combined company into a vehicle that can compete with Amazon. eBay confirmed that it had no talks with GameStop before the unsolicited bid. eBay stated that its board and management will review the deal and determine what course of action to take in a statement.



For GameStop shareholders, this deal would more than likely be dilutive and would heavily increase leverage on the balance sheet.

GameStop said its 1600 locations in the U.S. could become drop-off and shipping locations for eBay. GameStop also claimed that eBay is very inefficient and would achieve over \$2 billion in annualized cost cuts within a year of closing a deal. GameStop's CEO went on CNBC on Monday and stated that the opportunity is large, as eBay is the second-largest online commerce franchise. The CEO, Ryan Cohen, was very combative and provided minimal details on the offer and how it would be financed in his CNBC interview. GameStop shares moved lower after the CNBC interview, but are still up 17% year-to-date.

According to GameStop, they have acquired a 5% stake in eBay after beginning to accumulate shares in February. GameStop has been one of the most talked-about stocks of the last 6 years due to the meme frenzy of 2021, constant news stories, and a rotating door of CEOs. GameStop was in serious trouble when current CEO Ryan Cohen took the helm who has turned the company's performance around. He has made the company more efficient, fortified its balance sheet, and arguably stabilized the company.

Cohen also owns nearly 10% of GameStop's shares. The one issue pointed out online that we saw this week with this deal was that Ryan Cohen's current pay package includes options that are tied to company size and EBITDA levels, which are reportedly not adjusted for dilution. We will not come to a conclusion but will let our readers come to their own, as the combined entity would obviously be larger and would produce higher numbers.

This would not be the first time a small company has scooped up a larger company, but a deal closing seems unlikely in our eyes. Past examples of smaller companies buying larger firms include Paramount's pending purchase of Warner Bros, which was secured by Larry Ellison and sovereign wealth funds, Charter Communications buying Time Warner Cable in 2016, and Burger King buying Tim Hortons in 2014 and creating Restaurant Brands. These stocks have not been great performers since their deals have been announced. So even if a deal closes, GameStop shares could follow this trend.

We certainly do not have a stake in GameStop, but we will continue to follow this news, as down the road the combined entity could have some value.

What recession?

There has been a lot of chatter by market experts regarding a potential or looming recession. Economic conditions continue to deteriorate both above and below the border. Consumer balance sheets continue to weaken as interest rates remain elevated, affordability remains a problem, and the job market remains tight. Despite this weakness, consumers continue to spend, especially on experiences. We predicted this trend a few years ago as inflation ticked up, and it remains the case. Consumers are passing on phone upgrades, the latest technology, and new clothing for vacations, trips, and dinners. According to the credit bureau, they are servicing these expenses through credit, which is another indicator of how tight economic conditions currently are.

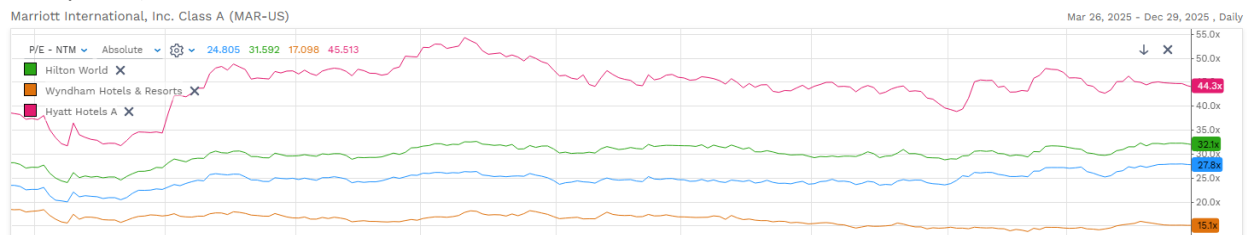


This trend is showing up in corporate earnings for a variety of companies, including airlines, restaurant groups, hotels, and travel platforms. We bring this up just a few weeks after we talked about the airline industry in this commentary. This week, we will continue the travel trend and talk about a current holding for us, Marriott International Inc.

Marriott International Inc. is a company many of you probably have heard of. The hotel operator owns over 30 hotel brands with over 1.5 million rooms worldwide. Marriott is one of the largest hotel operators in the world, with a market cap larger than Hilton Hotels and Hyatt Hotels combined. The company released its 1st quarter earnings on Wednesday morning. Marriott beat EPS estimates by 7% and revenue estimates by 1.4%. Marriott's CEO stated that the company's quarterly results were excellent and reflect strength in their brands as well as their competitive position in the marketplace. Management stated on their earnings call that earnings were once again led by robust Canadian and U.S. growth with strength across leisure and business travel through April. Quarterly strength was driven by RevPAR (revenue per available room), which came in higher than expected during the quarter. Marriott also raised its forecast for 2026 for the same metric. These positive figures come at a time when inflation remains stubborn, and there are major disruptions in the Middle East (especially when it comes to personal travel). Its outlook assumes a continued impact in the Middle East.

Marriott stated that the World Cup will add 30-35 basis points to RevPAR this year. They also expect adjusted EBITDA to increase by 8-10% in Q2. The company added over 15,000 rooms during Q1 and continues to grow its global presence.

The results displayed by Marriott last quarter reflect resilient global travel and industry-leading scale. The company's valuation sits at the upper range of its peer group. This elevated valuation is justified by its consistent earnings growth, stronger international mix, and enhanced stability from its asset-light, fee-driven model. We remain bullish on Marriott despite its recent price run over the last year (shares are up 42%).



Source: FactSet

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

MacNicol & Associates Asset Management
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