The Weekly Beacon

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 any observations.

The two main purposes of a Lighthouse are ***to serve as a navigational aid and to warn boats (Investors) of dangerous areas****. It is like a traffic sign on the sea.*

Sheringham Point. Shirley, British Columbia.

Folly Point Lighthouse, Jamaica.

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

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Chamath "never" fails us

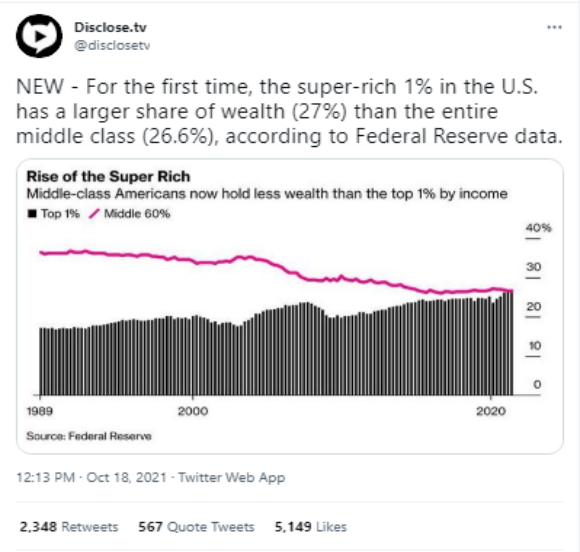
In the October 8th, 2021 edition of the Weekly Beacon, we highlighted some old tweets from Chamath Palihapitiya. He tweeted back in March that inflation is good, and it will help shrink the inequality gap. We labelled his comments as nonsense and false, inflation always creates a greater gap of inequality and benefits the richest the most.

This past week we highlighted inflation hitting another high and continued to repeat "this inflation is not transitory".

PERSONAL FINANCE · Published October 15

Inflation soars to highest rate in 13 years — here's what that means for interest rates

Chamath's comments come full circle, this week the Federal Reserve released data on wealth in America. The latest release marked the first time ever that the top 1% own more wealth than the entire middle class. Not the lower class, the entire middle class (60% of the country), middle America. It seems the U.S. has slowly turned into a version of an oligopoly. Gates, Bezos, Zuckerberg, and friends all won during Covid-19.



Guess Chamath was short-sighted or was just leading his followers on like usual.

We are not highlighting this to say billionaires should have a wealth tax or the government should seize a lot of there wealth. Successful ideas should have successful payouts, capitalism 101. The issue at hand is policy makers promising to help the little guy by printing money to solve an issue and the billionaire class benefiting the most. The solution by all Western governments is to print money and get the government involved. Endless fiscal expansion cannot be the answer, inflation helps those on the top. Serious change needs to occur when battling issues going forward or this wealth gap will only expand further. Printing money has become a wash, rinse, repeat process.

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EVs: How to play it? Traditional Auto Maker or Pure Auto Maker?

This week marked an interesting time in the automobile industry. Tesla and 15 other Electric Vehicle producers are worth more than the 50 largest traditional auto manufacturers combined. Tesla and the other 15 EV companies are worth $1.14 trillion, Tesla makes up 74% of that value. Electric vehicle companies are worth just under half of the entire automobile industry.

In 2020, 63.8 million new cars were sold globally, 3 million of those were electric vehicles. Electric vehicles sales jumped 43% in 2020 even though the pandemic filled year caused overall auto sales to decline 18%. Sales by traditional companies still dominate the overall automobile market (including traditionally produced EV's), 99% of all cars sold were by traditional companies. Just over 2.5% of that 99% are electric vehicles. Pure EV company's only account for approximately 1% of all automobile sales. The pure EV manufactures have a 28% market share of new units sold, significantly below an industry majority.

The market is simply betting on the future and betting quite big at these valuations.

We have mentioned how hard it may be to stock pick the electric car maker that will compete with Tesla as the market is littered with EV makers. The best way to play this trend remains with the inputs, rare earth metals and industrial metals that will be in short supply for years to come.

However, traditional auto makers that have made a commitment to partially transition or to fully transition to EVs could have major potential as the market seems to be only overvaluing pure EV makers. The market has left traditional automakers in the dust. Companies are being overvalued like Tesla, Rivian, and Lucid Motors as they represent the future while the general green idea seems to be left behind.

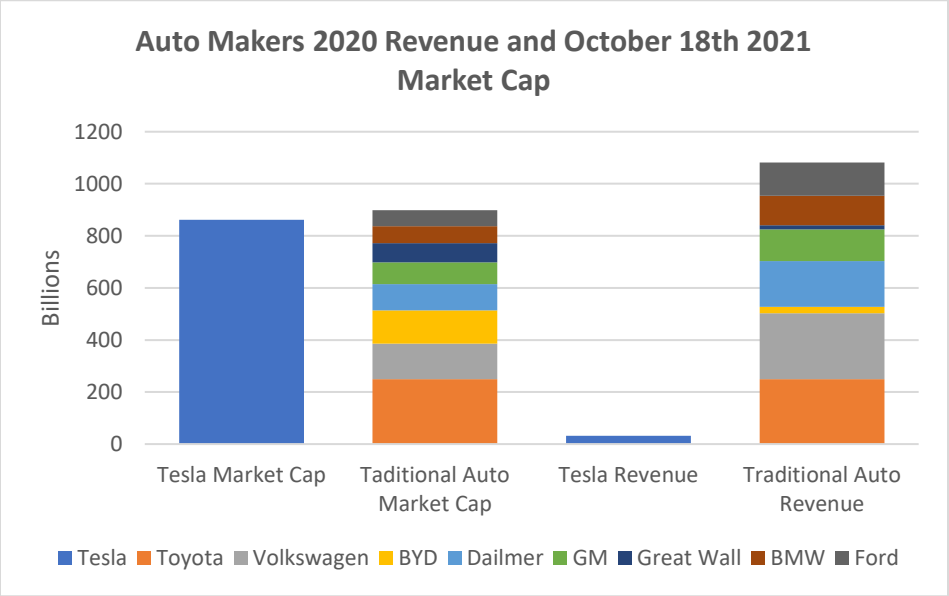
Looking at auto makers from a valuation standpoint….

Tesla trades around a 35x price to book, Nio trades above 15x, while Toyota who has made a green vehicle pledge trades at 1.15x and Volkswagen trades at 1.0x. The market seems to be solely focused on the new companies and have forgotten about the traditional ones that have the capital and infrastructure to mass produce vehicles.

Tesla has a larger market cap then the 7 largest auto makers in the world, once Ford (9th largest auto maker) is added, the industry slightly surpasses Tesla's market cap which is slowly approaching $1 trillion. Tesla had a 2020 revenue of $31.5 billion, 2020 was also the first profitable year for Tesla. Tesla's revenue is expected to grow to over $50 billion in 2021 and to just under $70 billion in 2022, according to average targets by analysts. Even with these jumps, Tesla will still only sell a minor fraction of global automobiles. The 8 largest non-Tesla auto manufactures in the world had a combined revenue of over $1 trillion in 2020 which is much above there combined market caps.

We are certainly not saying bet against Elon Musk. Tesla will be a dominant automobile manufacturer going forward, we are just stating that there are multiple avenues to play the green trend, buying Tesla and EV stocks is one, buying traditional auto manufactures is a second and a third would be buying the metals that all these companies need to buy to make EV's. Tesla also differs from a lot of other pure EV's

as it has the added self driving technology that could be worth a lot on its own in the future. Betting against Elon Musk may not be a smart idea but, going all in on him also comes with risk.

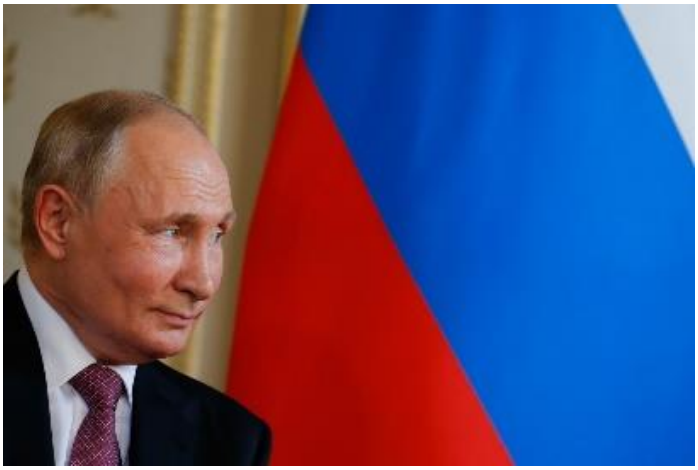


Tesla earnings were released Wednesday afternoon, Tesla beat revenue estimates and EPS estimates for the 3rd quarter of 2021. Both set quarterly records for Tesla. Even with the earnings boost the stock slipped after hours as some bulls were still let down from the release. Certain parts of the market thought they would smash estimates by a large margin.

Even with the semiconductor shortage, Tesla delivered more vehicles during the quarter then expected which is great news. Tesla had greater success sourcing semiconductor chips in China then in the U.S.

Tesla could go on another run, or it could dip, its quite overvalued. Tesla is only one of many ways to play the green wave.

Business is Booming for Putin and co.



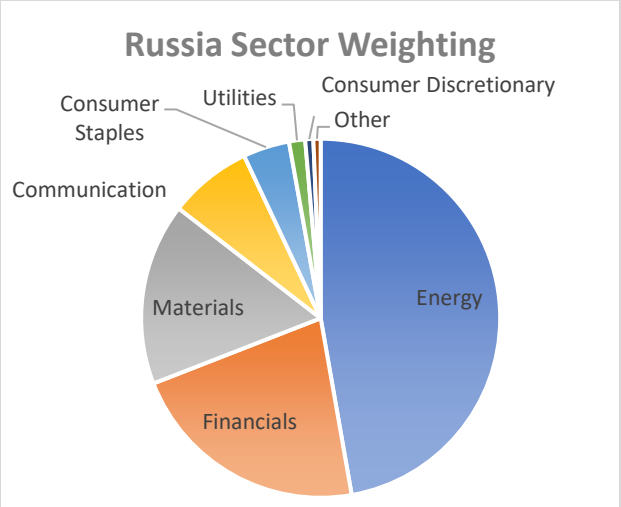
Over the past year, Russian equities have outperformed the U.S. market. The RTSI (Russian Index) has doubled the return of the S&P 500 over that period.

Russian equities have severely underperformed North American indexes in recent years. It could be time for this leading emerging market to outperform U.S. equities during this quasi-energy transition period.

YEAR	RTSI INDEX	S&P 500 INDEX	NASDAQ
2020	-10.42%	16.26%	43.64%
2019	44.9%	28.88%	35.23%
2018	-7.4%	-6.24%	-3.88%
2017	0.18%	19.42%	28.24%
2016	52.5%	9.54%	7.5%
2015	-4.25%	-0.73%	5.73%
2014	-45.19%	11.39%	13.4%
2013	-5.5%	29.6%	38.32%
2012	10.5	13.41%	15.91%
2011	-21.94%	0%	-1.8%

Russian index compositions completely differ to North American indexes. The Russian economy and stock market is driven by energy prices.

The iShares MSCI Russia ETF was used to analyze the sector breakdown of Russian markets, as the ETF aims to follow the Russian index. The ETF performs within a few basis points of the overall RSI Index.



The Russian index includes relatively no technology and mirrors an economy before the recent innovation we have seen with a heavy weighting on energy, specifically oil and natural gas. The S&P 500's largest sector exposure is information technology. In 1990 technology represented around 8% of the index, that ballooned to almost 30% at the height of the dot.com crash. By 2010 technology only made up 17% of the S&P 500 but 10 years later and its close to 30% yet again for the first time since the dot.com crash. Will history repeat itself?

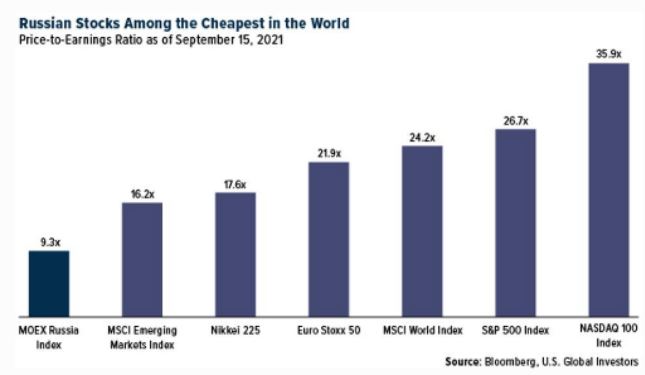
Maybe history repeats itself in terms of overvalued technology companies, maybe it doesn't, we are just pointing out the largest sector in the market in North America is the most overvalued where some companies trade at massive multiples. This is without mentioning the Nasdaq-100 which has a 45.42% technology weighting on top of 19.66% in communication services. Almost 65% in tech, a lot of which is overvalued. We lump in communication services because companies like Facebook, Alphabet, Netflix, and Activision Blizzard are considered communication service companies.

If these overvalued technology companies do take a dip, its important to own hard assets and companies that can create cash flow.

Two things Russia offer.

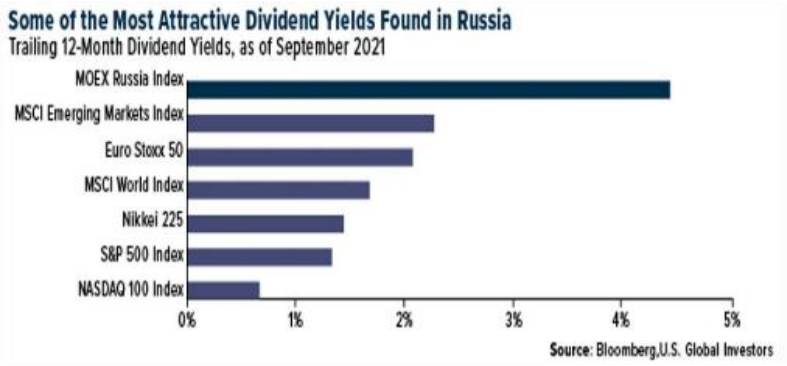
Even though the Russian regime pose political risk to their equity markets and investors should be weary, there are a few things that make Russia attractive.

1. Cheapest Multiples



Russian stocks P/E ratios are below every major market around the globe and its not even close. Russian equities trade at a P/E ratio that is almost 50% of what its emerging markets competitors are valued at. The low multiple has actually slightly risen over this year during the run Russian equities have been on.

2. Consistent Cash Flows



Russian stocks offer some of the most attractive dividend yields across the globe. As of September, Russian stocks on the MOEX Index had an average 12-month trailing dividend of 4.45%, double the yield of emerging markets and 3-4x the American index's offer. High consistent cash flow never hurts.

Some of the largest Russian companies, offer the same dividend year after year whether earnings are up or down which comes with certain risks but also certain downside protection.

3. ESG and Climate Goals

Western countries like Canada and the U.S. who have deep fossil fuel reserves have both vowed to slowly cut production. Biden and Trudeau also agreed to cancel the Keystone pipeline. The U.S. is the worlds largest oil producer and Canada historically has been the 3rd or 4th largest producer of oil. The U.S. is also the worlds largest natural gas producer and Canada is the 5th largest.

We bring these North American countries up because if they plan to cut production, the gap will need to be filled. In comes Russia, the 3rd largest oil producing country and the 2nd largest natural gas producer.

Net zero regulation: Russia will replace all the U.S. oil Biden wants to ban

By ÁINE QUINN on 2/9/2021

Russia has the worlds 8th largest oil reserves that remain. The only countries with more are Canada (cutting production) and 6 OPEC countries who Russia regularly spar with. Russia has the capacity and technology to expand production. Russia is also the worlds second largest oil exporter. Russia is in OPEC+ a larger organization then the original OPEC, which was formed due to fears of the U.S. shale market. OPEC+ is regularly scrutinized for its massive capital investment into oil instead of producing low-cost oil for the world. Russia also has much lower costs then Saudi Arabia and other OPEC members giving itself a distinct competitive advantage. This has caused Russia and OPEC into pricing wars. Our main point: Russia does not care what people say, and they continue to play by their own rules. They will fill the oil supply gap and will benefit from the world going green and cutting back production of fossil fuels.

Long story short: Russia will fill the gap.

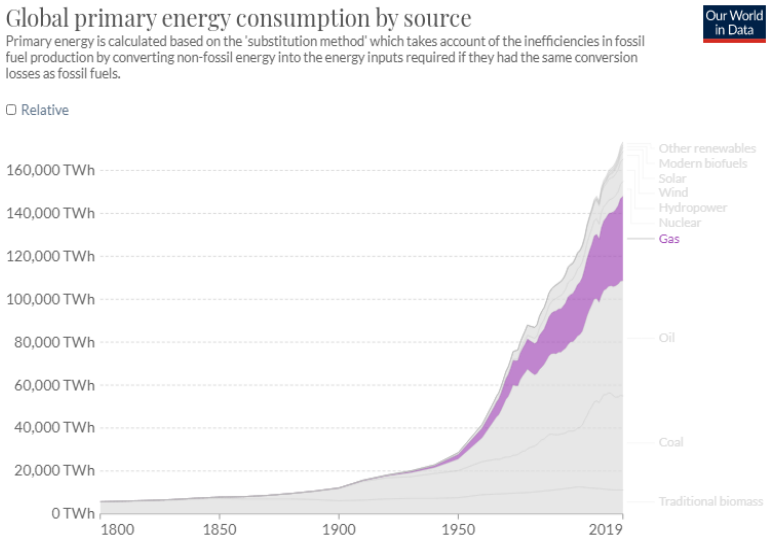
The Saudi-Russia oil price war was a 'very big mistake,' Qatar energy minister says

PUBLISHED MON, JUN 8 2020-11:02 PM EDT | UPDATED TUE, JUN 9 2020-9:25 AM EDT

Looking at Natural Gas……..

We are sure you have heard; natural gas is the cleanest fossil fuel. Natural gas has also increased in consumption over the past few years. This will only continue.

World energy consumption by source:



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Green activists are even slowly realizing, a fast green energy transition will only cause issues and renewables are only capable of so much. Europe might be teaching green realists a lesson.

Jul 8, 2021, 09:30am EDT | 10,462 views

Why The Green Transition Can't Happen Without Natural Gas

Ariel Cohen Contributor
Energy
I cover energy, security, Europe, Russia/Eurasia & the Middle East
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We only bring up Natural Gas and Russia because they are home to the world's largest natural gas reserves, almost 25% of the world's entire active reserves.

#	Country	Gas Reserves (MMcf)	World Share
1	Russia	1,688,228,000	24.3%
2	Iran	1,201,382,000	17.3%
3	Qatar	871,585,000	12.5%
4	United States	368,704,000	5.3%
5	Saudi Arabia	294,205,000	4.2%
6	Turkmenistan	265,000,000	3.8%
7	United Arab Emirates	215,098,000	3.1%
8	Venezuela	197,087,000	2.8%

Russia is also the worlds largest gas exporter in the world. The U.S. is the 6th largest exporter and has the worlds 4th largest reserves which at the current run rate will be depleted in about 60 years. Production may need to eventually slow in the U.S. to lengthen the life of domestic natural gas reserves.

Russia can continue full steam ahead, they have quadruple the natural gas the U.S. has.

Russia is a giant and have some of the worlds most powerful countries begging for their energy. Russia is the leading exporter for crude oil and natural gas for the European Union. This will only strengthen, and Russia will have a monopoly on European fossil fuels. Russia is also waiting final approval for its shiny new toy, the Nord Stream 2, another gas pipeline that will connect Germany to Russia.

Russia says Berlin could ease natural gas crisis by approving Nord Stream 2

By Walé Azeez and Katharina Krebs, CNN Business
Updated 10:07 AM ET, Thu October 7, 2021

Even with the energy shortage running through Western Europe, Russia has avoided increasing production of natural gas so that they can get this pipeline fully approved.

The gist: when countries cut back their dependence on fossil fuels for energy, they will increase dependence on renewables. Renewables as we have seen this year are unreliable and nowhere near

ready. Enter Russia: emergency oil and gas. Russia will also benefit from filling the void Canada and the U.S. leave in the energy sector across the globe.

4. Russia is set up for an EV boom

Even though people think the decarbonization of the world will hurt Russia, it may not fully. We have already mentioned natural gas and crude oil are not going anywhere, anytime soon. Russian regulation will continue to allow for the exploration and production of its massive reserves as it possibly becomes the worlds largest energy producer. Even with that being said, the West will push for a shift to green.

What do you need to create green energy?

Metals and lots of it.

The metals used to create EV's are not plentiful. Russia is home to trillions of dollars worth of these rare earth metals.

ANALYSIS

Huge reserves and huge potential: mining in Russia

By JP Casey | 07 Dec 2020

Russia ranks in the top 3 for exploration of iron, platinum, and gold globally. Currently, Russia lacks the infrastructure and capabilities to produce the rare earth metals they are home to. They export 95% of these metals as raw materials. Russia plans to put mass capital investment into the mining sector so that they can capture the full value of these booming metals.

Russia is also home to the 4th largest cobalt reserves in the world another EV input.

Nornickel the worlds largest palladium miner and one of the worlds largest producers of nickel, copper and platinum have a win-win scenario on there hands. Nornickel has benefited in the price rise of copper and nickel as both are major inputs in EVs. Palladium is a major input in gasoline cars, the recent price rise is the world realizing gasoline cars are not going anywhere anytime soon. Palladium is used to cut pollution in gas fueled cars as well as hybrid cars. Palladium mining has also become harder with stricter regulation across the world. Nornickel has projected nickel demand will grow by 20x over the next 10 years due to the EV boom. Win-win. Northern Russia is littered with miners and Russia does not have the regulation in place that restricts miners in countries like Canada and Australia.

Russia has also reopened numerous copper mining plants in recent years as copper has been dubbed the "black gold" of the green energy wave.

We note all these attractive elements of the Russian economy to expose investors to non-traditional markets. We also want to reiterate the political risk that comes with investing in Russian equities.

MacNicol & Associates Asset Management Inc.
October 22, 2021