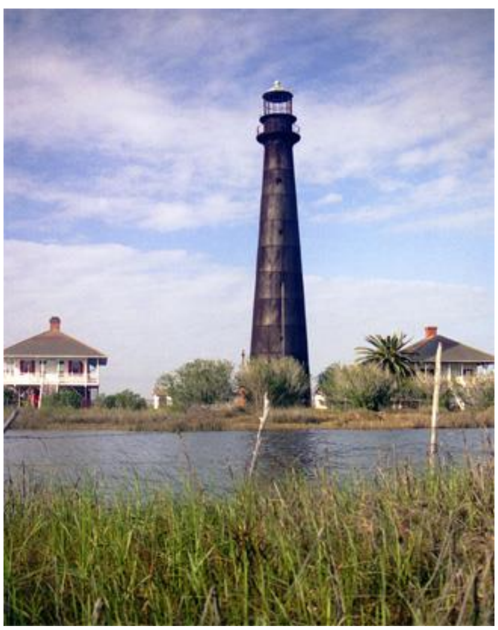
The Weekly Beacon

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 ships (Investors) of dangerous areas****. It is like a traffic sign on the sea.*

Aransas Pass (Lydia Ann) Lighthouse, Texas



Bolivar Point Lighthouse, Texas

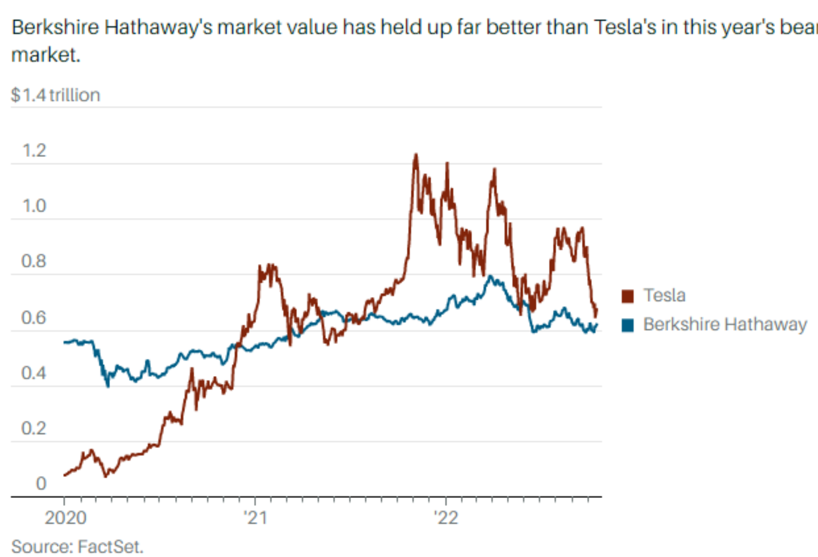
Feel free to send us your photos of Lighthouses to be featured in our weekly market observations.

Slow and Steady Wins the Race

Warren Buffett is known as the greatest investor to ever live. He did not earn that name through high-growth companies that promised to revolutionize the world. Some of his most successful investing has been through brick-and-mortar companies that have produced outsized returns on an annual basis.

Even though some young investors call Buffett “old” or “out of touch” he still chugs on. His fundamental approach to investing beats any quant fund in the long run. In recent years, many have pointed to his hesitancy to invest in the technology space as a reason not to invest in his company. Many have believed that he is limiting investor upside by ignoring the most disruptive companies. Buffett once told investors to never invest in anything they do not understand, and he has lived up to that. In recent years, he has invested in Apple giving his investors some exposure to technology.

We only bring this up because Buffett’s company Berkshire Hathaway is approaching an interesting milestone. A milestone that is related to its market capitalization.



Berkshire’s market cap is almost larger than Tesla’s. The reason why we mention this is because Tesla’s market cap was almost double Berkshire’s at the end of 2021. Berkshire’s investments have held up during market volatility as its holding was not trading at ridiculous multiples like Tesla. Buffett has also made some sound investments in energy companies this year due to the energy crisis. While Tesla remains, overvalued Berkshire keeps chugging. We assume Tesla investors wish they bought Berkshire………

2 minute read · September 28, 2022 9:38 PM EDT · Last Updated 20 days ago

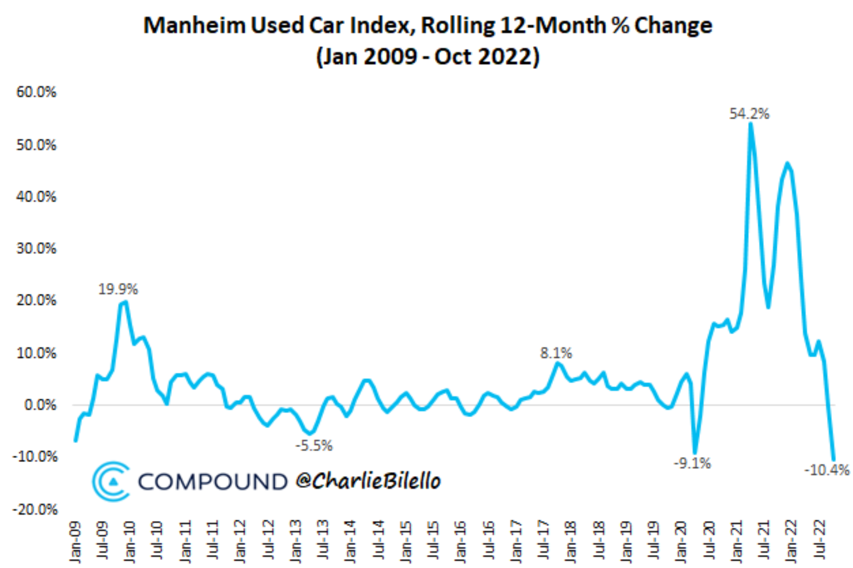
Buffett's Berkshire Hathaway buys 5.99 mln more Occidental shares

Berkshire's share price is down 6% YTD. The Nasdaq is down 15% YTD. Tesla and those tech darlings are much (much) worse. In times of uncertainty when everything does not just go up, Buffett and Berkshire flex their muscles. After all, the Oracle of Omaha is greedy when investors are terrified.

Auto Update

Used car prices soared during Covid-19, an asset class that depreciated suddenly skyrocketed due to supply issues. We hope you did not choose to buy a used car. Some consumers sold their cars for the same (or close to the same) price as they acquired them just a few years later.

As the world has opened up and production in the new car market has increased used car prices have dropped faster than they ever have in the last 15 years. Perhaps, now is the time to buy that used car you have had your eye on.



We only bring this up because it reflects simple supply-demand that many forget when analyzing various sectors. Home builds across the GTA and even across Canada are not growing at the same rate as population growth. Delays across the market are also stunting the time to build. In energy, the world is underproducing oil and gas causing a major supply imbalance. This has led to the use of dirty coal, and firewood for energy as well as led to blackouts. The issue in the energy space is the solution will take years to fix not months like in the car market. It will take years to build the infrastructure to produce more oil and companies are not even willing to do that because Western governments continue to attack and tax them more.

Also, anyone who bought a used Jeep or something of that nature when it has risen in price just practices the art of patience and should have waited for the price increases out…..

Midterms Approaching

Yes, we mention the U.S. Midterm elections a lot through this publication and no we will not stop doing so. Whether we like it or not politics have a massive impact on financial markets in today's world. It is important to be positioned before the elections as priorities change with different results at each level of government.

There is no presidential election but the entire House, a third of the Senate, and numerous Governor races are up for grabs. The entire balance of power for the second half of Biden's term as President is up for grabs. Will we get gridlock, or will Democrats continue to get their way with control of the Senate and House?

We will look more into this next week as the election approaches. We will look at the implications of each party winning and how that will affect various industries.

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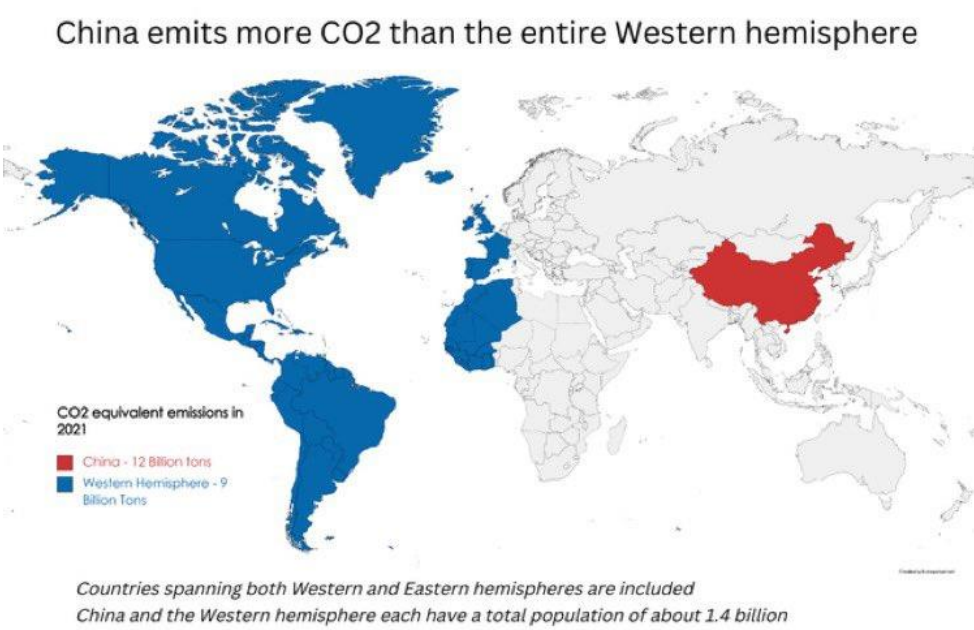
The West Cannot Change the Climate

No matter how hard the west tries to decrease fossil fuel usage (let's pretend it's possible), it will not have a large enough impact on global emissions.

The U.S., Canada, Japan, Australia, and Western Europe consistently pledge to decrease fossil fuel usage to combat climate change. These countries are looked at as the "greenest". They are supposedly leading the way. That may be good and all, but they are not the biggest carbon emitters in the world.

The entire western hemisphere emitted the same carbon as China did in 2021:



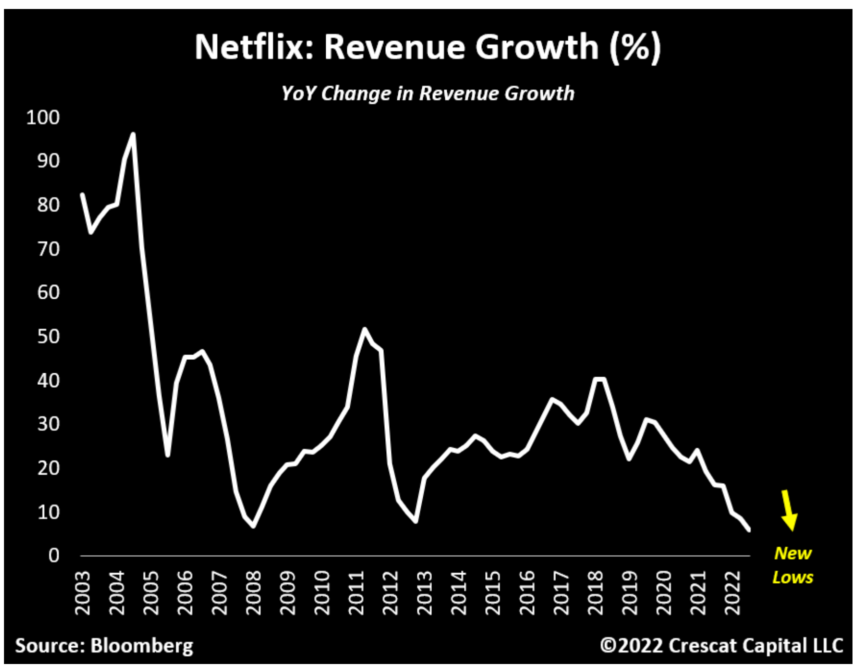
Yes, China emitted as much as half the world. China burns fuel and coal to increase economic development. They promise to stop this practice decades into the future (when they will surpass the U.S. as an economy and power). The west supports this idea yet want us to stop using oil and gas to power our cars, homes, and businesses. The idea is completely outlandish. Leave the biggest emitters alone to increase their economies and foot us with the bill.

Even when comparing U.S. natural gas to Russian oil or Chinese coal, it is unanimously agreed that U.S. energy is the cleanest fossil fuel in the world.

Western countries will not change the climate alone. Until China, India, and even Russia reduce their emissions, no significant progress will be made in this battle. We are not advocating for the reduction of fossil fuel usage; we are simply stating that it is absurd what the west is currently doing. Energy crises will continue to pile up as the west depends on Russia for energy and depends on unreliable renewable energy sources. The unfortunate result will be the middle and lower class footing the bill across the west for these horrible decisions made by policymakers.

Growth "Wall"

Investors who grew up after the Dot Com Bust (2000-2002) are finally coming to a reality, technology companies hit a growth wall, and they will not have consistent compounded growth of 10-15% forever. By growth we are not referencing stock price, we mean the top line on the income statement, revenue. Eventually, they will hit a growth "wall", it seems 2022 might be that wall. Look at Netflix's year over year Revenue growth since 2003 (courtesy of Crescat Capital):



More people have canceled their Netflix accounts than ever. We think it's a combination of things that we forecasted. Last year, many technology companies were trading at ridiculous multiples so we would not touch them, but we also thought, what could go wrong for these companies? We thought Netflix could be on the short end of the post-Covid boom, after 1.5 years of restrictions where people binged

Netflix, consumer demand was certainly going to drop (and it did). We also think some of the content that made Netflix successful over the last decade has become stale or has even moved onto other platforms (competitors caught up with new, fresh content).

Netflix has burned through billions creating and acquiring content and has yet to distribute any dividends to shareholders. Netflix's strategy has even changed. They recently released a version of their platform that is cheaper with advertisement. Are they desperate for a new revenue stream, or desperate to hold onto some subscribers at half the price? Either way a fascinating story and an uber-successful company. We just think growth has hit a "wall" at least in today's economic climate.

Just remember, if a company is down by 54% usually something is to blame, and a rebound is not guaranteed. Netflix is at a different part of its life cycle than at any point in its existence.

It is important to note that Netflix added subscribers in the third quarter which is the first gain of subscribers for the company in 2022. Earnings for Netflix were released on Tuesday.

Earnings and revenue were both up in Q3 and Netflix's stock price was up 13% on Wednesday as a response to the positive earnings release:

Q3 2022 — EPS beaten by 43.10%

EPS (USD)

Expected	Reported	Surprise
2.17	3.10	43.10%

Revenue (USD)

Expected	Reported	Surprise
7.84B	7.93B	1.05%

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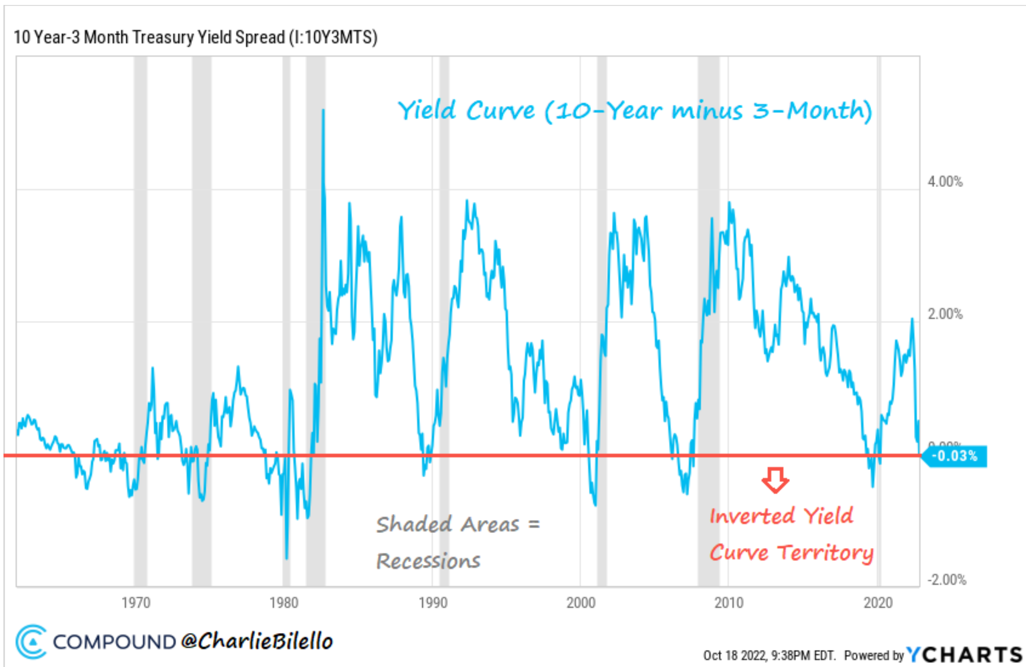
Even though the stock price bounced, do not expect it to bounce back to $700 like it was at the end of 2021.

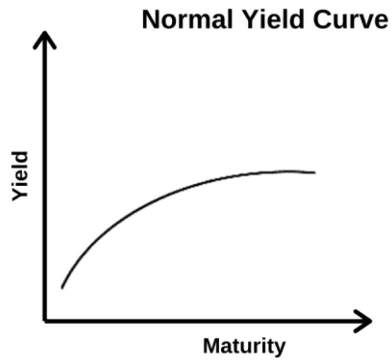
Recession: Confirmed?

Even though governments have adjusted the definition of a recession as a response to poor economic data that confirms a recession and claims we are economically strong, we believe we are in a recession. It seems a key indicator went off this week that would further confirm our thoughts.

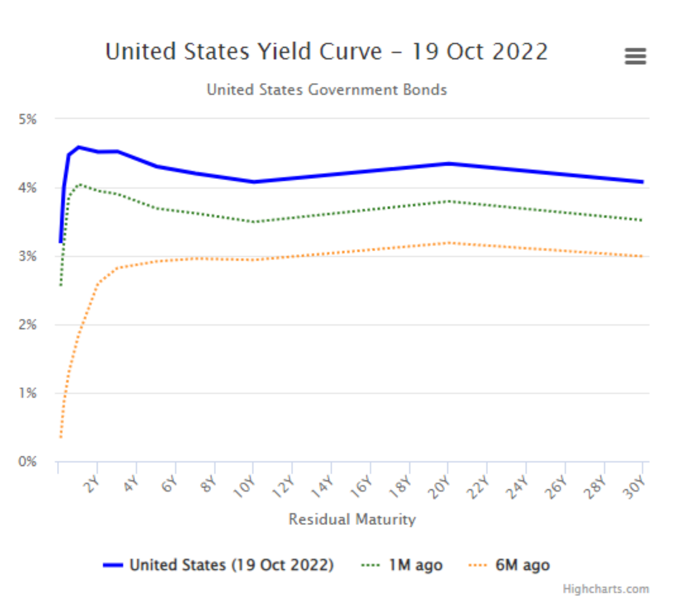


The 10 Year – 3 Month Treasury Yield spread inverted. This means the shorter-term Treasury note has a higher interest rate attached to it than the long-term one. This is not a regular occurrence. You can see in the image above that it has only dropped below that 0% red line a few times since 1970.

To remind people what a normal yield curve would look like (the longer the maturity, the higher the yield, implying higher risk as maturity is increased):



Compared to what the U.S. yield curve currently looks like:



After looking at those, we need to tackle 2 things, 1. What an inverted yield curve means, and 2. Why this confirms a "recession". An inverted yield curve shows that long-term interest rates are less than short-term interest rates. An inverted yield curve is unusual; it reflects bond investors' expectations for a decline in longer-term interest rates. This would increase borrowing costs for consumers, investors, and corporations more in the short term than in the long term.

We note that this is an interesting indicator as the last 8 recessions in the U.S. were all proceeded by the 10 year – 3-month Treasury yield spread inverting. The 2020, 2008, 2001, 1991, 1981, 1980, 1973, and 1969 recessions were all led by an inversion in this same yield curve that inverted this past week. Even though recessions usually occur months after this inversion, we think we are already in a recession meaning the recession proceeded with the inversion of the yield curve.

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We know we are throwing a lot at you, and we are not trying to scare you, but the economy is extremely important when tackling financial markets. Remember, throughout every recession certain subsectors, commodities and assets perform well. The key is to find the winners and get rid of all the overvalued losers.

This Weeks Humor

Costco doing something only Costco can do. $37k for Scotch while they also sell $1.50 hot dogs. Walmart and Target, your move.

MacNicol & Associates Asset Management Inc.
October 21, 2022

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