Porter & Co.
Investment Chronicles

Issue No. 4

July 2023

Porter & Co.

Porter & Co. Investment Chronicles

Welcome to *Porter & Co. Investment Chronicles*, our guide to the most important and interesting stories from the worlds of investing, finance, and economics that's available exclusively to Partners and *Big Secret* Elite members.

Each month, my team and I share the most valuable insights we come across from the hundreds of sources we regularly read and review – hedge fund letters, annual reports, SEC filings, investment newsletters, newspapers, Twitter threads, conferences, podcasts, and more – and digest them into one carefully curated, easy-to-read resource.

With the *Investment Chronicles*, you'll have your finger on the pulse of the markets without having to spend hours scouring the internet each day.

You can navigate through each issue using the hyperlinked Table of Contents below. All content also includes links back to the original source when possible, so you can easily click through for more details, to see a larger version of a chart or image, or to learn more about accessing paid content.

We're also building a dedicated *Investment Chronicles* web portal where you can access previous issues and search for content by tags and keywords.

We hope you'll come to think of our *Investment Chronicles* as being a highlight of your subscription with *Porter & Co*. We think it is the most comprehensive expression of our goal as a business: to give you the information we'd most want if our roles were reversed.

Porter Stansberry
Stevenson, MD
July 2023

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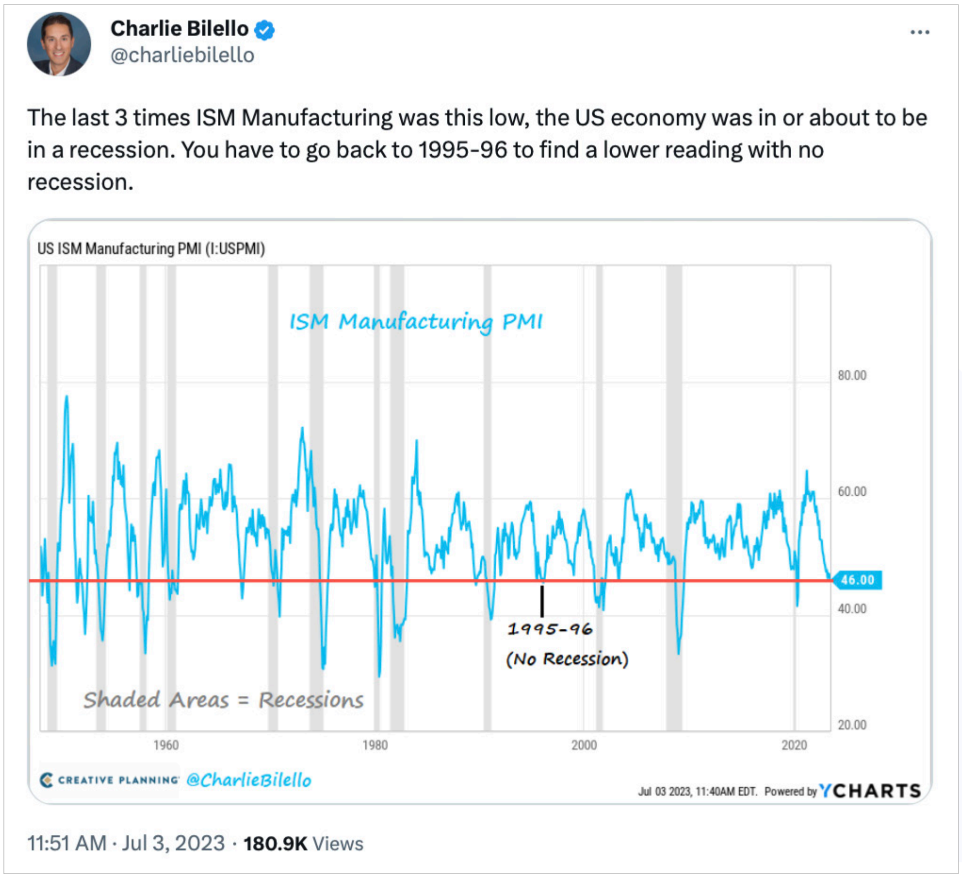
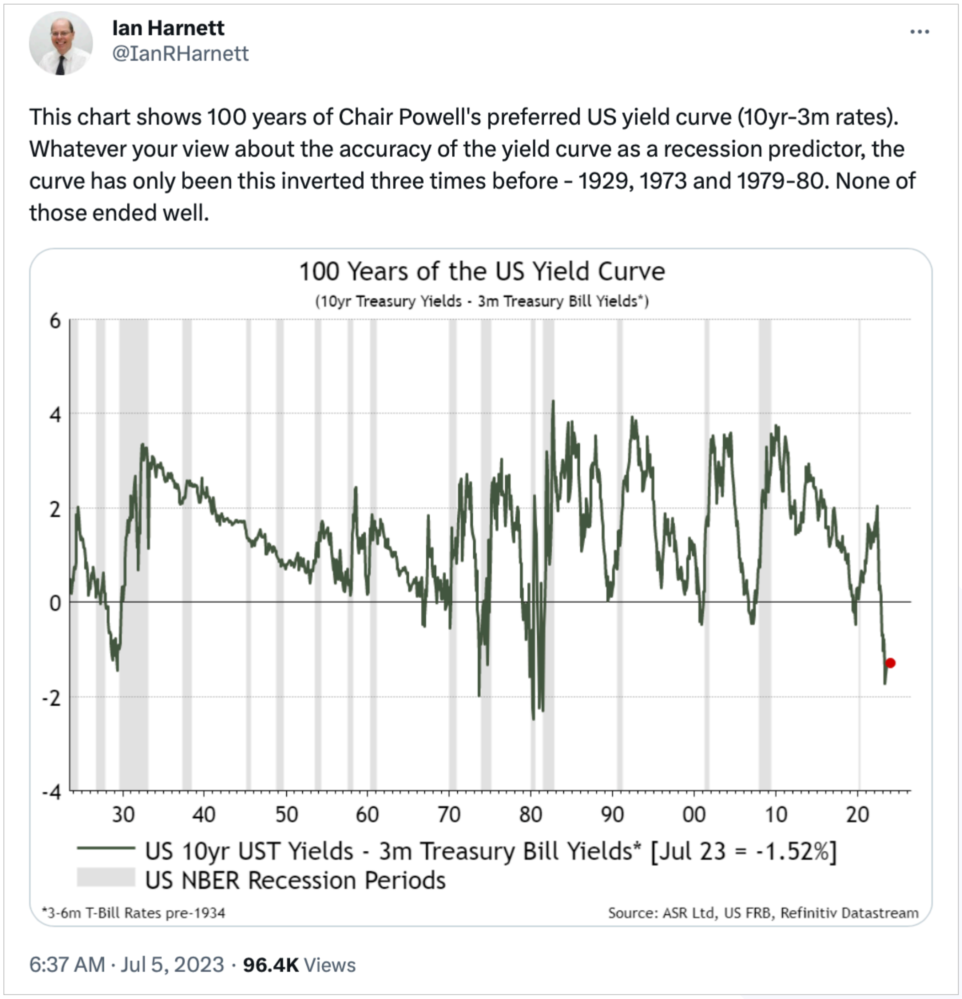
The Five

The Most Important Charts We're Watching This Month

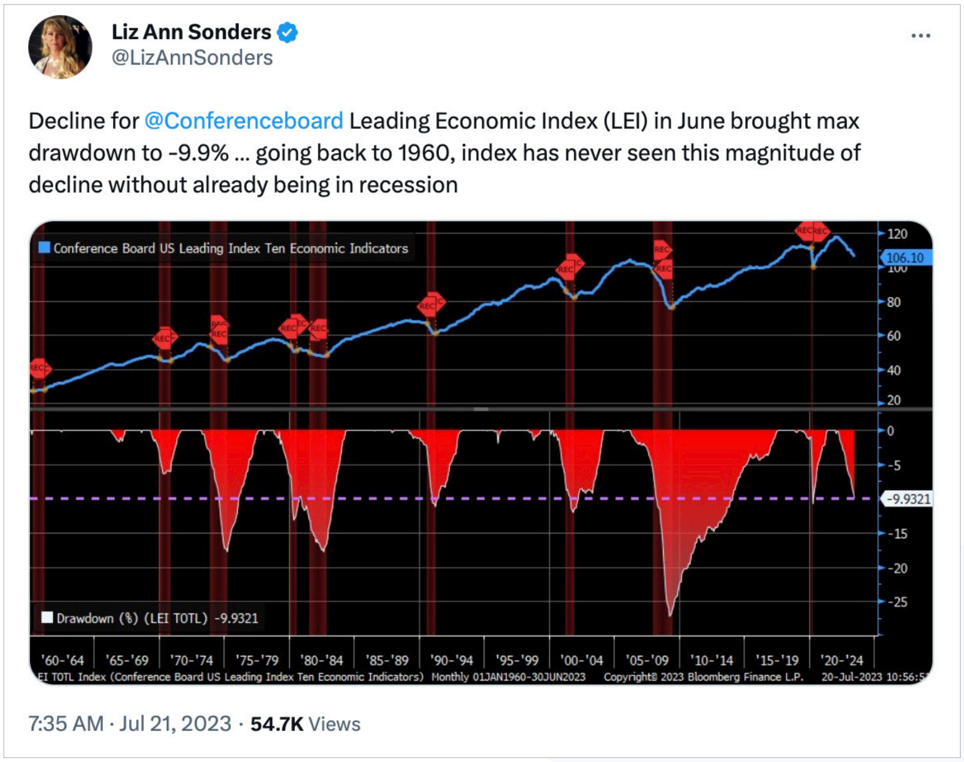
Several highly reliable signals suggest a recession is imminent. The Institute of Supply Management (ISM) Purchasing Managers Index (PMI) fell to 46 in June. Over the last 70 years, similar levels have indicated the U.S. was already in a recession, with very few false positives ([from Charlie Bilello via Twitter on July 3])...



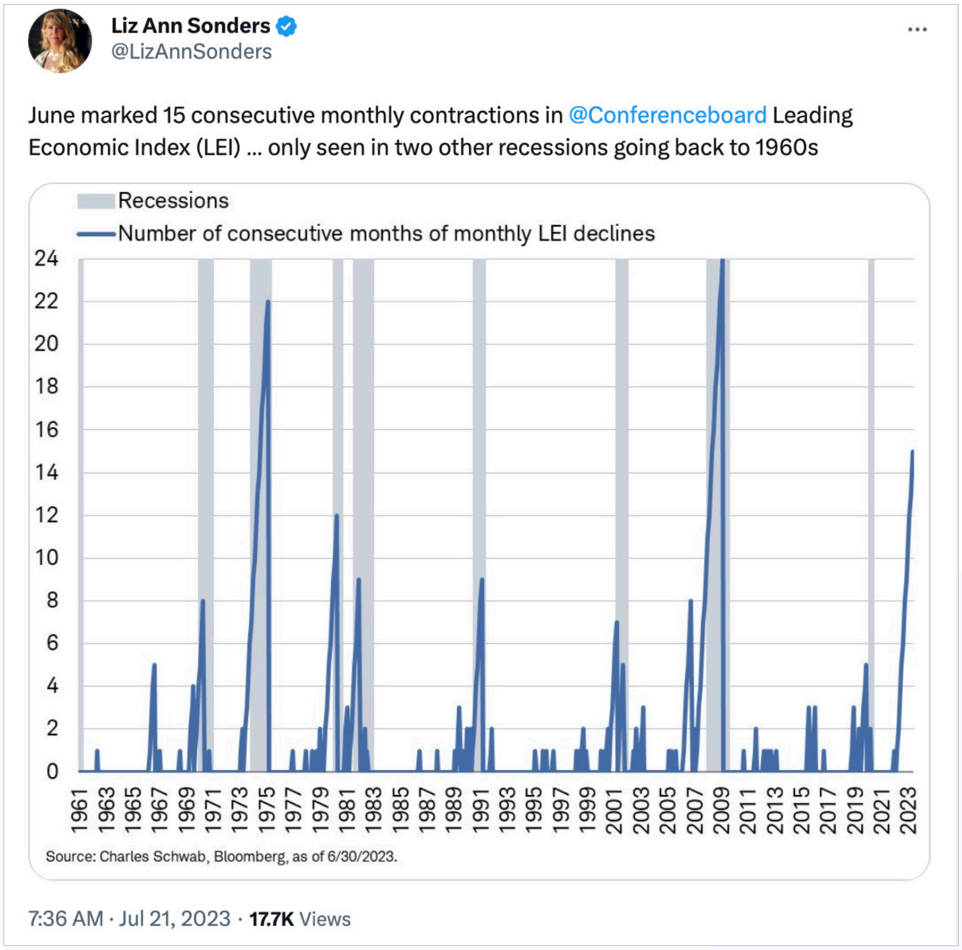
The Federal Reserve's preferred measure of the U.S. Treasury yield curve has never been this inverted without a severe recession following ([from Ian Harnett via Twitter on July 5](#))...



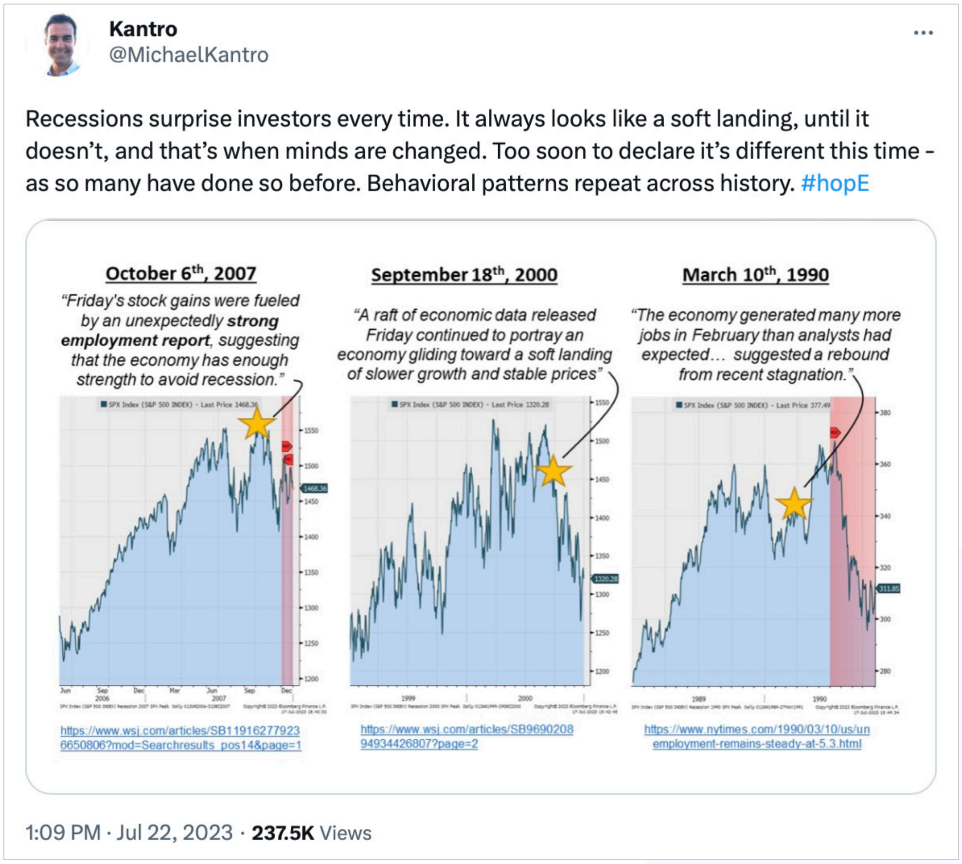
The Conference Board's Leading Economic Index (LEI) – which tracks a basket of indicators whose changes tend to precede changes in the real economy – also declined again in June, bringing its current "peak-to-trough" drawdown to -9.9%. Since 1960, contractions of this magnitude have only occurred when the economy was already in a recession ([from Liz Ann Sonders via Twitter on July 21]())...



The LEI has also now contracted for 15 consecutive months, a streak that has only occurred twice before: during the severe recession of 1973 - 1974 and the Great Financial Crisis of 2007-2009 (from Liz Ann Sonders via Twitter on July 21)...



And as Michael Kantro – Chief Investment Strategist at investment bank Piper Sandler – reminds us, every impending recession looks like a "soft landing," until it doesn't ([from Kantro via Twitter on July 22](#))...

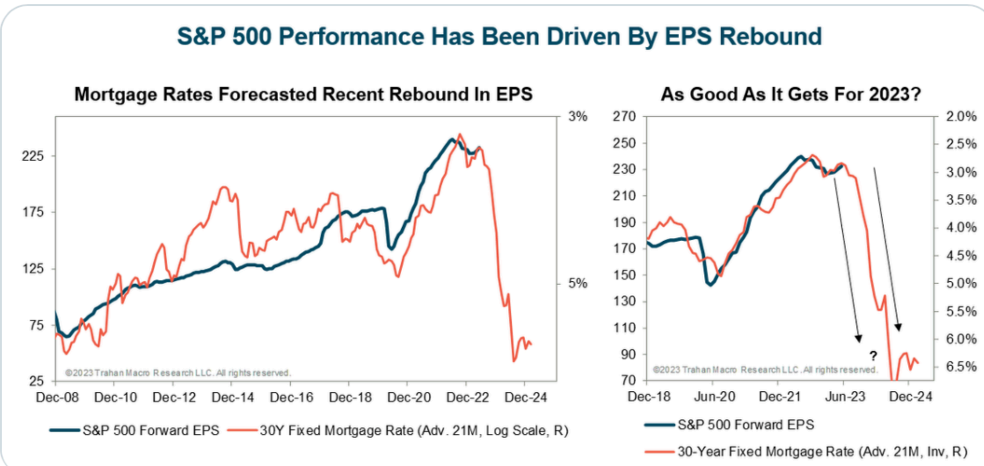


Economics and Markets

Mortgage rates have correctly forecasted U.S. corporate earnings over the past several years, and unfortunately, they're sending an ominous message today ([from Francois Trahan via Twitter on June 26]())...

Francois Trahan
@FrancoisTrahan

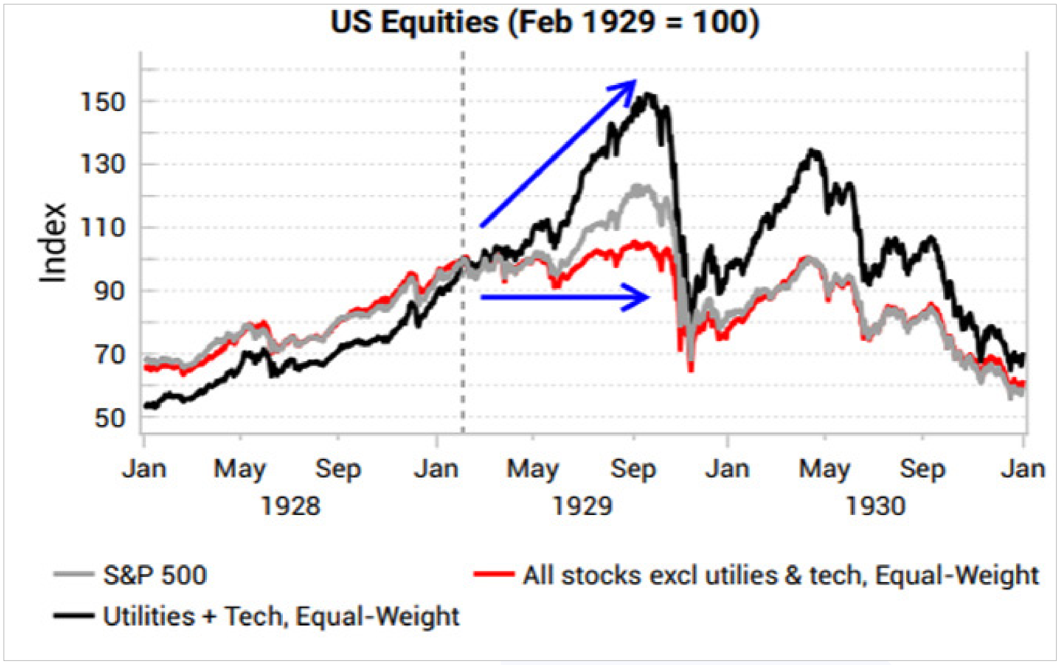
It's a lot easier to forecast trends in earnings expectations than a quarterly move here and there. Still, we have a few helpful indicators. This is mortgage rates and is somewhere between trend and short-term. We normally use this to forecast GDP or industrial production.



11:39 AM · Jun 26, 2023 · **17.4K** Views

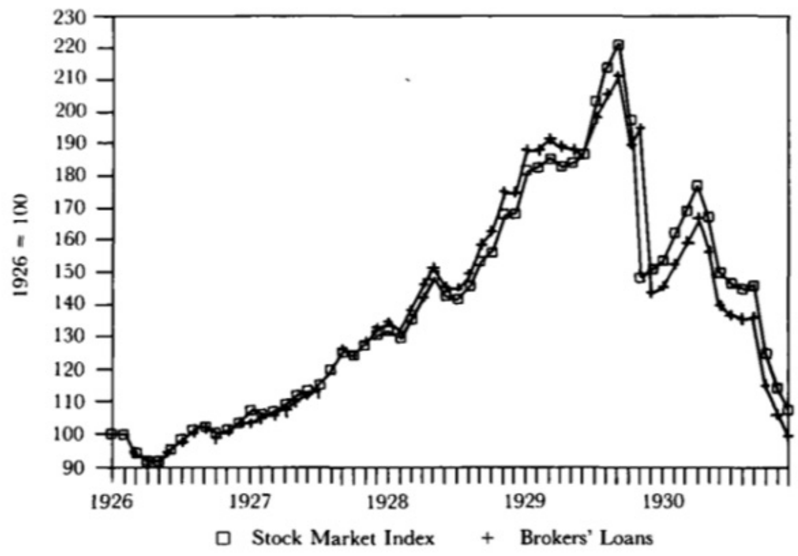
Today's macro environment shares some "uncomfortable" similarities with some major stock market tops of the past ([from The Variant Perception Blog on June 30]())...

> 1929, 1973 and the dotcom bubbles all saw sustained monetary policy tightening and a clear divergence of surging bubble stocks vs the average stock moving sideways/falling.
>
> The 1929 top was preceded by 18 months of tightening policy and a 9-month period of divergence between surging bubble stocks (utilities + tech, thanks to buzz around new technologies and electrification) vs the average stock.



From 1928 onwards, money supply eventually stopped expanding and rates started to rise, causing liquidity conditions to tighten. Despite this equities kept rallying and leverage kept rising (see below chart of equity prices vs brokers' loans).

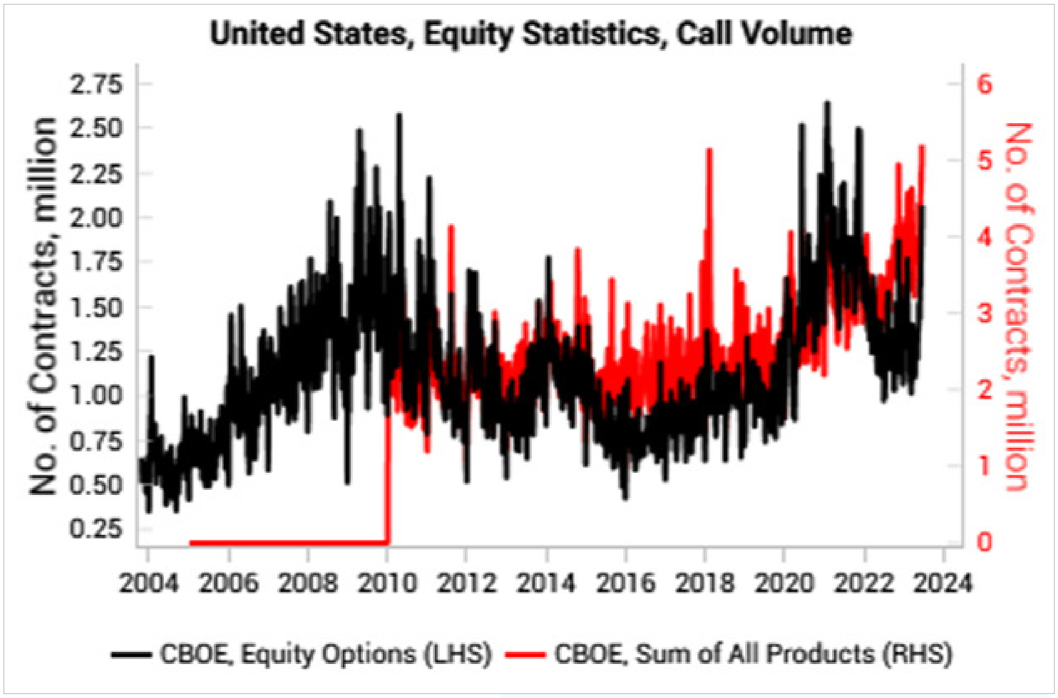
Figure 4
Stock Prices and Brokers' Loans



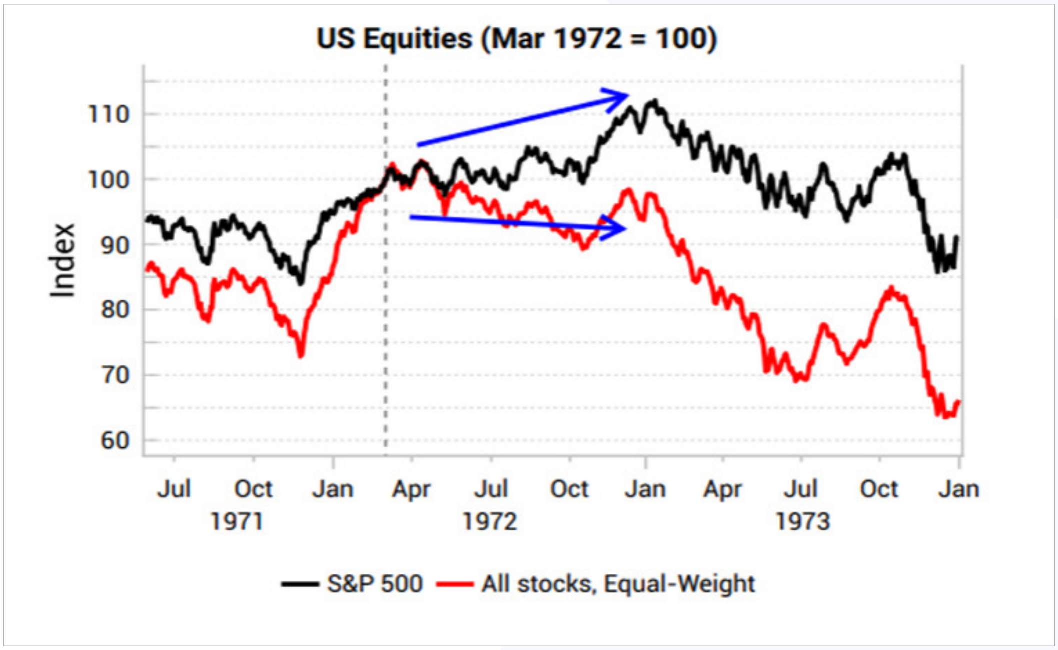
Source: Board of Governors of the Federal Reserve system (1943) and the New York Stock Exchange *Year Book* (1931).

When investors bought stock on margin, their broker usually paid the difference by taking out a broker's loan (collateralized by the stock) from a bank. When the Fed member banks slowed down their lending activities, private investors, corporations and foreign banks from Europe and Japan stepped in to offer credit. Charles Kindleberger has identified this supply of brokers' loans from non-bank sources as responsible for fueling the boom.

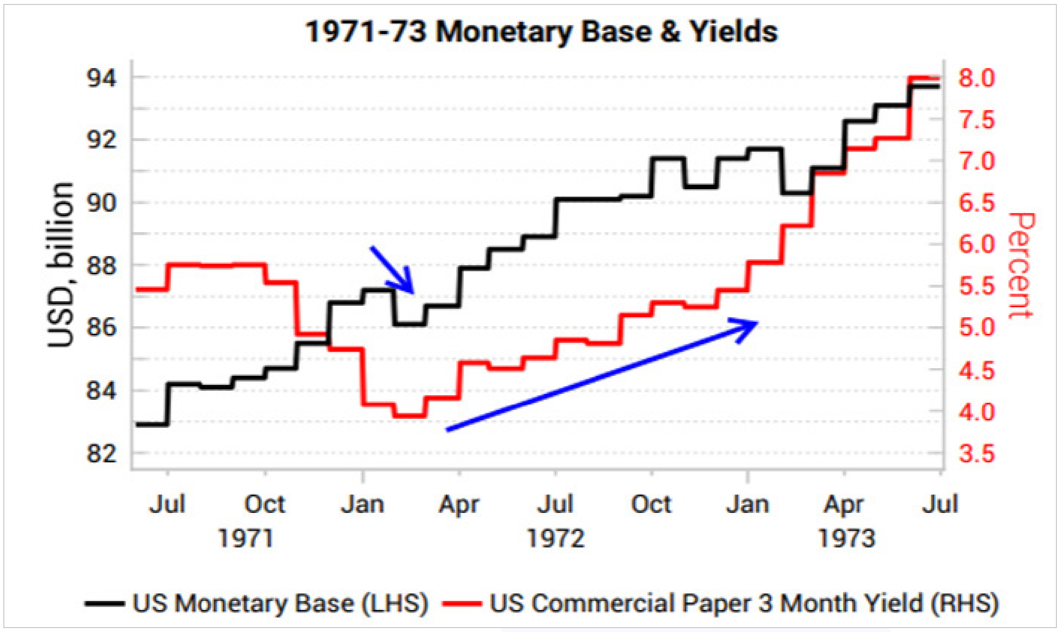
Today's surge in call volumes is reminiscent of investors sourcing alternative forms of leverage.



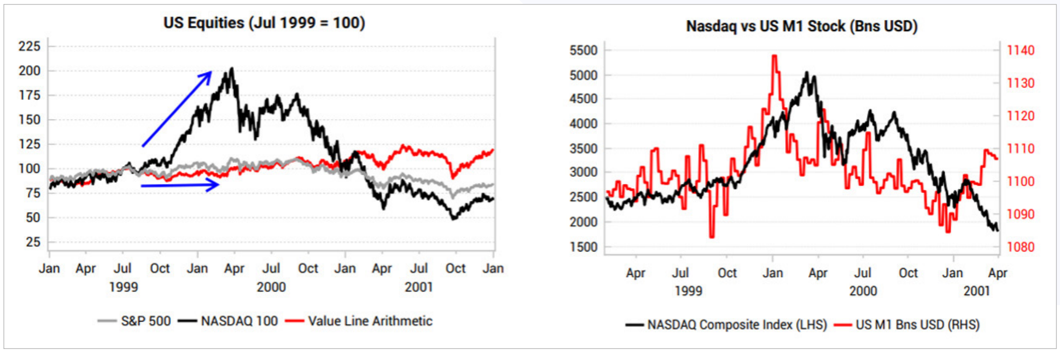
The end of the Nifty-Fifty bubble in 1973 was preceded by a year of rising yields, and a 9-month period where the average stock declined while market-cap weighted indices made new highs.



The 1973 top was preceded by a period of tightening liquidity conditions. The US monetary base initially dropped in March 1972, with yields starting to turn sharply higher. The Fed responded by pumping billions into the money market but yields kept rising.

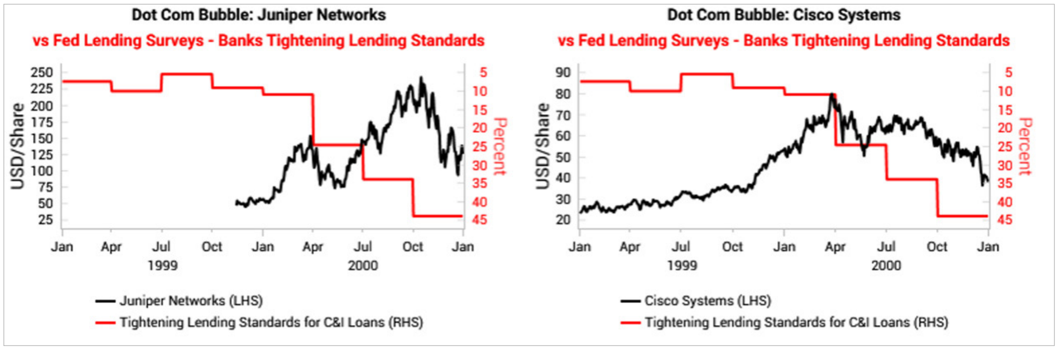


The dotcom bubble saw similar divergences between surging tech stocks vs the average stock. The Fed began withdrawing liquidity in early 2000 after the Y2K scare passed. The Nasdaq peaked in March 2000, had an initial sharp correction into May, before a strong recovery into August, despite Fed hikes and falling narrow money.



This has echoes to today, with banks already tightening lending standards but pockets of the market have still been able to surge.

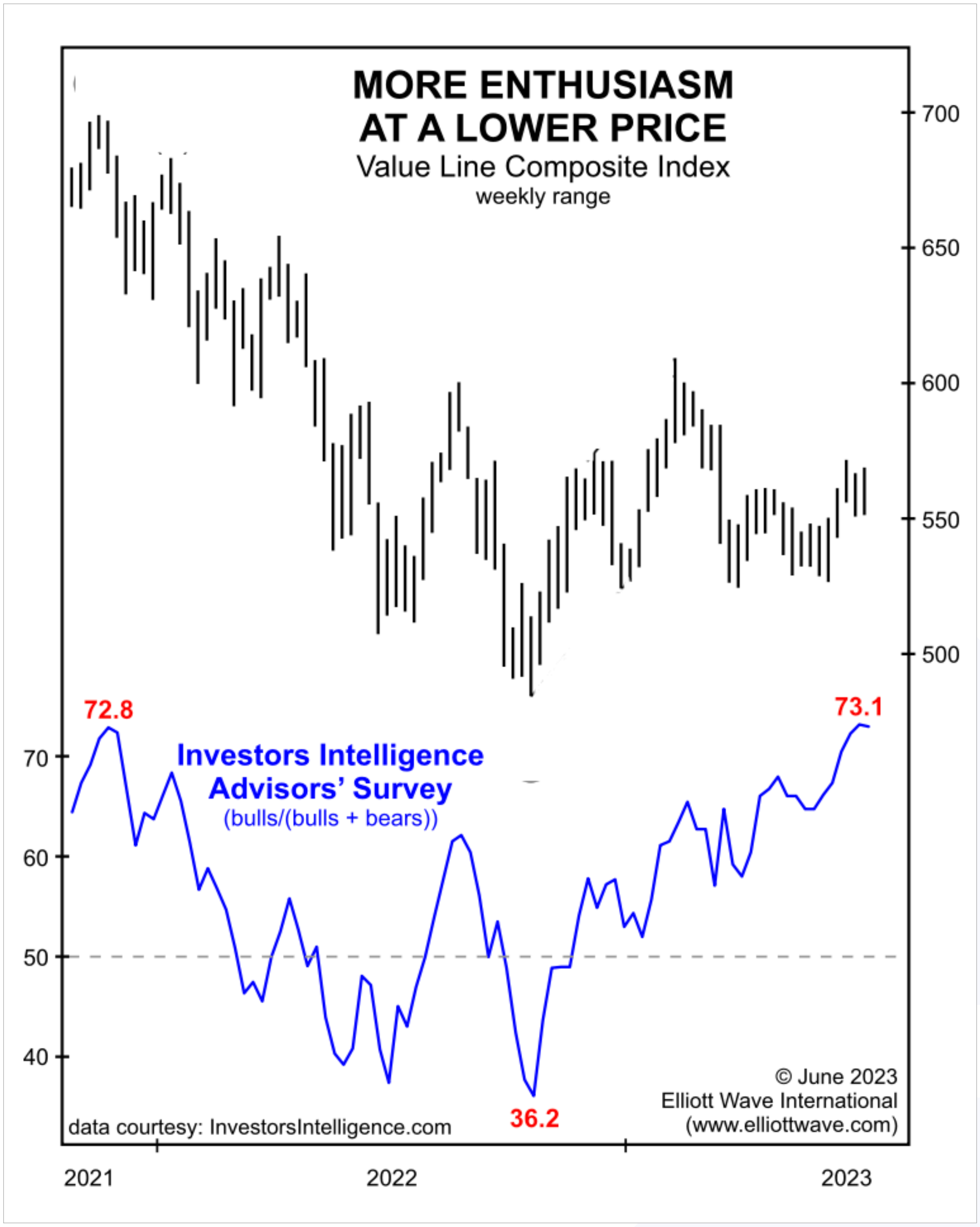
The below charts show Juniper Networks and Cisco during the dotcom bubble, with Juniper surging to highs in October 2000 despite a weak liquidity/credit backdrop.



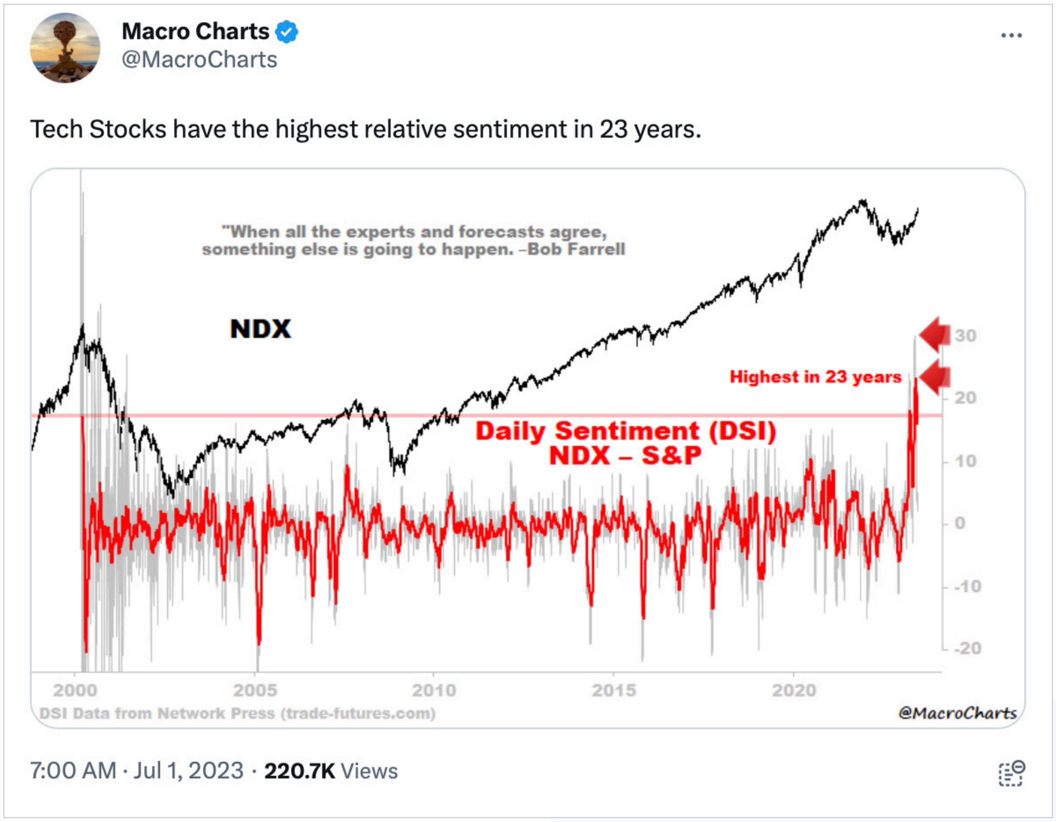
The nature of bubbles is that they can go on for much longer than anyone expects. During the dotcom bubble, Ray Dalio raised concerns about "a blowoff phase of the US stock market" in 1995, while George Soros' Quantum Fund famously lost 700m USD trying to short the internet bubble in 1997-98.

Continue reading here.

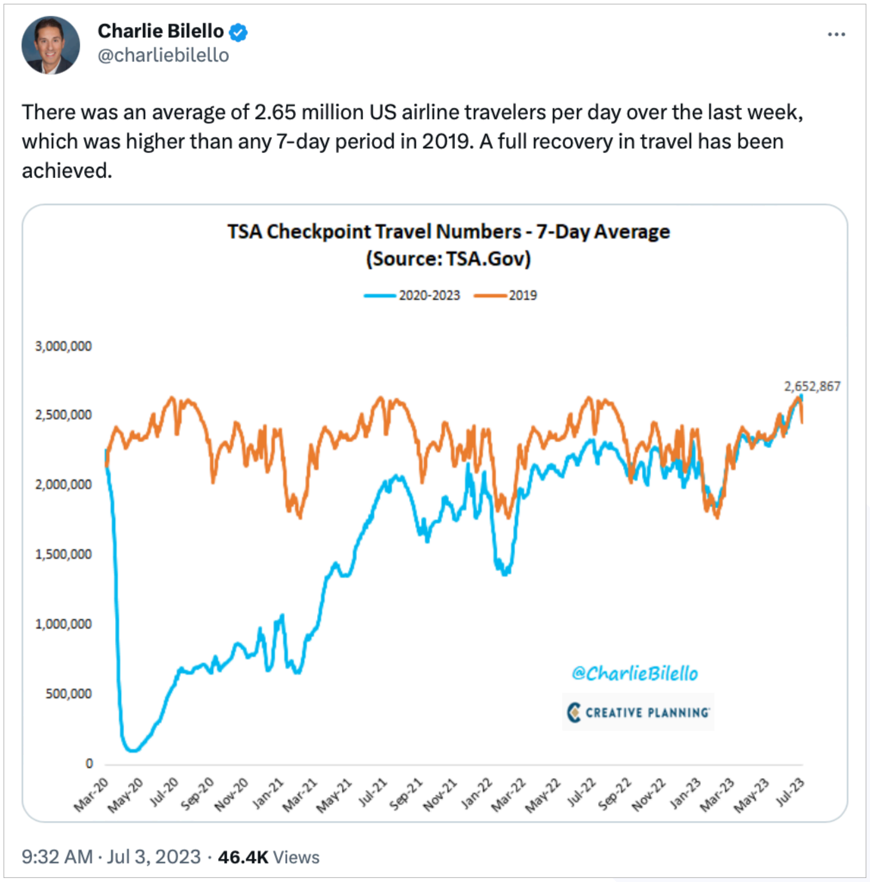
Investment newsletter writers were more bullish at the end of June than at the peak of the market in late 2021/early 2022 ([from the Elliott Wave Financial Forecast on June 30](#))...



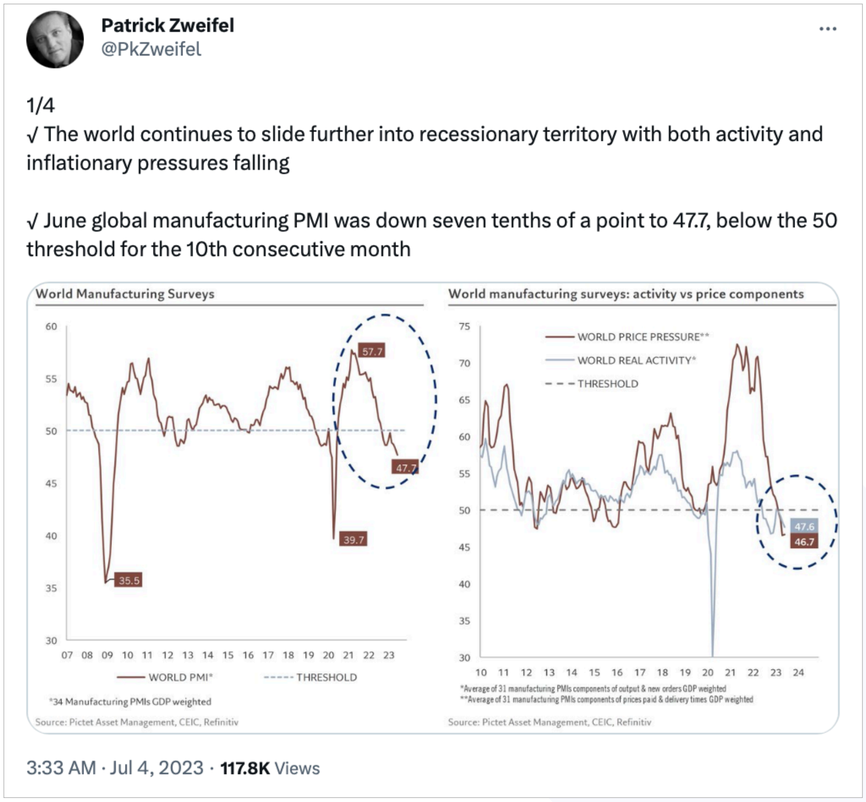
Traders were also more bullish on tech stocks relative to the overall market than any time since the peak of the dot-com bubble (from Macro Charts via Twitter on July 1)...



U.S. airline travel appears to have fully recovered from COVID-19 ([from Charlie Bilello via Twitter on July 3]())…



The global manufacturing sector is showing similar weakness as the U.S. (from Patrick Zweifel via Twitter on July 4)...



Continue reading here.

Vanguard data show America's retirees are betting heavily on stocks. What could go wrong? (from The Wall Street Journal on July 4)...

> Older Americans keep rolling the dice in the stock market, ignoring the conventional wisdom to protect their nest eggs by shifting more of their investments to bonds.
>
> Nearly half of Vanguard 401(k) investors actively managing their money and over age 55 held more than 70% of their portfolios in stocks. In 2011, 38% did so. At Fidelity Investments, nearly four in 10 investors ages 65 to 69 hold about two-thirds or more of their portfolios in stocks.
>
> And it isn't just baby boomers. In taxable brokerage accounts at Vanguard, one-fifth of investors 85 or older have nearly all their money in stocks, up from 16% in 2012. The same is true of almost a quarter of those ages 75 to 84.
>
> Having significant exposure to stocks later in life can be risky, advisers and economists say, if only because if the market were to tumble, retirees needing cash might have no choice but to sell their shares at bargain prices.
>
> Many changes over the past half-century have contributed to older Americans' reliance on

stocks, including the 1978 tax-law change that ushered in the 401(k) and several decades where stocks have bested bonds. During financial or economic crises – including in 1987, 2001, 2008 and 2020 – the Federal Reserve or Congress often stepped in to support the economy.

"The spirit of the times is 'Don't worry about the markets crashing. They will come back up and set new highs,'" said Robert Shiller, a Nobel Prize-winning economist at Yale University.

Catching up

Toby Bloom, 63, tried investing 60% of his retirement savings in stocks and 40% in bonds. But five years ago, the Albuquerque, N.M., resident realized his returns weren't high enough to achieve his goal of retiring by 2026 with at least $40,000.

So he moved 80% of his money into dividend-paying and other stocks in his IRA, which now holds $21,000.

"I am not going to make any money for retirement by being overly stodgy and conservative," said Bloom, an insurance agent.

Continue reading here (subscription may be required).

"Bubble expert" Jeremy Grantham estimates the market has a 70% chance of crashing in the next few years (from Fortune on July 5)...

A legendary investor whose expertise lies in major stock crashes says the market is heading toward a burst bubble, akin to the crises seen in 1929 and 2000.

British billionaire Jeremy Grantham is cofounder of investment management company GMO, which reportedly handles a near $65 billion in assets.

Grantham, estimated to be worth $1 billion himself, previously estimated an 85% likelihood that the stock market would crash but has since downgraded that to 70%.

Despite the figure dropping, Grantham is convinced the market has created a perfect storm for bubbles—such as asset prices—to burst, but said the emergence of artificial intelligence has delayed the pop.

Speaking to WealthTrack in an interview published over the weekend, Grantham, who specializes in long-term investment strategy, said stocks had benefited from an "almost perfect" environment for nearly a decade.

"I'm only interested in the really great bubbles like 1929, 2000, and 2021, [which] are the three senior bubbles in [the] U.S stock market. We have checked off pretty well every one of the boxes," he said.

Grantham... said these "boxes" are periods of long economic upswings, a strong bull market, and strong earnings.

In each of these scenarios, Grantham points out that the markets were then followed by a "sharp leg down."

In 1929 it was Black Thursday when $14 billion was wiped off the market in a single day; in 2000 the Nasdaq lost 76.81% of its value in less than two years; and in 2021 it similarly took a 10% hit.

Grantham said that a rally before his predicted crash was "all present and correct," pointing out that the S&P 500 had a 20% rise in June compared with its October low.

Grantham's gloomy predictions have a track record of being right.

Two years ago Grantham similarly told WealthTrack he expected to see a bubble of "epic" proportions because a number of different markets were trading at extremes: variously the housing market, the "meme" stock market, and the bond market operating at extreme lows.

A year later many of these assets saw major corrections, with meme-motivated shares like movie-theater company AMC seeing a massive drop-off by the summer.

Given that the impact of such an implosion could range from the desolation of the 1929 crash to the "respectable" recession of 2000, Grantham questioned: How quickly and for how long will the economy go down? How low will profit margins fall?

"They have fallen a decent bit already, but they could do a lot worse. And how badly other economic variables will be—the trouble within global trade, the trouble with China, the trouble with the war. And how will that play out? It's very difficult to tell."

Continue reading here (subscription may be required).

Small-cap stocks are at their cheapest relative valuation versus large-cap stocks in over 20 years (from Barchart via Twitter on July 6)...

Barchart
@Barchart

Small Caps haven't gotten much love this year but is it time to take a look at them? The Russell 2000 to S&P 500 ratio is at its lowest point in more than 20 years.

8:58 PM · Jul 6, 2023 · **34K** Views

Financial conditions have eased considerably over the past several months ([from Lisa Abramowicz via Twitter on July 9]())...

Lisa Abramowicz @lisaabramowicz1 · Jul 9

Stocks have rallied even in the face of much higher rates. "If the Fed is trying to solve for tighter financial conditions, it's not being very successful:" Fidelity's Timmer. This "suggests that the Fed is not as restrictive as we may all think" & the neutral rate is above 3-4%.

43 65 366 80.9K

Lisa Abramowicz
@lisaabramowicz1

The Bloomberg Financial Conditions Index is back to being as loose as it was before the bank failures in March.

7:56 PM · Jul 9, 2023 · **23.8K** Views

The U.S. banking system could be on a verge of a “seismic shift” ([from CNBC on July 10]())...

> The whirlwind weekend in late April that saw the country’s biggest bank take over its most troubled regional lender marked the end of one wave of problems — and the start of another.
>
> After emerging with the winning bid for First Republic, a lender to rich coastal families that had $229 billion in assets, JPMorgan Chase
>
> CEO Jamie Dimon delivered the soothing words craved by investors after weeks of stomach-churning volatility: “This part of the crisis is over.”
>
> But even as the dust settles from a string of government seizures of failed midsized banks, the forces that sparked the regional banking crisis in March are still at play.
>
> Rising interest rates will deepen losses on securities held by banks and motivate savers to pull cash from accounts, squeezing the main way these companies make money. Losses on commercial real estate and other loans have just begun to register for banks, further shrinking their bottom lines. Regulators will turn their sights on midsized

institutions after the collapse of Silicon Valley Bank exposed supervisory lapses.

What is coming will likely be the most significant shift in the American banking landscape since the 2008 financial crisis. Many of the country's 4,672 lenders will be forced into the arms of stronger banks over the next few years, either by market forces or regulators, according to a dozen executives, advisors and investment bankers who spoke with CNBC.

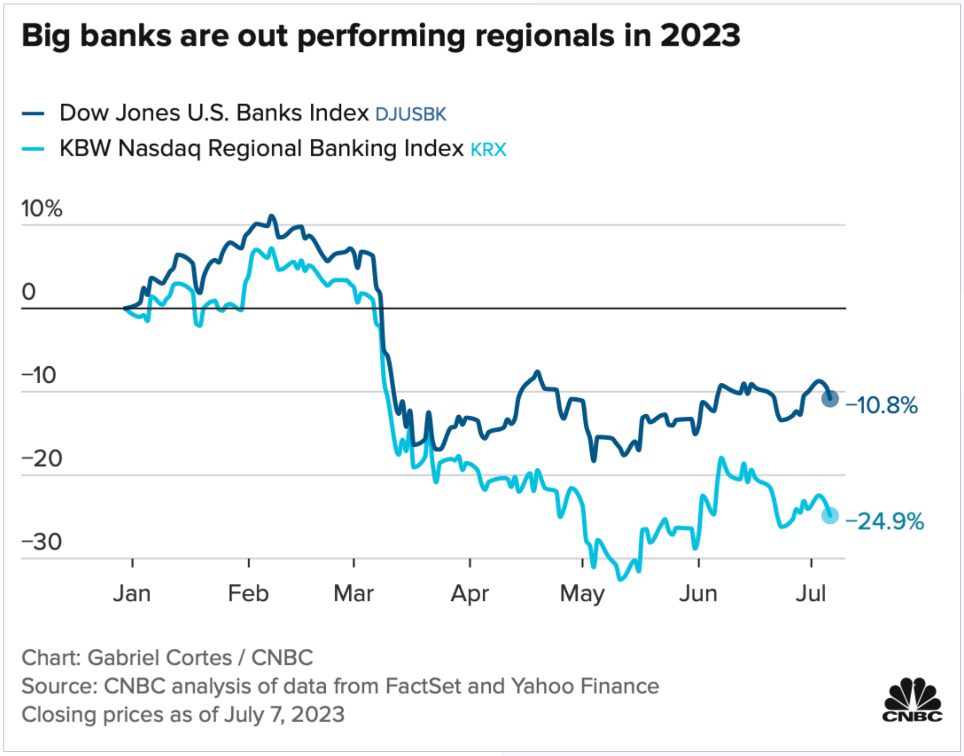
"You're going to have a massive wave of M&A among smaller banks because they need to get bigger," said the co-president of a top six U.S. bank who declined to be identified speaking candidly about industry consolidation. "We're the only country in the world that has this many banks."

How'd we get here?

To understand the roots of the regional bank crisis, it helps to look back to the turmoil of 2008, caused by irresponsible lending that fueled a housing bubble whose collapse nearly toppled the global economy.

The aftermath of that earlier crisis brought scrutiny on the world's biggest banks, which needed bailouts to avert disaster. As a result, it was ultimately institutions with $250 billion or more in assets that saw the most changes, including annual stress tests and stiffer rules governing how much loss-absorbing capital they had to keep on their balance sheets.

Non-giant banks, meanwhile, were viewed as safer and skirted by with less federal oversight. In the years after 2008, regional and small banks often traded for a premium to their bigger peers, and banks that showed steady growth by catering to wealthy homeowners or startup investors, like First Republic and SVB, were rewarded with rising stock prices. But while they were less complex than the giant banks, they were not necessarily less risky.



The sudden collapse of SVB in March showed how quickly a bank could unravel, dispelling one of the core assumptions of the industry: the so-called stickiness of deposits. Low interest rates and bond-purchasing programs that defined the post-2008 years flooded banks with a cheap source of funding and lulled depositors into leaving cash parked at accounts that paid negligible rates.

“For at least 15 years, banks have been awash in deposits and with low rates, it cost them nothing,” said Brian Graham, a banking veteran and co-founder of advisory firm Klaros Group. “That’s clearly changed.”

‘Under stress’

After 10 straight rate hikes and with banks making headline news again this year, depositors have moved funds in search of higher yields or greater perceived safety. Now it’s the too-big-to-fail banks, with their implicit government backstop, that are seen as the safest places to park money. Big bank stocks have outperformed regionals. JPMorgan shares are up 7.6% this year, while the KBW Regional Banking Index is down more than 20%.

That illustrates one of the lessons of March’s tumult. Online tools have made moving money easier, and social media platforms have led to coordinated fears over lenders. Deposits that in the past were considered “sticky,” or unlikely to move, have suddenly become slippery. The industry’s funding is more expensive as a result, especially for smaller banks with a higher percentage of uninsured deposits. But even the megabanks have been forced to pay higher rates to retain deposits.

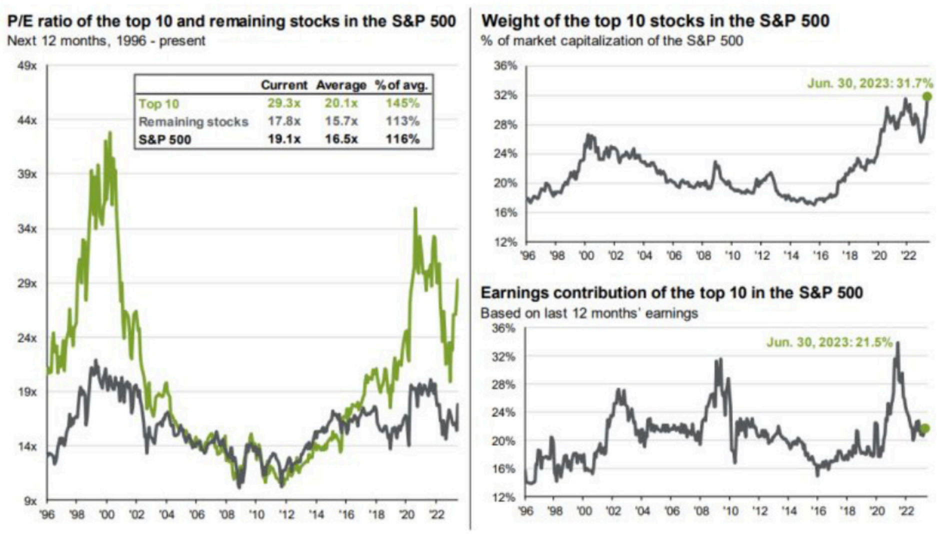
Continue reading here.

While the largest companies have been driving the market higher, they've also been accounting for a dramatically smaller share of overall earnings ([from Christopher Pavese via LinkedIn on July 10])...

Christopher Pavese • 3rd+
President & Chief Investment Officer at Broyhill Asset ...
2w •

+ Follow

Earnings contribution of the top ten stocks in $SPY has collapsed while their % of market capitalization has rocketed past all-time highs. Gonna be a great time for stock pickers as this unwinds . . . again.

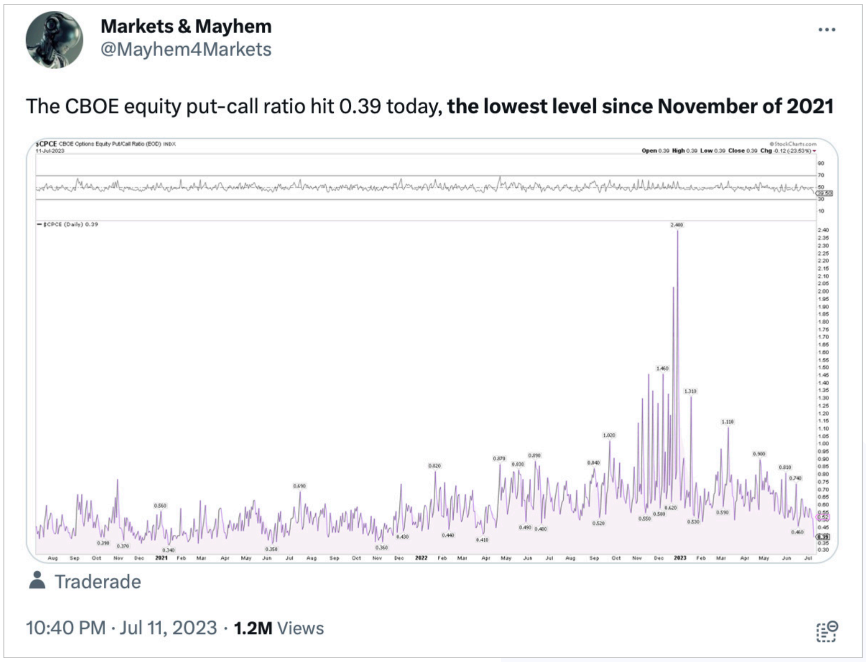


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
The top 10 S&P 500 companies are based on the 10 largest index constituents at the beginning of each month. As of 5/31/2023, the top 10 companies in the index were AAPL (7.5%), MSFT (7.0%), AMZN (3.1%), NVDA (2.7%), GOOGL (2.1%), GOOG (1.8%), Meta (1.7%), BRK.B (1.7%), TLSA (1.6%), UNH (1.3%) and XOM (1.2%). The remaining stocks represent the rest of the 494 companies in the S&P 500.
Guide to the Markets – U.S. Data are as of June 30, 2023.

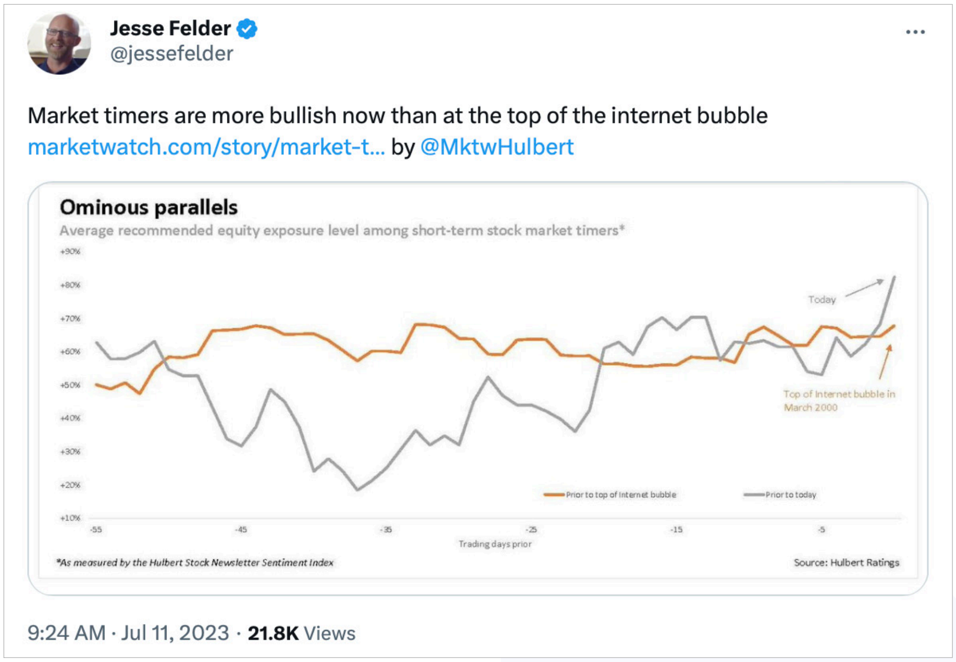
J.P.Morgan
ASSET MANAGEMENT

The last similar period of U.S. dollar strength saw emerging markets outperform the U.S. – and value stocks outperform growth stocks – over the following decade (from Jeff Weniger via Twitter on July 10)...

The CBOE equity put-to-call ratio fell to 0.39 this month, its lowest level since November 2021. Like [the charts we shared in last month's "The Five](#)," this is yet another indication that market participants have become extremely complacent today ([from Markets & Mayhem via Twitter on July 11](#))...



Short-term trading services are more bullish now than they were at the peak of the dot-com bubble ([from Jesse Felder via Twitter on July 11]())...

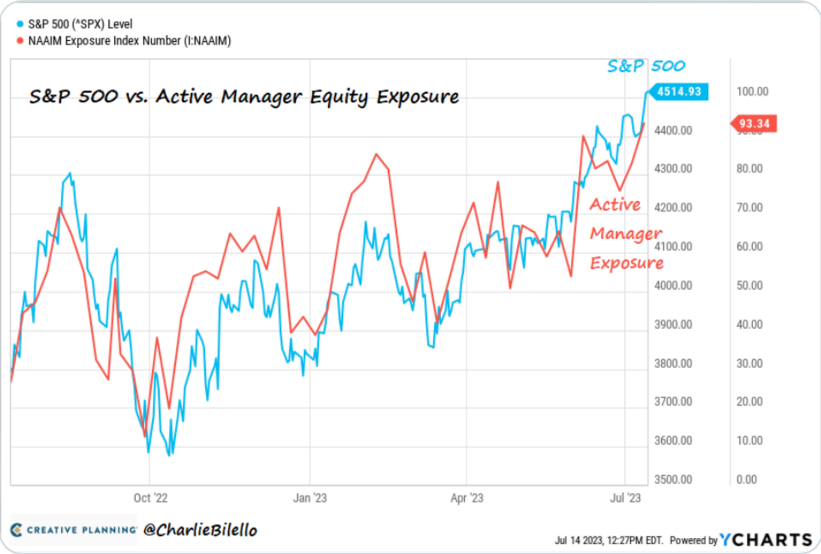


Active investment managers are also wildly bullish again today ([from Charlie Bilello via Twitter on July 14]())...

Charlie Bilello
@charliebilello

Active managers had less than 20% exposure to equities last October when the S&P 500 was at 3,500.

Today their equity exposure has jumped above 90% with the S&P 500 at 4,500. This is the highest exposure since November 2021.



12:35 PM · Jul 14, 2023 · **399.2K** Views

The U.S. government's fiscal health is currently as bad as it was during the worst of the Great Financial Crisis (from Otavio Costa on July 17)...

Otavio (Tavi) Costa
@TaviCosta

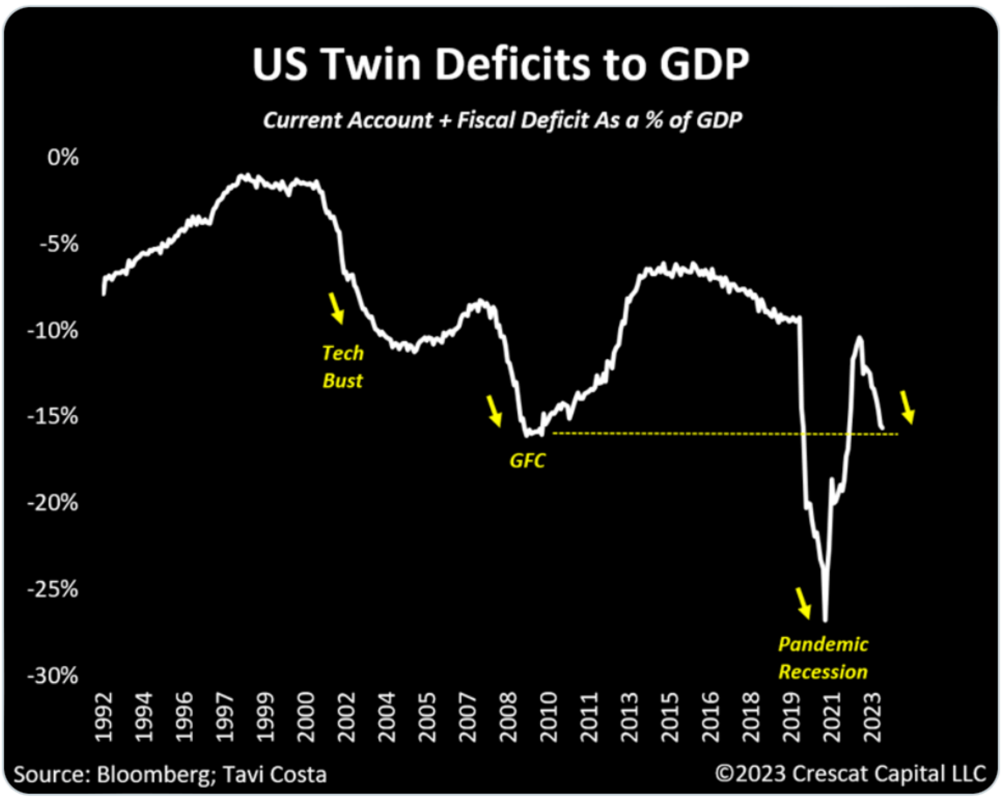
The US is now running twin deficits that are as severe as those experienced during the worst parts of the Global Financial Crisis.

This factor has contributed to the recent weakness in the US dollar.

Of even greater concern is the indication that this represents an ongoing structural issue that is still in the process of evolving.

Note that with each prior recession, this measurement has reached new lows.

This further emphasizes the importance of owning hard assets in this environment.



11:33 PM · Jul 17, 2023 · **257K** Views

This year's huge rally in mega-cap tech just forced a "special rebalance" in the Nasdaq 100 index (from The Wall Street Journal on July 21)...

> The Nasdaq-100 is getting rebalanced after its biggest tech companies got too big.
>
> The move was triggered earlier this month when the companies in the index with weightings exceeding 4.5% saw their combined weighting surpass 48%, according to Cameron Lilja, global head of index product and operations at Nasdaq. The rebalance, which takes effect Monday, will cap their combined weighting at 40% in accordance with the index's methodology.
>
> Shares of megacap tech companies have been on a tear this year, with Nvidia's stock more than tripling and Tesla's more than doubling. The Nasdaq-100 tracks the country's biggest tech companies and is weighted according to market cap, meaning bigger companies have a bigger influence on its performance.
>
> Nasdaq isn't adding or subtracting companies from the index.
>
> The weighting criteria are designed to align with fund diversification rules for regulated investment companies, according to Lilja.
>
> - Apple and Microsoft will remain the most heavily weighted components, but their weightings will be reduced to about 12% and 10% respectively, according to a note from Goldman Sachs' David Kostin, citing information Nasdaq provided to clients.
>
> - Broadcom's index weighting will increase the most, from 2.4% to 3%, according to Kostin.
>
> Billions of dollars of assets in funds tracking the Nasdaq-100, including the popular Invesco QQQ exchange-traded fund, stand to be affected as fund managers buy and sell shares to match the rebalanced index. Still, the rebalance will likely have limited impact on the performance of the affected stocks based on what happened after the last special rebalance in 2011, according to Kostin.

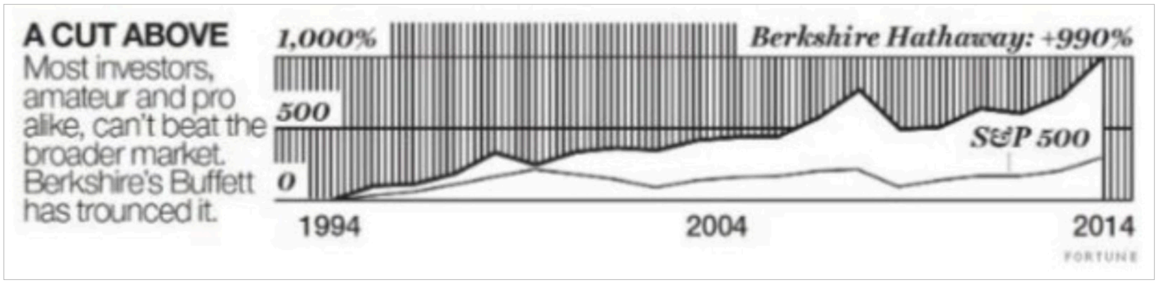
Continue reading here (subscription may be required).

The Legends Speak

Wisdom and Insight from the World's Greatest Investors

Berkshire Hathaway Chairman Warren Buffett's classic explanation of his real estate investments should be required reading for every investor (from Finding Compounders via Twitter on July 8)...

> "Investment is most intelligent when it is most businesslike."
> – Benjamin Graham, The Intelligent Investor
>
> It is fitting to have a Ben Graham quote open this essay because I owe so much of what I know about investing to him. I will talk more about Ben a bit later, and I will even sooner talk about common stocks. But let me first tell you about two small nonstock investments that I made long ago. Though neither changed my net worth by much, they are instructive.
>
> This tale begins in Nebraska. From 1973 to 1981, the Midwest experienced an explosion in farm prices, caused by a widespread belief that runaway inflation was coming and fueled by the lending policies of small rural banks. Then the bubble burst, bringing price declines of 50% or more that devastated both leveraged farmers and their lenders. Five times as many Iowa and Nebraska banks failed in that bubble's aftermath as in our recent Great Recession.
>
> In 1986, I purchased a 400-acre farm, located 50 miles north of Omaha, from the FDIC. It cost me $280,000, considerably less than what a failed bank had lent against the farm a few years earlier. I knew nothing about operating a farm. But I have a son who loves farming, and I learned from him both how many bushels of corn and soybeans the farm would produce and what the operating expenses would be. From these estimates, I calculated the normalized return from the farm to then be about 10%. I also thought it was likely that productivity would improve over time and that crop prices would move higher as well. Both expectations proved out.
>
> I needed no unusual knowledge or intelligence to conclude that the investment had no downside and potentially had substantial upside. There would, of course, be the occasional bad crop, and prices would sometimes disappoint. But so what? There would be some unusually good years as well, and I would never be under any pressure to sell the property. Now, 28 years later, the farm has tripled its earnings and is worth five times or more what I paid. I still know nothing about farming and recently made just my second visit to the farm.
>
> In 1993, I made another small investment. Larry Silverstein, Salomon's landlord when I was the company's CEO, told me about a New York retail property adjacent to New York University that the Resolution Trust Corp. was selling. Again, a bubble had popped — this one involving commercial real estate — and the RTC had been created to dispose of the assets of failed savings institutions whose optimistic lending practices had fueled the folly.
>
> Here, too, the analysis was simple. As had been the case with the farm, the unleveraged current yield from the property was about 10%. But the property had been undermanaged by the RTC, and its income would increase when several vacant stores were leased. Even more important, the largest tenant — who occupied around 20% of the project's space — was paying rent of about $5 per foot, whereas other tenants averaged $70. The expiration of this bargain lease in nine years was certain to provide a major boost to earnings. The property's location was also superb: NYU wasn't going anywhere.



I joined a small group — including Larry and my friend Fred Rose — in purchasing the building. Fred was an experienced, high-grade real estate investor who, with his family, would manage the property. And manage it they did. As old leases expired, earnings tripled. Annual distributions now exceed 35% of our initial equity investment. Moreover, our original mortgage was refinanced in 1996 and again in 1999, moves that allowed several special distributions totaling more than 150% of what we had invested. I've yet to view the property.

Income from both the farm and the NYU real estate will probably increase in decades to come. Though the gains won't be dramatic, the two investments will be solid and satisfactory holdings for my lifetime and, subsequently, for my children and grandchildren.

I tell these tales to illustrate certain fundamentals of investing:

- You don't need to be an expert in order to achieve satisfactory investment returns. But if you aren't, you must recognize your limitations and follow a course certain to work reasonably well. Keep things simple and don't swing for the fences. When promised quick profits, respond with a quick "no."

- Focus on the future productivity of the asset you are considering. If you don't feel comfortable making a rough estimate of the asset's future earnings, just forget it and move on. No one has the ability to evaluate every investment possibility. But omniscience isn't necessary; you only need to understand the actions you undertake.

- If you instead focus on the prospective price change of a contemplated purchase, you are speculating. There is nothing improper about that. I know, however, that I am unable to speculate successfully, and I am skeptical of those who claim sustained success at doing so. Half of all coin-flippers will win their first toss; none of those winners has an expectation of profit if he continues to play the game. And the fact that a given asset has appreciated in the recent past is never a reason to buy it.

- With my two small investments, I thought only of what the properties would produce and cared not at all about their daily valuations. Games are won by players who focus on the playing field — not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays.

- Forming macro opinions or listening to the macro or market predictions of others is a waste of time. Indeed, it is dangerous because it may blur your vision of the facts that are truly important. (When I hear TV commentators glibly opine on what the market will do next, I am reminded of Mickey Mantle's scathing comment: "You don't know how easy this game is until you get into that broadcasting booth.")

My two purchases were made in 1986 and 1993. What the economy, interest rates, or the stock market might do in the years immediately following — 1987 and 1994 — was of no importance to me in determining the success of those investments. I can't remember what the headlines or pundits were saying at the time. Whatever the chatter, corn would keep growing in Nebraska and students would flock to NYU.

There is one major difference between my two small investments and an investment in stocks. Stocks provide you minute-to-minute valuations for your holdings, whereas I have yet to see a quotation for either my farm or the New York real estate.

It should be an enormous advantage for investors in stocks to have those wildly fluctuating valuations placed on their holdings — and for some investors, it is. After all, if a moody fellow with a farm bordering my property yelled out a price every day to me at which he would either buy my farm or sell me his — and those prices varied widely over short periods of time depending on his mental state — how in the world could I be other than benefited by his erratic behavior? If his daily shout-out was ridiculously low, and I had some spare cash, I would buy his farm. If the number he yelled was absurdly high, I could either sell to him or just go on farming.

Owners of stocks, however, too often let the capricious and irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits — and, worse yet, important to consider acting upon their comments.

Those people who can sit quietly for decades when they own a farm or apartment house too often become frenetic when they are exposed to a stream of stock quotations and accompanying commentators delivering an implied message of "Don't just sit there — do something." For these investors, liquidity is transformed from the unqualified benefit it should be to a curse.

A "flash crash" or some other extreme market fluctuation can't hurt an investor any more than an erratic and mouthy neighbor can hurt my farm investment. Indeed, tumbling markets can be helpful to the true investor if he has cash available when prices get far out of line with values. A climate of fear is your friend when investing; a euphoric world is your enemy.

During the extraordinary financial panic that occurred late in 2008, I never gave a thought to selling my farm or New York real estate, even though a severe recession was clearly brewing. And if I had owned 100% of a solid business with good long-term prospects, it would have been foolish for me to even consider dumping it. So why would I have sold my stocks that were small participations in wonderful businesses? True, any one of them might eventually disappoint, but as a group they were certain to do well. Could anyone really believe the earth was going to swallow up the incredible productive assets and unlimited human ingenuity existing in America?

When Charlie Munger and I buy stocks — which we think of as small portions of businesses — our analysis is very similar to that which we use in buying entire businesses. We first have to decide whether we can sensibly estimate an earnings range for five years out or more. If the answer is yes, we will buy the stock (or business) if it sells at a reasonable price in relation to the bottom boundary of our estimate. If, however, we lack the ability to estimate future earnings — which is usually the case — we simply move on to other prospects. In the 54 years we have worked together, we have never forgone an attractive purchase because of the macro or political environment, or the views of other people. In fact, these subjects never come up when we make decisions.

It's vital, however, that we recognize the perimeter of our "circle of competence" and stay well inside of it. Even then, we will make some mistakes, both with stocks and businesses. But they will not be the disasters that occur, for example, when a long-rising market induces purchases that are based on anticipated price behavior and a desire to be where the action is.

Most investors, of course, have not made the study of business prospects a priority in their lives. If wise, they will conclude that they do not know enough about specific businesses to predict their future earning power.

I have good news for these nonprofessionals: The typical investor doesn't need this skill. In aggregate, American business has done wonderfully over time and will continue to do so (though, most assuredly, in unpredictable fits and starts). In the 20th century, the Dow Jones industrial index advanced from 66 to 11,497, paying a rising stream of dividends to boot. The 21st century will witness further gains, almost certain to be substantial. The goal of the nonprofessional should not be to pick winners — neither he nor his "helpers" can do that — but should rather be to own a cross section of businesses that in aggregate are bound to do well. A low-cost S&P 500 index fund will achieve this goal.

That's the "what" of investing for the nonprofessional. The "when" is also important. The main danger is that the timid or beginning investor will enter the market at a time of extreme exuberance and then become disillusioned when paper losses occur. (Remember the late Barton Biggs's observation: "A bull market is like sex. It feels best just before it ends.") The antidote to that kind of mistiming is for an investor to accumulate shares over a long period and never sell when the news is bad and stocks are well off their highs. Following those rules, the "know-nothing" investor who both diversifies and keeps his costs minimal is virtually certain to get satisfactory results. Indeed, the unsophisticated investor who is realistic about his shortcomings is likely to obtain better long-term results than the knowledgeable professional who is blind to even a single weakness.

If "investors" frenetically bought and sold farmland to one another, neither the yields nor the prices of their crops would be increased. The only consequence of such behavior would be decreases in the overall earnings realized by the farm-owning population because of the substantial costs it would incur as it sought advice and switched properties.

Nevertheless, both individuals and institutions will constantly be urged to be active by those who profit from giving advice or effecting transactions. The resulting frictional costs can be huge and, for investors in aggregate, devoid of benefit. So ignore the chatter, keep your costs minimal, and invest in stocks as you would in a farm.

My money, I should add, is where my mouth is: What I advise here is essentially identical to certain instructions I've laid out in my will. One bequest provides that cash will be delivered to a trustee for my wife's benefit. (I have to use cash for individual bequests, because all of my Berkshire Hathaway (BRKA) shares will be fully distributed to certain philanthropic organizations over the 10 years following the closing of my estate.) My advice to the trustee could not be more simple: Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund. (I suggest Vanguard's. (VFINX)) I believe the trust's long-term results from this policy will be superior to those attained by most investors — whether pension funds, institutions, or individuals — who employ high-fee managers.

And now back to Ben Graham. I learned most of the thoughts in this investment discussion from Ben's book The Intelligent Investor, which I bought in 1949. My financial life changed with that purchase.

Before reading Ben's book, I had wandered around the investing landscape, devouring everything written on the subject. Much of what I read fascinated me: I tried my hand at charting and at using market indicia to predict stock movements. I sat in brokerage offices watching the tape roll by, and I listened to commentators. All of this was fun, but I couldn't shake the feeling that I wasn't getting anywhere.

In contrast, Ben's ideas were explained logically in elegant, easy-to-understand prose (without Greek letters or complicated formulas). For me, the key points were laid out in what later editions labeled Chapters 8 and 20. These points guide my investing decisions today.

A couple of interesting sidelights about the book: Later editions included a postscript describing an unnamed investment that was a bonanza for Ben. Ben made the purchase in 1948 when he was writing the first edition and — brace yourself — the mystery company was Geico. If Ben had not recognized the special qualities of Geico when it was still in its infancy, my future and Berkshire's would have been far different.

The 1949 edition of the book also recommended a railroad stock that was then selling for $17 and earning about $10 per share. (One of the reasons I admired Ben was that he had the guts to use current examples, leaving himself open to sneers if he stumbled.) In part, that low valuation resulted from an accounting rule of the time that required the railroad to exclude from its reported earnings the substantial retained earnings of affiliates.

The recommended stock was Northern Pacific, and its most important affiliate was Chicago, Burlington & Quincy. These railroads are now important parts of BNSF (Burlington Northern Santa Fe), which is today fully owned by Berkshire. When I read the book, Northern Pacific had a market value of about $40 million. Now its successor (having added a great many properties, to be sure) earns that amount every four days.

I can't remember what I paid for that first copy of The Intelligent Investor. Whatever the cost, it would underscore the truth of Ben's adage: Price is what you pay; value is what you get. Of all the investments I ever made, buying Ben's book was the best (except for my purchase of two marriage licenses).

Warren Buffett is the CEO of Berkshire Hathaway. This essay is an edited excerpt from his annual letter to shareholders.

This story is from the March 17, 2014 issue of Fortune.

Billionaire investor Howard Marks on "taking the temperature" of the markets (from the Financial Times on July 10)...

How can an investor make useful observations regarding the status of the markets? Most of the time, markets are near the middle ground — perhaps a little high or a little low, but not so extreme as to permit dependable conclusions.

Investors' records of success with calls in markets such as these are poor. Even if they are right about asset prices being out of line with fundamental valuations, it is very easy for something that is a little overpriced to go on to become demonstrably more so, and then to turn into a raging bubble, and vice versa.

However, once in a while, markets go so high or so low that the argument for action is compelling and the probability of being right is high. When markets are at these extremes, the key to generating superior future investment returns lies in understanding what is responsible for the current conditions.

Everyone can study economics, finance and accounting and learn how the markets are supposed to work. But superior investment results come from exploiting the differences between how things are supposed to work and how they actually do in the real world.

To do that, the essential inputs are not economic data or financial statement analysis. The key lies in understanding prevailing investor psychology, or what I like to call "taking the temperature of the market." Here is what I consider the most essential components:

- Investors should learn to recognise market patterns. Study market history in order to better understand the implications of today's events. Ironically, investor psychology and market cycles — which both seem flighty and unpredictable in the short term — fluctuate in ways that have more for regular patterns when viewed over the long term (though with highly variable causality, timing, and amplitude).

- Understand that cycles stem from excesses and corrections. I define cycles not as a series of up and down movements, each of which regularly precedes the next, but rather as a series of events, each of which causes the next. I think economies, investor psychology and markets eventually become too positive or too negative, and afterwards they eventually swing back towards moderation (and then usually towards excess in the opposite direction). Thus, a strong movement in one direction is more likely to be followed by a correction in the opposite direction than by a trend that "grows to the sky".

- Watch for moments when most people are so optimistic that they think things can only get better, an expression that usually serves to justify the dangerous view that "there's no price too high". Likewise, recognise when people are so depressed that they conclude things can only get worse, as this often means they think a sale at any price is a good sale. When the herd's thinking is either Pollyanna-ish or apocalyptic, the odds increase that the current price level and direction are unsustainable.

- Remember that in extreme times, the secret to making money lies in contrarianism, not conformity. When emotional investors take an extreme view of an asset's future and, as a result, take the price to unjustified levels, the "easy money" is usually made by doing the opposite.

This is, however, very different from simply diverging from the consensus all the time. Most of the time, the consensus is as close to right as most individuals can get. So to be successful at contrarianism, you have to understand (a) what the herd is doing, (b) why it is doing it, (c) what is wrong with it, and (d) what should be done instead.

Continue reading here (subscription may be required).

Legendary value investor Seth Klarman joins the great Jim Grant for a rare public conversation on investing and markets (from Grant's Current Yield Podcast on July 12)...

You can listen here or via YouTube using the linked timestamps below:

Introduction: 0:00
Charity: 2:36
Why a Seventh Edition of "Security Analysis": 3:20
Spirit of Graham and Dodd: 7:11
Margin of Safety: 14:56
Buying the Dip: 18:37
Market Efficiency: 23:06
Human Progress: 26:29
Social Media: 31:34
Blitzscaling: 36:45
Growth and Change: 39:08
Opportunity: 40:33

Highlights from one of Warren Buffett's most powerful speeches on successful investing (from The Thinking Investor on July 15)...

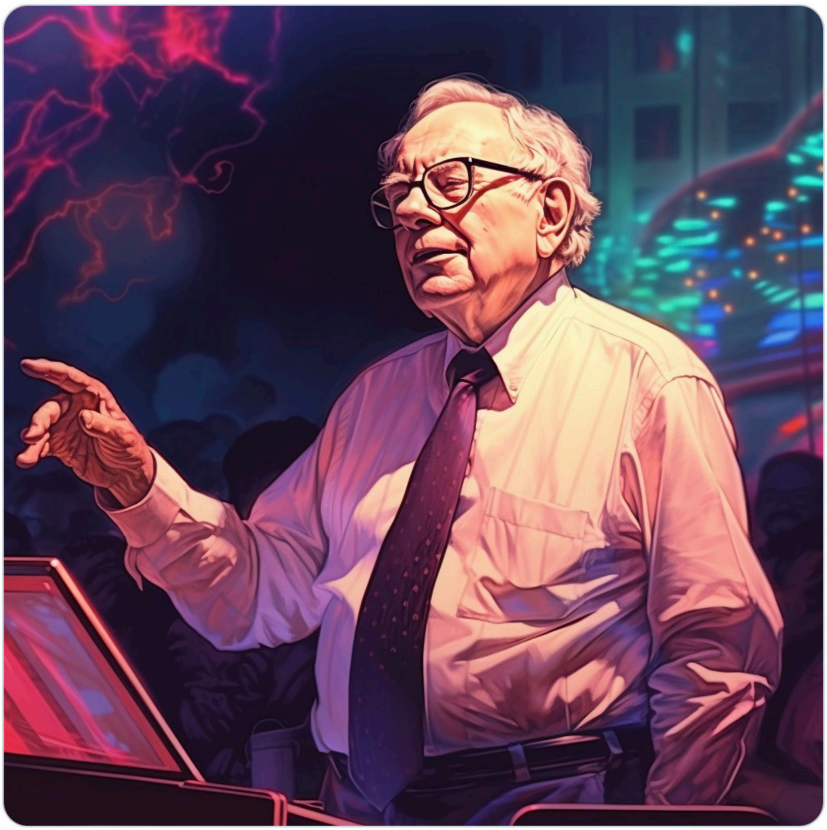
The Thinking Investor @IrrationalMrkts · Jul 15

The most legendary investor of all time: Warren Buffett

In 1998, Warren gave a lecture to students at the University Of Florida discussing wealth, thinking, and investing.

In 84 minutes he put together a masterclass on building wealth.

Here's a breakdown of the key points:



28 235 1,087 354.4K

The Thinking Investor @IrrationalMrkts · Jul 15

The importance of a moat

A moat is what protects a business from the predatory nature of capitalism.

If you want businesses that you can hold for a long time, it must have a moat to protect itself from competitors.

Buffett gives the example of...

1 5 83 18K

The Thinking Investor @IrrationalMrkts · Jul 15

Geico.

In insurance, the service is a commodity.

But the differentiation is in being the low-cost provider that comps couldn't compete with.

Buffett knew this moat was durable.

He knew this because he only 👇

2 1 44 16.2K

The Thinking Investor @IrrationalMrkts · Jul 15

Buys businesses in his circle of competence.

Anybody can understand Coca-Cola, but nobody can understand EVERYTHING.

He had a great quote that was highly relevant to the late 90s in relation to the tech bubble that was about to pop:

1 2 46 15.3K

The Thinking Investor @IrrationalMrkts · Jul 15

"If I were teaching a class in business school.

On the final exam, I would pass out the information on an Internet company.

And ask each student a value it.

And anybody that gave me an answer, I'd flunk."

The reason this is so important is that ⤵️

1 1 42 14.4K

The Thinking Investor @IrrationalMrkts · Jul 15

To properly value a business, you must understand its future economics.

"You can understand some businesses, but not all businesses."

It's vital that you buy businesses that you can understand, and stay away from what you are incapable of understanding.

Lastly...

1 2 53 13.1K

The Thinking Investor @IrrationalMrkts · Jul 15

Understand what's knowable

"What you really want to do in investments is figure out what's important and knowable.

If it's unimportant or unknowable you forget about it."

Most people fail to realize the majority of information floating around is unimportant ⬇️

1 1 41 11.9K

The Thinking Investor @IrrationalMrkts · Jul 15

"We have never either bought a business or not bought a business because of any macro feeling of any kind.

We don't read things about predictions about interest rates or business or anything like that because it doesn't make any difference."

Buffett gives a great example ⤵️

1 4 35 32K

The Thinking Investor @IrrationalMrkts · Jul 15

"I mean let's say in 1972 when we bought See's candy.

I think maybe Nixon put on the price controls a little bit later..."

1 1 25 9,808

The Thinking Investor @IrrationalMrkts · Jul 15

"Let's say we'd seen it but so what?

We then missed a chance to buy something for $25 million that's earning $60 million pre-tax now...

We don't want to pass up the chance to do something intelligent because of some prediction about something that we're no good on anyway."

1 1 31 9,271

The Thinking Investor @IrrationalMrkts · Jul 15

Buffett provided an interesting thought experiment on how he'd act if he knew where interest rates were 12 months from now:

"If.... Alan Greenspan was on one side of me and Bob Rubin on the [other] side.

They're both whispering in my ear exactly...

2 1 22 8,528

The Thinking Investor @IrrationalMrkts · Jul 15

what they're going to do [in] the next 12 months.

It wouldn't make any difference to me and what I would pay for Executive Jet or General Reinsurance or anything else."

1 1 25 7,730

The Thinking Investor @IrrationalMrkts · Jul 15

To summarize what he thinks about how the macro affected decision-making:

"We just don't read or listen to or do anything in relation to the macro factors at all, zero."

Now if you listen to Buffett speak, it's obvious he understands the macro environment very well.

But he...

1 1 29 7,368

The Thinking Investor @IrrationalMrkts · Jul 15

Realizes that this doesn't mean he needs to act on this knowledge.

Most of the time, he remains highly aware and simply waits for a rare opportunity to present itself.

Full lecture here 👇

youtube.com

Warren Buffett speaks with Florida University

Warren at his best with relevant insights and observations into the market, and more importantly the temperament ...

2 20 75 7,709

[Continue reading here. You can also watch the full video of Buffett's speech right here.]

Investment Ideas

Research suggests the safest investment "asset" is probably not what you think (from Cambria Investments in June 2023)...

In 2012, Eike Batista had an estimated worth of more than $35 billion.

The self-made Brazilian billionaire created an empire that stretched from mining to oil to public works. Many considered him the pride of Brazil.

Barely two years later, he had lost all $35 billion...and owed another $1.2 billion to creditors.

How does this happen? How does a $35 billion portfolio evaporate practically overnight?

You could point to several poor decisions, but perhaps the biggest of all was concentration risk (and Buffett's favorite destroyer, leverage). Batista's wealth was overwhelmingly tied to the global commodities boom. While that investment concentration was a huge tailwind in helping Batista become rich, it eventually proved his downfall as well.

This points to a critical takeaway every investor needs to be aware of...

The portfolio that helps you get rich isn't necessarily the portfolio that's going to help you stay rich.

Research backs up the old saying "shirtsleeves to shirtsleeves in three generations." 70% of wealthy families lose their wealth by the 2nd generation, and a whopping 90% by the third generation. Granted, some of that is due to high spending, addiction, bad luck, leverage, or just poor decisions. But a lot of it is how people invest their money. Can you invest in a certain way to bombproof your portfolio to minimize losses?

In this piece, let's do what Batista should have done – spend a few minutes focusing on the "stay rich" part of the equation. If you're an investor who has already amassed great wealth what's the right market approach that will help you keep (and potentially even grow) your wealth?

What is the Safest Asset?

Let's say you've "won the game."

"Funded contentment." That's the description my friend Brian Portnoy uses to describe the purpose of wealth accumulation. Essentially, enough money to live the life you've dreamed about.

Now, what that amount is varies for all of us. For some it could be $100,000, for others $1 million or even $10 million wouldn't be enough. But let's say you hit your number.

What now? What if we no longer care about increasing our wealth, but rather, to simply protect it. As mentioned before, the portfolio that helps you get rich isn't necessarily the portfolio that's going to help you remain rich.

So what is the "safest" asset in the world? Is there such a thing?

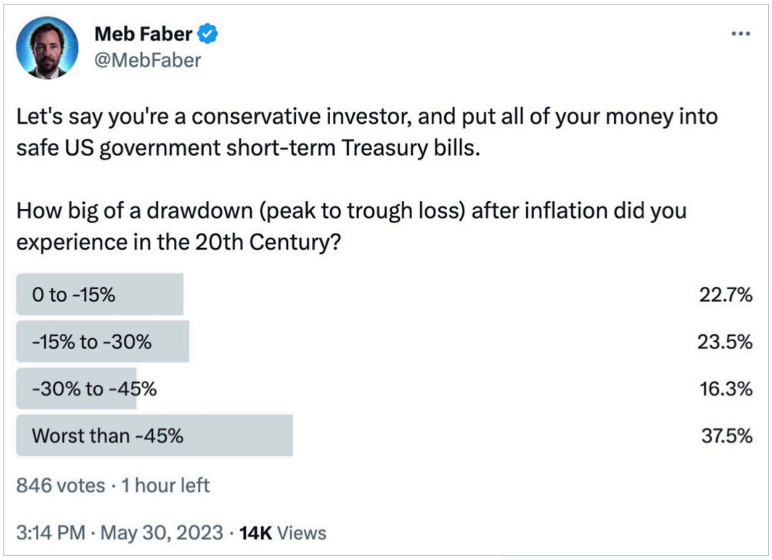
When trying to engineer a "stay rich" portfolio, it makes sense to start with what the investing community refers to as the "risk- free" asset – US government Treasury bills.

Many investors believe T-bills to be the safest, most conservative investment available. In fact, if you look at T-bills back to 1926, they returned 3.4% per year with zero drawdown or losses. Pretty safe, right? Not a single down year, not even a down month!

Not exactly.

These are nominal returns, and nominal returns are an illusion because they don't take inflation into account. All that matters to any investor is returns after inflation, or what we call real returns. And if you measure the returns of T-bills after inflation you see a different story – unfortunately, this is a story most investors haven't seen.

I recently asked my Twitter followers the question below...



The actual real max drawdown was a whopping -49%!

But as you can see, about two-thirds of those who answered got this wrong. These are very intelligent people with far greater investing experience than most, yet they seriously underestimated the losses in short-term bonds.

So, the risk-free rate isn't risk free at all. (And by the way, I'm ignoring other global sovereign bond markets including some that produced a -100% loss.)

The original version of this article ignored what a lot of people do with their money – leave it in the bank at 0% interest... the modern-day version of stuffing it under the mattress. A full third of investors responded to a poll that they earned 0% interest on their bank deposits or "didn't know." Over the past 100 years you eventually lose all your wealth (95%) at an inflation clip of about 3% per year. Ouch!

What about parking your hard-earned dough in other asset classes? Might real returns be safer elsewhere?

Unfortunately, no. The losses are even worse when we expand our analysis to other asset classes. Below are max real drawdowns back to 1926:

US Stocks:	**Foreign Stocks:**	**10 Year US Bonds:**	**Gold:**
-79%	-78%	-61%	-85%

Ouch.

The naysayer might look at this and say “These are max drawdowns that likely played out over several years. A smart investor would have gotten out after, say, one year of bad returns.”

With that in mind, the below table highlights the worst 12-month, 3 year, 5, year, and 10 year period of real returns for each of the asset classes after annualized inflation of 2.94%. As you can see, nothing was truly “safe.”

Real Returns After Inflation 1926-2022	Cash Under Mattress	Cash T-bills	US Stocks	Foreign Stocks	10 Year Bonds	Gold
Annualized Returns	-2.94%	0.36%	6.85%	4.61%	1.82%	2.00%
Volatility	1.82%	1.82%	18.80%	16.04%	7.17%	14.99%
Max Drawdown	-94.22%	-48.91%	-79.18%	-78.01%	-60.63%	-84.39%
% Positive Months	36.34%	60.82%	59.97%	57.04%	53.61%	41.49%
Worst 1 Year Returns	-16.90%	-16.58%	-63.95%	-56.75%	-24.69%	-42.24%
Worst 3 Year Returns	-28.90%	-25.33%	-76.08%	-64.07%	-34.87%	-50.76%
Worst 5 Year Returns	-38.18%	-28.11%	-51.70%	-76.33%	-38.62%	-67.42%
Worst 10 Year Returns	-57.24%	-42.29%	-45.45%	-70.89%	-44.43%	-65.24%

SOURCE: Global Financial Data, Meb Faber as of 12/31/22. Performance is hypothetical.

It could be reasonable to argue that people would prefer a slow erosion of wealth to a sharp loss, and in this case, T-bills do indeed look safest on these metrics. They had lower volatility, more positive months, and the lowest worst 12-month period.

However, the slower erosion of bonds might appear less painful at first glance but consider the analogy of the frog and the boiling water. As the analogy goes, if you throw a frog into a pot of boiling water, it will feel the pain and jump right out. But if you put a frog into a pot of cool water then turn on the burner, the frog will remain in the water until it boils.

The slow drawdowns with T-bills is a bit like the frog sitting in water that’s simmering toward a boil.

So, let’s pause and briefly recap. At this point, it’s clear that there’s no single asset that is guaranteed to preserve your wealth. The best we’ve done is a -49% decline. In the safest asset you still lost half your money at some point!

What now? Is there a way to combine assets and build a “minimum loss” portfolio?

Combing Asset Classes to Reduce Risk

Asset allocation strategies have long been known to reduce risk for a portfolio. So, what’s the worst drawdown we’ve seen with the venerated 60/40 portfolio?

60/40:
-54%

Ok, that doesn't help really.

In addition to a global portfolio of stocks and bonds, how about adding real assets like real estate, commodities, and gold? This allocation looks like the "Global Market" (we'll refer to it as "GAA") portfolio we discussed in our Global Asset Allocation book (free download here).

Real Returns After Inflation 1926-2022	Cash T-bills	US 60 / 40	GAA
Annualized Returns	0.36%	5.28%	4.64%
Volatility	1.82%	11.92%	8.40%
Max Drawdown	-48.91%	-53.79%	-33.96%
% Positive Months	60.82%	58.93%	63.40%
Worst 1 Year Returns	-16.58%	-43.26%	-15.37%
Worst 3 Year Returns	-25.33%	-49.30%	-22.98%
Worst 5 Year Returns	-28.11%	-26.33%	-15.79%
Worst 10 Year Returns	-42.29%	-31.69%	-18.18%

SOURCE: Global Financial Data, Meb Faber as of 12/31/22. Performance is hypothetical.

As you can see, we give up some real return, but we lower our max drawdown as well as the worst 1,3,5, and 10 year scenarios.

This all points to a takeaway which I think is vastly understated by almost every investor on the planet...

Nearly every allocation (or single asset class) will likely decline by at least 30% on a real basis – and probably more – in your lifetime.

That's a hard pill for many to swallow. But at least you have this knowledge ahead of time, which will hopefully help you anticipate it and better weather the storm.

So, What Does This Mean? Are T-Bills Still the Safest?

You might read this and think "Ok, you've been a real ray of sunshine and shown me that every asset class and portfolio is still susceptible to huge drawdowns. So, if it's all bad, then I might as well start back at the beginning – T-bills seem to offer safety, so that's where I'll park my wealth."

I'll propose an alternative suggestion.

Our studies have shown that historically, an investor can combine a diversified global market portfolio with some cash to produce an outcome with similar or better loss levels as T-bills, yet greater returns.

Real Returns After Inflation 1926-2022	Cash T-bills	25% GAA 75% T-bills	50% GAA 50% T-bills	75% GAA 25% T-bills	GAA
Annualized Returns	0.36%	1.48%	2.57%	3.62%	4.64%
Volatility	1.82%	2.74%	4.49%	6.42%	8.40%
Max Drawdown	-48.91%	-36.87%	-31.18%	-29.22%	-33.96%
% Positive Months	60.82%	59.97%	61.25%	61.51%	63.40%
Worst 1 Year Returns	-16.58%	-16.18%	-17.55%	-23.86%	-15.37%
Worst 3 Year Returns	-25.33%	-26.10%	-26.95%	-28.12%	-22.98%
Worst 5 Year Returns	-28.11%	-25.87%	-24.86%	-25.41%	-15.79%
Worst 10 Year Returns	-42.29%	-35.64%	-28.68%	-21.13%	-18.18%

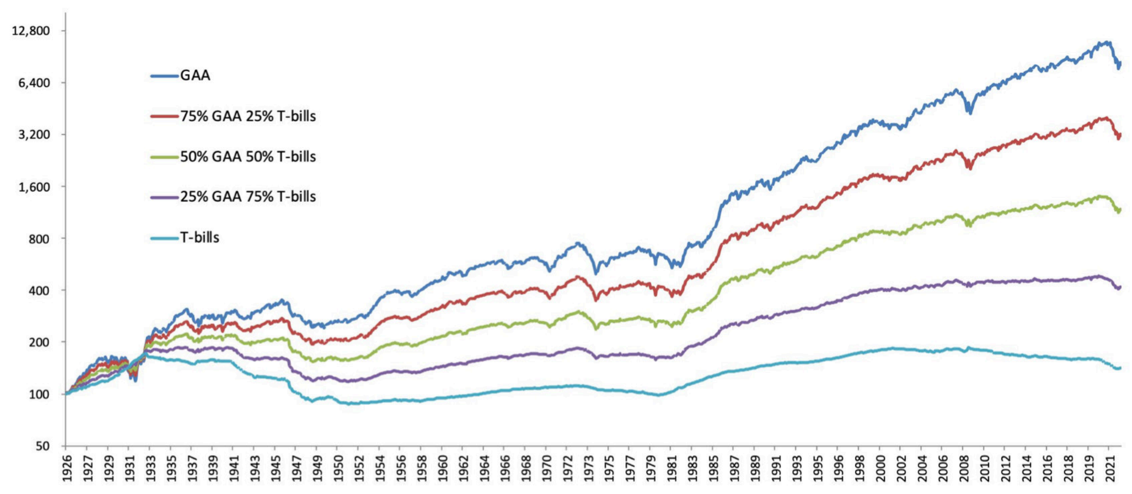
SOURCE: Global Financial Data, Meb Faber as of 12/31/22. Performance is hypothetical.

This approach enables an investor to engineer a strategy that offers comparable loss levels of T-bills, yet while generating an additional two plus percentage points of return per year.

Or, perhaps framing the return as "yield" would make more sense as a comparison?

At a minimum, the "GAA" part of the equation offers some protection from the catastrophic losses Batista incurred when concentrating all his wealth in just one asset class.

Below we chart the T-bills vs. various GAA and T-bills combos. As you can see, there is a little more volatility with the GAA/T- bills, but well worth it for much higher returns over time.



SOURCE: Global Financial Data, Meb Faber as of 12/31/22. Performance is hypothetical.

Of course, this is a philosophical departure for many. Many conservative investors keep their safe money in a savings account that earns T-bill like returns. But is that really the safest place for it? History would suggest that investing across a broad global portfolio with some cash has been a safer allocation than T-bills alone.

For those looking to be even more different, which is nearly impossible, you could consider active approaches like adding trend following to the mix. Below is a table including a hypothetical trend system modeled after our old paper, perhaps the best performing portfolio of them all! (Note: no transaction costs included.)

Real Returns After Inflation 1926-2022	Cash T-bills	US 60 / 40	GAA	IVY
Annualized Returns	0.36%	5.28%	4.64%	5.51%
Volatility	1.82%	11.92%	8.40%	6.76%
Max Drawdown	-48.91%	-53.79%	-33.96%	-18.82%
% Positive Months	60.82%	58.93%	63.40%	62.97%
Worst 1 Year Returns	-16.58%	-43.26%	-15.37%	-12.38%
Worst 3 Year Returns	-25.33%	-49.30%	-22.98%	-16.77%
Worst 5 Year Returns	-28.11%	-26.33%	-15.79%	-14.11%
Worst 10 Year Returns	-42.29%	-31.69%	-18.18%	-4.85%

SOURCE: Global Financial Data, Meb Faber as of 12/31/22. Performance is hypothetical.

Continue reading here.

Judd Arnold – founder of Lake Cornelia Research Management – shares the bullish case for offshore energy services firms, including Tidewater (from the Value Hive Podcast on June 30)...

Judd discusses why Tidewater is the best energy stock at the moment. He explores offshore opportunities, like VAL, RIG, and NE. Judd highlights the importance of liquidity and provides insights on finding post-bankruptcy ideas. He also mentions Pagaya (PGY) as an interesting company and shares additional investment ideas.

[0:00] Why Tidewater is the best
[10:00] You are long CAPEX, not price.
[15:00] Sub Sea 7
[25:00] Offshore opportunities ($VAL $RIG $NE)
[30:00] Liquidity is King
[40:00] Finding Post Bankruptcy Ideas
[55:00] Pagaya $PGY
[1:20:00] Other Ideas

A bullish case for India's largest bank (from Lyn Alden Investment Strategy on July 9)...

HDFC Bank (HDB) of India is a stock I've been bullish on for years, although there were times where I increased or reduced exposure to it based on valuation. The company just completed the merger-acquisition of its parent company at the start of this month, which creates one of the largest banks in the world by market capitalization.

Company and Merger Background

The Housing Development Finance Corporation (generally known as HDFC) was founded in 1977 and has been a primary financier of real estate in India.

From the country's independence in 1947 until the early 1990s, India had a partially socialist economics model (state-directed and protectionist), and had rather slow structural growth. In the early 1990s, there were a series of reforms to liberalize and open up the economy to the world more broadly, and to incorporate more market-oriented aspects. Growth has been stronger ever since. As part of this shift, HDFC launched HDFC Bank as a subsidiary in 1994.

HDFC continued focusing on real estate finance, insurance, asset management, and a few other areas, while HDFC Bank remained partly owned by HDFC and grew into the largest bank in the country. HDFC retained some of the shares as a partial parent company.

In 2022, it was announced that HDFC Bank would acquire-merge its parent HDFC into itself, to create a more streamlined full-service banking giant. Early this month, that merger completed ahead of schedule.

In addition to streamlining the overhead costs and corporate structure, one of the biggest opportunities that comes from the merger is the ability to cross-sell HDFC's products to HDFC Bank customers.

> *HDFC Bank has around 83 million customers but only 2% have a housing loan with HDFC. An additional 5% of the bank's customers have a housing loan from other lenders, he said explaining that it means 93% of HDFC Bank's customers do not have a home loan.*
>
> *This presents a "significant opportunity to cross sell and a potential to tap into the customer base that have not taken a housing loan at all," the director said, adding that HDFC Bank will now be able to offer mortgage services.*
>
> *Mortgage penetration in India is "extremely low" and only accounts for approximately 11% of its GDP.*
>
> *That's much lower than 26% in China, and between 20% to 40% in South East Asia, HDFC said. Most developed markets have more than 50% mortgage penetration, the company added.*
>
> *– CNBC, July 4th, 2023*

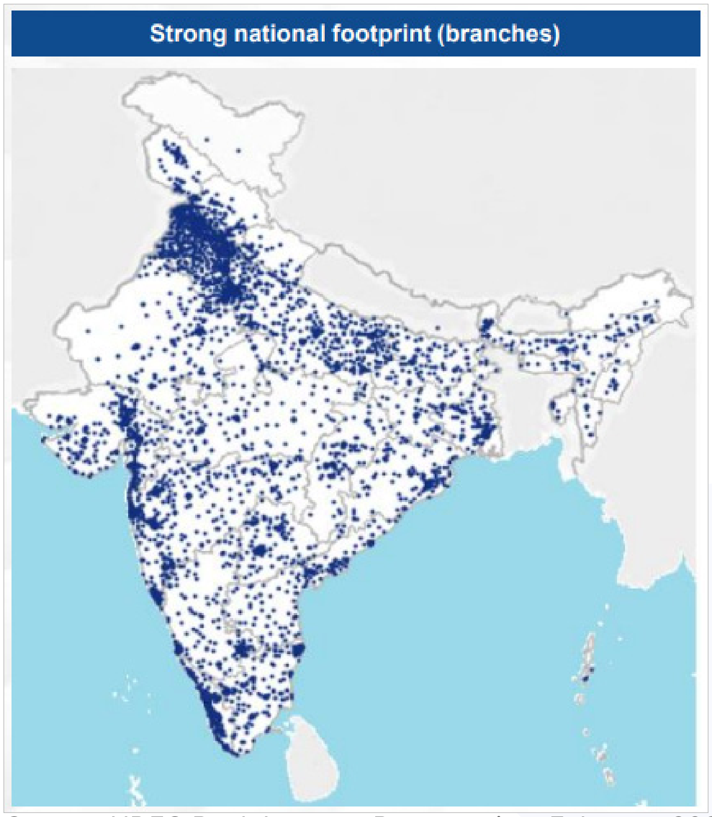
India is one of the fastest-growing countries in the world in terms of real GDP, and the financial sector of the country is growing even faster than overall GDP, because India is starting from a baseline that is under-banked compared to its peers. The country has low mortgage penetration, and low household debt in general.

HDFC Bank now has a stronger opportunity and a stronger incentive to bundle services together, and increase the percentage of its customers that have a home loan with them.

HDFC Bank Overview

HDFC Bank offers a full suite of financial services to retail and corporate customers

Pre-merger, HDBC Bank had about 23,000 branches spread around India:

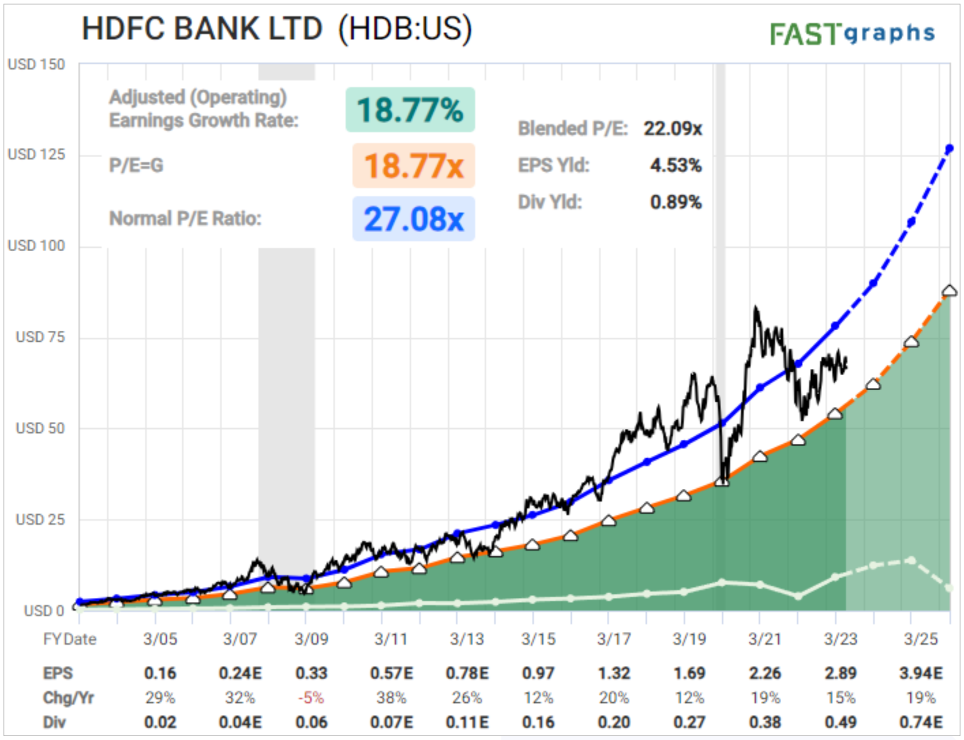


Source: HDFC Bank Investor Presentation: February 2023

This may seem like a lot, and at first glance might even seem to be at the point of saturation. However, India has a population of over 1.4 billion people, and HDFC Bank only has 83 million of them (about 6%) as customers. Additionally, India still has a per-capita GDP of under $3,000 USD. Even if they triple that number, it'll be slightly lower than what Brazil has today.

So, HDFC Bank has a huge runway of opportunity to gain more customers and to increase revenue from each customer over time.

The stock is expensive compared to developed market banks, but it continues to have big top-line and bottom-line growth and it is in-line with its historical normal valuation:



As a base case, I continue to expect India to experience substantial economic growth and to become more financialized, and for HDFC Bank to have a strong potential for appreciation over the next decade. The "long India" view is something I think is best to let play out over a decade rather than to bother trying to trade it.

Primary Risks

As the country's largest bank, and one that does not trade cheaply, HDFC Bank is exposed to any macro risk that could slow down India's growth or cause a financial crisis in the country.

Mainly, India's ability to import enough energy and other commodities to fuel a 1.4 billion person country remains its key vulnerability (and by extension, one of the reasons I remain bullish on hydrocarbons over the next decade). To roughly quantify things, India consumes less than a third of the oil that China consumes per capita, and China consumes less than a fifth of the oil that the United States consumes per capita. By extension, India consumes less than 1/15th of the oil that the United States consumes per capita.

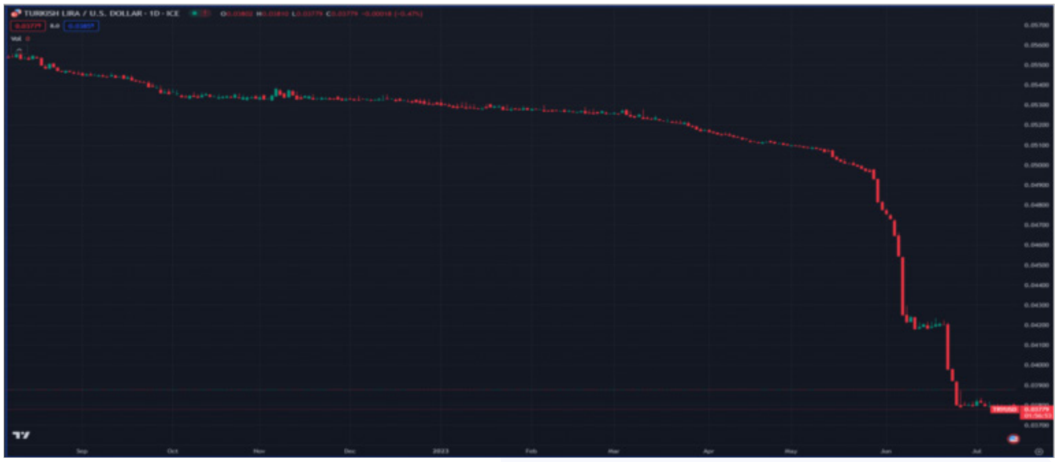
As another quantitative point, both Brazil and Mexico consume comfortably more oil per capita than China, and by extension consume 4x-5x as much as India. India could multiply its resource intensively significantly and still be at developing country consumption levels.

If India were to consume as much as China does per capita, that would require about 8 million more barrels per day, which basically requires finding another Saudi Arabia worth of oil supply. Some western nations may reduce their overall consumption, but then again countries like Indonesia and Nigeria and Pakistan are very large-population countries with very low per-capita consumption that could climb up the ranks as well.

India continues to trade significantly with Russia, and indeed has absorbed a large portion of the Russian energy exports that Europe has given up. India tends to use a pragmatic approach to foreign trade, being willing to trade with anyone that has commodities, including Russia and Iran. India and China are on tense political terms as two major regional powers sitting right next to each other, and yet India is part of the BRICS and the Shanghai Cooperation Organization anyway, and tends to align with China on various mutual economic interests.

[Continue reading here (subscription required).](#)

Turkey could soon be a "buy" for western investors ([from KEDM's Monday Monitor on July 17](#))…



With his reign secured, Erdogan banned the Turkish CB from intervening in the currency market.

Now you probably seen Erdy and Putin bff pictures, and he shrewdly used his relationship with the Russian President to get more gas and oil then he ever dreamt of. (Even gave free gas for a month to the entire country at election time). In return, Erdy blocked Sweden's bid for NATO, supported Putin's oil sales and even stopped supplying Ukraine with Drones and other light toys.

But we were surprised to see things changing last week. First he approved Sweden joining NATO, which was a big blow to Putin. Right after that, Zelensky appeared in Istanbul and Erdy gave him a departing gift of Ukrainian prisoners of war that were jailed in Turkiye, Putin was furious as he claimed that they were not Erdy's to set free.

What does this all mean? We think Erdy is moving back to the NATO/EU axis and will be sitting on IMF's lap very soon. If this continues, this is very positive from a foreign investors returning/ liquidity perspective.

Look, we are excited to play Turkiye this year & 2024, but not gonna jump the gun here. We'll be patient and dive in only when we feel the key threats are neutralized. We need to be comfortable that the KKM gets diffused orderly. So once again we are in wait and see mode (sometimes KEDM themes take years to develop).

If you are following it, don't waste your time tracking meaningless KPIs like Export Data, PMIs, Incoming Tourist numbers, factory power usage etc. Don't be the dumb smart money.

[Continue reading here.](#)

Here's an undervalued small-cap oil and gas stock with a potentially bullish upside catalyst (from Bison Interests on July 18)...

At Bison, we look for heavily discounted oil and gas equities with good assets, survivable balance sheets, proven management teams, and imminent catalysts to help close valuation dislocations in public markets.

This sometimes involves buying equities with core businesses trading at low valuations that also have secondary assets that could be worth a significant portion of their current enterprise values. We believe these offer a degree of downside protection and may offer revaluation trajectories less tied to short-term commodity price movements.

Journey Energy (TSE: JOY), an Alberta-based publicly traded oil and gas company for which Bison has previously shared its investment thesis, meets these criteria. Despite materially outperforming peers since we disclosed this thesis, Journey's core business has gotten cheaper as underlying fundamentals rapidly improved. Concurrently, Journey has continued to ramp up its power generation business, which is growing so rapidly and cost-effectively that it could be on a path to eventually be worth more than Journey's current enterprise value. More on this below.

Razor Energy: Small Oil Company Selling its Power Assets

In assessing the potential value of Journey's power generation business it is helpful to look at its neighbor which recently sold a similar asset: Razor Energy (TSXV: RZE). Razor had exposure to power generation assets through its wholly-owned subsidiary, FutEra Power. Razor effectively sold the majority of its interest in this power generation business through a recapitalization in which its largest lender, the Alberta Investment Management Company ("AIMCo"), agreed to swap all its outstanding debt to Razor in exchange for shares of FutEra. After considering certain price adjustments, this deal implies a healthy value for Journey's power generation assets.

Razor Recapitalization Transaction Overview

As part of the transaction, AIMCo forgave $63.2 MM of outstanding Razor debt in exchange for 70% of FutEra's outstanding equity, including some convertible preferred shares paying a 12% dividend with a liquidation preference. These preferred shares will effectively give AIMCo another 9% of the outstanding FutEra common shares when converted. FutEra also assumed $10.7MM of outstanding Razor debt to another lender and ~$3.7MM of negative working capital from Razor. Adding the net value of these assumed liabilities to the value of the forgone debt gives us an effective transfer price of $75MM:

FutEra Equity Interest Net Effective Transfer Price, in $MM		
Forgone Outstanding Indebedness to AIMCo	$	63.2
Indebtedness to Arena Investors, LP Transferred to FutEra	$	10.7
Estimated Negative Working Capital Transferred to FutEra	$	3.7
Less: Liabilities Attributable to Razor	$	(2.7)
FutEra Equity Interest Effective Transfer Price	**$**	**74.9**

Adjusting for the fully diluted ownership AIMCo received in FutEra, this transaction implies a value of $92MM for FutEra's entire business:

Implied FutEra Equity Valuation		
Common Share Ownership Transferred to AIMCo		70%
Common Shares Attributable to Convertible Preferreds		9%
Estimated Impact of Preffered Dividend		2%
Effective FutEra Equity Interest Transffered to AIMCo		**81%**
FutEra Equity Interest Effective Transfer Price, in $MM	$	74.9
Implied Futera Valuation, in $MM	**$**	**92.4**

It is worth noting that Razor Energy itself only had a market capitalization of ~$20MM at the time of the deal—this recent transaction implied a value for a wholly owned subsidiary that was ~5x Razor's market cap. Razor also materially de-levered its balance sheet in this transaction, and its small size does not appear to have been an impediment to the divestiture valuation.

Transaction Value Look-Through for Journey Energy

The Futera transaction implies significant upside for Journey Energy's nearby, rapidly growing power business. FutEra has 21MW of nameplate installed power generation capacity at its Swan Hills facility, but we estimate the true effective capacity is closer to 17MW, based on disclosures and comments from Razor and Futura management. This implies a value of $5.4/MW for this transaction:

Power Generation Value Implied by FutEra Transaction		
Current Power Generation Capacity, in MW		17.0
Implied FutEra Valuation, in $MM	$	92.4
Implied Value per MW, in $MM	**$**	**5.4**

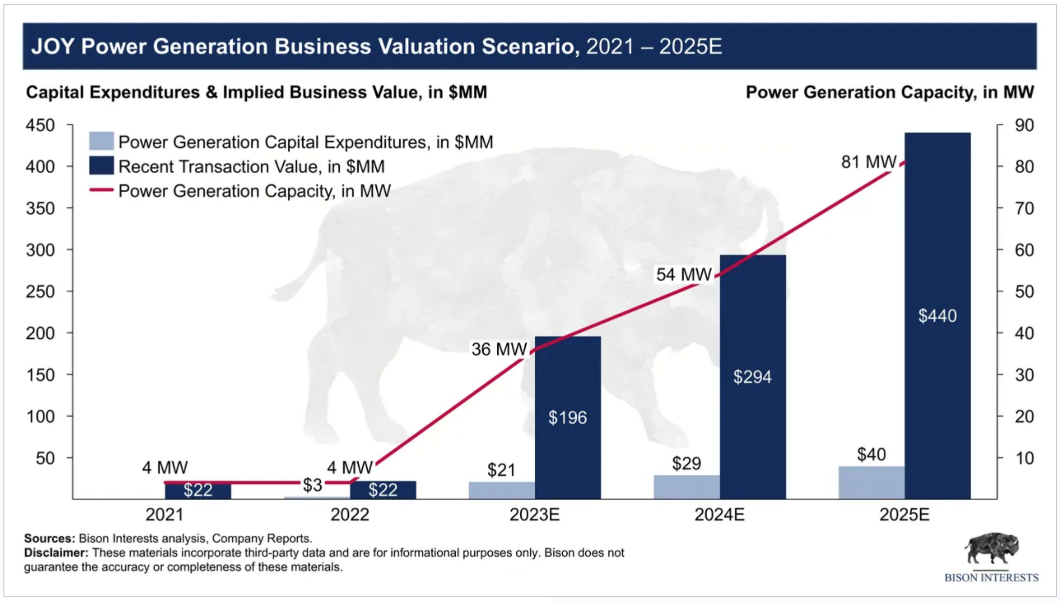
Journey currently has 4MW of installed power generation capacity at its Countess facility. Journey had also received preliminary approval to build a 15.5MW generation facility at its Gilby gas plant and recently completed the purchase of a 16.5MW power generation facility in Mazeppa, Alberta. Altogether, Journey is expected to have 36MW of effective power generation by early 2024. The implied value for Journey's power generation, once it is up and running, may be $196MM following this transaction:

Implied Journey Power Generation Business Value		
Countess Power Generation Capacity, in MW		4.0
Gilby Power Generation Capacity, in MW		15.5
Mazeppa Power Generation Capacity, in MW		16.5
Total Power Generation Capacity for 2024, in MW		**36.0**
Implied Valuation per MW, in $MM	$	5.4
Implied Value for Journey's Power Generation Business, in $MM	**$**	**195.7**

Implications for Journey Energy

The Futura transaction valuation has positive implications for Journey, whose power generation assets could be worth ~60% of its current market cap of ~$330MM by early 2024. It is worth noting that Journey's power generation business is rapidly growing and has an extremely high return on investment as compared to traditional oil and gas exploration and production. For instance, Journey's Countess power generation facility had a payback period of only 2.5 years!

By our estimates, Journey's power generation business could be worth as much as ~$440MM by 2025 if it continued to grow rapidly and cost-effectively:



As Journey scales up this business over time, power generation may soon make up a significant portion of the overall business and cash flow. AIMCo's willingness to swap its debt for equity in a power generation business reflects its understanding of improving fundamentals in an undervalued sector and was a way for the pension manager to secure a long-term infrastructure cash flow stream at a comparatively low valuation.

Journey's power assets are integrated with its gas production, resulting in lower production costs, higher margins, and an option to sell gas into the spot market should prices recover. For this reason, Journey's gas production may even be worth more than the $5.4MM/MW implied in the FutEra transaction. Consider this excerpt from Journey's Q1 2023 earnings press release:

"The currently operating, 4 MW Countess facility, which was originally commissioned in the fourth quarter of 2020, is already close to paying out the original investment. Based on Journey's realized power prices in 2022, the average, effective, net realized price for natural gas used to generate power for the year was approximately $10.54/mcf. [...]

"As a comparison, the average AECO benchmark price for 2022 was approximately $5.43/mcf and $3.23/mcf for the first three months of 2023."

The above implies that Journey can get ~3 times as much value from its gas production when converting it to power. It is also worth noting that Journey will be a direct beneficiary of rising power prices in Alberta once its new facilities are running (after having suffered from being a net high-priced power consumer ahead of the commencement of the new power generation facilities).

Conclusion/Takeaways

Despite a promising outlook for Journey's power generation business, few analysts and market participants seem to be giving it any credit. This became apparent when Journey shares sold off following Journey's Q1 earnings announcement. Cash flow came in lower than expected in Q1, largely due to lower price realizations following higher WCS differentials, which have subsequently improved, and higher operating expenses due to high power prices. However, Journey's rapidly growing power generation business will soon entirely offset these costs, as they are expected to rapidly shift from a net consumer to a net power producer in less than a year.

Additionally, the market may be incorrectly attributing power generation capital expenditures to oil development activity, showing artificially depressed capital efficiency. The commencement of 32 MW of power generation by early 2024 should illustrate the high return nature of these capital expenditures, as well as the low capital requirements on Journey's low decline oil & gas production business.

The recent pullback in Journey's share price presents an opportunity to invest in a discounted low-decline oil and gas producer with proven management. And as a bonus, investors are getting exposure to a rapidly growing, high-margin power generation business in an environment where power prices are rising. As the cash flow from Journey's power generation becomes more material and Journey's overall margin profile improves, we see the potential for a material re-rate in their valuation.

Continue reading here.

A micro-cap stock with 10x upside potential in the left-for-dead cannabis industry (from Mindset Value on July 20)...

On the face of it, Grown Rogue (OTC: GRUSF) looks tiny and insignificant. The stock is a penny cannabis stock and a very illiquid one at that, trading around C$0.23 per share. Its volume has recently risen from almost nonexistent to 53,000 shares a day. But even that is only about C$10,000 a day in total trading volume!

Why in the world would you buy a stock that is that illiquid? In a nutshell, the company has a competitive cost advantage over much larger cannabis companies when it comes to producing high-quality indoor cannabis flower and their growth is poised to explode from 30% year over year growth to potentially over 100% growth at a time when most cannabis companies are retrenching and showing little if any growth at all.

I believe Grown Rogue is the most efficient indoor cannabis cultivator that is publicly traded in the world. My research shows that it is operational excellence that is in short supply in the cannabis industry, not limited licenses and that is what Grown Rogue has mastered and gives it a competitive advantage.

Grown Rogue produces the #1 flower in Oregon, a market with sophisticated consumers and a legacy market where if you don't produce the best flower, it won't sell. But Grown Rogue's secret sauce is producing this high-quality flower for less than $600 a pound inclusive of all expenses. They've taken that formula and entered Michigan, where they are now around a top 5 flower producer. One advantage is that all Grown Rogue does is cultivate. They do not do retail and they do not do edibles.

Their recent earnings tell the tale of the company's performance in a time of struggling cannabis companies. Grown Rogue recently reported record revenue growing almost 30%, record EBITDA and free cash flow in their latest quarter.

And now the company is on the move beyond Oregon and Michigan.

The company signed a strategic partnership with Goodness Growth, a struggling MSO, that needed help with their cultivation. Grown Rogue will receive at least 20% of any improvement in operating income from Maryland and Minnesota for the help in cultivation. That's right, Grown Rogue is now receiving royalty income from two limited license states, one which just went adult use and the other which goes adult use in the next year or so.

I wrote about the opportunity and interviewed Grown Rogue's CEO, Obie Strickler. https://mindsetvalue.substack.com/p/goodness-growth-goes-rogue

I believe that the Goodness deal is just the beginning for Grown Rogue entering another 10-12 limited license states with their Oregon quality flower, but more importantly at Oregon cost as well. I believe the company is on a path towards $40 to $50 million in EBITDA and $15 to $20 million in free cash flow on a current market cap of approximately $30 million. At that valuation, I could care less about the liquidity.

But it is even better for Mindset investors because we negotiated a convertible debt deal in December, where we get paid a 9% yield and can convert into the stock at C$0.20 CAD. The stock is currently trading above that at $C0.22 per share. Please note that we value our convert at our cost position for now to be conservative.

And now we are investing in Grown Rogue in another convertible that again pays 9% and converts into the stock at C$0.24 per share and includes an additional warrant at C$0.28 per share. We are essentially getting paid while we wait for a company that has the potential to go up by more than 10 times in value.

Continue reading here.

Bonds and Credit Markets

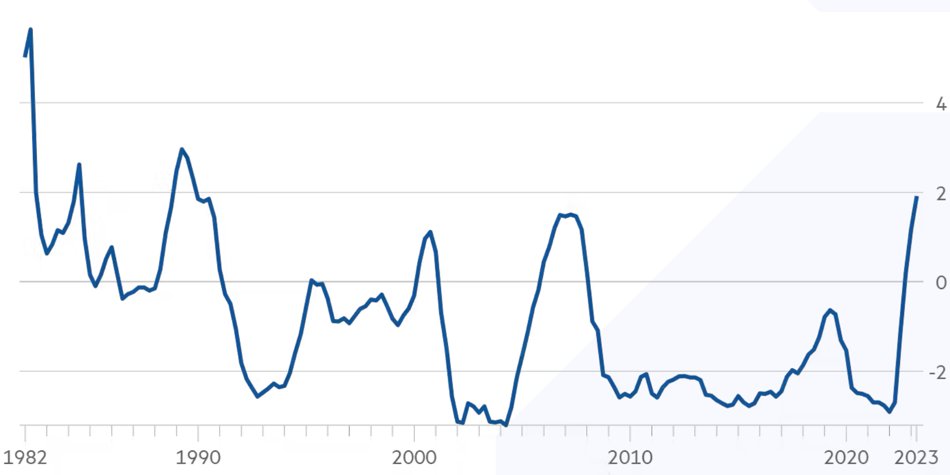
Sovereign/Government Bonds and Credit

History says it's still too soon to dismiss the significance of last fall's Treasury yield curve inversion (from the Financial Times on July 5)...

> The puzzle here, as we see it, is how to balance evidence of a remarkably strong economy against the history of past rate-rising cycles and the accompanying inverted yield curves. First quarter 2023 real GDP was almost 2 per cent, estimates for second-quarter growth look similarly healthy, the housing market is resilient, consumer confidence is rising, the labour market is strong, and on and on. At the same time the yield curve is deeply inverted and for the past 60 years that has been a remarkably reliable recession indicator.
>
> The solution to this puzzle may be as simple as timing. As Dominic White of Absolute Strategy Research pointed out to us, in the 10 recessions the 10-year/three-month yield curve has predicted since 1957 (without a false positive), the average period between the first inversion of the curve and the official start of recession has been nine months. The range runs from four months (the 1960-61 recession) to 16 months (2007-09).
>
> This time around, the curve first inverted last October 18, a little under nine months ago. History has more time to be right.
>
> This is true of the stance of monetary policy, too. One way to measure it is by comparing the real fed funds rate to the estimated neutral rate, the policy rate that neither worsens inflation nor stifles growth.
>
> A real policy rate above the neutral rate should slow the economy. Relying on the New York Fed's estimates of the neutral rate, policy has only been meaningfully tight since the fourth quarter of last year:

Policy has only recently become tight

Real fed funds rate spread over neutral rate, %



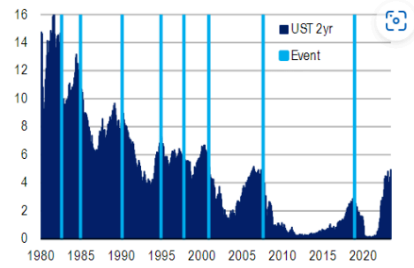
Neutral rate uses NY Fed estimates; fed funds rate deflated using 10-year Cleveland Fed inflation expectations
Sources: New York Fed, Cleveland Fed

Over the past 40 years, peaks in 2-year Treasury yields have always been followed by a crisis ([from Lisa Abramowicz via Twitter on July 9](#))...

Lisa Abramowicz
@lisaabramowicz1

Since 1980, peaks in U.S. 2-year yields have always been followed by a risk-off event within the next year or so: BofA's Oleg Melentyev. "The full extent of damage is unknown until the peak in policy tightening is behind us. We are clearly not at that point yet:" he wrote.

Exhibit 1: Peaks in 2yr UST yields followed by risk-off events
Time lag = months between peak UST 2yr yield and an event



Source: BofA Global Research

BofA GLOBAL RESEARCH

Exhibit 2: Details of specific risk-off events
ΔOAS = change in HY OAS since peak UST 2yr yield

Peak 2yr	Event	Description	Time lag	ΔOAS
Jul-81	Aug-82	LatAm	13	377
Jun-84	Dec-84	S&L	6	368
Mar-89	Feb-90	Drexel	11	624
Dec-94	Dec-94	Mexico	0.5	95
Apr-97	Oct-97	Asia	6	342
May-00	Nov-00	Tech	6	290
Jun-06	Aug-07	GFC	14	486
Dec-18	Dec-18	Pivot	0.5	152
Average			7	342

Source: BofA Global Research

BofA GLOBAL RESEARCH

8:31 PM · Jul 9, 2023 · **108.5K** Views

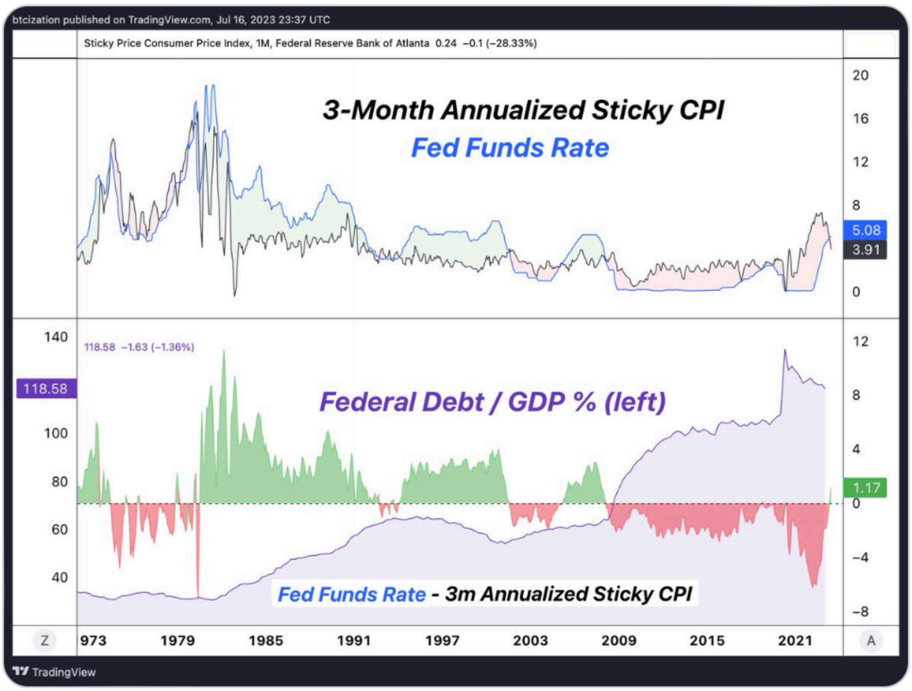
Sustained inflation is likely the U.S. government's only hope of avoiding an overt debt crisis ([from Dylan LeClair via Twitter on July 16]())...

Dylan LeClair
@DylanLeClair_

Three years of inflation compounding at ~5.7% has gotten public Debt/GDP from 134% to 119%.

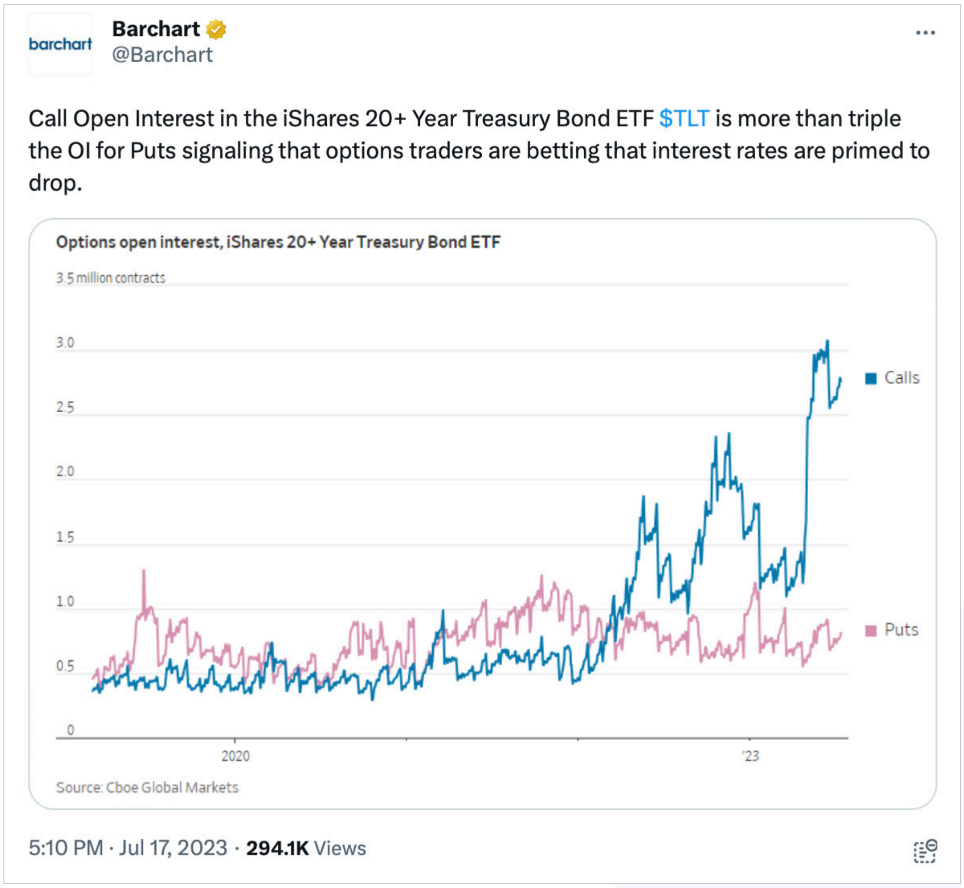
The only way you're going to lower debt as a percentage of GDP is with persistent negative real yields.

And now, interest expense is about to be +$1 Trillion due to higher yields. GL



7:39 PM · Jul 16, 2023 · **142.2K** Views

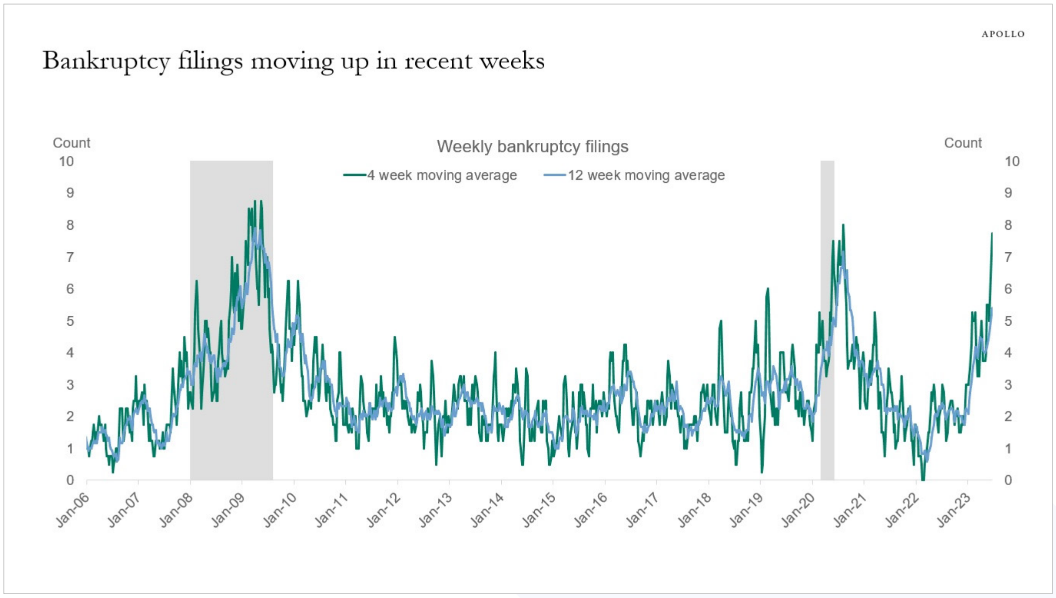
Options market positioning suggests investors are extremely bullish on long-term Treasury bonds (i.e., expecting long-term rates to fall) (from Barchart via Twitter on July 17)...



Corporate Bonds and Credit

Corporate bankruptcy filings continue to surge (from The Daily Spark on June 28)...

> Weekly data for corporate bankruptcy filings has started to meaningfully deteriorate in recent weeks, see chart below. The faster speed of slowing in the weekly data is not consistent with the gradual rise in the monthly default rates seen in HY, IG, and loans.



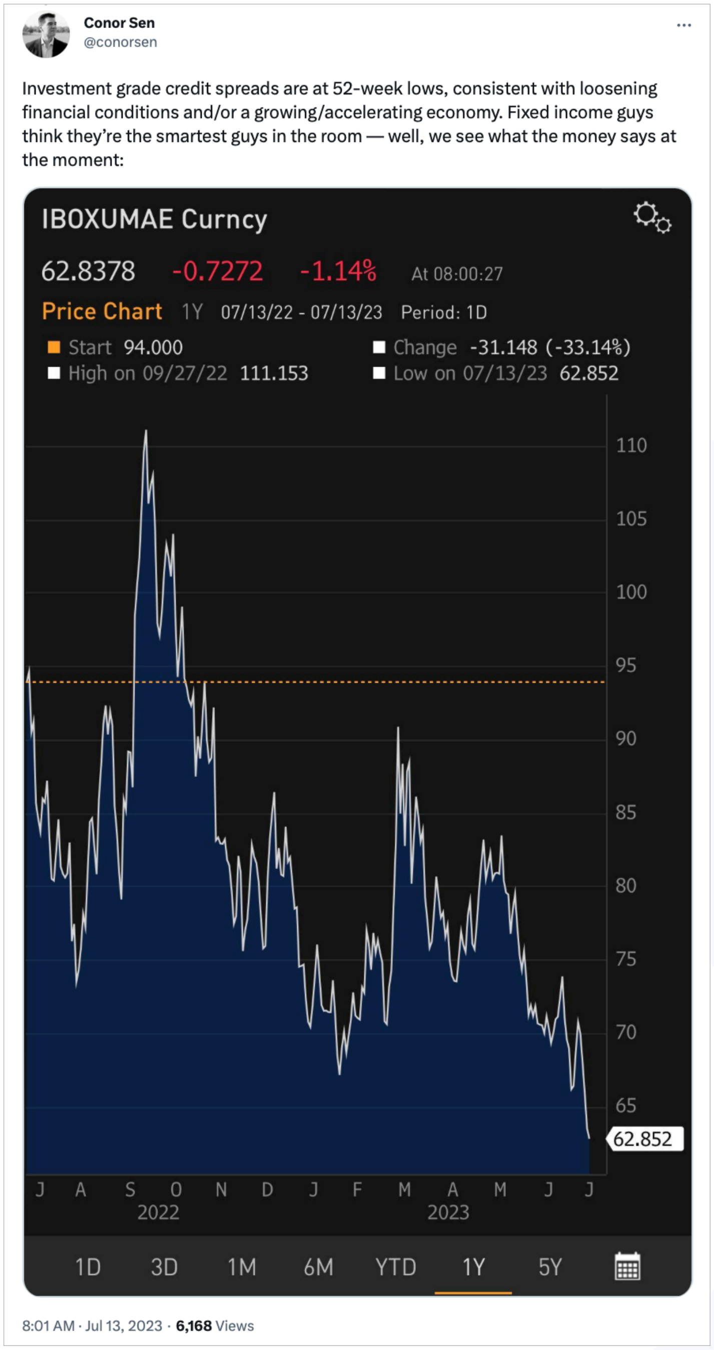
Continue reading here.

Torsten Slok – Chief Economist at private equity giant Apollo Global – believes the credit default cycle is already underway (from Bloomberg on July 13)...

> Corners of the consumer and corporate market are beginning to feel the pain from the Federal Reserve's ultra-aggressive rate hikes, even though broader macroeconomic indicators are still showing signs of strength, says Apollo's Torsten Slok.
>
> "A default cycle has started," the chief economist told Bloomberg TV Thursday, pointing to rising delinquency rates for auto loans and credit cards, and higher default rates within the high-yield and loan market.
>
> Slok says the strong recovery in the labor and housing markets isn't a sign that the Federal Reserve's aggressive monetary tightening hasn't worked its way through the economy. Rather, the effects are being felt in areas that are more inconspicuous.
>
> "It's very clear that the effects of monetary policy are showing up in the the background and it will eventually begin to slow things down," he said.

Continue reading here (subscription may be required).

Despite plenty of evidence a recession is likely, investment-grade credit spreads remain near their tightest levels in years (from Conor Sen via Twitter on July 13)...



One of the world's top bankruptcy attorneys warns of a "$500 billion corporate-debt storm" (from Bloomberg on July 18)...

Richard Cooper's phone is something of an early alarm bell for the global economy. Lately, it's been ringing a lot.

A partner at Cleary Gottlieb, a top law firm for corporate bankruptcies, he's advised businesses worldwide for decades on what to do when they're drowning in debt. He did it through the global financial crisis, the oil bust in 2016 and Covid-19. And he's doing it again now, in a year when big corporate bankruptcies are piling up at the second-fastest pace since 2008, eclipsed only by the early days of the pandemic.

"It feels different than prior cycles," Cooper said. "You're going to see a lot of defaults."

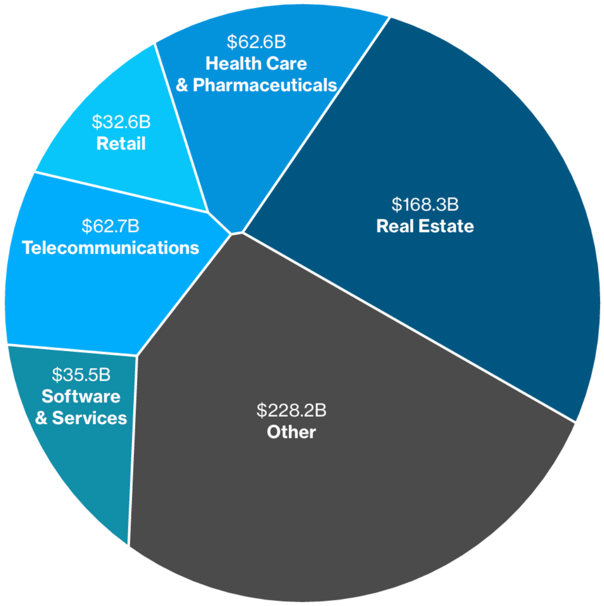
His perch has given him a preview of the more than $500 billion storm of corporate-debt distress that's already starting to make landfall across the globe, according to data compiled by Bloomberg. The tally is all but certain to grow. And that's deepening worries on Wall Street by threatening to slow economic growth and strain credit markets just emerging from the deepest losses in decades.

On the surface, much of it looks like the usual churn of capitalism, of companies undermined by forces like technological change or the rise of remote work that has emptied office buildings in Hong Kong, London and San Francisco.

Yet underneath there's often a deeper, and more troubling, through-line: Debt loads that swelled during an era of unusually cheap money. Now, that's becoming a heavier burden as central banks ratchet up interest rates and appear set to hold them there for longer than nearly everyone on Wall Street expected.

Industries With Most Distressed Debt

Total outstanding corporate bonds and loans trading at distressed levels exceed $590 billion



Source: Bloomberg reporting
Note: Distressed loans are those trading below 80 cents. Distressed bonds are those below 80 cents with a spread greater than 1,000 basis points.

The rising tide of distress is, of course, to a certain degree by design. Caught by surprise as inflation surged, monetary policymakers have been aggressively draining cash from the world's financial system, intentionally seeking to slow their economies by stanching the flow of credit to businesses. Inevitably, that means some will fail.

But pockets of corporate credit look particularly vulnerable after ballooning during the years of rock-bottom interest rates, when even faltering companies could easily borrow to delay the reckoning.

In the US, the amount of high-yield bonds and leveraged loans — which are owed by riskier, less creditworthy businesses — more than doubled from 2008 to $3 trillion in 2021, before the Federal Reserve started its steepest rate hikes in a generation, according to S&P Global data. Over the same period, the debts of non-financial Chinese companies surged relative to the size of that nation's economy. And in Europe, junk-bond sales jumped over 40% in 2021 alone. A lot of those securities will need to be repaid in the next few years, contributing to a $785 billion wall of debt that's coming due.

Continue reading here (subscription may be required).

BlackRock's Head of Macro Credit Research warns credit distress is likely even if we somehow avoid a recession (from Bloomberg Surveillance on July 19)...

It won't take a recession to cause a wave of defaults. And Wall Street has yet to fully price in that distress.

That was the view from BlackRock's Amanda Lynam on Surveillance this morning. She joined a slew of recent guests in flagging concerns around some riskier credit valuations — and reminding us of the potential trouble spots even if the US economy eases out of its inflationary surge without a painful economic contraction.

"Companies are taking reserves against interest-sensitive pockets of the market like commercial real estate, for example. But they're saying they'll need those reserves even if there is a soft landing," Lynam said. "So it's not necessarily reserves in the case of a worst-case downturn, but it's reserves even if we kind of get an OK outcome."

Credit investors will need to be careful, she said, because assessing property valuations may be even trickier with old standards no longer relevant in the post-pandemic area. "There's going to be a new sense of price discovery."

Regional banks are likely to feel "most of the pain," Lynam said, echoing the concerns aired earlier this year when the upheaval at Silicon Valley Bank and First Republic Bank stirred concerns about future CRE lending in particular.

"We're also seeing that's where a lot of the reserves are being upticked," she said. "But I don't think it's going to be limited to those areas."

Continue reading here (subscription may be required).

Warren Buffett's experience in junk bonds during the dot-com bust highlights the incredible returns possible in distressed debt investing (from Alex Morris (TSOH Investment Research (via Twitter on July 19)...

Alex Morris (TSOH Investment Research)
@TSOH_Investing

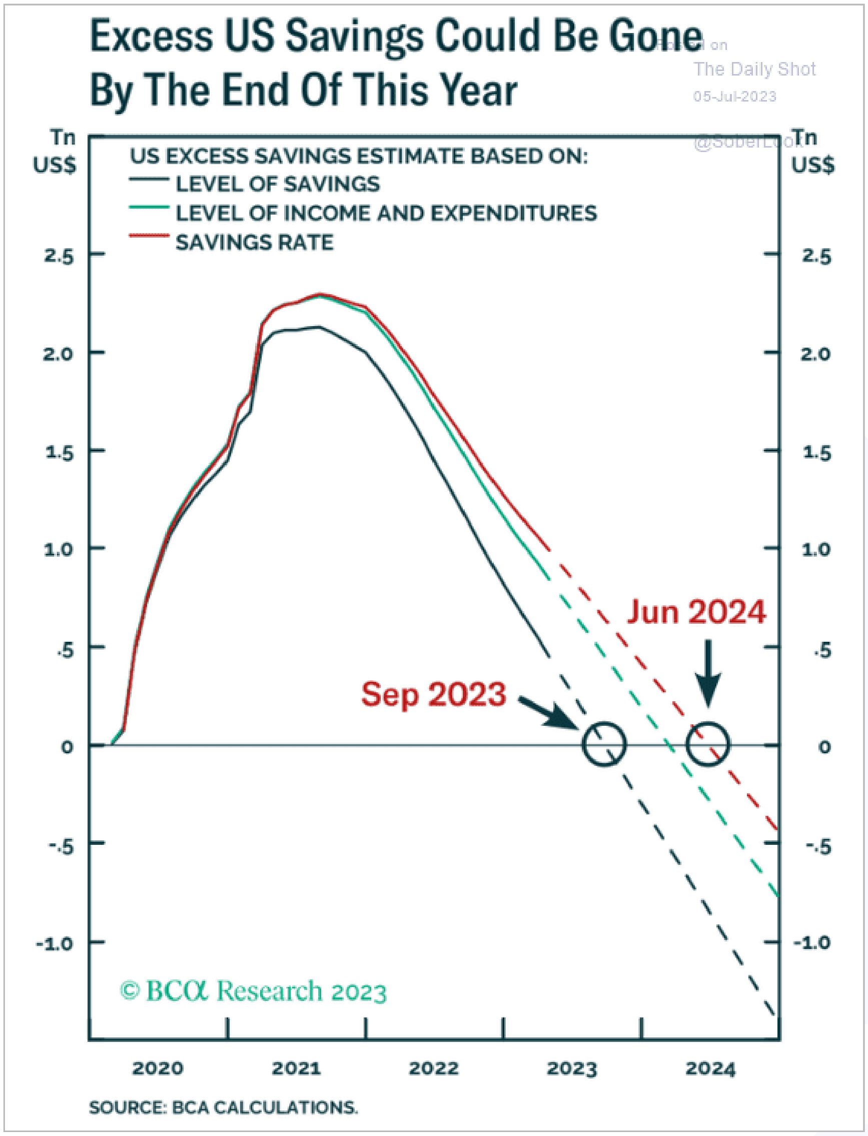
Warren Buffett, 2005 meeting - "We bought about $7 billion of junk bonds [in the fall of 2002]... bonds yielding anywhere from 25% to 60% - 70% on a yield basis; within 12-14 months, those same bonds sold at a 6% yield. You don't need to do that very many times in your life."

Company	Highest Yield at Purchase	Lowest Yield at Sale	Elapsed Time (in months)
Williams	75.4%	7.0%	14
Dynegy	62.7	6.0	14
Qwest	54.1	8.5	14
Crown Cork & Seal	48.5	4.4	17
Nortel	44.3	5.4	13
CMS Energy	42.7	4.1	13
ABB	33.7	4.7	13
Lucent	31.6	7.5	16
Corning	28.3	4.4	12
Tyco	26.5	4.7	6

Last edited 11:28 AM · Jul 19, 2023 · 41.1K Views

Consumer Credit

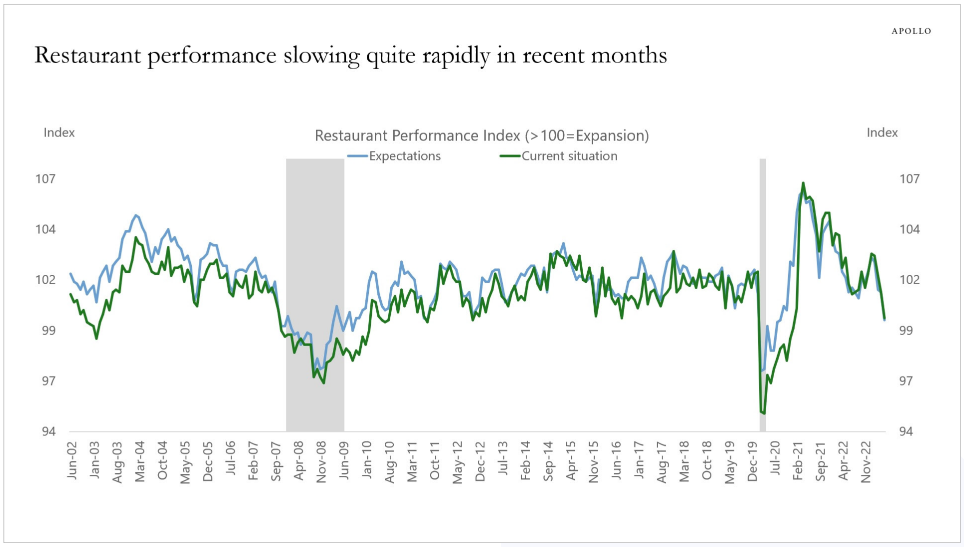
U.S. households could run out of COVID-era "excess savings" as soon as September ([from BCA Research via The Daily Shot on July 5](#))...



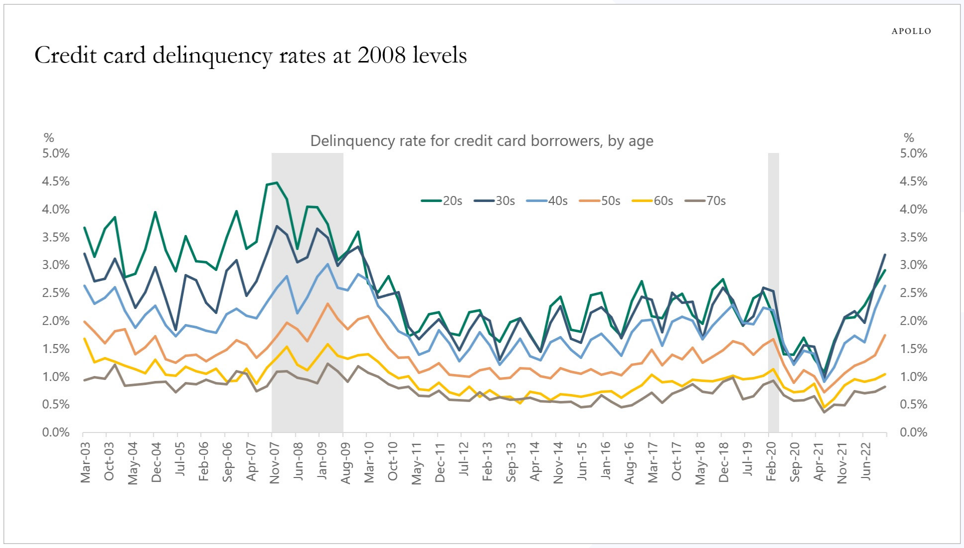
Several signals suggest the U.S. consumer is already "tapping out" ([from The Daily Spark on July 6]())...

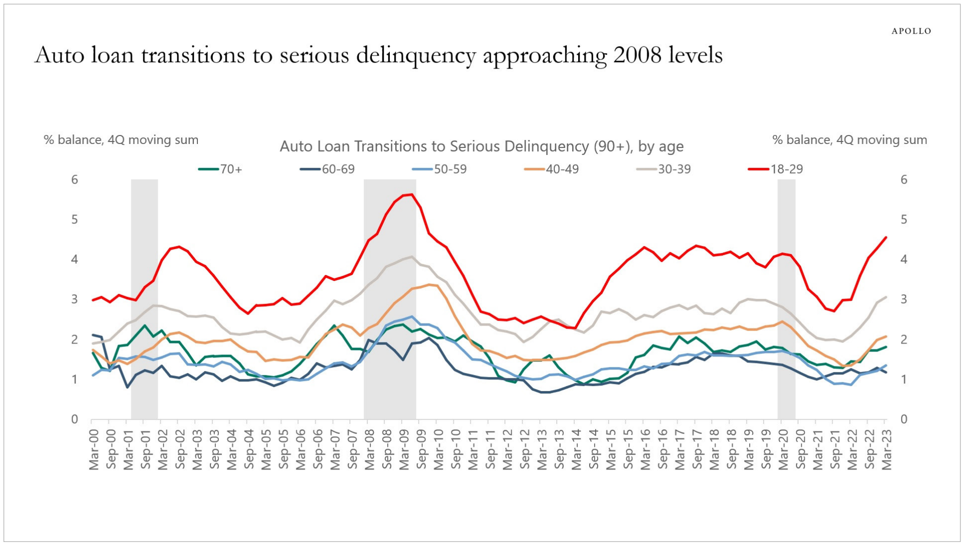
Just when everyone is abandoning the recession call, the data starts to slow down.

1) The Restaurant Performance Index has sharply declined in recent months...

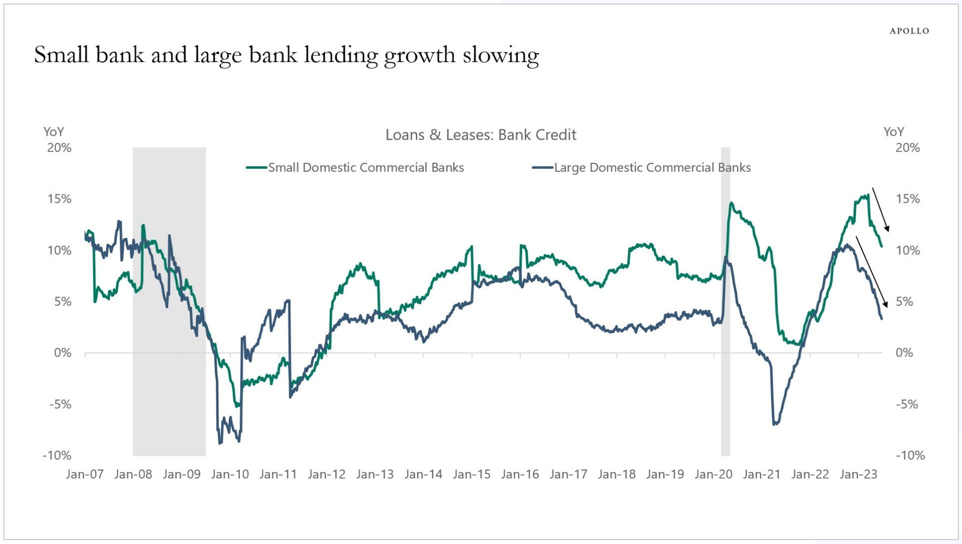


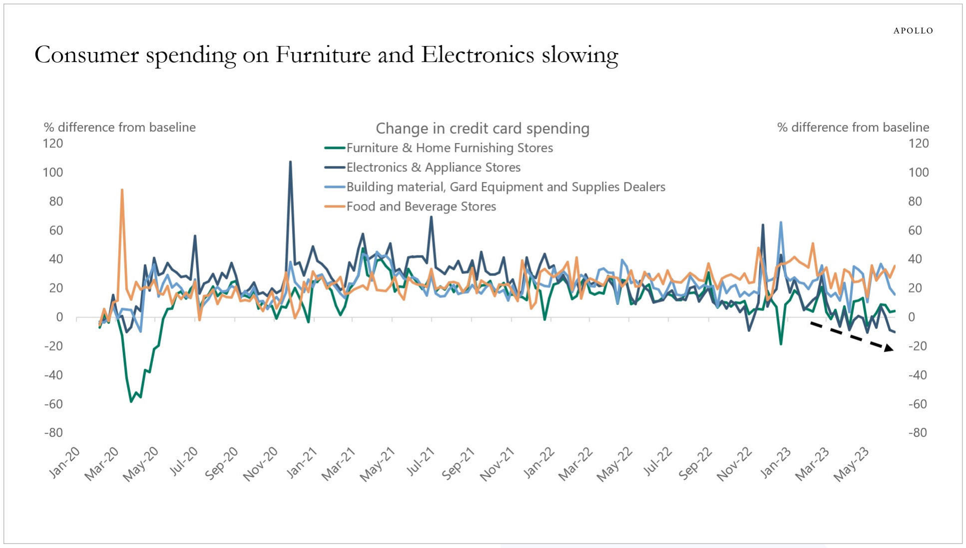
2) Credit card and auto loan delinquencies continue to rise, and these trends will continue with the Fed on hold well into next year...





3) Weekly data for bank lending is slowing rapidly, and weekly credit card data shows that consumer spending on durables that require financing, such as furniture and electronics, is slowing...

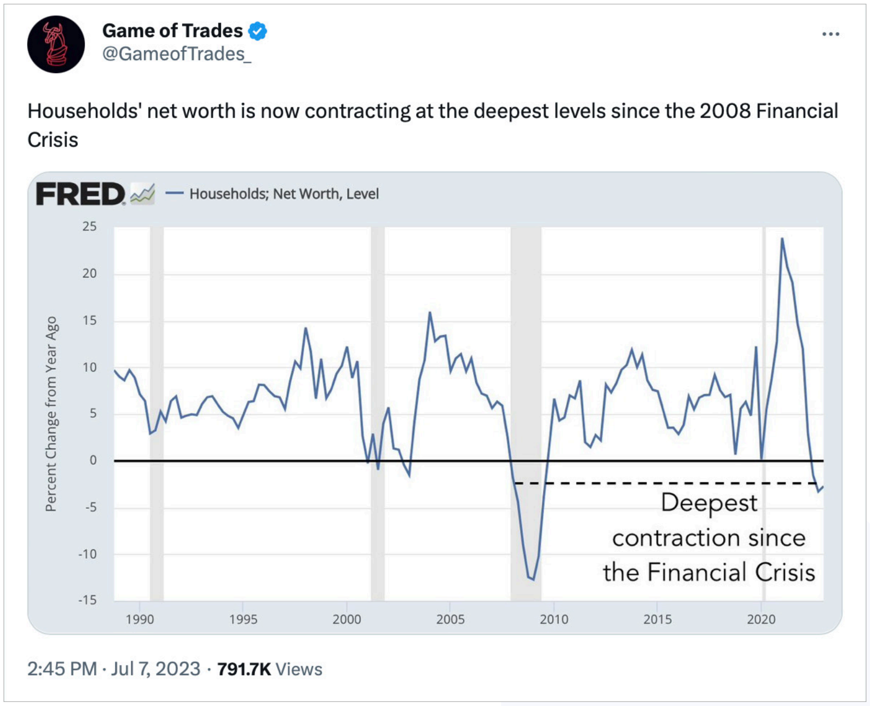




The bottom line is that Fed hikes are starting to negatively impact consumer spending…

[Continue reading here.](#)

U.S. households' net worth is declining sharply for only the second time in 35 years ([from Game of Trades via Twitter on July 7](#))...



The Federal Bank of New York's latest Survey of Consumer Expectations suggests consumer credit availability is tightening significantly ([from the New York Fed on July 10](#))...

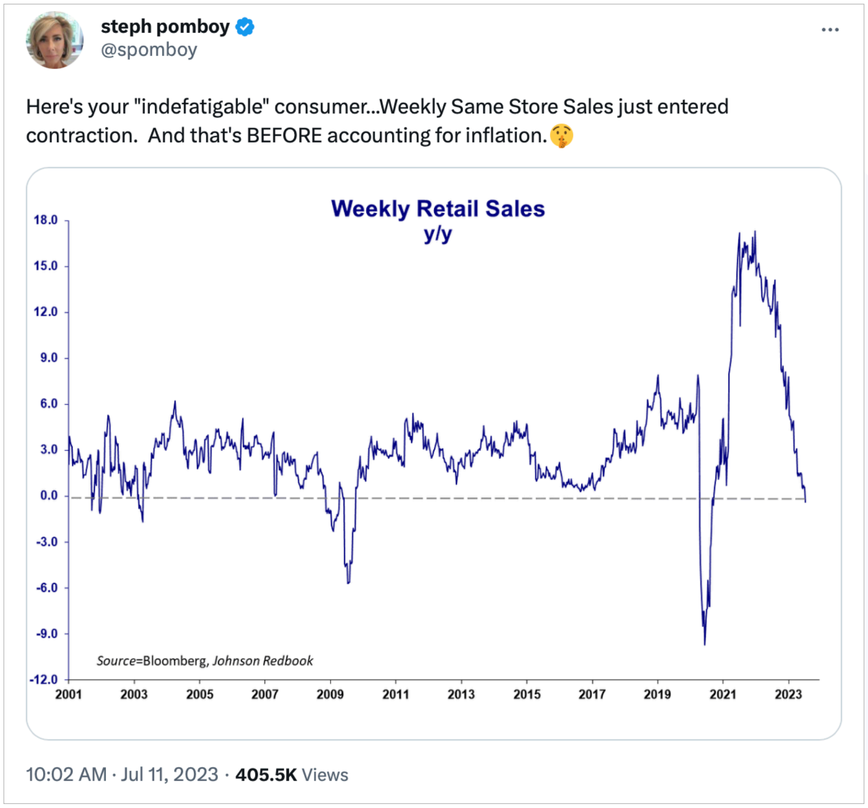
At a Glance: Findings from the June SCE Credit Access Survey

- The application rate for any kind of credit over the past twelve months declined to 40.3 percent from 40.9 percent in February, its lowest reading since October 2020. Application rates declined to 11.9 percent for auto loans and 12.5 percent for credit card limit requests, but increased to 24.8 percent for credit cards, 6.5 percent for mortgages, and 5.3 percent for mortgage refinances.
- The overall rejection rate for credit applicants increased to 21.8 percent, the highest level since June 2018. The increase was broad-based across age groups and highest among those with credit scores below 680.
- The rejection rate for auto loans increased to 14.2 percent from 9.1 percent in February, a new series high. It increased for credit cards, credit card limit increase requests, mortgages, and mortgage refinance applications to 21.5 percent, 30.7 percent, 13.2 percent, and 20.8 percent, respectively.
- The proportion of respondents reporting that they are likely to apply for one or more types of credit over the next twelve months rose to 26.4 percent from 26.1 percent in February.

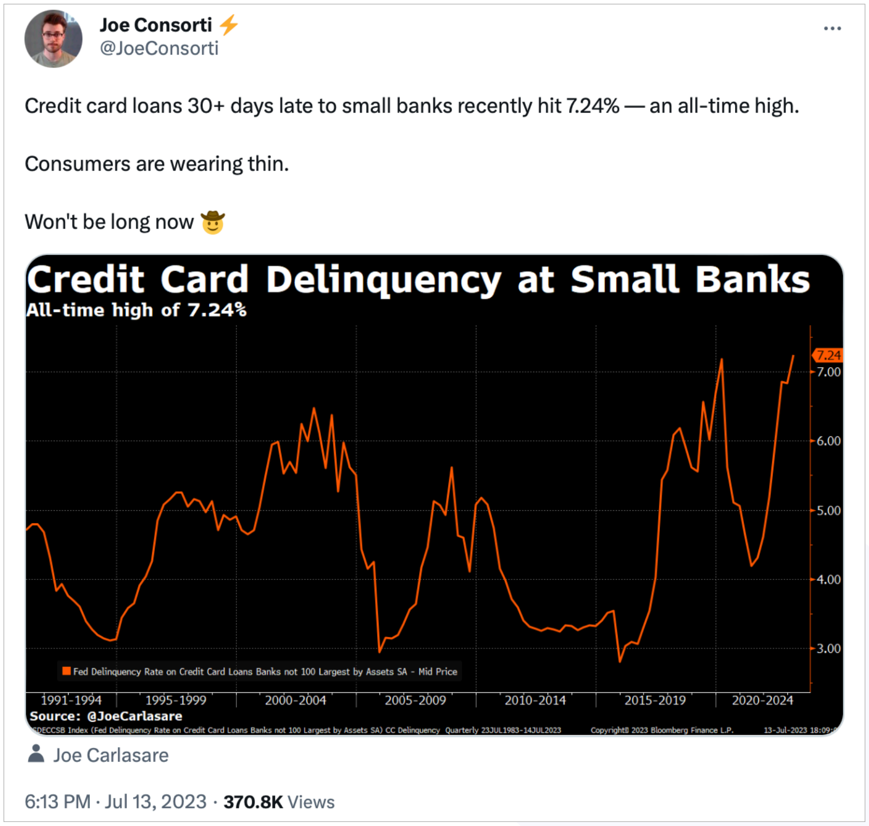
- The average reported probability that a loan application will be rejected increased sharply for all loan types. It rose to 30.7 percent for auto loans, 32.8 percent for credit cards, 42.4 percent for credit limit increase requests, 46.1 percent for mortgages, and 29.6 percent for mortgage refinance applications. The readings for auto loans, mortgages, and credit card limit increase requests are all new series highs.

Continue reading here.

Weekly same-store sales just went negative for the first time since the COVID lockdowns (from Steph Pomboy via Twitter on July 11)...



Credit card delinquencies at small banks just hit the highest level on record ([from Joe Consorti via Twitter on July 13]())...



Student loan repayments will equate to a 5% pay cut for the average American ([from The Wall Street Journal on July 15]())...

> Tens of millions of federal student-loan borrowers will soon owe monthly payments for the first time in more than three years. Some of them aren't ready for it.
>
> The payment and interest pause put extra cash into people's pockets, but they tended to spend it rather than save it, according to recent research. Some borrowers are now concerned about being able to cover their student-loan bills this fall. Many of those who feel financially ready have started dialing back their spending on coffee, clothing and other everyday purchases.
>
> The typical monthly loan payment will be between $210 and $314, Wells Fargo estimated using data collected in 2019. This amount is equivalent to a pay cut of about 4% to 5% off U.S. median household income before taxes, according to the Wells Fargo analysis.
>
> Some 37 million borrowers saved about $195 billion from the pause on payments as of April 2022, the Federal Reserve Bank of New York estimated. The return of loan payments will take more of a bite out of many borrowers' budgets than a single year of dramatic rises in inflation did. From December 2021 to December 2022, the income of a typical U.S. household decreased on average by 1% when adjusting for inflation, according to estimates from the economists Thomas Blanchet, Emmanuel Saez and Gabriel Zucman.

[Continue reading here (subscription may be required).]()

Real Estate

Falling office commercial real estate (CRE) prices are creating another unexpected headache for New York City landlords (from The Wall Street Journal on July 4)...

> For over a century in New York, commercial-property investors have carved up the value of the city's skyscrapers by separating the land from the building and trading the pieces separately.
>
> But now, in the midst of one of the worst office downturns since World War II, that practice is escalating disputes between the owners of the different pieces.
>
> Under ground-lease arrangements, the building operator pays rent to the owner of the land. Historically, these rents have been recalibrated periodically based on the land's appraised value at that moment in time. That process, often contentious, is especially tricky now because of slowing property sales and turmoil in the office sector.
>
> Office-building operators are hoping they might be spared dramatic jumps in their ground rent in part because the office market is getting pummeled by high interest rates and the weak return-to-office rate. Office rents have been declining since the pandemic, with building owners forced to offer significant concessions to attract tenants.
>
> "If I am a ground-lease tenant, right now is probably a good time to be doing a rent reset," said Joshua Stein, a New York real-estate attorney and the author of a coming book on ground leases. "The value of land is declining dramatically."
>
> Ground rents historically have been based on the appraised value of the land as if it were vacant. But the value of land under office buildings is based partly on surrounding office-market values. Those values are difficult to determine right now because there has been a dearth of office-building sales.
>
> In the first quarter of 2023, investors purchased only $489.5 million in Manhattan office properties compared with $5 billion in the first quarter of 2022, according to data firm MSCI Real Assets.
>
> Against this backdrop, a battle over land values and ground rents is currently under way on the west side of Manhattan between Vornado Realty Trust, one of the city's biggest office and retail landlords, and the family that owns the land under Penn 1, Vornado's marquee office tower. Vornado owns the building and recently renovated it for $450 million but has leased the ground underneath since 1998.
>
> Vornado recently renewed its ground lease with New York's Korein family through 2073 and is now wrangling over how much rent the company will pay for the next 25 years. In early 2022, Vornado Chairman Steve Roth estimated the rent for Penn 1's ground lease could jump to $26 million from $2.5 million a year. But by the end of the year, he was telling investors "we now think that number should be quite a bit lower" based on current market conditions, interest rates and availability of financing.

Continue reading here (subscription may be required).

Global consulting giant McKinsey projects "hybrid work" is here to stay, which indicates demand for office and retail space in major cities is unlikely to recover to pre-pandemic levels anytime soon (from McKinsey Global Institute on July 13)...

> Real estate in the world's superstar cities has not kept up with shifts in behavior caused by the pandemic. The cities' vibrancy is at risk, and they will have to adapt.
>
> - Hybrid work is here to stay. As a result, office attendance has stabilized at 30 percent below prepandemic norms.
> - The ripple effects of hybrid work are substantial. Untethered from their offices, residents have left urban cores and shifted their shopping elsewhere. For example, New York City's urban core lost 5 percent of its population from mid-2020 to mid-2022, and San Francisco's lost 6 percent. Urban vacancy rates have shot up. Foot traffic near stores in metropolitan areas remains 10 to 20 percent below prepandemic levels.
> - Demand for office and retail space in superstar cities will remain below prepandemic levels. In a moderate scenario that we modeled, demand for office space is 13 percent lower in 2030 than it was in 2019 for the median city in our study. In a severe scenario, demand falls by 38 percent in the most heavily affected city.
> - Real estate is local, and demand will vary substantially by neighborhood and city. Demand may be lower in neighborhoods and cities characterized by dense office space, expensive housing, and large employers in the knowledge economy.
> - Cities and buildings can adapt and thrive by taking hybrid approaches themselves. Priorities might include developing mixed-use neighborhoods, constructing more adaptable buildings, and designing multiuse office and retail space.

Continue reading here.

Morgan Stanley warns the broad CRE market could fall 30% from its peak (from MarketWatch on July 17)...

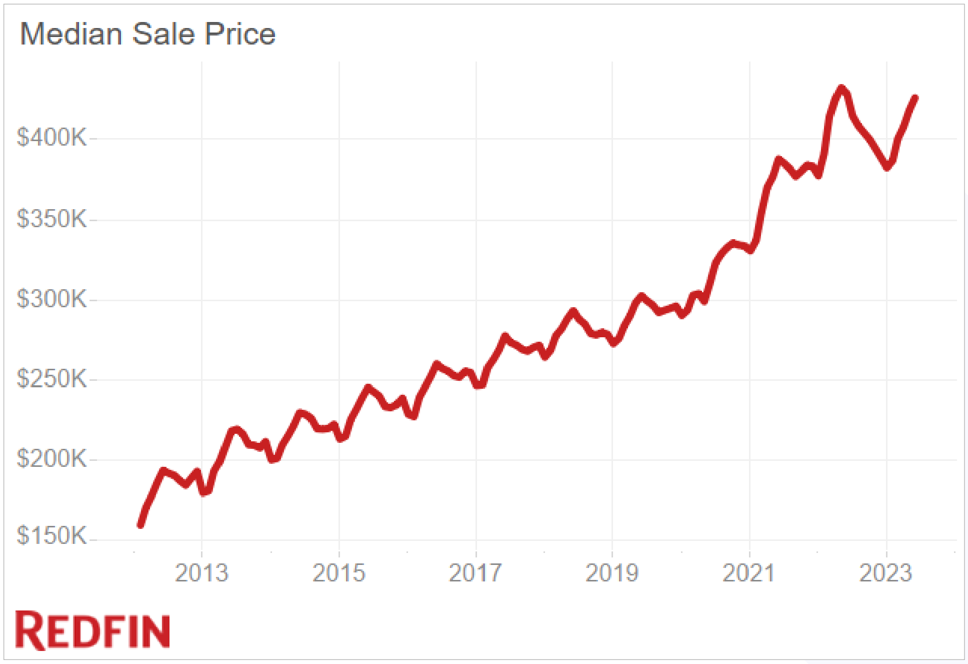
> The U.S. economy isn't the only thing unwilling to capitulate despite sharply higher interest rates.
>
> Commercial real-estate prices have been heading lower in the wake of the pandemic and the Federal Reserve's inflation fight, but the bulk of the pain still looks poised to come, according to Morgan Stanley analysts.
>
> Prices for apartment buildings, offices properties, and retail centers were pegged at about 8%-14% lower in May from peak levels (see chart), or less than Morgan Stanley's initial estimates (blue line).
>
> But the worst for property owners looks yet to come, according to Morgan Stanley's REIT research team led by Ronald Kamden. The team reiterated its call for a 27.4% peak-to-trough price drop for all commercial property types through the end of 2024.
>
> That compares with a 34.9% drop roughly 15 years ago during the global financial crisis, but also a subsequent period in which prices rose nearly 150% through the pandemic, according to Morgan Stanley data.

Prices have been heading lower overall, but with retail, industrial and office properties in the suburbs and central business districts, still facing the majority of their anticipated price declines "as transaction activity and distressed sales rise," the team wrote in a Monday client note.

Continue reading here (subscription may be required).

Unlike CRE prices, U.S. home prices are closing in on a new all-time high (from Redfin on July 17)...

A record low number of homes for sale combined with an uptick in homebuyer demand propped up housing prices in June, even as elevated mortgage rates kept many buyers on the sidelines. The median U.S. home sale price was $426,056 in June, just 1.5% ($6,341) below the all-time high of $432,397 set in May 2022.



June's median sale price was down 0.6% from a year earlier—the smallest decline of the past five months—and the average home sold for more than its list price for the first time in roughly a year.

“Today’s housing market is extraordinary; it feels hot even though there are very few homes changing hands,” said Redfin Chief Economist Daryl Fairweather.

“Sellers are getting multiple offers if their home is priced well and in a desirable area even though there aren’t a lot of buyers out there. That’s because house hunters have so few homes to choose from. More buyers are starting to come out of the woodwork as they get used to elevated mortgage rates, which is making the market feel even hotter.”

While mortgage rates are expected to start gradually declining in response to cooling inflation, they’re unlikely to fall enough to bring a critical mass of sellers back to the market anytime soon, meaning housing supply should remain low. When rates do ultimately fall more significantly, prices will likely jump as more buyers move off of the sidelines.

Continue reading here.

This simple statistic explains why U.S. housing supply remains stubbornly low (from MarketWatch via Realtor.com on July 17)...

> Mortgage rates are inches away from 7% – but less than a tenth of U.S. homeowners have a home loan at that rate.
>
> In fact, only 9% of all existing mortgages in the U.S. were taken out with a rate of above 6%, according to data from the Federal Housing Finance Agency, and analyzed by Torsten Slok, chief economist of Apollo Global Management.
>
> Around a quarter of all mortgages—23%—have a rate of less than 3%, Slok added, and 38% homeowners have a mortgage rate of between 3% and 4%.
>
> In other words, the vast majority of U.S. homeowners have low mortgage rates.
>
> **Today's home buyer vs. pandemic-era buyer**
>
> Millions of homeowners took advantage of ultra-low rates during the pandemic to lower their monthly payments. A recent study by the New York Fed found that 14 million outstanding mortgages were refinanced during the pandemic years. The typical homeowner who did so during this period saw their monthly payment fall by $220, the Fed said.
>
> But today's homebuyer is facing a much more expensive path to homeownership: Mortgage rates have surged since, and the 30-year was averaging at 6.96% as of July 13, according to Freddie Mac.
>
> A typical new homeowner today will join the ranks of the small group that has a home loan with an interest rate of above 6%.
>
> But with millions of homeowners holding onto such low rates, that presents a big problem that's frozen the housing market—one of low supply. That's driven by their reluctance to sell.
>
> If a homeowner was to sell their home and purchase another property, if they need to take out another mortgage, they would have to take out a home loan at a rate of 7% or even higher, depending on what their lender was quoting them.
>
> "The bottom line is that homeowners across America do not have any incentive to move and get a new mortgage," Slok said.

Continue reading here.

U.S. homebuilder sentiment continues to improve as supplies remain tight (from Bloomberg on July 18)...

> US homebuilder sentiment rose in July to the highest level in 13 months as buyers continued to opt for new construction amid a tight housing supply.
>
> The National Association of Home Builders/Wells Fargo gauge increased for a seventh-straight month, to 56 from 55 in June. The figure matched the median estimate in a Bloomberg survey of economists.

Despite the improvement in sentiment, the homebuilder index remains below end-of-2021 levels, when mortgage rates were lower. High rates continue to suppress the number of homes for sale, contributing to the uptick in new-home construction.

"Although builders continue to remain cautiously optimistic about market conditions, the quarter-point rise in mortgage rates over the past month is a stark reminder of the stop and start process the market will experience as the Federal Reserve nears the end of the ongoing tightening cycle," said NAHB Chief Economist Robert Dietz.

The index of current sales rose to a one-year high of 62, while the expectations gauge moderated to 60. The prospective buyer traffic component advanced to 40, marking the highest reading since June 2022.

Continue reading here (subscription may be required).

An insider's look at the carnage in New York's office real estate market (from New York Magazine on July 18)...

Every time the real-estate market crashes, people say, "This time is different." When there's distress all around, it's hard to grasp how there could ever be an upside. But with the benefit of hindsight, you can see that if you'd had enough money when things got bad, you could have made a killing by taking the other side of the bet. Let's go back to 2009. There was calamity as far as the eye could see: bank bailouts, paralyzed credit markets, a toxic heap of mortgage debt crushing the world economy. Scott Rechler, having fortuitously sold his family's real-estate company at the top of the market to a competitor for $6 billion, decided it was a good time to go shopping for office buildings. After raising more money from sovereign wealth funds, other institutional investors, and wealthy private individuals overseas, he went on an opportunistic buying spree. Over three years, he spent $4.5 billion on Manhattan office acquisitions. By 2020, his company, RXR, was a major office landlord with more than 22 million square feet of space in the city.

Today, three years after the pandemic emptied office buildings nationwide, Rechler has been forced to reckon with the possibility that the buildings that were worth so much not so long ago may now not even be worth keeping. Corporate tenants are typically locked into multiyear leases, which guarantee stability in the commercial real-estate market for a time. But every month, more leases expire, giving tenants an opportunity to rethink their space, and every day, employers are staring at empty desks. Many companies, which had been trying to squeeze more workers into less space for years, are not renewing. That leaves an office landlord facing hard choices. What should Rechler do, for instance, with 5 Times Square, a million-square-foot building that 20 years ago was a gleaming centerpiece of 42nd Street's revival? After the departure of its longtime anchor tenant and major renovations, it's currently close to empty.

Not long ago, real-estate industry leaders were urging the city's workers to return to their office buildings. Rechler told me in 2020 that it was a "civic responsibility." They've since surrendered to the changed reality. Sometimes tenants are downsizing and upgrading to more expensive spaces; sometimes they are economizing under the guise of offering flexibility. From the landlord's perspective, motive hardly matters — space is space, and it's got to be rented. Add in sharp hikes in interest rates, which make refinancing a huge commercial mortgage a potentially ruinous proposition, and you have a crisis that threatens not just the solvency of office buildings but the loans that are attached to them and the banks that hold them and, by extension, the whole economy.

“We’re crossing a chasm,” Rechler told me when I visited him at his office at 75 Rockefeller Plaza in early June. More than any of the city’s other major landlords, he’s been warning of what he calls a “slow-moving train wreck.” Like it or not, everyone suffers if banks collapse. And if you are a New Yorker, you have a great deal at stake in the market because of the enormous public revenue offices generate — 21 percent of the city’s property-tax levy — money that goes to pay for schools, public housing, fire trucks, pensions, parks, and so much else that makes life in New York tolerable.

According to Cushman & Wakefield, Manhattan’s office-vacancy rate is around 22 percent, the highest recorded since market tracking began in 1984. When you include sublet space, more than 128 buildings in Manhattan currently list more than 200,000 square feet of space as available for lease, according to data from the firm CoStar. The available space in these buildings alone amounts to more than 52 million square feet: the equivalent of more than 40 skyscrapers the size of the Chrysler Building. Certain areas and building types are particularly endangered — the Garment District lofts once favored by tech start-ups, the generic glass gulch of Third Avenue in the 40s and 50s — but the pain is widely distributed. Many large property owners are now performing triage, trying to determine which buildings are still worth anything like what they paid for them. In Rechler’s case, this reassessment has taken the form of a process he calls “Project Kodak,” after the once mighty film-and-camera company. He classifies buildings that are worth saving as “digital.” The duds he deems “film.”

Rechler, 55, is a bald, blunt real-estate dynast. He comes from a Long Island family that turned a small fortune made by his grandfather — he patented the folding aluminum beach chair — into a very large one, mostly by building industrial and office parks in the suburbs. When he was in his early 30s, Scott pushed the family company into Manhattan real estate before he sold it in 2007 to SL Green Realty Corp., which is now Manhattan's largest commercial landlord. He took his peak-of-the-market profits and set out to build RXR on his own. Like any successful commercial-property owner, he has hedged his company's risks by partnering with other real-estate firms, spending other people's money — in his case, mostly from overseas investors — and selling off bits and pieces of his portfolio at advantageous moments.

Rechler said he began Project Kodak from a position of relative strength, which has allowed him to be cold-blooded when it comes to culling the buildings he owns. Of course, he would say that: Commercial real estate is a bluffing business, so it is rare for its players to admit they are in trouble. All the big landlords — SL Green, Vornado Realty Trust, Brookfield Properties, the old real-estate families — are facing the same problem of vacancy and shrinking demand. Where Rechler differs from the rest, though, is in his relative candor about the consequences. "Obviously, when we lose money, it hurts, and in many of these cases we will lose money," he said. "You need to rise to the opportunity and re-create value."

Rechler casts himself in the mold of businessmen like Nelson Rockefeller, Felix Rohatyn, Mike Bloomberg, and Dan Doctoroff, who have taken charge in times of distress, at least according to their own mythology. "There's been a void of leadership," Rechler told me. Under Governor Andrew Cuomo, Rechler played an influential role on the board of the Port Authority of New York and New Jersey, and he later served as the chairman of the Regional Plan Association. His desk is equipped with a ring light and a microphone for his frequent appearances on podcasts and CNBC, in which he pleads for action from regulators and policymakers. He speaks against a backdrop of graffiti art — a pair of pieces by Mr. Brainwash, collaged images of road signs and Superman and uplifting spray-painted slogans (FOLLOW YOUR DREAMS … NYC IS BEAUTIFUL).

Rechler also sits on a board that oversees the Federal Reserve Bank of New York and has been outspoken about the possibility of economic "contagion" emanating from distressed commercial-real-estate debt. Rechler predicts that within two years, there will be "500 to 1,000 fewer regional banks" owing to failures and forced consolidations. He has been advocating, with some success, for action from banking regulators, who can influence lenders' decisions when it comes to troubled loans. He wants lenders to loosen up the credit markets, which would benefit the industry in general and Rechler in particular, though his self-interest doesn't make him wrong. "Some people accuse Scott of speaking his own book," says one of his real-estate competitors. "But what he says is right on the money."

"I think raising the alarm is important," Rechler said. "Government has been really good at responding to crisis. They've been really poor at proactively trying to prevent crisis. So we could wait three, four years until our tax revenues are down 20 or 30 percent, and our transit system once again is broke and falling apart, and we have crime on our streets and homelessness in these dark areas where we have vacant buildings, or we could try to get ahead of the game."

Rechler is confident that, on the other side of the agony, there will be new opportunities for his business and for the city. "I was with Mike Bloomberg yesterday talking about this," he said. "How anytime anyone bets against New York evolving, they lose that bet." An inherent part of evolution, though, is elimination. Some real-estate companies will not survive the crisis. Office buildings will end up demolished. A group of people who have long owned the city, both literally and politically, could end up making less and mattering less. This time might really be different. That may not sound like a tragedy; few New Yorkers miss their sweaty daily commutes, their crammed open-plan galleys, their plastic-packed salads. But what is this city if its skyline is now obsolete?

Continue reading here.

The value of distressed U.S. office properties rose 36% to $24.8 billion in the second quarter (from Bloomberg via Yahoo Finance on July 19)...

> About $24.8 billion of US office buildings were in distress at the end of the second quarter, surpassing previous leading commercial real estate laggards — hotels and retail properties.
>
> The total value of offices that were financially troubled or already repossessed by lenders shot up about 36% from the first quarter, MSCI Real Assets reported Wednesday.
>
> At the end of June, $22.7 billion of retail properties — including malls — and $13.5 billion of hotels were in distress. The total for all troubled commercial properties was almost $72 billion, up 13% from the first quarter.
>
> "The office sector was responsible for the largest share of marketwide distress," according to the report, based on filings for bankruptcies, defaults and other publicly reported property issues. "It's the first time since 2018 that neither the retail nor hotel sector was the biggest contributor."
>
> It's likely to get worse for offices.
>
> "The things needed to slow the pace aren't happening," Jim Costello, an MSCI economist and a co-author of the report, said in an interview. "Investors are putting a low probability on debt becoming cheap and everybody being back in the office like they were before."
>
> MSCI identified an additional $162 billion of properties in potential distress, with problems such as delinquent loan payments, high vacancies or maturing debt.
>
> US offices face higher stress than other real estate sectors because of weak demand as remote work gains widespread acceptance. Office use in 10 major US cities is at about half of its pre-pandemic rate on average, according to badge-swipe data from Kastle Systems Inc. More than 20% of US office space was vacant as of June 30, brokerage Jones Lang LaSalle Inc. reported.
>
> Prices for office buildings fell 27% in the year through June, compared with a 12% decline for all commercial-property types, according to real estate analytics firm Green Street. Corporate landlords such as Blackstone Inc., Brookfield Asset Management Ltd. and Starwood Capital Group have stopped payments on office buildings they've deemed to be money losers.

Continue reading here.

The lack of existing home supply is creating a boom in the new-home market (from The Wall Street Journal on July 19)...

> After mortgage rates shot up last year, Ivory Homes, one of Utah's largest builders, suddenly had few buyers for the hundreds of homes it had under construction. So Clark Ivory, the chief executive, laid off 9% of his staff, and by January he had slashed construction by nearly 80% from its 2022 peak.
>
> Then, much to his surprise, sales of new homes started picking up. By May, even though mortgage rates weren't really budging, sales for all home builders were at their highest level since early 2022.
>
> Millions of American homeowners have been reluctant to sell because they can't afford to give up the low mortgage rates they have now. Only 1.08 million existing homes were for sale or under contract at the end of May, the lowest level for that month in National Association of Realtors data going back to 1999.

For many would-be buyers—in Utah and in many other markets—new construction has become the only game in town. Newly built homes accounted for nearly one-third of single-family homes for sale nationwide in May, compared with a historical norm of 10% to 20%. Existing-home sales in May fell 20% year-over-year, while new single-family home sales that month rose 20% on an annual basis.

That divergence is yet another example of how this housing market is behaving like no other. “It’s such a rare thing,” said Rick Palacios Jr., director of research at Irvine, Calif.-based John Burns Research & Consulting, who predicts the disparity will widen in coming months.

So far, the home-building revival, coupled with financial incentives offered by builders, is providing only minor relief to prospective buyers. Builders aren’t erecting enough homes to offset the shortage of existing ones on the market, meaning buyers in many places still face bidding wars. On a national basis, home prices have only declined a small amount from their record highs in spring 2022. Interest rates have risen in recent weeks to their highest level this year.

For builders like Ivory, though, it has been a lifeline. Builder confidence, which declined every month in 2022, has risen for seven straight months to its highest level since June 2022, according to the National Association of Home Builders.

Investors believe the home-building industry—one of the most sensitive to changes in interest rates—has already gone through its recession and is coming out the other side

Publicly traded home builders have reported stronger-than-expected results this year. The S&P Homebuilders Select Industry stock index is up 39.8% this year as of Tuesday’s close, outpacing the S&P 500’s 18.6% gain. Share prices for D.R. Horton, Lennar and PulteGroup, the three largest home builders, have performed even better.

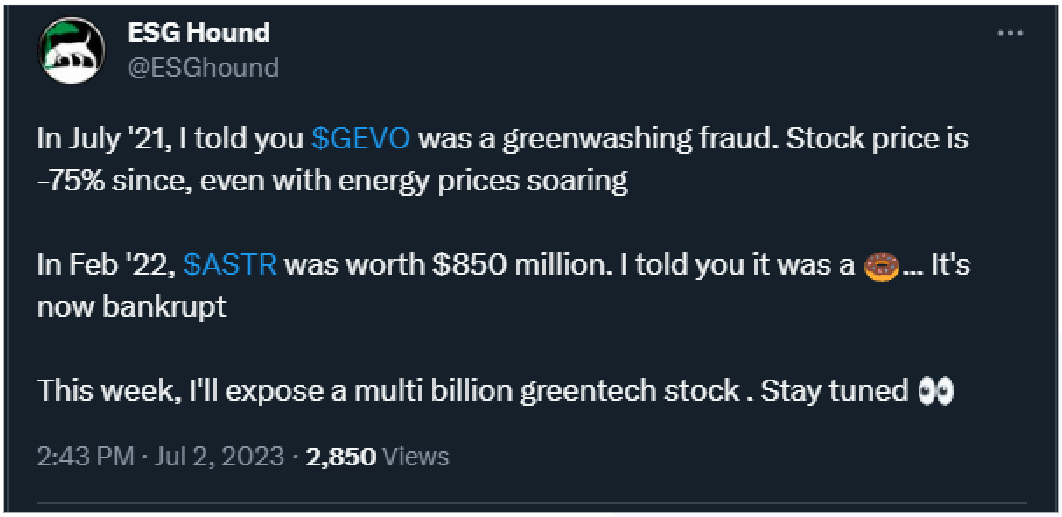
Continue reading here (subscription may be required).

Special Situations

Activist Investing, Spin-Offs, Arbitrage, Mergers & Acquisitions (M&A), and More

An activist short seller alleges fraud at "green" battery tech firm Enovix – which also happens to be a current *long* investment position of famed short seller Marc Cohodes (from ESG Hound on July 5)...

Hello again, friends. I haven't written a stock-specific thesis on this publication in over a year, but it's time to mix things up again. Today, I'll present evidence that Enovix, a California-based battery company with meager revenues, big promises, and an eye-watering $3 billion market capitalization is riding high on hype and little else.



Putting the content of a post that outlines a short-selling thesis behind a paywall isn't really good for business or exposure... but I don't want all my lovely subscribers to get the short end of the stick, so they'll get an 18-hour jump on the report here, as well as a post tomorrow, breaking down how exactly I put this piece together.

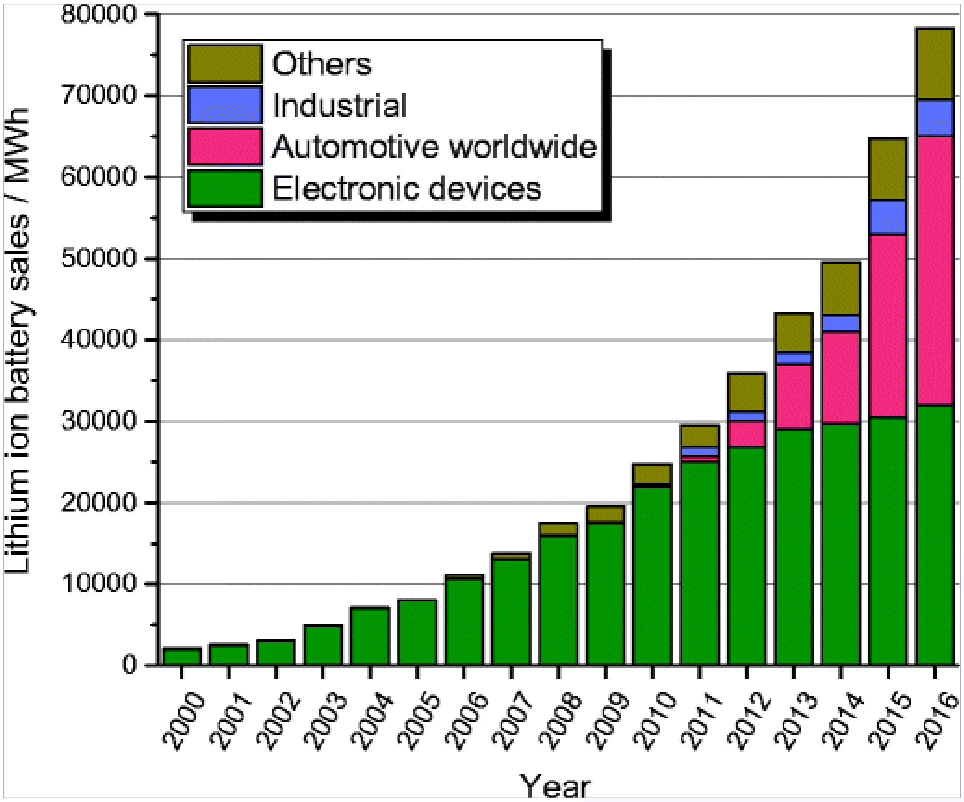
You ready? Let's go

Summary

- Enovix Management has repeatedly misled customers about their manufacturing capabilities and volumes.
- Last November, and just four days after the Bay Area Air Quality Management released records that revealed management was overstating production capabilities at their Fab-1 facility in California by ten times, management released guidance indicating that production at this facility would be significantly lower going forward...

Background

Enovix, headquartered in Fremont, California, was founded by three ex-IBM employees in 2007. They set out to make a better battery and their timing couldn't have been better.



"Lithium ion, lithium metal, and alternative rechargeable battery technologies: the odyssey for high energy density" Placke et al (2017)

Between the company's founding and today, global Lithium Ion battery production has increased by well over 30-fold. The explosion of power-hungry smartphones drove the first surge in production following the release of the iPhone in 2007. Demand for cells took off to new heights as EVs and stationary storage deployment became the hot new thing in subsequent years.

Enovix's current pitch is a battery that uses silicon, instead of graphite, as the battery anode. The anode stores positively charged lithium ions in the battery's charged state; as the battery is discharged during usage, the free lithium crosses back into the cathode (a lithium metal oxide).

Chemically, a silicon-based anode offers an attractive appeal. On a mass basis, silicon can accommodate several times more lithium ions in the charged state. This increases the mass efficiency of a battery. It is such an appealing concept that Panasonic, unquestionably the leader in global battery technology and manufacturing, announced its intention to develop a silicon anode battery back in 2009. As of today, Panasonic appears to have entirely abandoned the idea.

But why?

Well, the tricky part of silicon is that while its mass efficiency is clearly superior to the industry standard graphite, silicon has a bit of a volume problem. Silicon anodes can (and do) swell up to 300% in volume when fully saturated with lithium. Silicon also degrades upon repeated charging cycles. These two factors make silicon anode batteries highly dangerous as the physical and chemical fluctuations between charging states risk the battery suddenly discharging, which can result in catastrophic self-immolation.

ENVX claims to have solved this problem by tightly packing the battery components into a rigid rectangular steel casing. We'll get more into this in later posts, but that's the pitch. Small, energy-dense batteries using silicon anodes for things like laptops and portable devices where every gram of mass matters.

But despite being in business for 15 years, the company still has no meaningful revenue to speak of. They handed out samples of their "revolutionary" battery to prospective customers as early as 2018, yet no major buyer has shown up with an order.

Perhaps that's why they jumped on the SPAC reverse merger craze of 2021 to go public. Sitting today at a $3 billion valuation, the company somehow avoided the great SPAC wipeout, though still 50% below their meme stonk highs of 2021.

ENVX Management Spent all of 2021 and 2022 Lying to Shareholders

Nothing stated above is new information. But here's where we get to the good stuff. Take a look at the "Fab Scale-Up Strategy slide:"

Fab Scale-Up Strategy

	Fab-1	Fab-2	Fab-3[2]
Production Site	Fremont	Buy fab & upgrade	JV / licensing in automotive
First Revenue	Q2'22	Q2'23	2025
Revenue (2025)	$220M[1]	$581M	
Capacity (cells)	45M/yr	89M/yr	
Capacity (Wh)	254 MWh	1.53 GWh	35 GWh
Cash Flow Trough	($208M)	($327M)	

51 ENOVIX

[1]Product-dependent revenue, which could vary by +/-20% based on product mix.
[2]Upside to financial plan

In the initial SPAC presentation in 2021, ENVX laid out their plans to start producing their battery at "Fab-1" in Fremont. With a capacity of 45 million units and a total capacity of 254 MWHr per year, that meant that the average cell would be in the 5.6 Wh range, or roughly a 60% Mix of the IoT/Wearable cell (1.17 Wh) product and a 40% in the industrial/Mobile cell range:

This guidance, Fab-1 capacity of 45 million units and $220 million in revenue, has never been officially walked back by the company. However, on November 1, 2022, the company dropped a bombshell on investors in the Q3 Earnings release:

"We expect Fab-1 improvement activities to extend into 2023, but at a slower rate given the decision to redirect resources to Gen2. Given this, we expect to exit 2023 at a run rate of under one million battery cells produced"

A downgrade of "45 million units annual capacity" to "one million in production of only our smallest battery" is quite an about-face. Fret not, though; the company has moved on to promising great things for Fab-2, to be located in Malaysia, in the very near future!

"But Eric!" I hear you cry. "Companies re-evaluate stuff all the time, simmer down, this is all about Fab-2 now."

But, if we look at the timeline for how ENVX discusses production goals and accomplishments for their Fremont facility, what emerges is a very clear picture of dishonest management. This is the basis for a good short-selling opportunity. Management that repeatedly lies, obfuscates, and refuses to adequately address past falsehoods, preferring instead to move on to even bigger promises in the future, represents equity that should be avoided by investors.

Continue reading here.

Energy delivery firm MDU Resources plans to spin off its construction services business (from the Securities and Exchange Commission on July 10)...

Upon completing MDU Resources Group, Inc.'s (NYSE: MDU) previously announced strategic review of its wholly owned construction services business, MDU Construction Services Group Inc., the MDU Resources board of directors has determined that it will pursue a potential tax-advantaged separation of the construction services business from MDU Resources.

The board said a tax-advantaged separation of the construction services business supports MDU Resources' goal of enhancing value for stockholders by becoming a pure-play regulated energy delivery company, an objective MDU Resources first announced in late 2022.

"After an extensive strategic review, the board decided our best path forward to optimize value for stockholders is a potential tax-advantaged separation of MDU Construction Services Group. This decision reflects the strong financial performance of this business and long-term growth opportunities tied to continued electrification of the economy, as well the tax basis of the business and current market conditions," said David L. Goodin, president and CEO of MDU Resources. "We are focused on determining the best method and timeline to effect a separation."

MDU Construction Services Group has experienced record-breaking performance in recent years, with record revenue of $2.7 billion in 2022 and a record backlog of $2.13 billion of work at Dec. 31. For 2023, MDU Resources most recently reported it expects revenue from its construction services business of $2.8 billion to $3.0 billion, with margins slightly higher compared to 2022, and earnings before interest, taxes, depreciation and amortization (EBITDA) in the range of $200 million to $225 million.

MDU Resources also said it expects additional project opportunities to result from the federal Infrastructure Investment and Jobs Act and the energy transition underway in the U.S.

Continue reading here.

Canadian pharmaceutical company Knight Therapeutics announces a huge share buyback program (from GlobeNewswire on July 12)...

> Knight Therapeutics Inc. (TSX:GUD) ("Knight" or the "Company "), a leading pan-American (ex-US) specialty pharmaceutical company, announced today acceptance by the Toronto Stock Exchange (the "TSX") of the Company's Notice of Intention to Make a Normal Course Issuer Bid ("NCIB").
>
> Pursuant to the NCIB, the Company proposes to purchase, from time to time over the next 12 months, if considered advisable, up to 5,999,524 common shares of the Company, being approximately 10% of its public float of 59,995,245 common shares, as of June 30, 2023. As of June 30, 2023, there were a total of 107,177,220 common shares issued and outstanding.
>
> Purchases may commence on July 14, 2023 and will conclude on the earlier of the date on which purchases under the bid have been completed and July 13, 2024. The Company may purchase up to a daily maximum of 23,539 common shares (being 25% of the average daily trading volume of 94,158 common shares, for the last six calendar months). The common shares may be purchased for cancellation through the facilities of the TSX or through alternative Canadian trading systems at times and in numbers to be determined by the Company. The Company had previously sought and obtained approval from the TSX to purchase up to 7,988,986 common shares under an NCIB and the Company has, in the twelve months preceding this announcement, purchased such 7,695,125 common shares through the facilities of the TSX and alternative Canadian trading systems at a weighted average price per share of $4.99.
>
> Knight also entered into an automatic share purchase plan with a broker in order to facilitate purchases of its common shares under the NCIB. Under Knight's automatic share purchase plan, Knight's broker may repurchase common shares which it would ordinarily not be permitted to due to regulatory restrictions or self-imposed blackout periods. Purchases will be made by Knight's broker based upon the parameters prescribed by the TSX and applicable Canadian securities laws and the terms of the parties' written agreement. The automatic share purchase plan has been pre-cleared by the TSX and will be implemented effective as of July 14, 2023.
>
> The Company believes that the market price of Knight's common shares, from time to time, may not reflect the inherent value of the Company and purchases of common shares pursuant to the bid may represent an appropriate and desirable use of the Company's funds. The price that Knight will pay for Common Shares in open market transactions will be the market price at the time of purchase.

Continue reading here.

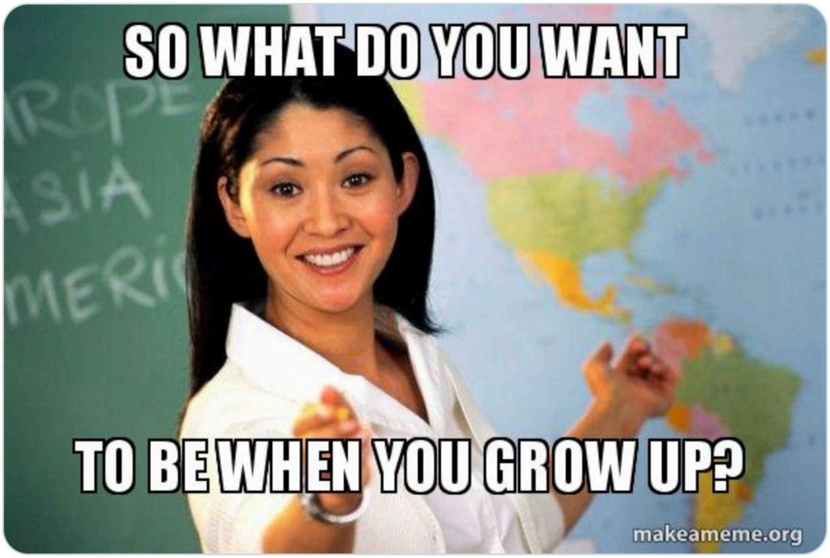
Two notable short sellers are targeting "AI service provider" Applied Digital Corp ([from KEDM.com via Twitter on July 13](#))...

KEDM.com @KEDM_COM · Jul 13

From potato farm to bitcoin miner to AI service provider?

Meet $APLD... a company still grappling with the childhood question: What do you want to be when you grow up?

Today, they chose AI, but 2 notable short-sellers aren't buying it...



3 · 11 · 6,290

KEDM.com @KEDM_COM · Jul 13

Who's targeting them? @StockJabber of @BearCaveEmail & @WolfpackReports.

Both have tweeted about it and their full reports can be found on their respective pages.

Here's just a few things to note 👇

1 · 2 · 691

KEDM.com @KEDM_COM · Jul 13

Year to date, $APLD stock rocketed 600%+ at its high.

Was last seen trading roughly 30% down from its 52 week high.

1 · 1 · 479

KEDM.com @KEDM_COM · Jul 13

Claims against the company: Let's start with @BearCaveEmail -

"The Bear Cave believes Applied Digital relies on puffery over substance and is a perfect case study on our market's bizarre underbelly of reverse mergers, microcaps, and shell companies."

1 · 2 · 315

KEDM.com @KEDM_COM · Jul 13

Here's what @WolfpackReports had to say:

"The explosion of interest in AI after the emergence of Chat GPT has predictably attracted the worst promoters and scumbags to peddle fake AI wares to credulous investors, and our analysis indicates that APLD is one of these grifters..."

1 · 341

KEDM.com @KEDM_COM · Jul 13

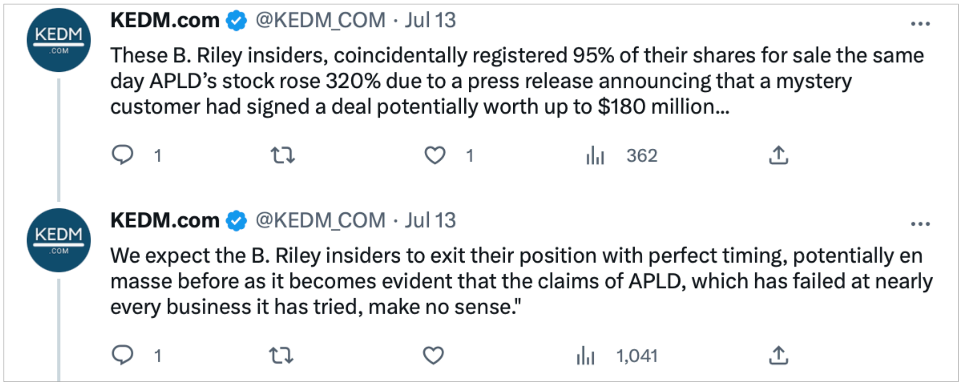
Lastly, it's important to mention that this is a derivative of $RILY, with Wes Cummins, who is the head of B Riley's hedge fund, also occupying the positions of CEO and Chairman of the Board.

A little more context on this one from @WolfpackReports 👇

1 · 478

KEDM.com @KEDM_COM · Jul 13

"One clue that this is a stock promotion is the heavy involvement of our favorite bottom feeding investment bank, B. Riley, whose insiders (including Wes Cummins who simultaneously serves as the President of B. Riley Asset Management and the CEO of APLD) own 48.4% of APLD...



Activist shareholder Elliott Investment Management has established a huge position in offshore oil driller Seadrill Limited (from KEDM's Monday Monitor on July 17)...

> Elliott loaded up on the offshore name through equity swaps; looks like they are now at 15.65% of Seadrill's share capital. The boilerplate 13D filing doesn't really tell what their intentions are.
>
> Curiously following this as it involves one of our favorite themes. This is the second week Elliott popped up with reporting positions in offshore (last week they reported 10% in SUBC NO).

Elliott is also now targeting troubled drugmaker Catalent (from The Wall Street Journal on July 19)...

> Elliott Investment Management has built a significant stake in Catalent (CTLT) and is pushing for a shake-up on the contract drugmaker's board.
>
> Elliott has been talking to potential director candidates about joining a slate of nominees to run in a proxy contest, people familiar with the matter said.

The exact size of Elliott's stake couldn't be learned. Catalent has a market capitalization of roughly $8.4 billion, with its stock up just 3% so far this year. The shares closed Wednesday at $46.32, less than half where they traded a year ago.

Catalent's nomination window for director candidates closes on July 29, according to the company's proxy materials.

Elliott's stake and push for change comes at a tumultuous time for Catalent, which provides outsourced drug manufacturing for pharmaceutical and biotech companies. The Somerset, N.J., company played a critical role in the rapid mass production of vaccines during the Covid-19 pandemic and has more recently been seen as a possible takeover target.

In recent months, however, Catalent has faced significant setbacks including the departure of its chief financial officer in April.

The company also announced that greater-than-expected costs along with many operational snafus at some of its manufacturing sites—some of which were tied to failed Food and Drug Administration facility inspections—would weigh heavily on its results.

After several delayed results announcements, the company said in June that revenue for the three-month period ended March 31 fell 19% to $1.04 billion. It booked a net loss of $227 million, compared with net earnings of $141 million in the same period a year earlier.

Catalent Chief Executive Officer Alessandro Maselli, who has been in the role for a little over a year, said at the time that the company was making progress in addressing its operational challenges, while also working to cut costs.

Last month, Catalent named a new CFO, Matti Masanovich, who had previously been the finance chief of Tenneco Automotive until it was acquired by private-equity firm Apollo.

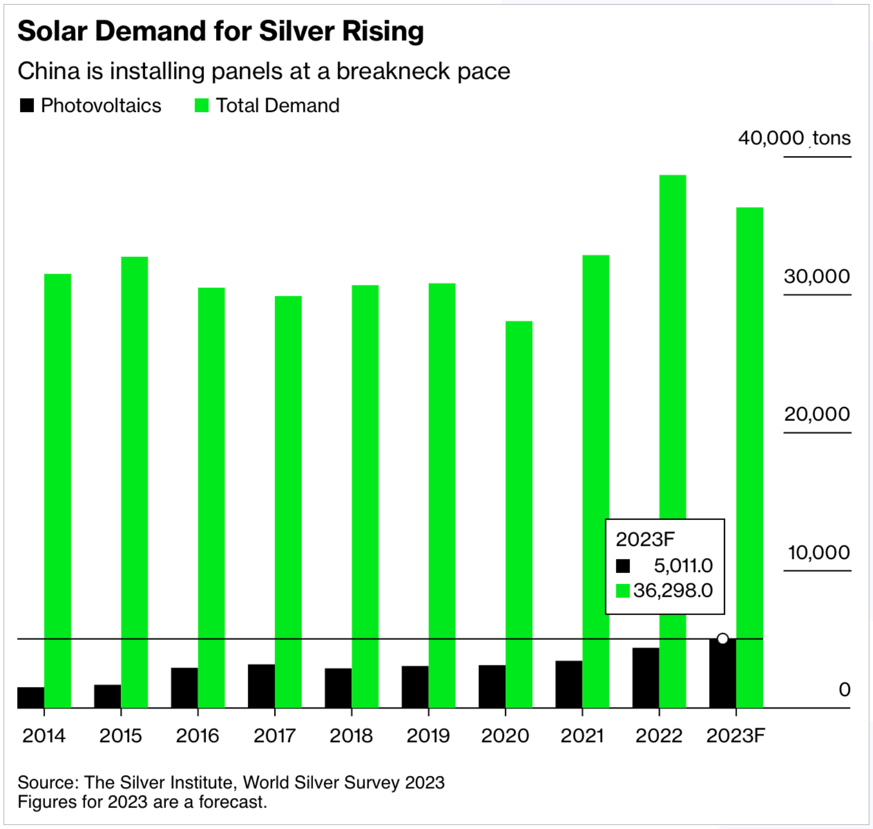
Elliott is known for taking on tech companies and others and forcing changes that include sales and executive shake-ups. One of the biggest, busiest and most feared activists, it has taken on companies including NRG Energy, Salesforce, Twitter and Pinterest.

Continue reading here (subscription may be required).

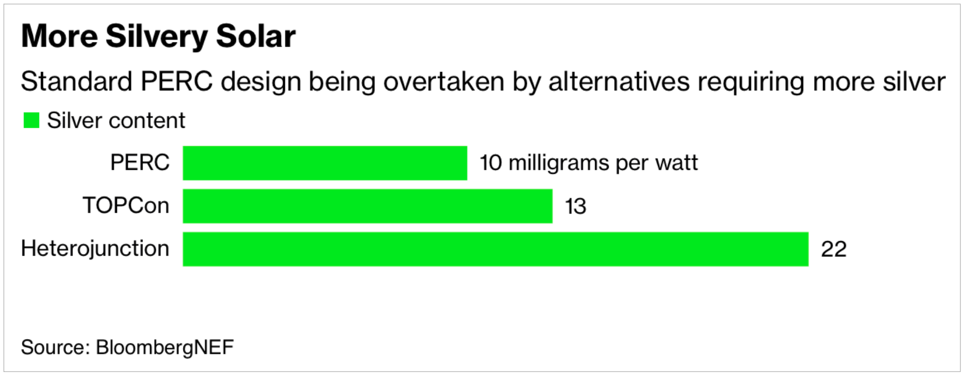
Precious Metals

Surging solar panel demand is beginning to "squeeze" silver supplies ([from Bloomberg on July 2]())...

> Changes to solar panel technology are accelerating demand for silver, a phenomenon that's widening a supply deficit for the metal with little additional mine production on the horizon.
>
> Silver, in paste form, provides a conductive layer on the front and the back of silicon solar cells. But the industry is now beginning to make more efficient versions of cells that use a lot more of the metal, which is set to boost already-increasing consumption.
>
> Solar is still a fairly small part of overall silver demand, but it's growing. It's forecast to make up 14% of consumption this year, up from around 5% in 2014, according to a report from The Silver Institute, an industry association. Much of the growth is coming from China, which is on track to install more panels this year than the entire total in the US.



> Solar is a "great example of how inelastic demand for silver is," said Gregor Gregersen, founder of Singapore-based dealer Silver Bullion. The solar industry has evolved to become much more efficient with using smaller amounts of silver, but that's now changing, he said.
>
> The standard passivated emitter and rear contact cell will likely be overtaken in the next two to three years by tunnel oxide passivated contact and heterojunction structures, according to BloombergNEF. While PERC cells need about 10 milligrams of silver per watt, TOPCon cells require 13 milligrams and heterojunction 22 milligrams.



At the same time, supply is starting to look tight. It was flat last year, even as demand rose by nearly a fifth, figures from The Silver Institute show. This year, production is forecast to increase by 2% while industrial consumption climbs 4%.

[Continue reading here (subscription may be required).]

The gold/silver ratio suggests silver remains historically undervalued today ([from Jesse Felder via Twitter on July 6])...

The Russian government claims BRICS nations will announce a new gold-backed currency next month (from Kitco News on July 7)...

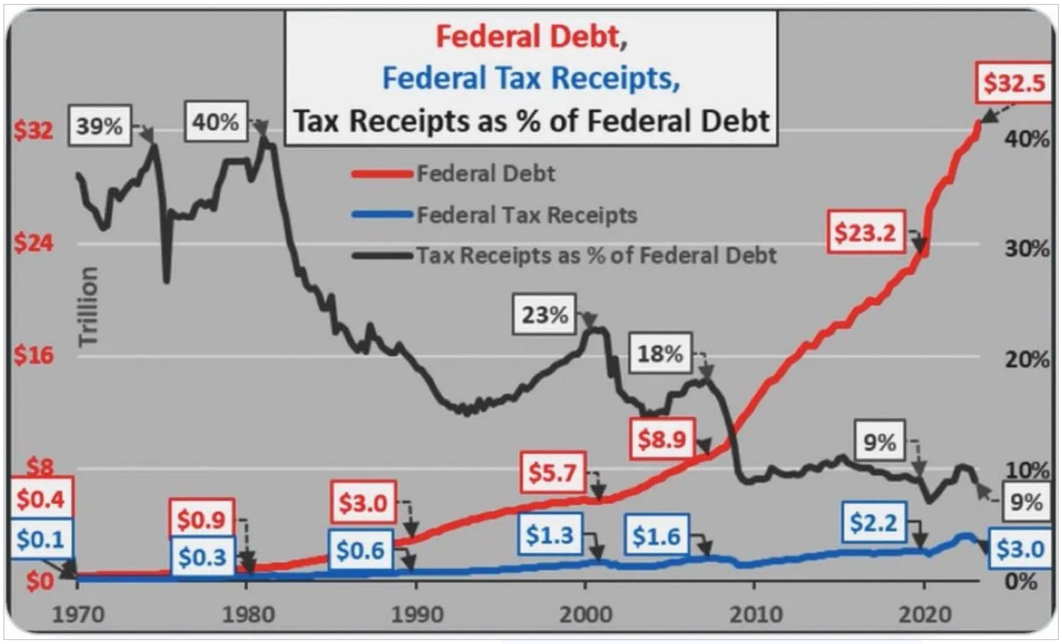
> The gold market could see new bullish momentum as the world could see a new type of gold standard.
>
> Friday, according to state-run RT, the Russian government has confirmed that Brazil, Russia, India, China and South Africa, also known as BRICS nations, will introduce a new trading currency backed by gold. The official announcement is expected to be made during the BRICS summit in August in South Africa.
>
> The latest news is adding new momentum to the ongoing de-dollarization trend unfolding in the global economy. Since mid-2022, central banks worldwide have been buying gold at a historic pace in part to diversify their reserve away from the U.S. dollar.
>
> For many analysts, a gold-backed currency is the next evolution in this process. Many analysts have seen China's recent gold purchases as an attempt to bring international credibility to the yuan.
>
> At the same time, the U.S. government's weaponization of the U.S. dollar against Russia for invading Ukraine has created some geopolitical uncertainty among some nations allied with Russia.
>
> While the prospect of a gold-backed BRICS currency will provide significant support to gold, some analysts expect that it will take time before the impact is felt in the market.
>
> Thorsten Polleit, chief economist at Degussa, said that while the announcement is a step in the right direction, there is still a long way to go to become reality.
>
> "At first glance, a new transaction unit, backed by gold, sounds like good money – and it could be, first and foremost, a major challenge to the US dollar's hegemony," he said in an exclusive comment to Kitco News.
>
> However, Polleit added that the devil is in the details.
>
> "For making the new currency as good as gold, a truly sound currency, it must be convertible into gold on demand. I am not sure whether this is what Brazil, Russia, India, China and South Africa have in mind," he said. "Using gold as money, the unit of account would be a true game changer, no doubt about it. It could lead to a sharp devaluation of many fiat currencies vis-à-vis the yellow metal (including the BRICS fiat currencies), and it could catapult up goods prices in terms of fiat currencies. It could be a shock to the global fiat money system. I am not sure that this is what the BRICS wish to achieve."
>
> Polleit added that another option would be for the BRICS nation to create a new bank for financing foreign trade that would require holding gold as capital.
>
> "Against this gold stock, the new bank could, say, grant financing loans to exporters, and issue the "new currency"; or BRICS exports will be sold against the "new currency" and/or gold," he said. "I think it is fair to say that it is early to come up with a final conclusion where this will lead us to – we need more details."

Continue reading here.

Periods of low volatility during uptrends – like we're experiencing today – tend to be very bullish for gold ([from Aazan Habib, Paradigm Capital via The Daily Shot on July 14]())...

The chart below suggests gold is one of the cheapest assets in the world today ([from FFTT Tree Rings on July 21]())...

> This chart from Chris Hamilton at Econimica grabbed our attention, not as an immediate indicator, but rather, as a jaw-dropping piece of context. An attempt to see the forest for the trees, if you will.
>
> 1980: Everybody hates the [US Dollar (USD)] and [US Treasury Bonds (USTs)], even as US Federal debt is 40% collateralized by US Federal tax receipts, the foreign-held portion of USTs are ~130% collateralized by the market value of US official gold, and long-term USTs are yielding nearly 15%.
>
> 2023: Everybody loves the USD and USTs and gold is significantly under-owned by western investors, even as US Federal debt is now only 9% collateralized by Federal tax receipts, the foreign-held portion of USTs are only ~7-8% collateralized by the market value of US official gold, and 10y USTs yield under 4%.



Via Econimica

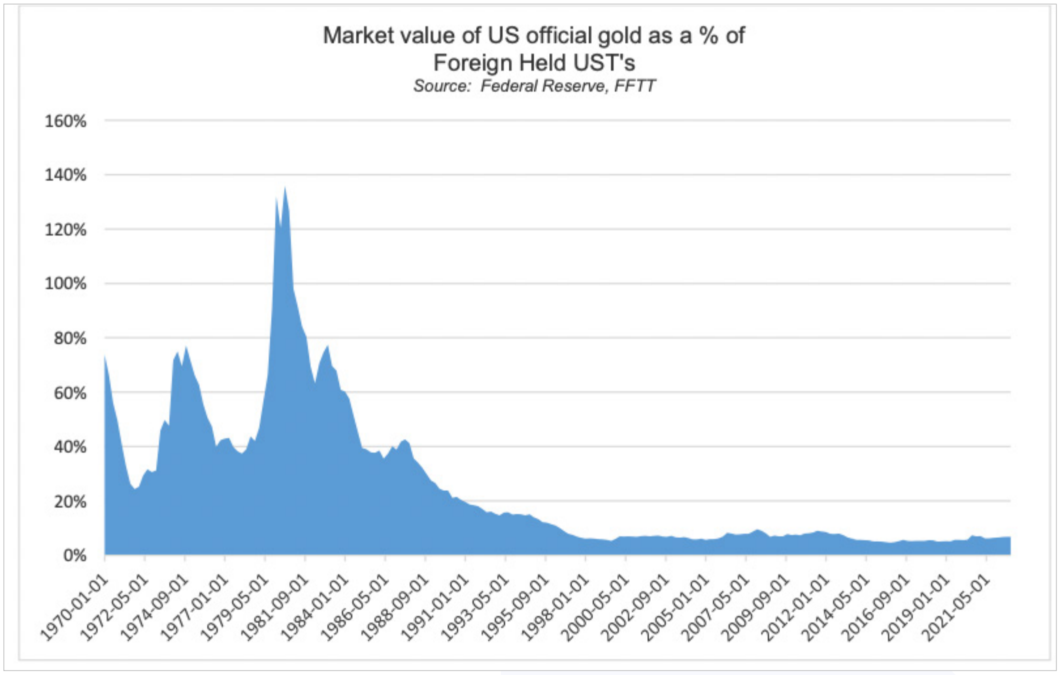
In 1980, nobody wanted USTs at 15%, despite the facts that US debt/GDP was down to 30%, US tax receipts were collateralizing 40% of total Federal debt, and the market value of US official gold was 130% collateralizing the foreign-held portion of the debt (that was the very definition of a gold bubble.)

In contrast, today everybody wants USTs as “risk free collateral” despite the US government mathematically requiring negative real rates to sustain its 120% of GDP debt load, US Federal tax receipts collateralizing less than 10% of total US Federal debt and the market value of US official gold collateralizing only 7% of foreign-held USTs.

We have no idea when this astonishing contrast will matter, but as we noted earlier, we hold our gold and gold miner positions unlevered so we can wait. In the unipolar world that existed, the above might have never mattered; in the multi-polar world that is evolving, it will likely matter at some point.

The chart below elaborates on this point: During the Cold War (1970-89 shown), the market value of US official gold as a % of foreign-held USTs never fell below 20%. As soon as the USSR broke up, gold fell below 20% to as low as 5%.

This chart then ties into the point we made in the second Tree Ring point – if the USD has to compete on its merits in a multi-polar world, the implied gold backing of US foreign debt will likely have to rise, meaningfully.



With the market value of US official gold back to only 7% and a multipolar world clearly re-emerging, the chart above suggests to us that gold may be one of the cheapest assets on the board (it would need to triple just to get back to 1989 valuations relative to foreign-held USTs, and would have to rise nearly 20x to return to 1980 levels relative to foreign-held USTs)...at a time when investors cannot get enough of USTs on which the US government cannot sustainably afford positive real rates (as we showed above.)

Continue reading here (subscription required).

Energy

Toyota reportedly makes a massive breakthrough in electric car battery technology (from The Guardian on July 4)...

> Toyota says it has made a technological breakthrough that will allow it to halve the weight, size and cost of batteries, in what could herald a major advance for electric vehicles.
>
> The world's second largest carmaker was already pursuing a plan to roll out cars with advanced solid-state batteries, which offer benefits compared with liquid-based batteries, by 2025.
>
> On Tuesday, the Japanese company said it had simplified production of the material used to make them, hailing the discovery as a significant leap forward that could dramatically cut charging times and increase driving range.
>
> "For both our liquid and our solid-state batteries, we are aiming to drastically change the situation where current batteries are too big, heavy and expensive," said Keiji Kaita, president of the Japanese auto firm's research and development centre for carbon neutrality. "In terms of potential, we will aim to halve all of these factors."
>
> David Bailey, a professor of business economics at the University of Birmingham, said that if Toyota's claims were founded, it could be a landmark moment for the future of electric cars.
>
> "Often there are breakthroughs at the prototype stage but then scaling it up is difficult," he said. "If it is a genuine breakthrough it could be a gamechanger, very much the holy grail of battery vehicles."
>
> Kaita said the company had developed ways to make batteries more durable and believed it could now make a solid-state battery with a range of 1,200km (745 miles) that could charge in 10 minutes or less.
>
> The company expects to be able to manufacture solid-state batteries for use in electric vehicles as soon as 2027, according to the Financial Times, which first reported on Toyota's claimed breakthrough.

Continue reading here.

Josh Young – portfolio manager for energy-focused investment firm Bison Interests – shares his view on the oil markets, including the implications of an impending recession and the long-term outlook for supply and demand (from Public's Leading Indicator podcast on July 5)...

You can view this video on Youtube via the linked timestamps below:

> Introduction: 0:00
> What Happened in 2022: 1:20
> Negative Returns: 4:00
> Market Psychology: 7:31
> Future of Energy: 15:47
> Outlook for Oil Prices: 19:09

Stephen Stapczynski @SStapczynski · Jul 10

Warren Buffett ramps up bet on US liquefied natural gas 🇺🇸🚢

💰 Berkshire Hathaway will pay $3.3 billion to take total control of the Cove Point LNG export plant in Maryland (they previously had 25%)

📉 Buffett swooped in after global gas prices eased

bloomberg.com

Berkshire Hathaway to Expand US LNG Plant Stake for $3.3 Billion

Berkshire Hathaway Energy agreed to buy Dominion Energy Inc.'s stake in a Maryland liquefied natural gas export project for $3.3 billion.

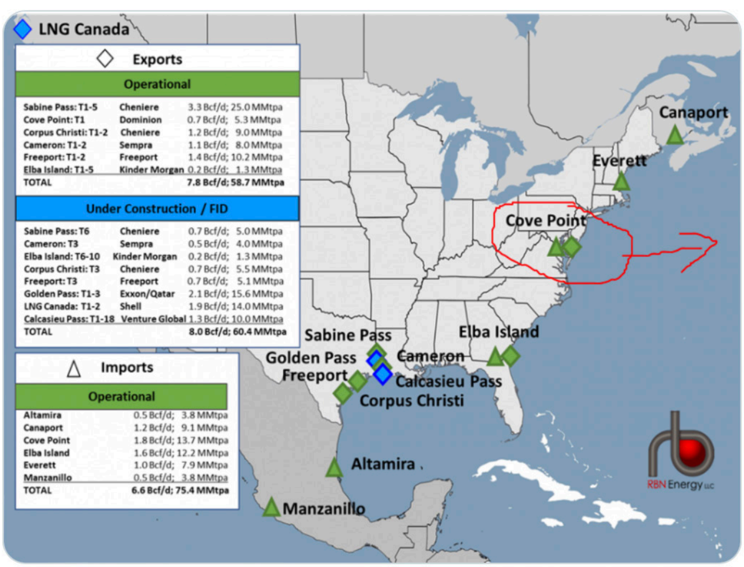
6 · 155 · 481 · 163.9K

Stephen Stapczynski @SStapczynski · Jul 10

Cove Point is in a good location to profit off of Europe's rising LNG demand 🚢🇪🇺

🏃 The plant isn't on the Gulf Coast, and can send fuel to Europe a little faster

📝 (To be sure, Cove Point's supply is tied up in long-term contracts with companies that aren't Berkshire)



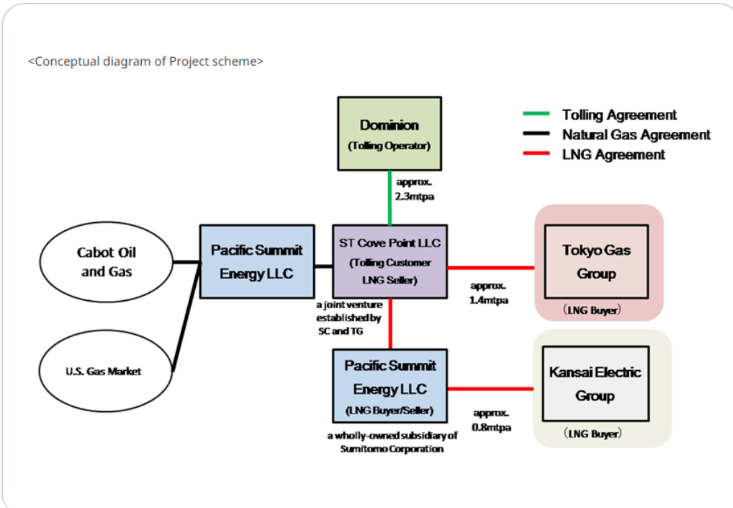
9 · 10 · 58 · 7,467

Stephen Stapczynski @SStapczynski · Jul 10

🇯🇵 There is also a Japanese trading house element here

👉 Sumitomo Corp (which Berkshire is invested in) offtakes LNG from Cove Point
👉 Sumitomo also involved in helping to source the feedgas for Cove Point
👉 (NOTE: Berkshire bought Dominion's stake)

sumitomocorp.com/en/europe/busi…



5 30 4,806

A start-up aimed at commercializing a more advanced form of nuclear energy – and backed by OpenAI founder Sam Altman – is set to go public ([from the Financial Times on July 11](#))…

> A nuclear fission start-up backed by Sam Altman is to go public through a merger with a special purpose acquisition company set up by the OpenAI chief executive in a deal that values the business at $850mn.
>
> Oklo, where Altman serves as board chair, has agreed a transaction with AltC Acquisition Corporation, a blank-cheque company set up by Altman and former Citigroup executive Michael Klein.
>
> The transaction between Oklo and AltC is unusual because Altman is involved with both companies. Under the terms of the agreement, the Spac sponsors have agreed to performance hurdles tied to the founder equity and lock-up periods running from one to three years.
>
> Altman "recused himself from all negotiations between the parties, and from all discussions and decisions of both the Oklo and AltC boards involving the transaction", said a spokesperson for AltC.

The deal is expected to provide the California-based group with $500mn, so long as shareholders do not redeem their shares. Oklo plans to use the funds for its nuclear energy production, scheduled to go to market in about four years' time, as well as constructing a fuel recycling facility set to begin in the "early 2030s".

Altman and Klein, a serial Spac sponsor who has taken public companies such as electric-car maker Lucid and healthcare provider Multiplan, founded AltC in July 2021. The announcement of a deal with Oklo comes as a two-year deadline to find a target or return cash to shareholders was approaching.

Continue reading here (subscription may be required).

The shale oil industry is shutting down drilling rigs at the fastest pace in years (from The Wall Street Journal on July 17)...

The shale patch is shedding rigs at the fastest pace since the height of the Covid-19 pandemic despite healthy oil prices.

Behind the drop in rigs is a tale of the haves and the have-nots. Private companies, which added rigs at a breakneck pace as the pandemic abated, have drilled up many of their best remaining wells, forcing them to decelerate.

Meanwhile, their larger, public brethren aren't tweaking their drilling programs as they sit on larger inventories of premium, undrilled wells.

The number of rigs drilling for oil and gas has dropped to about 670 from around 800 at the beginning of the year, with private drillers accounting for roughly 70% of the decrease, according to David Deckelbaum, an analyst at investment bank TD Cowen.

The slowdown augurs tepid U.S. crude-production growth for the rest of the year, analysts said. Even though larger public companies mostly aren't shedding oil rigs, they aren't growing rapidly either, as they adhere to investors' desire for capital restraint. The Energy Information Administration expects domestic growth output to increase by fewer than 300,000 barrels a day in 2024 from this year.

Taylor Sell, chief executive of Element Petroleum, said the company's break-even—or the price needed to fund drilling without a loss—had increased by between $5 and $10 to reach between $55 and $60 a barrel, in part because the cost of materials such as steel pipes remains high, at roughly 40% more than 18 months ago, he said.

Element last December dropped its only active rig as the company sought to save its best wells for more auspicious times or for a potential buyer, Sell said. "We are not drilling right now to protect inventory," he said, adding that the company would put a new rig to work in September to test new acreage.

As pandemic lockdowns lifted and economies reopened, smaller drillers tried to deploy rigs to tap soaring oil prices. Russia's invasion of Ukraine, which pushed the U.S. benchmark past the $120 mark, saw private operators in the Permian Basin of New Mexico and West Texas commandeer about half of the rigs in that region, fueling a quick rebound in U.S. oil production.

Continue reading here (subscription may be required).

U.S. shale production is set to fall next month for the first time this year (from Reuters via Nasdaq.com on July 17)...

> U.S. shale oil production is set to fall to nearly 9.40 million barrels per day (bpd) in August, which would be the first monthly decline since Dec. 2022, data from the Energy Information Administration showed on Monday.
>
> Output from the Permian basin, the top oil producing region in the country, is set to fall to 5.76 million bpd next month, the lowest level since April, the EIA data showed.

Continue reading here.

Here's more on the thinking behind Berkshire's big investments in the energy sector (from Kingswell on July 18)...

> Last week, Berkshire Hathaway Energy agreed to purchase Dominion Energy's 50% interest in the Cove Point LNG terminal and pipeline for $3.3 billion. This boosts BHE's stake in the Maryland-based facility up to 75% — and gives Berkshire control of a rare domestic asset capable of exporting natural gas overseas.
>
> This comes hot on the heels of Berkshire increasing its ownership of Occidental Petroleum to over 25%. (And, lest we forget, Berkshire also holds 132.4 million shares of Chevron. Unless, of course, that changed during Q2 2023.)
>
> Any way you slice it, Warren Buffett and co. seem to be doubling down on their commitment to the energy industry. In particular, a commitment to legacy energy sources — like oil and natural gas — that are decidedly out of favor in certain circles.
>
> Why is that?
>
> Well, other than being delightfully contrarian, the future of O&G production is not quite the dead end that some would have you believe.
>
> I've gathered together some recent news and updates about Berkshire's "old" energy investments (like Oxy and Chevron) that will hopefully connect the dots and fill in the picture a little more clearly.
>
> **Occidental Petroleum**
>
> Oxy CEO Vicki Hollub recently hopped on Barron's Streetwise podcast and, in a few short minutes, summed up her company's "best of both worlds" approach. In short, OXY is a cash cow with a growth story.
>
> While its detractors blame Oxy (and other oil companies) for a long list of environmental sins, Hollub remains focused on incorporating Direct Air Capture (DAC) technology in a way that will maximize energy production, while also making the entire process a little cleaner.
>
> And, importantly, she insists that this isn't some pie-in-the-sky dream. But, rather, a technique that syncs up well with the company's existing core competencies.

> *We're going to use radial fans that already exist today — they're used in other types of industrial situations — so we'll pull air through a contact tower and the contact fluid that's going to take the [carbon dioxide] out of the air is potassium hydroxide. Our chemicals business is the largest marketer of that in the United States and the second-largest in the world. So we have a lot of skill and ability and knowledge around how to use potassium hydroxide. That's a key component.*
>
> *In the contact tower, to make it mix better and to create better efficiency, you need to put diffusers in the air so that the mixing happens. The diffusers in the contact tower will be PPC-based, which is another product that we make.*
>
> *We're building the first [DAC facility] in the Permian Basin where we already have the infrastructure to support it. So there are a lot of reasons why this strategy fits for us — because what we didn't want to do … was try to be something that we're not.*

What I find most exciting, though, is what Oxy has planned for the carbon dioxide after it has been sucked out of the atmosphere. (Spoiler: increased oil production.)

> *We strongly believe our industry should adapt the same strategy that we have — and that is to take [carbon dioxide], put it in the oil reservoirs which creates more oil production but the incremental oil that it produces will emit less than the [carbon dioxide] volume that we had to inject to get it.*
>
> *So that means the [carbon dioxide] going in is higher than what the extra oil coming out will emit when used.*

Remember that Wall Street Journal article from March that warned about the declining fortunes of the Permian Basin? Hollub credits Oxy's proprietary subsurface techniques (which result in better fracking results) as the reason her company has sidestepped this production downturn.

> *If you go back and you listen to earnings calls from other CEOs, many of them are talking about their wells [not being] as productive last year as they were the year before. But for seven years in a row, we've grown our productivity in the Delaware Basin while others could not … Even in comparable settings where others have the same assets as we do, our team has been able to go above and beyond.*

When you combine Occidental Petroleum's engineering prowess, incredible asset base in the Permian, and the introduction of DAC in the near future, it's easy to see why Warren Buffett is so eager to make the company one of the cornerstones of his investment portfolio.

Trying to predict the exact future of the energy business is a fool's errand, but Oxy appears as well positioned as any to deal with what might lie ahead.

Speaking of Vicki Hollub and Occidental Petroleum, I recently stumbled upon a Charlie Munger interview from 2020 in which he explains why Berkshire Hathaway agreed to help Oxy finance its high-priced acquisition of Anadarko.

> *It's perfectly obvious that the Permian Basin is our #1 oil reservoir and we don't have another one like it … so, of course, we did it. It's not very difficult [to make that decision very quickly]. But, you're right, there are all kinds of organizations with their endless due diligence. We knew enough to act — and, by the way, they were in a hurry.*
>
> *You don't need perfect. If you're 96% sure, that's all you're entitled to in many cases. I see these people doing this due diligence and the weaker they are as thinkers, the more due diligence they do.*

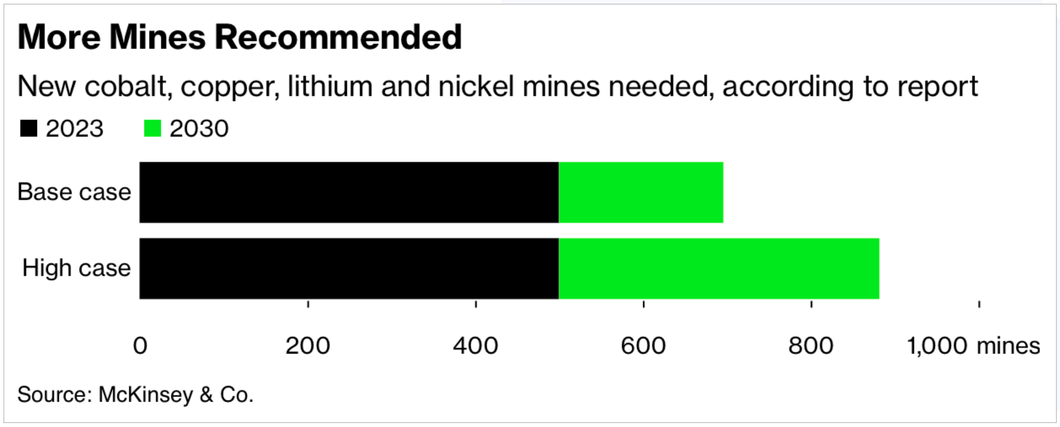
> *How much brains does it take to know that the Permian Basin is America's best oil reserve? It's layer after layer after layer. There is nothing comparable ... [Vicki Hollub] is a production engineer — she's good — and they get better results from that shale than other people.*
>
> *It's a no-brainer. At least, it's a no-brainer if you don't make it hard.*

Continue reading here.

Other Commodities

Global consulting giant McKinsey warns of huge potential shortages in "clean energy" metals (from Bloomberg on July 4)...

> McKinsey & Co. joined the growing chorus warning that metals considered key to the clean-energy transition face shortages in coming years, potentially suppressing the adoption of electric cars, wind turbines and solar panels.
>
> These deficits likely will slow global decarbonization efforts by raising supply-chain costs and, consequently, the prices of lower-carbon products, McKinsey said in a report released Wednesday. Trafigura Chief Executive Officer Jeremy Weir and BloombergNEF have expressed similar concerns.
>
> Nickel, necessary for the lithium-ion batteries that power electric vehicles, is expected to face shortages of about 10% to 20% by 2030, while dysprosium, a rare-earth element commonly used in electric motors, may experience deficits of as much as 70%, McKinsey said. Supplies of copper, lithium, cobalt, iridium and tin also may be crimped.
>
> The number of the approximately 500 cobalt, copper, lithium and nickel mines operating today will need to increase by as much as 76% to almost 900 in order to meet demand for batteries, the McKinsey analysts wrote.



> [...] McKinsey recommends investments in mining, refining, and smelting increase to between $3 trillion and $4 trillion by 2030 — a 50% annual increase compared with the previous decade.

Continue reading here (subscription may be required).

Commodities are likely to follow gold higher over the next several years (from Otavio Costa via Twitter on July 12)...


Otavio (Tavi) Costa
@TaviCosta

Commodity rallies are almost never isolated developments.

Natural resource assets are highly interconnected and once one starts moving, the others follow accordingly.

Although we may assume these commodity assets have entirely unique price dynamics, the historical correlation between them is remarkably strong.

We are likely experiencing the initial phase of another long-term gold cycle, and other precious or base metals shouldn't be too far behind.

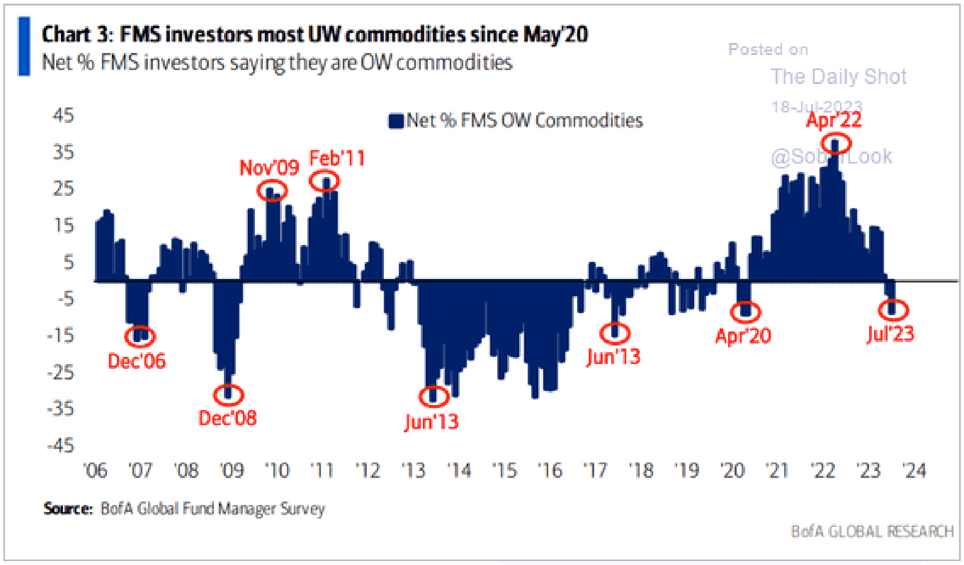
9:09 AM · Jul 12, 2023 from Denver, CO · **26.7K** Views

Grain prices are rising again after Russia announces an end to Ukraine export deal (from The Wall Street Journal on July 17)...

> Russia said it was withdrawing from an international agreement that allowed Ukraine to resume much of its Black Sea grain exports, raising concerns about a key link in the global food supply chain.
>
> Kremlin spokesman Dmitry Peskov said the deal had been terminated but that Russia would rejoin the agreement if its demands were met, according to state news agency TASS. Russia has repeatedly threatened to pull out of the agreement, demanding that the West facilitate its food and fertilizer exports, which it says have been hampered by sanctions.
>
> Russia's invasion of Ukraine last year forced a halt to all exports from Ukraine's main Black Sea ports, contributing to a surge in global food prices and contributing to fears that the war could push millions of people around the world closer to starvation.
>
> The agreement between Russia, Ukraine and Turkey, facilitated by the United Nations, was signed in Istanbul in July last year, permitting Ukrainian exporters to resume shipping corn, wheat, sunflower oil and other goods from three ports around the city of Odesa.
>
> Moscow's decision to withdraw from the deal renews fears that Russia's assault on Ukraine could again threaten global food security. Ukraine is one of the world's largest suppliers of wheat, corn and sunflower oil. Western officials have accused Russia of using the threat of disrupted food supplies to coerce other countries into siding with it during the war.
>
> The Russian invasion is one of a series of global shocks, including the Covid-19 pandemic and severe weather resulting from climate change, that pushed 122 million people into hunger between 2019 and 2022, according to a report by U.N. agencies published earlier this month.
>
> "Ultimately, participation in these agreements is a choice. But struggling people everywhere and developing countries don't have a choice," said U.N. Secretary-General António Guterres, speaking in New York on Monday. "Hundreds of millions of people face hunger and consumers are confronting a global cost-of-living crisis."

Continue reading here (subscription may be required).

Fund managers are more underweight commodities than anytime since the COVID lows (from BofA Global Research via The Daily Shot on July 18)...



Bitcoin and Crypto

Larry Fink – CEO of giant asset manager BlackRock – says Bitcoin is an "international asset" (from Bitcoin Magazine on July 5)...

> BlackRock, the world's largest asset manager with nearly $9 trillion in assets under management, has made significant strides toward embracing bitcoin, as indicated by its recent filing for a spot bitcoin exchange-traded fund. The company's decision to take steps to offer its clients exposure to the digital asset is likely to bring a surge of institutional adoption to the space.
>
> The company also recently resubmitted its filing after the SEC responded that the initial filings required more information in regards to the exchange's involved, subsequently adding Coinbase to the filing, as other firms refiling did.
>
> And now, BlackRock's CEO, Larry Fink, has made an appearance on Fox Business where he stated that the role of bitcoin and crypto is "digitizing gold."
>
> "Instead of investing in gold as a hedge against inflation … or the devaluation of your currency … [bitcoin] can represent an asset that people can play as an alternative," Fink stated. The description reinforces the perception of bitcoin as a store of value, akin to the role gold has traditionally played in investment portfolios. By likening bitcoin to gold, Fink acknowledges the international nature of the digital asset, highlighting its potential as a global store of wealth — and indeed, during his news appearance, Fink further emphasized that "Bitcoin is an international asset."
>
> [...] BlackRock's pursuit of a Bitcoin ETF and Fink's endorsement of bitcoin as digitized gold reflect a notable shift in the attitude of major financial institutions toward bitcoin. These developments suggest that BlackRock, along with other industry giants, recognizes the potential of bitcoin to reshape the financial landscape.

Continue reading here.

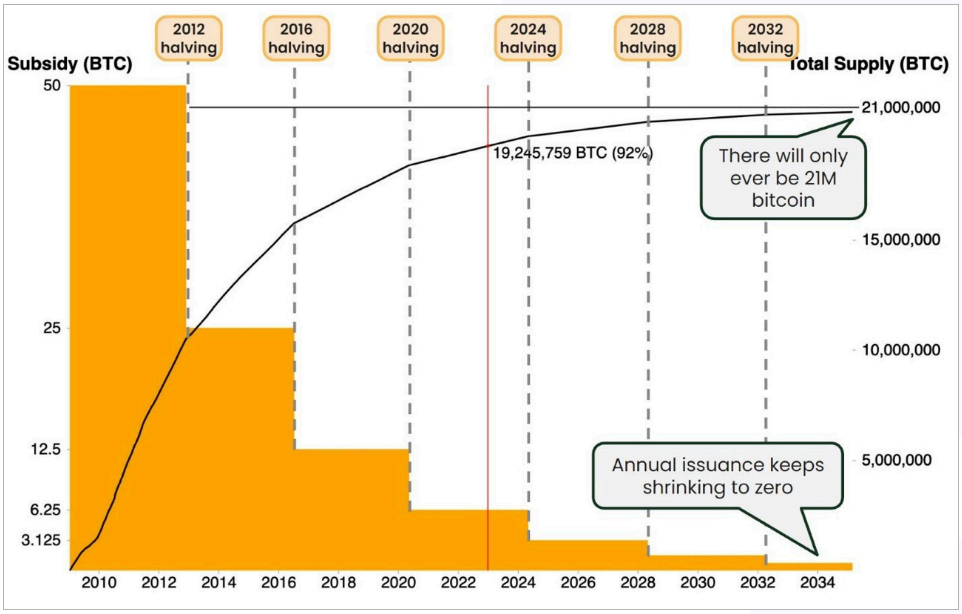
Why the next Bitcoin bull market could be bigger than many anticipate (from Onramp Bitcoin on July 10)...

> There have been two iron rules of Bitcoin's four-year price cycles:
>
> The bear market low never goes below the prior peak.
>
> Each bull market delivers less upside than the cycle before it.
>
> In November 2022, we broke rule #1 (the $15k price bottom was below the $20k peak from 2017).
>
> I'm starting to think we might break rule #2 after the upcoming halving.
>
> My thinking consists of two pieces. First, last cycle's bull market saw headwinds that are unlikely to exist during the next bull market. Second, there are new tailwinds brewing that could fuel the next bull market in a big way.
>
> What happened last cycle

Despite rallying ~8x from the 2020 halving to the 2021 peak, Bitcoin's price performance paled in comparison to prior cycles. Here's how the last cycle compared to the 4-year halving cycles that preceded it:

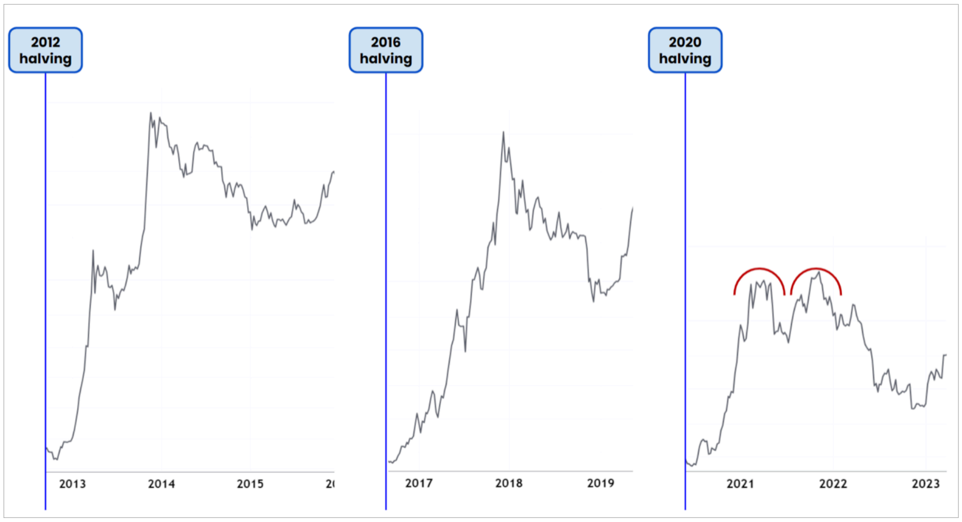
Halving #	Halving date	Price at halving	Peak date	Peak price	Growth	Years to peak
1	11/28/2012	$12	11/30/2013	$1,157	~100x	1.0
2	7/9/2016	$675	12/15/2017	$19,659	~30x	1.4
3	5/11/2020	$8,802	11/10/2021	$68,988	~8x	1.5

This decaying amplitude of bull markets is to be expected in one sense. This is because each subsequent halving represents a smaller reduction of new supply issuance relative to the circulating supply.



However, I'll argue that we were on track for the 2021 bull market to deliver ~15x performance instead of the ~8x we got. What happened?

The confluence of several factors resulted in a different bull market peak than in all prior Bitcoin bull markets. Instead of a parabolic advance culminating in a blow-off top, we got a bi-modal rounded top spread out over six months.



In my opinion, there were four factors that prevented the bull market from extending into a blow-off top:

China ban

In mid-2021, China announced it was banning Bitcoin mining. This caused an influx of sell pressure because of the sudden fear of what would happen to Bitcoin plus the logistical needs of Chinese Bitcoin miners to sell coins to fund the relocation of warehouses full of Bitcoin mining hardware.

Next cycle: Very unlikely to happen again.

The preponderance of leverage

Before the 2018 ascent of BitMex, the pioneer of leveraged futures trading in Bitcoin, the Bitcoin market did not have a significant amount of leverage. That meant that the 2017 bull market (and all earlier ones) took their course without leveraged speculators influencing proceedings.

The 2021 post-halving bull market was the first one characterized by widespread use of leverage.

During the bull run, this leverage skewed heavily towards long positions. Because of the mechanics of these leverage markets, this results in the leveraged long traders paying daily interest to their counterparties on the other side of the trade. These interest payments created a natural braking effect on the price of Bitcoin.

Prior bull markets were characterized by a manic blow-off top where suddenly there were no sellers left and desperate bidders pushed the price up dramatically in the final days and weeks in order to find willing sellers. By contrast, the 2021 bull market had more willing sellers because they were being paid high interest rates to take a short position.

Next cycle: Likely to play a role (these sophisticated financial products are part of this asset maturing). Will partially smooth out excessive enthusiasm (tops) and excessive pessimism (bottoms).

Paper Bitcoin issuance

When FTX collapsed, it turned out that they owed customers $1.4B in Bitcoin (80k coins) that they didn't have. That is "paper Bitcoin." These customers owned it on paper, but at the end of the day, it wasn't really there.

80k Bitcoin amounted to ~25% of all the Bitcoin mined over that year. In other words, FTX's "issuance" of incremental Bitcoin supply "added" 25% to the amount of new supply created that year.

This meant that demand for Bitcoin during the bull market was being spread between purchases of actual Bitcoin and purchases of imaginary Bitcoin. In other words, FTX diminished the acute supply shortage (and resulting price run) substantially.

Next cycle: Likely to occur in some form. (Recently, I highlighted how BlackRock's ETF could become a major source of paper Bitcoin issuance, either at the expense of BlackRock or their clients.)

The Fed's pivot to QT

The Fed's response to the Covid crisis was a massive stimulus package that fueled a bull market across stocks, real estate, commodities, and crypto. That Quantitative Easing undoubtedly helped fuel the 2021 Bitcoin bull market.

The mid-2021 China ban temporarily derailed the Bitcoin bull market. But Bitcoin's price and momentum recovered. By late-2021, Bitcoin was breaking out to new highs and appeared poised to make a run for $100k+.

However, the Fed's sudden shift in late 2021 to Quantitative Tightening marked the exact top for Bitcoin.

At that point, markets shifted from heady enthusiasm to fear about what interest rate hikes would mean for markets after a decade of Zero Interest Rate Policies (ZIRP). The shortage of sellers that a blow-off top requires was no more.

As with all of the above factors, its hard to say how significant of a force this pivot from QE to QT was for Bitcoin. But in my opinion, it's no coincidence that it marked the top.

Next cycle: The shift from QE to QT that muted the 2021 bull market appears most likely to be replaced next bull market by a 2024 shift from QT back to QE.

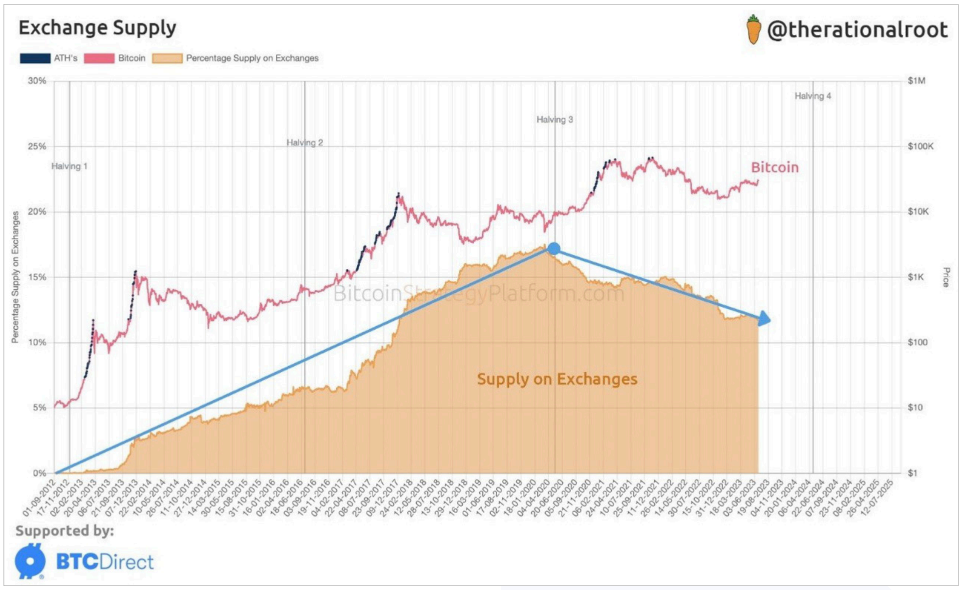
Without these four factors, I think we would have seen Bitcoin's price extend into a blow-off top in the ~$125k range. This would have meant a ~15x bull market, as per the table at the top of this article.

Obviously, we didn't get that. And there's no point in reflecting on the "what ifs," except to help us take stock of conditions going into the next Bitcoin halving, now just 10 months away.

The conditions of next cycle

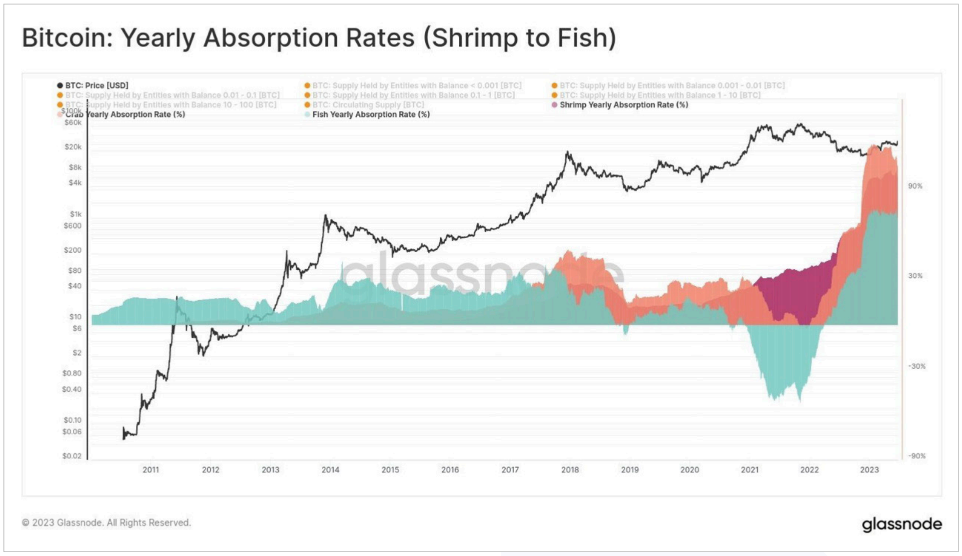
The halving is coming. That's always bullish, specifically because of the supply/demand price mechanics that are set in motion. But what is different this cycle is the supply shortage that is building up already...

1. Exchanges have been seeing a supply exodus for several years



2. 70% of supply is being held by long-term holders now

3. Small holders are accumulating coins faster than Bitcoin is being mined



This last chart says that something has changed.

[Continue reading here.]

The Federal Reserve just completed a "successful test" on the viability of a digital dollar ([from PaymentsJournal on July 13])...

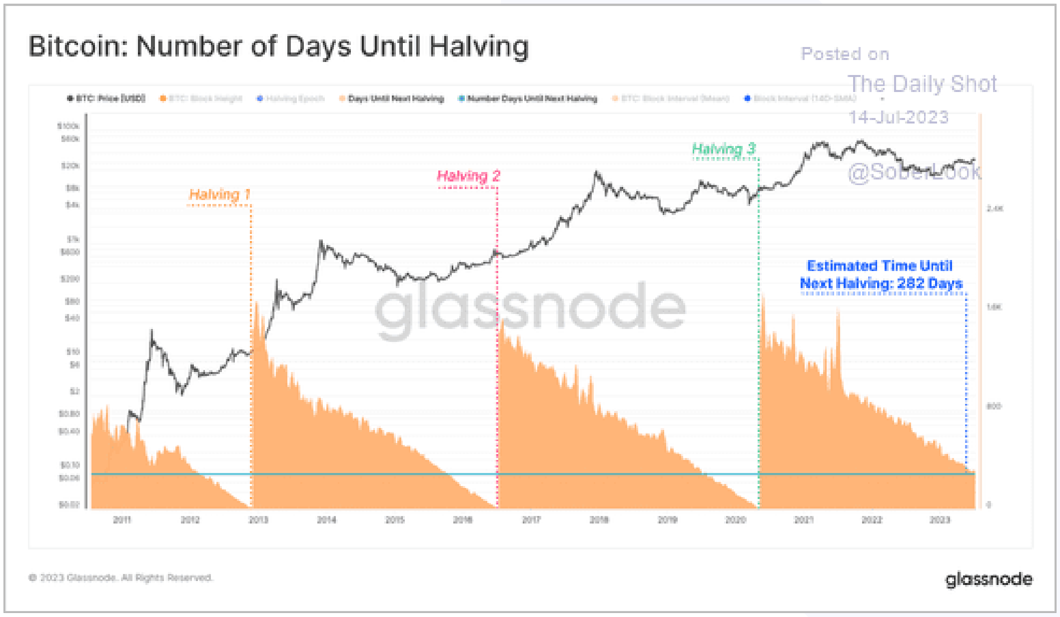
> A division of the Federal Reserve Bank of New York has concluded a monthslong test on the viability of a digital dollar, according to Bloomberg. The experiment, carried out at the Fed's New York Innovation Center, focused on a technology called a regulated liability network, which allows banks to issue digital money representing their customers' funds. The Fed concluded that digital dollars could significantly improve wholesale payments—in particular— cross-border payments.
>
> "The high-level news from the New York Fed's pilot is that a digital currency has real applications and is technically and legally possible," said James Wester, Head of Cryptocurrency at Javelin Strategy & Research. "That won't be a surprise to anyone who has paid attention to the digital asset space for any length of time."
>
> Currently, the process of sending money overseas can be slow and cumbersome due to the diverse systems used by banks and governments worldwide. The use of digital dollars on a shared ledger has the potential to revolutionize this process by synchronizing dollar-denominated payments and enabling near-real-time settlement.
>
> With the increasing shift to digital, the financial industry has been exploring ways to leverage technology to improve payment systems. The rise of cryptocurrencies and blockchain technology has sparked innovation, with many financial institutions and technology companies exploring the potential of digital currencies. The NY Fed's experiment adds to this growing body of research and demonstrates that regulated digital currencies, such as digital dollars, can offer tangible benefits in terms of speed, efficiency, and security.

It's worth noting that the test was conducted on a private blockchain, requiring permission to participate, rather than using public blockchains associated with cryptocurrencies. This choice reflects the cautious approach of central banks and financial institutions, who are prioritizing regulatory compliance and privacy in their digital currency experiments.

Despite the positive findings of the test, the NY Fed emphasized that it does not indicate an imminent decision to issue a central bank digital currency (CBDC). The experiment was a proof of concept to evaluate the feasibility and benefits of digital dollars, rather than a policy announcement.

Continue reading here.

Bitcoin's next "halving" is roughly 280 days away (from Glassnode via The Daily Shot on July 14)...



Here's an important reminder about too-good-to-be-true "fixed yields" in crypto (or any other asset) ([from Saifedean Ammous via Twitter on July 14](#))...


Saifedean Ammous
@saifedean

I've said it before and I'll say it again, if anything offers you a fixed yield, you are the yield. The shitcoin might be called Celsius or staking or Treasuries, but if it pretends it can guarantee a return, it's a ponzi that's paying old entrants from the money of new entrants

Pledditor @Pledditor · Jan 20

Alex @Mashinsky honestly believed Celsius could scale up to giving out 7% APY to the entire planet.... 💀💀

Good on @ToneVays and @saifedean for calling out the unsustainable yield scammers *years* before it blew up.

3:38 AM · Jul 14, 2023 · 188.5K Views

Democratic presidential candidate Robert F. Kennedy Jr. announces a plan to end bitcoin taxes and back the U.S. dollar with Bitcoin and gold ([from Bitcoin Magazine via TheStreet on July 18](#))...

> "My plan would be to start very, very small, perhaps 1% of issued T-bills would be backed by hard currency, by gold, silver platinum or bitcoin," Kennedy said, describing his vision for returning to a hard currency standard in the U.S.

He added that, depending on the outcome of that initial step, he would increase that allocation annually.

This potential policy reimagines the financial system, pointing to a future where bitcoin's absolute scarcity and sound monetary principles reinforce the U.S. dollar's eroding position as the world reserve currency.

"Backing dollars and U.S. debt obligations with hard assets could help restore strength back to the dollar, rein in inflation and usher in a new era of American financial stability, peace and prosperity," he declared.

In addition, Kennedy announced his administration "will exempt the conversion of bitcoin to the U.S. dollar from capital gains taxes."

"The benefits include facilitating innovation and spurring investment, ensuring citizen privacy, incentivizing ventures to grow their business and tech jobs in the United States rather than in Singapore, Switzerland, Germany and Portugal," he added. "Non-taxable events are unreportable and that means it will be more difficult for governments to weaponize currency against free speech, which as many of you know, is one of my principal objectives."

During his announcement today, Kennedy reiterated the slew of commitments he made to foster Bitcoin adoption during a speech at the Bitcoin 2023 conference in May, which included "defending the right of self custody of bitcoin," upholding "the right to run a node at home" and defending "industry-neutral regulation of energy."

Kennedy framed his commitments to Bitcoin as integral to the ideals of his uncle, President John F. Kennedy, and his own vision for governing a free and equitable country.

"My uncle, President Kennedy, when he was in office, understood the importance of hard currency and the dangers of having pure fiat currency with no other option," Kennedy said. "He understood the relationship between fiat currency and war, fiat currency and ... very, very destructive environmental projects and also these giant aggregations of wealth and the unbalance, the disparities in wealth that are the ultimate yield of every fiat currency."

Reflecting on the history of fiat currencies, Kennedy didn't mince words, citing the frequent use of unbacked paper currency to fund wars without the need for specific government taxation or citizens' approval.

"Fiat currency was invented to fund wars," he said. "I like base currencies because they make it more difficult, you have to go to the public. You can't just print money to fund the war and tax the public through the hidden tax of inflation. You actually have to go to the public and say, 'Here's what this war is going to cost.'"

He emphasized his regulatory outlook that "bitcoin is not a security and should not be regulated as one" and his commitment to "put an end to the current policies of the Biden administration that are invited by Choke Point 2.0 to punish banks that are dealing with bitcoin."

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Multiple spot Bitcoin ETFs just took the first step toward potential Securities and Exchange Commission (SEC) approval. Here's when a decision could come (from Cointelegraph on July 19)...

> Spot Bitcoin exchange-traded fund (ETF) applications from several firms have been published in the Federal Register, moving them one step along in the United States Securities and Exchange Commission's (SEC) process.
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> According to records updated July 19, the Federal Register received notices of proposed rule changes allowing Bitcoin (BTC) ETF applications from BlackRock, Fidelity, Invesco Galaxy, VanEck, and WisdomTree. Publishing the applications in the official journal of the U.S. government gives the SEC a window of opportunity to accept or reject the request, extend the time allowed or open the application for public comment.
>
> Publication in the Federal Register was an expected step following the initial filing of the applications in June. Exchanges representing the firms filed amended applications naming crypto firm Coinbase as a surveillance-sharing partner following reports the SEC considered the previous filings insufficient.
>
> The five applications followed one from Bitwise published in the register on July 18, with a spot BTC ETF application from Valkyrie expected on July 21. These dates give the SEC an initial window of 45 days — until early August — to reach a decision, but the commission has the option of extending the process for up to 240 days — until March 2024 — for final approval or denial.
>
> To date, the SEC has not approved a spot investment vehicle with direct exposure to cryptocurrencies like BTC but began allowing ETFs linked to BTC futures starting in 2021. In June, the Volatility Shares Trust launched a leveraged Bitcoin futures ETF, one of the first of its kind in the United States.

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