AN EXCLUSIVE PUBLICATION FOR PARTNER PASS AND ELITE MEMBERS

# INVESTMENT CHRONICLES

Issue No. 10 | January 2024

# 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, Securities and Exchange Commission ("SEC") filings, investment newsletters, newspapers, X (Twitter) threads, conferences, podcasts, and more – and digest them into one carefully curated, easy-to-read resource.

With *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 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 dig in for more details, to see a larger version of a chart or image, or to learn more about accessing paid content.

We hope you'll come to think of *Investment Chronicles* as 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
January 2024

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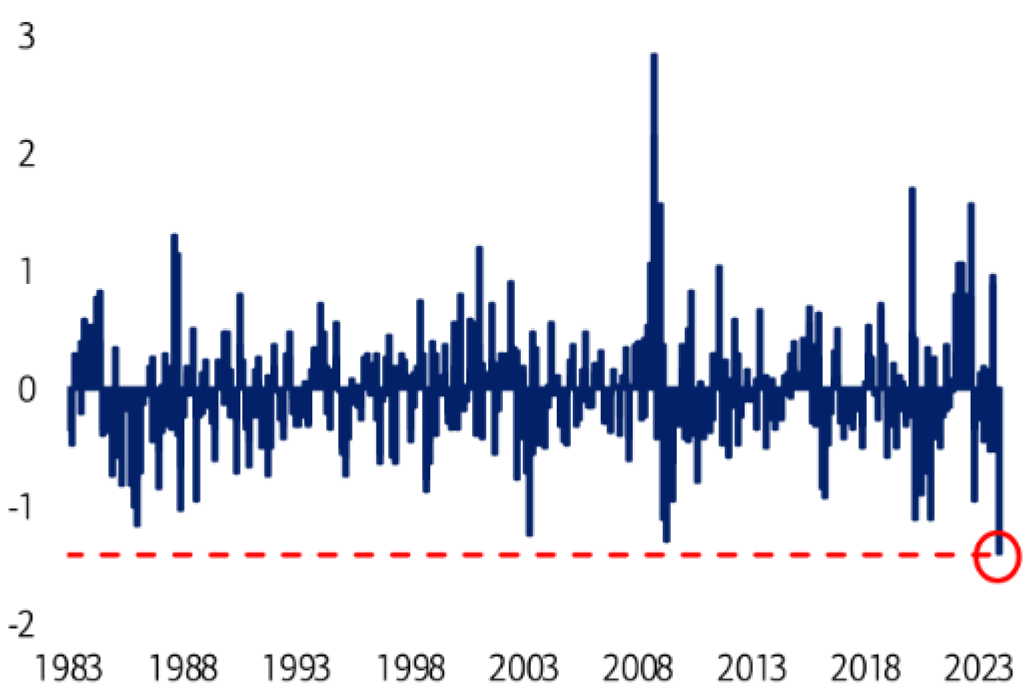
# THE FIVE

### The Most Important Charts We're Watching This Month

**The big story in January was the dramatic resurgence of investors' "animal spirits" following [the Federal Reserve's apparent policy pivot last month](). This shift ushered in the fastest easing of financial conditions on record ([from BofA Global Research/ Barchart via X]())...**





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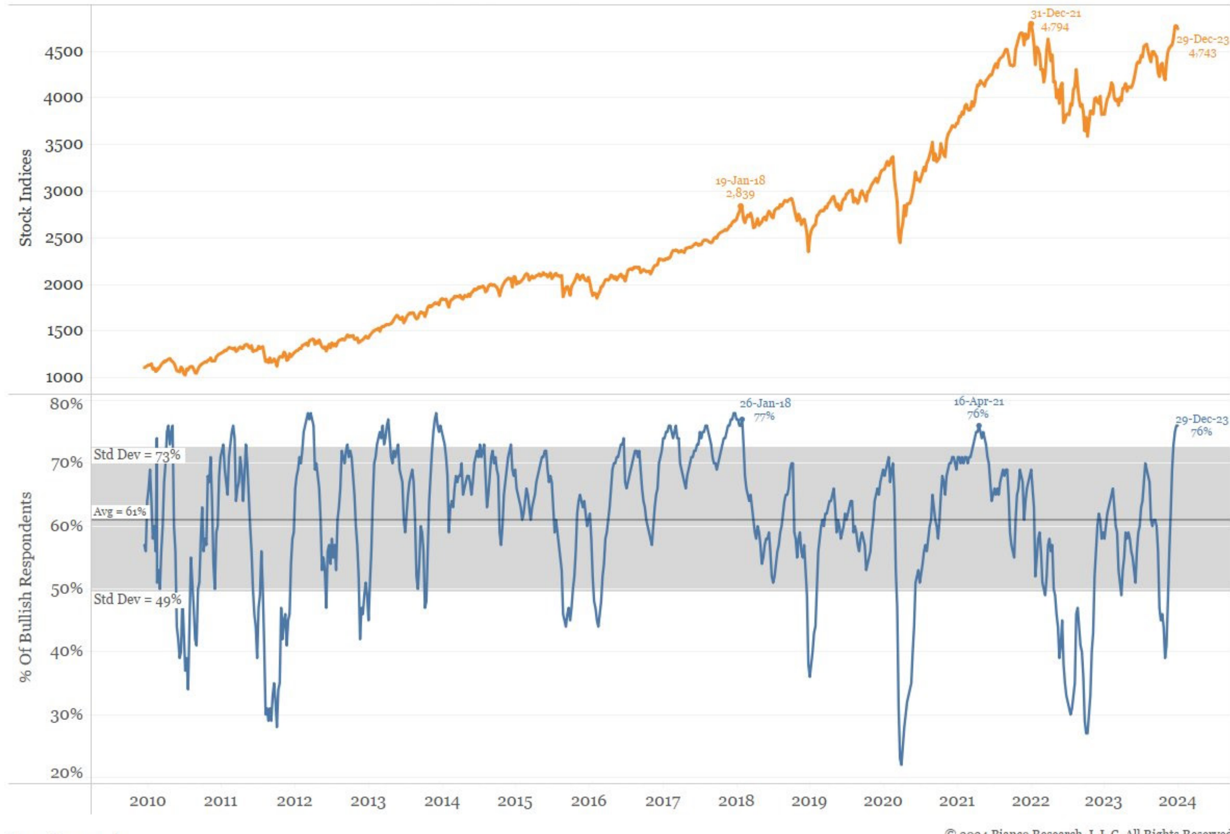
**Surveys show professional investors are once again extremely bullish, with sentiment surpassing even the peak of the previous bull market in 2021 (from Consensus/Jim Bianco via X)...**



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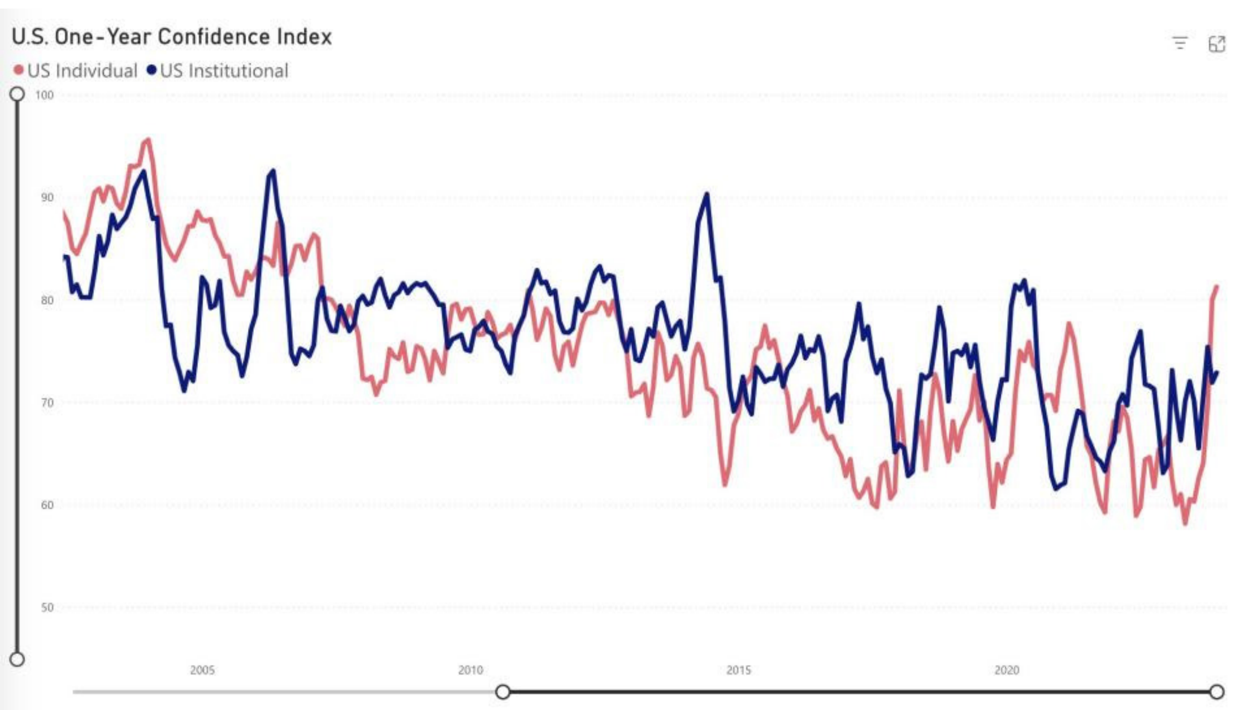
**Data suggest Individual investors are even more bullish, with 80% of respondents expecting the broad market to end the year higher. By this measure, mom-and-pop investors are more bullish than they've been anytime since March 2007, nearly a year before the Great Financial Crisis began (from Yale School of Management via Yahoo Finance)...**





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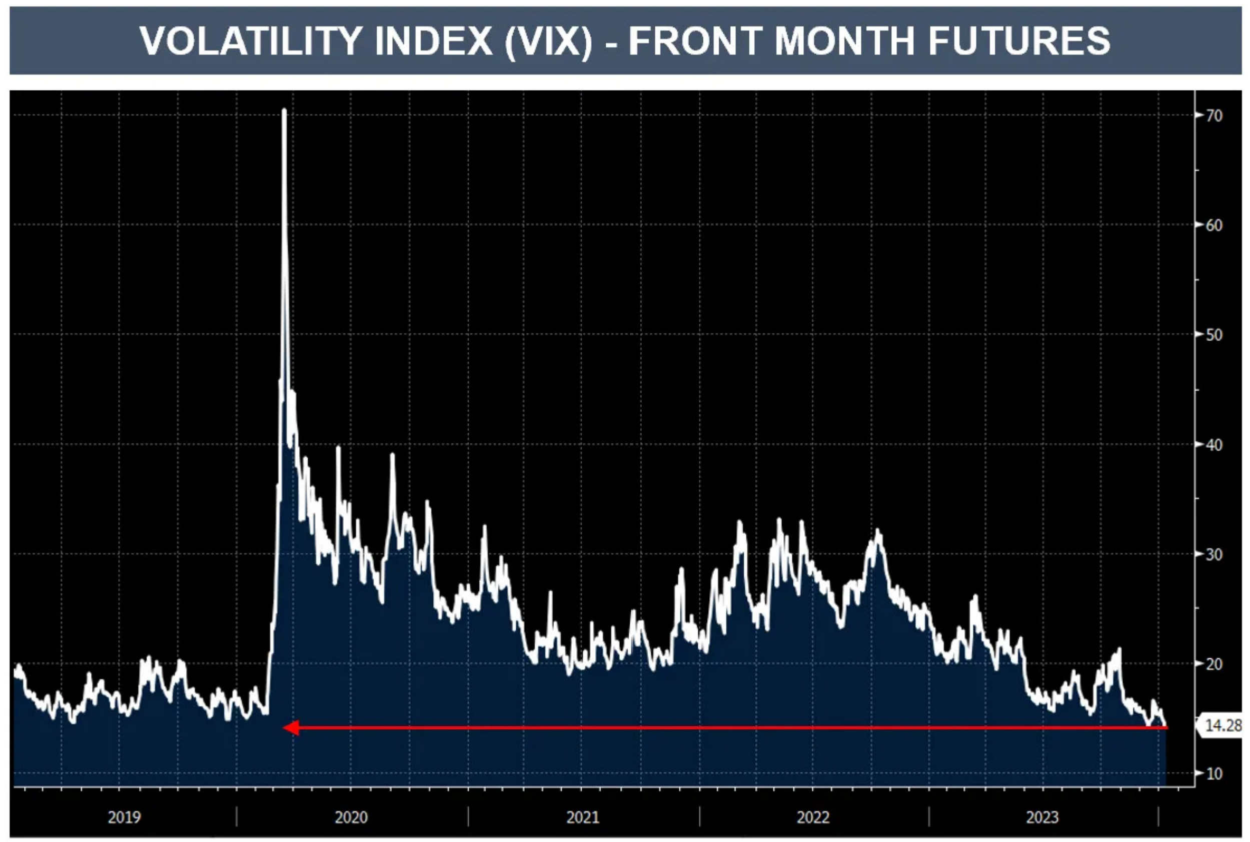
**Meanwhile, the CBOE Volatility Index (VIX) – the market's "fear gauge" – has continued to fall. It is now trading at its lowest levels since before the COVID-19 crash – and near its lowest levels on record – suggesting investors are historically complacent today (from The Next Economy)...**



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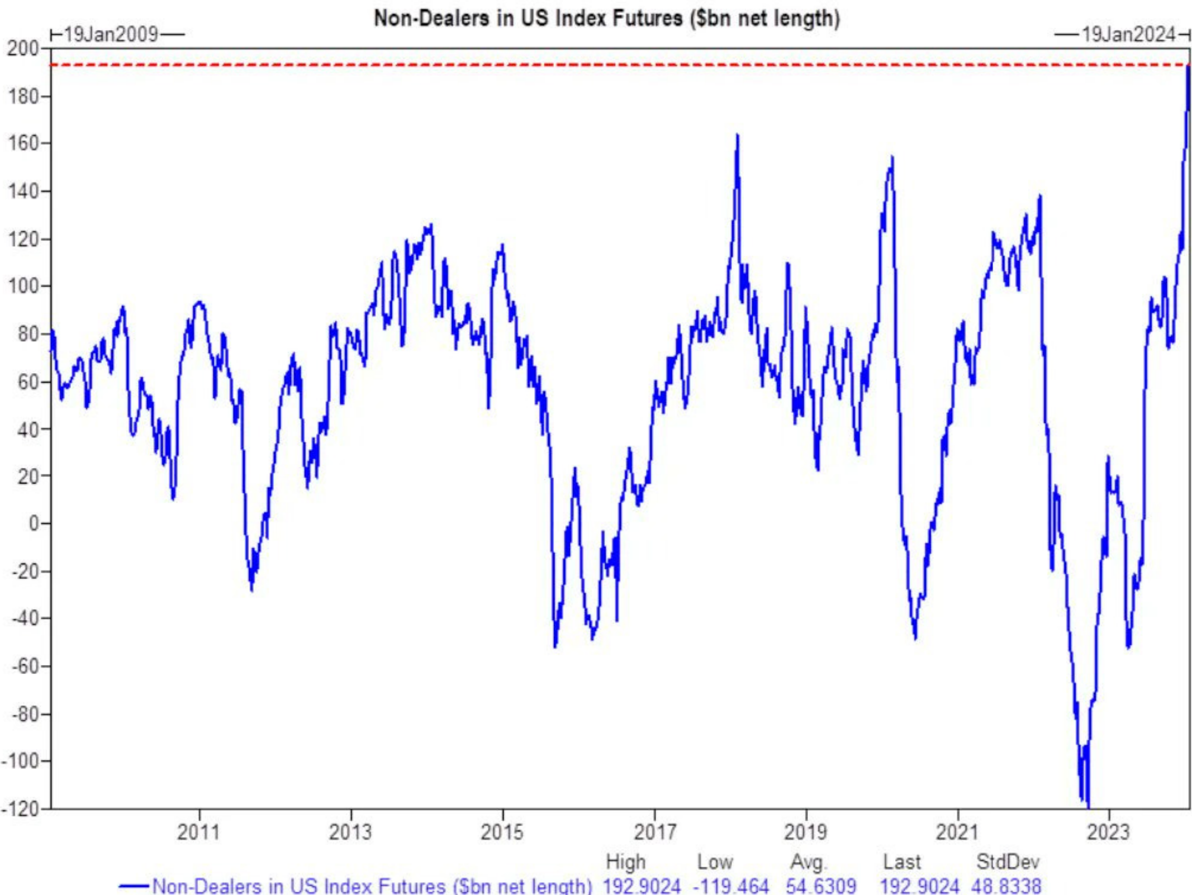
**This recent surge in bullish sentiment has coincided with similar shifts in market positioning. For example, "non-dealer" – i.e., all investors excluding market makers – long positions in market index futures has surged to all-time highs (from Daily Chartbook/Jesse Felder via X)...**





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## ECONOMICS AND MARKETS

**This is what it would take to see a repeat of the past decade's extraordinary stock-market returns (from AQR)...**

U.S. equities recently completed a majestic 10-year run, with the S&P 500 outperforming cash by 11.9% per year between July 1, 2013 and June 30, 2023.

To be sure, the ride was not always smooth. The market realized sizable drawdowns in 2015, 2018, 2020, and, most recently, in 2022 when elevated inflation and aggressive monetary policy-tightening led to a 17% selloff. By the end of the second quarter of 2023, however, the market had recovered most of its losses and was back to trading near all-time highs.

There are reasons for both optimism and pessimism about future U.S. equity market performance. Pessimists can point to rich valuations (both absolute and relative to other markets), above-target inflation and tightening financial conditions due to restrictive monetary policy, and exceptionally elevated macroeconomic uncertainty.2 On the other hand, optimism about the prospect of a painless disinflation has increased over the past year. And this, along with euphoria over the potential impact of artificial intelligence on corporate earnings, has given some investors hope that the best is yet to come for U.S. stocks.

I offer no near-term prognostication in this note. Instead, I seek to shed light on two questions:

1. How exceptional was US.equity market performance over the last decade?

2. What would it take for equities to deliver similar excess-of-cash returns over the next decade, or even to deliver long-run average returns?

The latter is the critical question. In order to make prudent investment decisions, investors must have realistic expectations about future excess-of-cash equity market returns.

Using a simple return decomposition, I show a repeat of the past decade's equity market performance would require a heroic set of assumptions: both extraordinary real earnings growth and all-time-high valuations. While this outcome is not impossible, it is an implausible baseline assumption.

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I further show that given low current dividend yields and positive real cash rates, even historically average equity market performance would likely require price-earnings multiples to expand from already rich valuation levels…

Extrapolation is often imprudent, especially in financial markets where strong performance often tends to be associated with rich valuations. Stars must align in order to see an encore of last decade's equity market performance—exceptional real earnings growth and all-time high valuations, with investors likely paying at least 80% more per dollar of earnings than at present. This proposition is even more dubious against the current backdrop of elevated macro uncertainty, persistent inflation, and contractionary monetary policy.

Investors who are implicitly or explicitly relying on a repeat of the past decade or even on above-average equity market performance, such as those making reallocation decisions based on performance relative to equities, should take caution. The same is true even for investors who have reduced their equity allocations in favor of illiquid alternatives. Equity beta is ubiquitous and even illiquid assets such as private equity and private credit ultimately depend on the same drivers of returns—how much real cash flows will grow, and how much investors are willing to pay for cash flows.

If we see a repeat of the past decade, hooray! In this scenario, there may be little harm

in holding an allocation to lower beta and/ or convex liquid alternatives, but also little benefit. If, however, equity performance is more in line with historical averages, or economic weakness and a return to more normal valuations cause equity markets to underperform, then truly diversifying alternatives are likely to be meaningfully more valuable to investors over the next decade.

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**The Federal Reserve reportedly has "no plans" to extend its emergency bank lending program when it expires in March (from MarketWatch)...**

The Federal Reserve has no plans to extend an emergency loan program it launched last year to bolster the capacity of the banking system in the wake of the collapse of Silicon Valley Bank.

The Bank Term Funding Program will expire on March 11 as it reaches its original one-year time limit, Fed Vice Chair for Supervision Michael Barr said at a panel appearance on Tuesday.

"The program worked as intended," Barr said. "It dramatically reduced stress in the system very quickly. It was highly effective," he said, adding "it really was established as an emergency program."

At the moment, banks have $141.2 billion in loans outstanding from the bank program, according to the latest Fed data.

Banks may refinance debt until the last day of the program in March, with a maximum repayment time of one year.

The government set aside $25 billion last year as a backstop for the emergency program, which was established to stem a rush of deposit outflows from banks following the collapse of Silicon Valley Bank in March 2023.

Continue reading here (subscription may be required).

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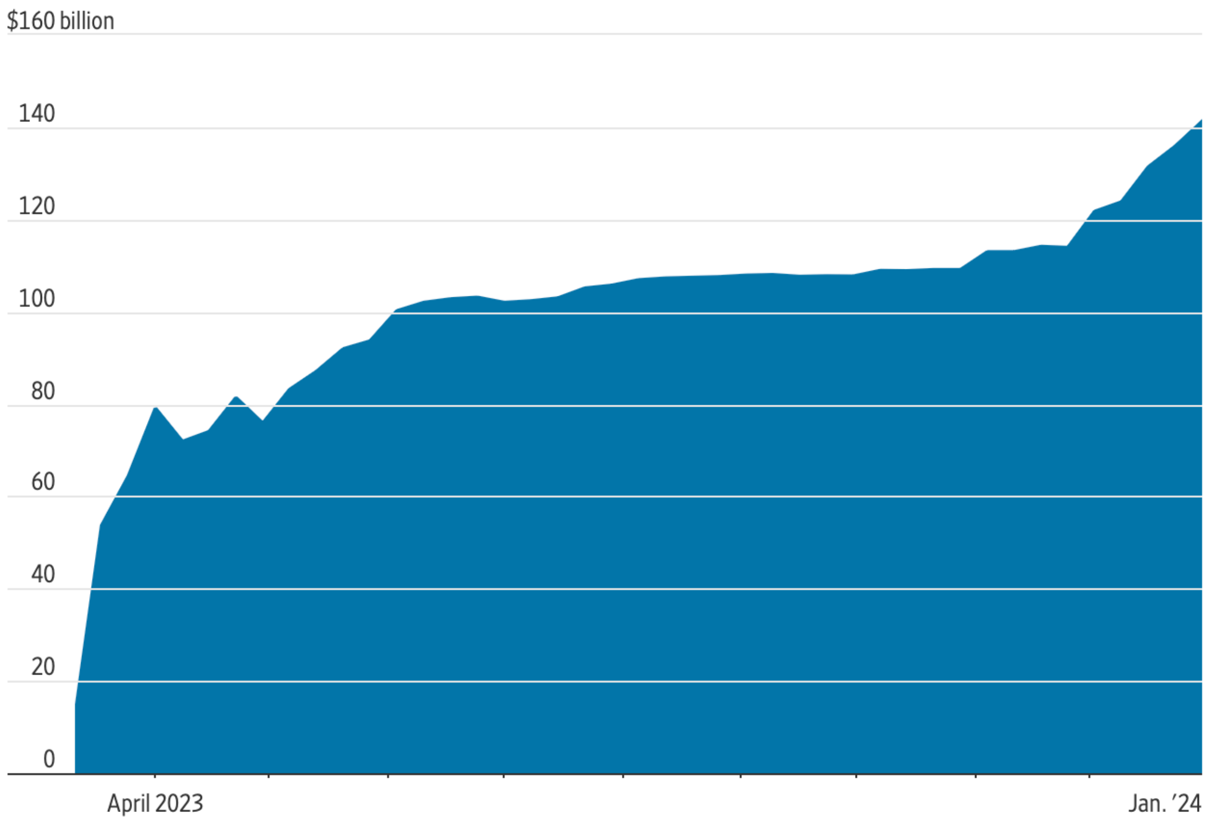
**In the meantime, banks have reportedly been gaming the BTFP program for profit (*from The Wall Street Journal*)...**




An emergency lending program the Federal Reserve created during the 2023 banking crisis has turned into easy money.

Borrowing from the Fed's bank term funding program has increased to new highs in recent weeks, a strange consequence of the market's flip to forecasting multiple Fed rate cuts over the coming 12 months.





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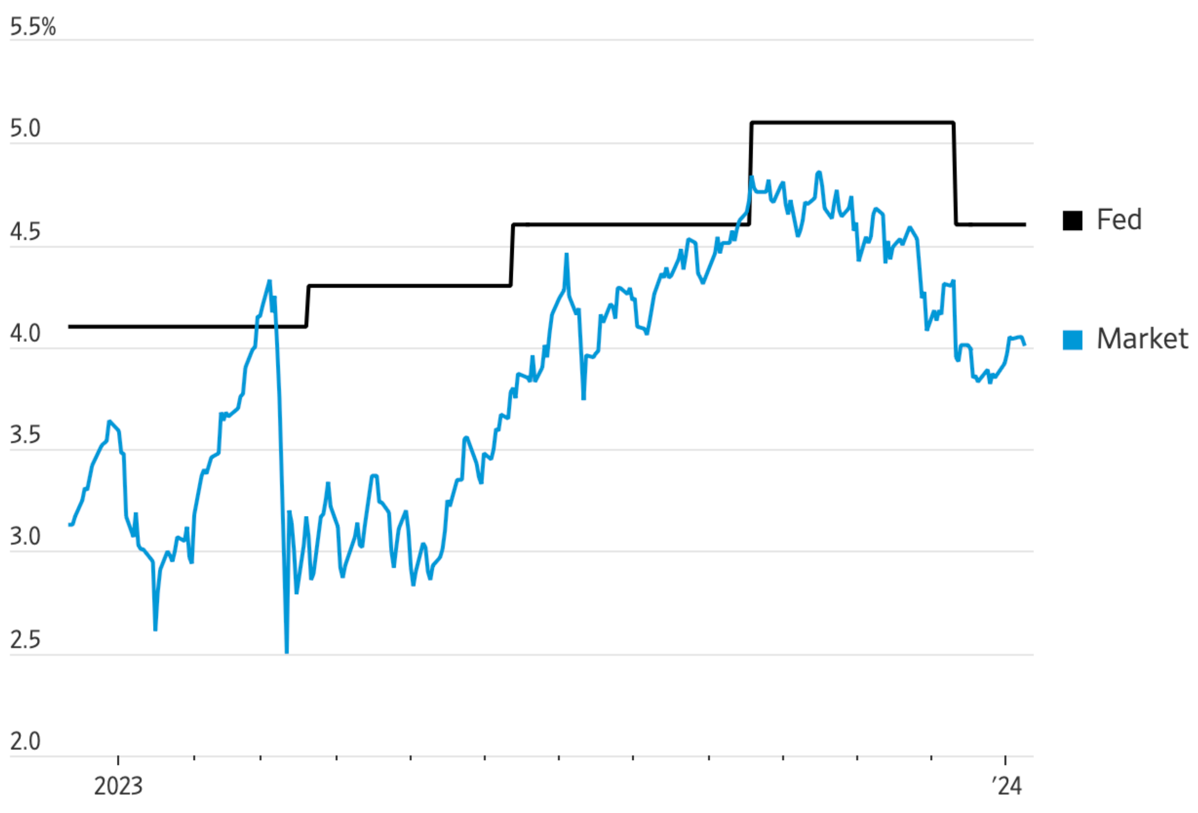


The rate banks pay to use the program, BTFP for short, is tied to future interest-rate expectations. Now that investors have priced in a series of rate cuts later this year, banks are able to pocket the difference between what they pay to borrow the funds and what they can earn from parking the funds at the central bank as overnight deposits.

In March, the failure of Silicon Valley Bank spooked depositors, sending banks scrambling for cash. The Fed rushed to their aid, taking beaten-down bonds at face value as collateral for one-year loans. The program's creation helped calm depositors into believing banks had access to ample funds.

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The facility charges banks a rate equivalent to the market's expectation for where benchmark interest rates average over the next year, plus an additional 0.1 percentage point. Initially, borrowing was expensive because investors were pricing in higher rates in the future.

A dramatic reversal in rate expectations in recent months has changed the math.

While the Fed offers financing below 5% through its rescue program, it is currently paying banks 5.4% on parked reserve balances.

Continue reading here (subscription may be required).





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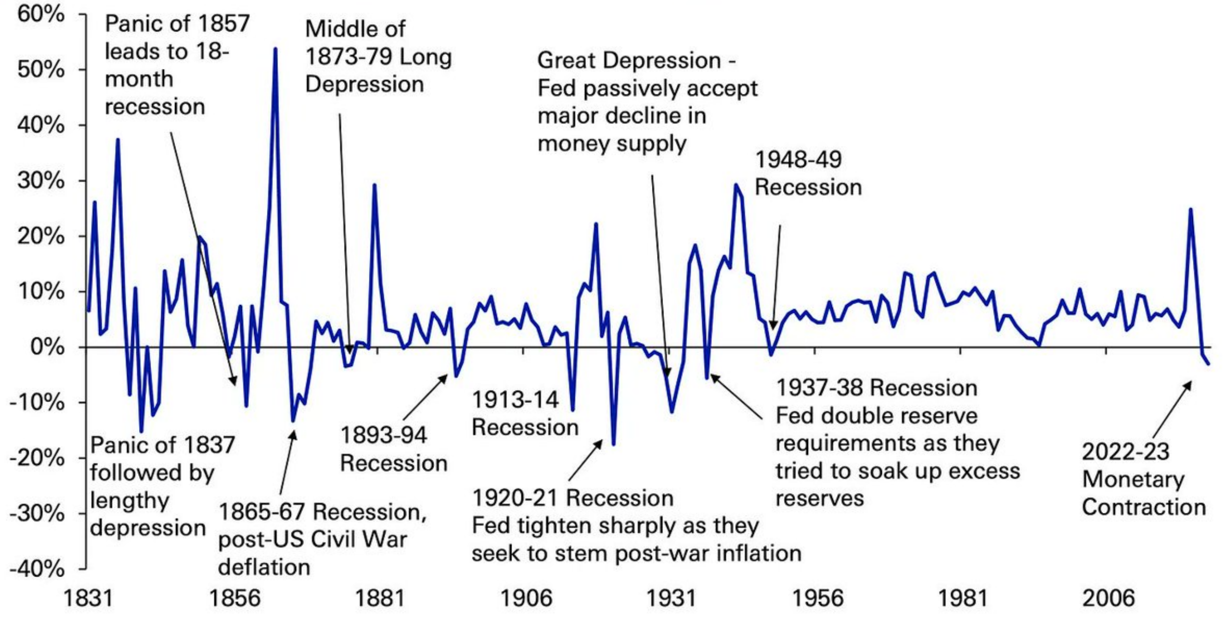
**A sharp decline in the money supply – like we've seen over the past couple years – has historically always caused problems (from Jesse Felder via X)...**

"We have never seen the money supply contract this fast without some sort of negative outcome." https://dailychartbook.com/p/daily-chartbook-358 via @ dailychartbook



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**Why the economy has held up as inflation has plunged (for now) (from The Daily Spark)...**

There is an ongoing debate about how core PCE inflation could come down from 5.5% to 3.2% without a slowdown in the economy, but this debate ignores that the cyclical components of GDP, including housing, have slowed sharply as a result of Fed hikes, and the non-cyclical components have continued to see strong growth in particular with strong post-Covid tailwinds to restaurants, hotels, and airlines.

The cyclical components of GDP are the interest rate-sensitive components such as housing, capex, and durable goods, and these parts of the economy slowed significantly when the Fed started raising rates, see chart below.

Put differently, it is misleading to say that Fed hikes have not had any negative impact on the economy. Fed hikes had a very negative effect on the interest rate-sensitive parts of the economy, most notably housing, and the result was a decline in housing inflation. With housing having a 40% weight in the CPI basket, the result was a decline in headline and core inflation for both CPI and PCE.

So why did the economy not slow down more, and why did Fed hikes not result in a rise in unemployment? There are two reasons.

First, the post-Covid economy saw surprising strength in the non-cyclical components of the economy, such as eating at restaurants, staying at hotels, and flying on airplanes, etc. Consumers wanted to travel, go to concerts and sporting events after Covid, and this has kept consumer spending strong.

Second, financial conditions eased significantly following SVB, and this boosted GDP growth to 4.9% in the third quarter of 2023. Similarly, the rally in the stock market, credit markets, and Treasury markets since October and after the Fed pivot in December have also eased financial conditions significantly, likely boosting the cyclical components of GDP over the coming months.

As the chart below shows, the bottom line is that the non-cyclical components continue to grow steadily because of post-Covid strong demand for consumer services, and the cyclical components are rebounding because of easier financial conditions.

The likely scenario is that the economy will reaccelerate over the coming months, which will put renewed upward pressure on inflation and, hence, bring back a more hawkish Fed.

In short, the Fed is not done fighting inflation, and, as a result, it is too early to argue that this is a soft landing because both the cyclical and non-cyclical components of GDP are likely to be solid over the coming months, see again the chart below.





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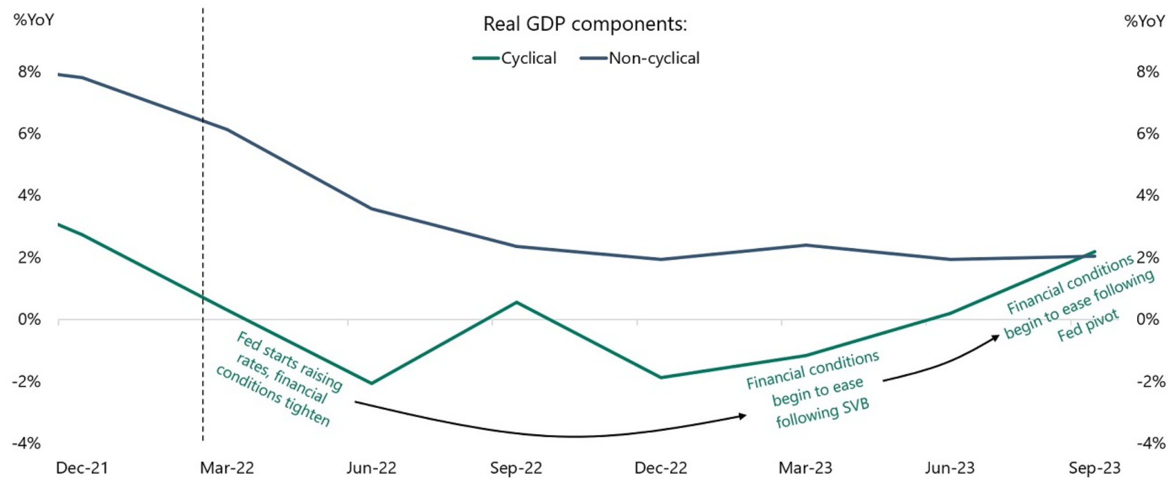


Source: BEA, Haver Analytics, Apollo Chief Economist. Note: Cyclical components include interest-sensitive components, i.e., durable goods consumption, nonresidential structures, equipment investment, and residential investment. Non-cyclical components include non-durable goods consumption, services consumption, and nonresidential investment in intellectual property products.

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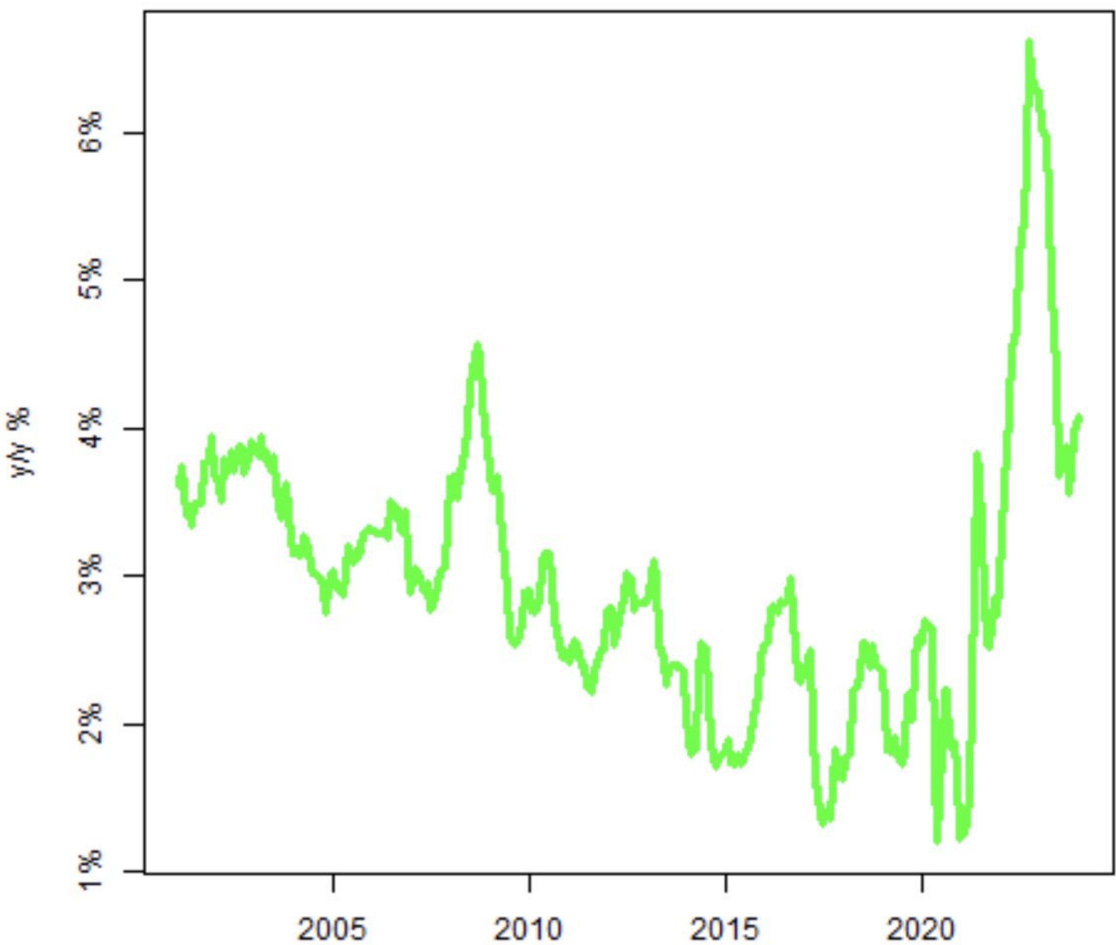
**Here's another reason inflation could prove "stickier" than the consensus currently expects (from E-piphany)...**

[The] system is normalizing after COVID (and more relevantly, after the spastic and dramatic fiscal and monetary response to COVID). But normal is no longer sub-2%. Core services ex-shelter (so-called "supercore") abstracts both from the deceleration in housing and the sharp drop in core goods, and it is hooking higher (this is partly because Health Insurance had been artificially depressing it and that effect is waning).

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**Why stock market volatility could move higher again soon (from The Next Economy)...**

Modern financial markets are highly developed. Over the past decades they have created ever more refined concepts for investors to hedge against a myriad of risks, and for observers to use their pricing for clues on the economy and markets.

One of these concepts is *volatility*, as measured by the *VIX* index ("vol") and its first derivative, the *VVIX* index ("vol of vol"). These are created by the pricing of options. *Why?*

- **If option sellers expected *volatility* to be high, then they price options more expensively**. High *volatility* means prices swings are larger, which in turn means the strike price of an option is more likely hit, leading to a loss for the option seller. *So they want to be compensated for that risk*
- **Conversely, if option sellers do not worry about *volatility*, they will sell their options more cheaply**

**A low *volatility* reading tells us that market participants have *no fear* of wider market swings ahead. Now, regular readers will be familiar with my constant search for *market extremes* and my intention to *fade* them. I believe the market's volatility readings have reached an extreme low, *and the odds are it rises from here.***

**First, let's look at the *VIX* Index. It has just touched a 6-year low (!):**

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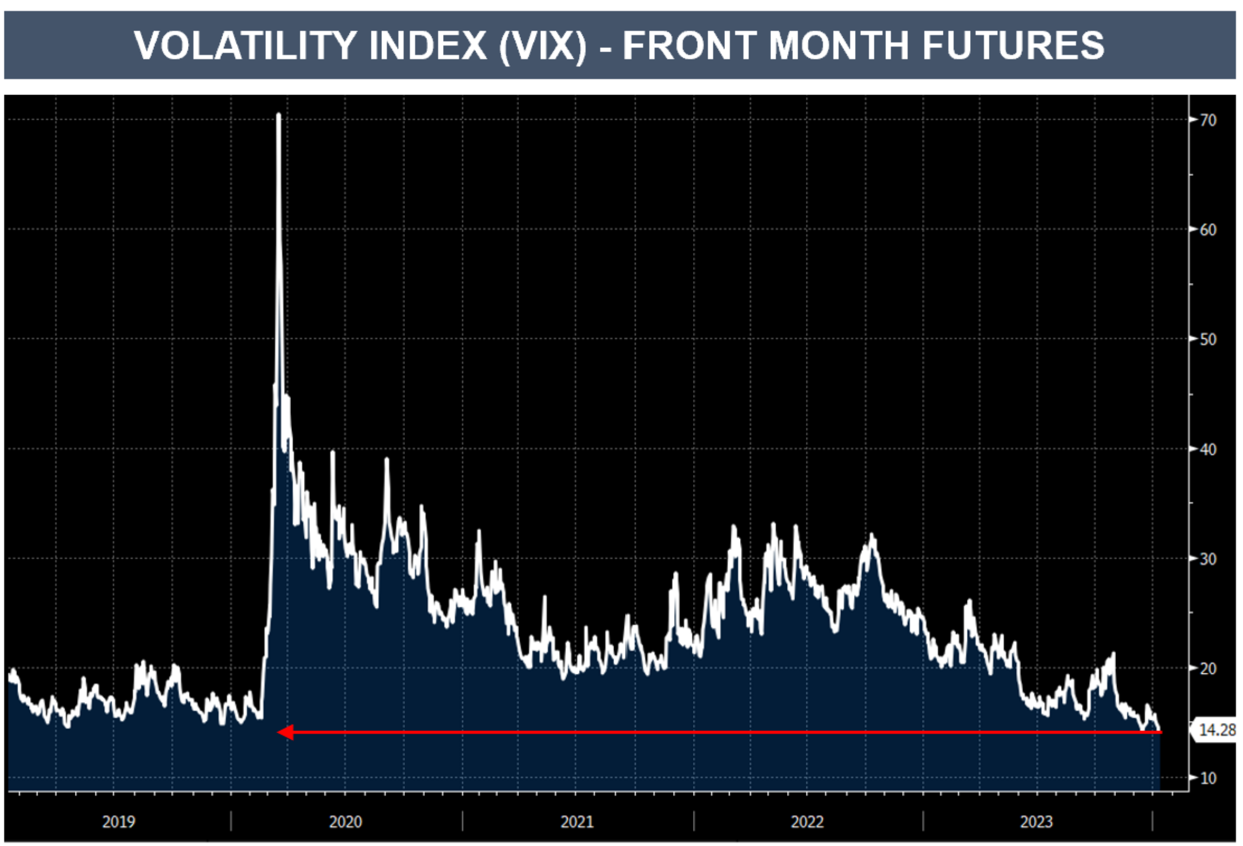


*Source: Bloomberg*

**More so, the volatility of the *VIX* itself, measured by the *VVIX index* has also reached a multi-year low:**





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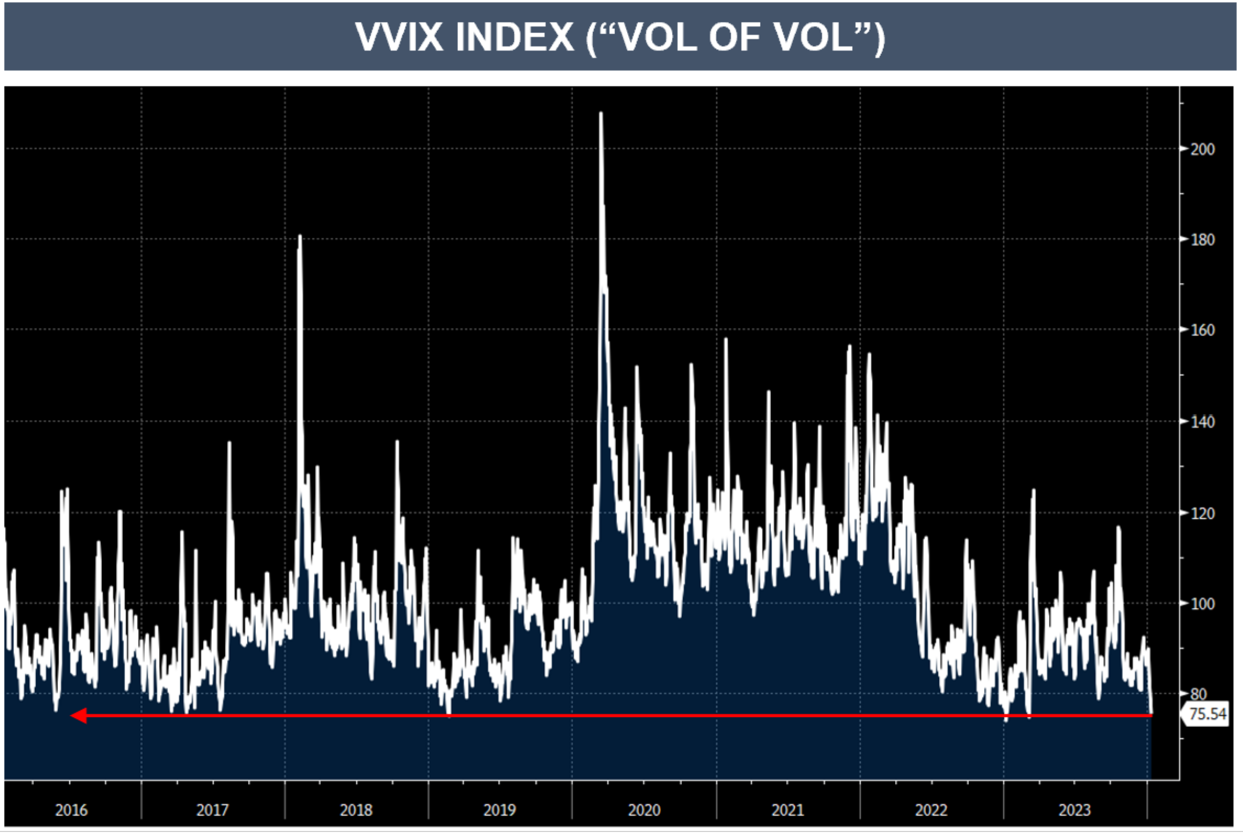


*Source: Bloomberg*

- **This tells us investors not only expected volatility to be low *now*, *but also to stay that way*. If the volatility of volatility ("vol of vol") is exceptionally depressed, very few expect big moves in the *VIX* any time soon**

***In other words, investors currently expect exceptionally calm markets, and expect them to stay that way, too.***

Now, if we look at the *VVIX* chart above, we note that these spikes to the downside usually reverse pretty quickly. Keeping *reflexivity* in mind, that makes sense. *Why?*

- **If *volatility* and its first derivative, the *VVIX* are exceptionally low, *everyone has their guard down*. In this environment, policy makers may be too complacent to take forceful action, geopolitical adversaries may see an opening, or pricing may simply next move in a way that is uncomfortable for many**

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***I think it is likely that volatility has made a low here.* What will drive it up? I don't know, but here are some dynamics that could be made responsible soon:**

- **China could impose aggressive sanctions on Taiwan** if the incumbent party wins again this weekend. It has indicated to do so, yet this seems ignored by markets right now
- **The Middle East crisis could resurface**, e.g. via an escalation in Yemen
- **The US economy could deteriorate more than expected**, meaning the Fed is behind the curve with rate cuts

**It does not always need a negative scenario to drive up volatility. *Also consider the following an option*:**

- Some think that the Fed (and the Treasury) are already way too lenient right now. A "*crash-up*" in risk assets might follow, as investors rush to the **safety of real assets** amidst excessive and inflationary deficit spend. Emerging markets such as Brazil provide a template for it. I will write about this in one of the coming posts, and why I see it as the less likely outcome.

*The economy and markets are a reflection of human behavior*. If volatility is low, something new may suddenly cause substantial stress just by virtue of being new. Conversely, when volatility is high, something known may start to be disregarded.

- **Just think of the Israel/Hamas conflict.** The first headlines saw market volatility rush upwards in October. It has been going on since, and has arguably escalated with the involvement of Yemen. *Yet, as volatility had declined from elevated levels, no one in markets was in the mood to hear about it anymore*.

***Conclusion:***

- *Markets very often take pricing to extremes, and in my view volatility (VIX) and "vol of vol" (VVIX) currently represent such an extreme. I think it has put in a low for some time*
- *There could be plenty of reasons to drive up volatility going forward, from geopolitical tensions around Taiwan or the Middle East, to monetary policy that may be slow to adjust, or even a "crash up" in risk assets (latter not likely in my view)*





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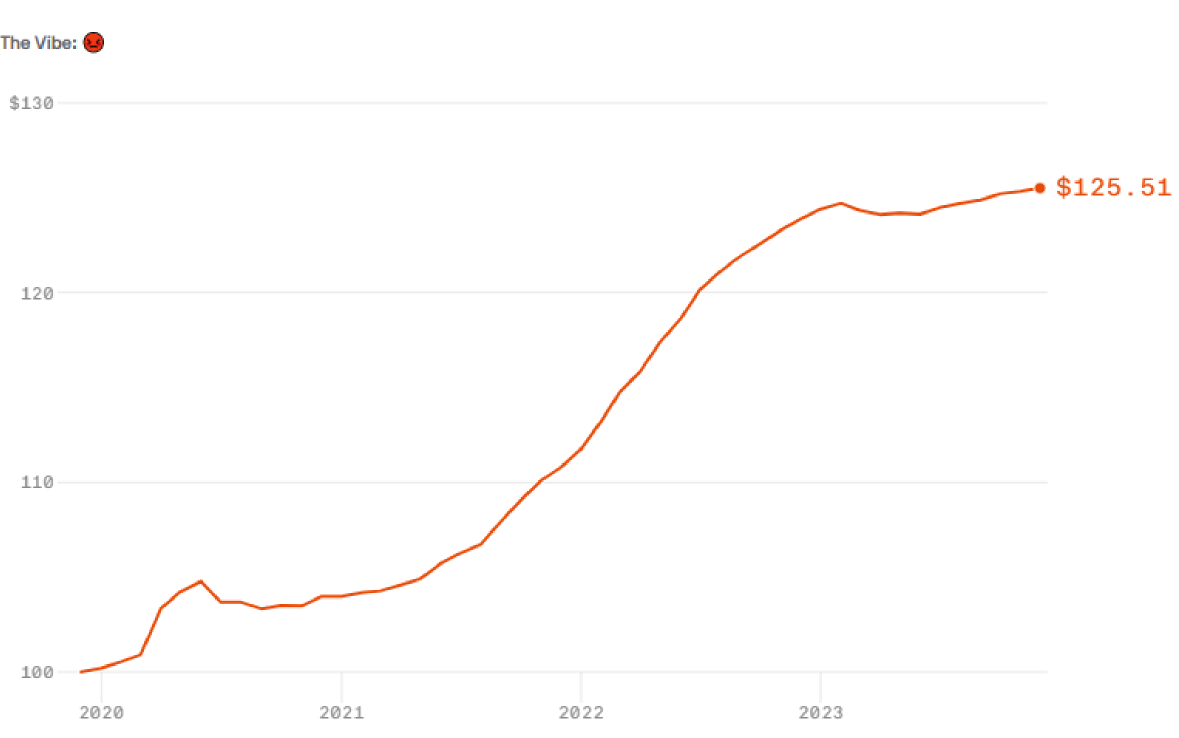
**Inflation has been particularly burdensome for food prices (from Barchart via X)...**

Your grocery bill has increased more than 25% over the last four years!



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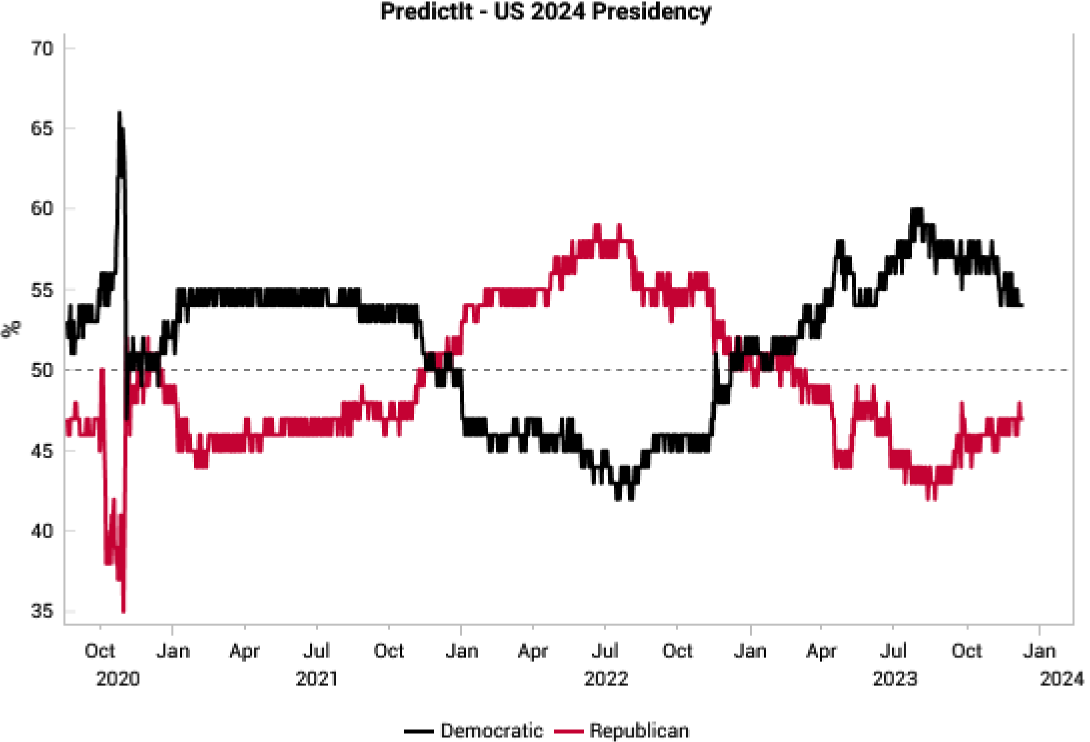
**These are the "keys" to watch for during the upcoming U.S. presidential election (from The Variant Perception)...**

### "Man + Machine" applied to politics / history

We do not profess to be political gurus. Our approach is to look for historical analogies to contextualize today's environment. For example, at the outset of the Russian-Ukraine war, we flagged 20th-century examples of surprise wars and the market implications (link). Today, we re-visit a U.S. election framework that we last flagged in 2020 (link).

Polling data and betting markets remain the primary tools to analyze election outcomes, but these tend to be widely followed, reducing the "edge" from using them in isolation.




In this report, we highlight again a fairly differentiated U.S. election framework developed by historian Allan Lichtman. According to Lichtman, elections should *not* be thought of as voters looking to the future and deciding between alternative policies and personalities. Rather elections are referendums on the past





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Voters can be happy with the past four years and want a continuation of the status quo (favoring the incumbent party). Voters can also be unhappy with the past four years and simply want change - irrespective of the type of change - which would favor the challenging party.

This framework was originally developed in Lichtman's 1981 paper with Russian scientist Vladimir Keilis-Borok: Pattern recognition applied to presidential elections in the United States, 1860-1980: Role of integral social, economic, and political traits. Since then, Lichtman has published books periodically on the same framework titled The Keys to the White House.

**The Keys to the White House**

Lichtman proposes 13 yes or no questions to determine if voters are happy with the past 4 years and likely to vote for the incumbent party. These include questions such as whether real incomes have increased, if there have been any scandals, and if a third-party challenger is running. The questions are worded from the perspective of the incumbent party.

If eight or more conditions are satisfied out of the 13, the incumbent party is predicted to win. Using this simple checklist framework, he has "predicted" all out-of-sample elections since 1984.

The reason we put the word predicted in quotes is because there are a few quirks with his out-of-sample results. In the 2000 election, his system predicted Al Gore to win, who did win the popular vote but lost narrowly in the electoral college. In 2016, his system predicted Donald Trump would win, but Trump lost the popular vote.

Nevertheless, we think this simple checklist offers plenty of food for thought on handicapping election risks. The table below sets out Lichtman's 13 conditions along with our current assessment of whether the conditions have been met and the likelihood the condition will still hold on the eve of the election.

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| Key | Threshold condition | Score | Likelihood Score Holds On Eve of Election | Note |
|---|---|---|---|---|
| **Party Mandate** | After the midterm elections, the incumbent party holds more seats in the U.S. House of Representatives than it did after the previous midterm elections. | 0 | Certain | Dems Lost House Seats (2019: 235, 2021: 222, 2023: 213) |
| **Contest** | There is **NO** serious contest for the incumbent-party nomination. | 1 | Almost Certain | Biden 70%+ in betting markets to be nominee |
| **Incumbency** | The incumbent-party candidate is the sitting president. | 1 | Almost Certain | Biden 70%+ in betting markets to be nominee |
| **Third party** | There is **NO** significant third party or independent campaign. | 1 | Almost Certain | No one close to Ross Perot |
| **Short-term economy** | The economy is **NOT** in recession during the election campaign. | 0.5 | Uncertain | Godot's Recession / 1969-70 Roadmap vs Fiscal path-dependence juicing economy |
| **Long-term economy** | Real per-capita economic growth during the term equals or exceeds mean growth during the previous two terms. | 1 | Almost Certain | Covid timing |
| **Policy change** | The incumbent administration effects major changes in national policy. | 1 | Certain | Fiscal/Industrial Policy/IRA etc. |
| **Social unrest** | There is **NO sustained** social unrest during the term. | 0.5 | Uncertain | Jan 6th, likely ramp up in election year |
| **Scandal** | The incumbent administration is **UNTAINTED** by major scandal. | 0.5 | Uncertain | Trump presidency may have reset bar for "scandal", Hunter Biden indictment probably counts |
| **Foreign/military failure** | The incumbent administration suffers **NO** major failure in foreign or military affairs. | 0 | Almost Certain | Russia-Ukraine War, Middle East Unrest, Afghanistan Pullout |
| **Foreign/military success** | The incumbent administration achieves a major success in foreign or military affairs. | 0 | Almost Certain | China cold war |
| **Incumbent charisma** | The incumbent-party candidate is charismatic or a national hero. | 0 | Almost Certain | Biden appeal too narrow (55% unfavorable rating), Reagan / Obama had broad appeal |
| **Challenger charisma** | The challenging-party candidate is **NOT** charismatic or a national hero. | 1 | Almost Certain | Trump appeal too narrow (52% unfavorable rating), Reagan / Obama had broad appeal |
| | Incumbent wins if total score is 8 or above | 7.5 | | |

Based on our current assessment, the incumbent Democrats' score of 7.5 is just below the 8 threshold, which means they are likely to narrowly lose the 2024 election. There are a few key uncertainties at present, so we have assigned a 0.5 score to these topics:

a) whether the Trump presidency resets the bar for what counts as a scandal

b) if the U.S. economy will be in recession on the eve of the election

c) if social unrest ramps up in 2024 as election season heats up

There is also still some small uncertainty about Biden and Trump becoming the nominees. We have assumed they will be the nominees again for the purposes of our assessment.





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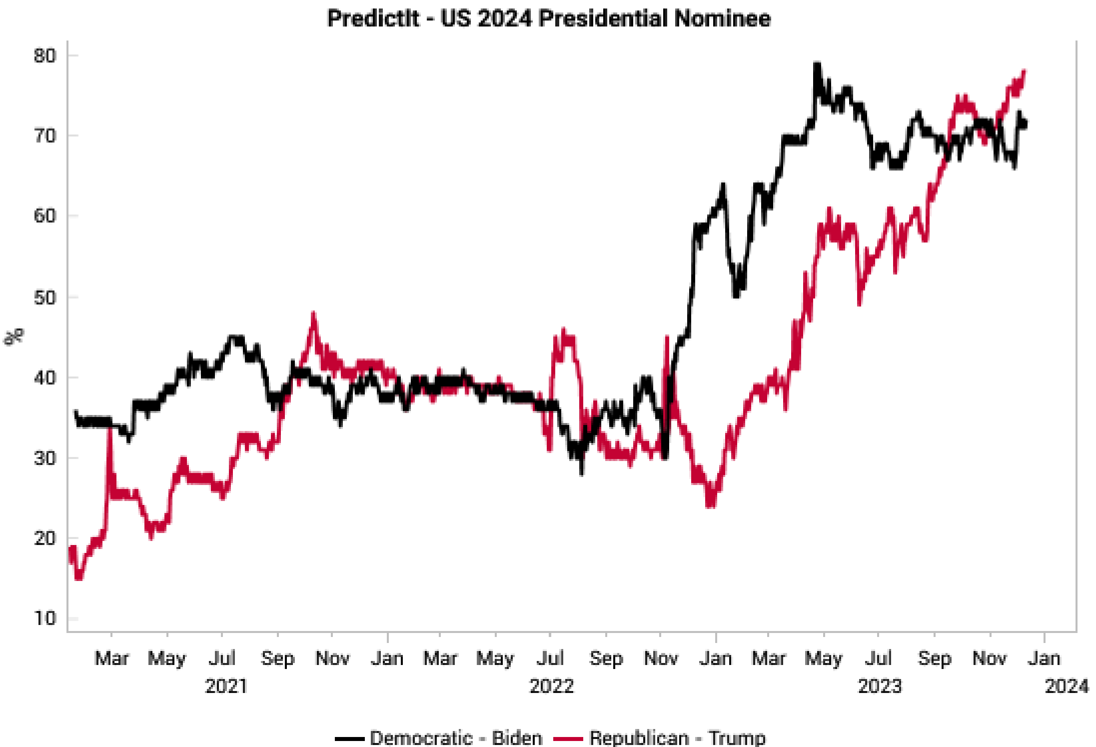


For context, the incumbent Republicans had a score of 6 on the eve of the 2020 elections, while the incumbent Democrats had a score of 7 on the eve of the 2016 election. The generic congressional polls are now giving a slight edge to the Republicans, in line with Lichtman's framework.

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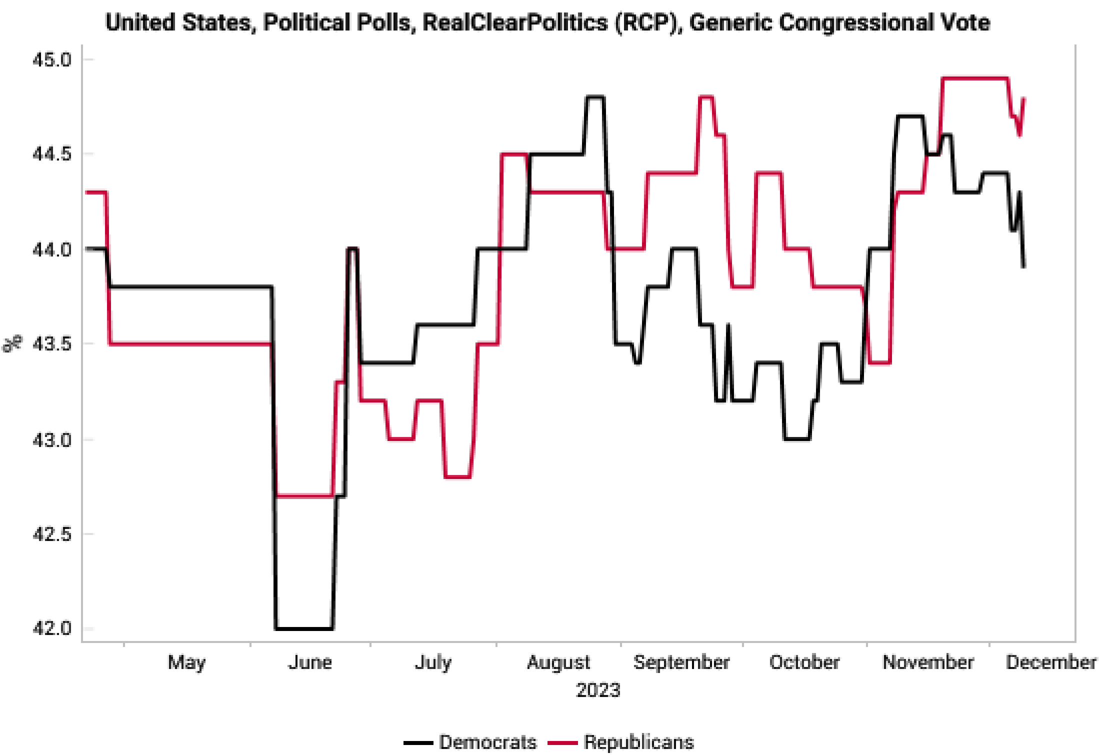


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**Here's a list of 2024 outlooks from some of the world's biggest investment firms (from Behind the Balance Sheet)...**

Last year, most of the outlooks I looked at were similar, reflecting fears of an imminent recession. Of course, they were almost universally wrong, as they probably are most years.

I say "probably" because when I was a professional investor, I paid no attention to any of these publications. This may mean you don't want to read on, but there are always some interesting snippets in the banks' work.

**Blackstone**

Regular readers will recall my farewell to Byron Wien, who penned his annual Ten Surprises letter for 38 years. Blackstone will be producing something different this year, but they wrote a piece about how the 10 Surprises for 2023 turned out.

They were right that the Fed wouldn't pivot; were wrong in expecting a recession (as did almost every commentator); they correctly expected a recovery in markets; were bullish on European and Japanese assets (half right); were wrong to be bullish on commodities; and they bet that Elon Musk would turn Twitter around – on that they are certainly early and likely wrong.

It's refreshing to see a financial institution prepared to review its predictions in this way, but sadly rare. *Spoiler:* The ones I cover below might not be as accurate.

**BlackRock**

"The economy is normalizing from the pandemic and being shaped by structural drivers: shrinking workforces, geopolitical fragmentation and the low carbon transition. Seemingly strong U.S. growth actually reflects an economy that's still climbing out of a deep hole created by the pandemic shock –and tracking a weak growth path.

Our bottom line for 2024: Investors need to take a more active approach to their portfolios. "

"A more volatile macroeconomic regime, alongside relatively high rates, may mean investors need to demand greater compensation for taking on equity risk." They like AI, medical innovation and reshoring themes.

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"Climate resilience is emerging as a new investment theme within the low carbon transition....... increased demand for solutions that help economies prepare for, adapt to and withstand climate hazards .... We see geopolitical fragmentation and economic competition driving a surge of investment in strategic sectors like tech, energy and defense."

**Barclays Private Bank**

"The most anticipated recession in history is still nowhere to be seen. Simply because it didn't happen in 2023, many investors are now expecting it in 2024. While each day passing brings us closer to the next economic contraction, we continue to believe that the whole "recession debate" is misplaced.

"What we do expect is a world where economic growth trends lower, sometimes flirting with contraction. With that, we also expect inflationary pressures to recede, albeit gradually from here. With main central banks having been extremely aggressive in their pursuit of higher interest rates, we would expect them to change tack as the year progresses (given expectations of falling inflation). However, investors should be careful what they wish for: monetary policy may not turn accommodative unless the outlook meaningfully deteriorates.

"Cash is now a comforting and arguably rewarding alternative. 2024 could be about extending (fixed income) duration to capture more than just coupons until maturity. Similarly, equity investors would need to tweak their allocation to favour sectors and regions that can respond well when growth slows and rates start falling."

**BNP Paribas**

When I wrote last year's article, I said "BNP are an outlier in their negativism". This year's report is titled "Stepping into a New Reality". Highlights are:

"In 2024, the cash that drove economic activity in 2023 will start running low. In the US, excess savings will soon be spent, and business investment will wane. Europe is more vulnerable to recession risk and will face stagflation, while China struggles to resolve its property crisis. Tighter financial conditions will weigh on economic growth and corporate profits."

They "favour government bonds over equities, anticipating lower bond yields as central banks cut rates to support growth, and lower equity prices as expected earnings fail to materialise."

They like AI, disruptive tech, private infrastructure debt and China equities. Everyone likes AI, as you will see...





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### Cambridge Associates

"The cyclical backdrop will remain weak in 2024. The consensus expectation is for the global economy to grow 2.7%, which is slightly less than growth is anticipated to be in 2023 and below its post-2000 average of 3.5%. Risks are skewed to either matching the consensus expectation or missing it lower.

"Three major drivers inform these views. First, credit growth in key markets is likely to remain subdued, given high interest rates and the increase in bank underwriting standards. Second, consumer spending growth is likely to either slow (United States) or remain slow (euro area and United Kingdom), given the depletion of any excess savings that accrued during the pandemic and weakness in consumer confidence. Third, numerous challenges, such as the war in Ukraine, the Israel-Hamas war, and China's real estate crisis, will continue to weigh on sentiment and have the unfortunate potential to escalate.

"We expect global equity performance will be below its long-term median level, but we believe investors should hold equity allocations ...Within equities, we see opportunities in developed value, developed small caps, and China. We doubt European and emerging markets ex China equities will outperform."

Within credit, they like "structured credits, particularly high-quality collateralized loan obligation debt, and we expect high-yield bonds will outperform leveraged loans. But we remain neutral on high yield because spreads are compressed."

### Citi Private Wealth

"Our analysis suggests that the global economy is healing and poised for further recovery.

- Inflation is coming down. Wage growth is moderating, even in services.
- Employment growth is slowing.
- The US economy is more resilient than many expected.
- Some US industries suffered a "rolling recession" in 2023. These sector contractions will roll out in 2024. Though the new year will initially see a slowdown in growth, there will be no broad-based economic collapse.
- For many sectors and markets, equity valuations are more reasonable than investors believe.
- Corporate profits are rebounding and are likely to hit an all-time high in 2025.

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- High short-term interest rates today are unlikely to be available tomorrow. The same is true for longer-term rates. Investors should not assume that they will be able to maintain rates as they roll over short-term Treasurys and bonds.
- As rate pressures recede, the US dollar is likely to decline.
- We expect global economic growth to strengthen in 2025. This should become apparent to investors as earnings estimates for 2025 rise. We expect a 12% increase in earnings per share (EPS) over the next two years."

*Equities to Benefit from Earnings Growth*

*Source: Citi Private Wealth*

They also see value in growth small caps and mid-caps in the US:

*Forward P/E of Growth Stocks by Size Band*





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*Source: Citi Private Wealth*

"In the past five years, the profitable SMID firms of the S&P 400 and 600 growth indices have averaged annual EPS growth of 11%. That's even above the 9% pace of the large cap S&P 500 growth index. Yet, the SMID growth shares trade cheaper, for an unusually deep discount of 39% on current-year estimates compared to the valuation for the large cap segment. In fact, they trade 29% below their own 25-year history based on trailing price-to-earnings (P/E) ratio."

**Deutsche Bank**

This report is titled "Top 10 themes for 2024". I won't go into all of them, but I thought this was quite an interesting report...

"The big focus of 2024 will be the slew of elections around the world. We expect some volatility around these, particularly if markets become nervous about fiscal spending promises.

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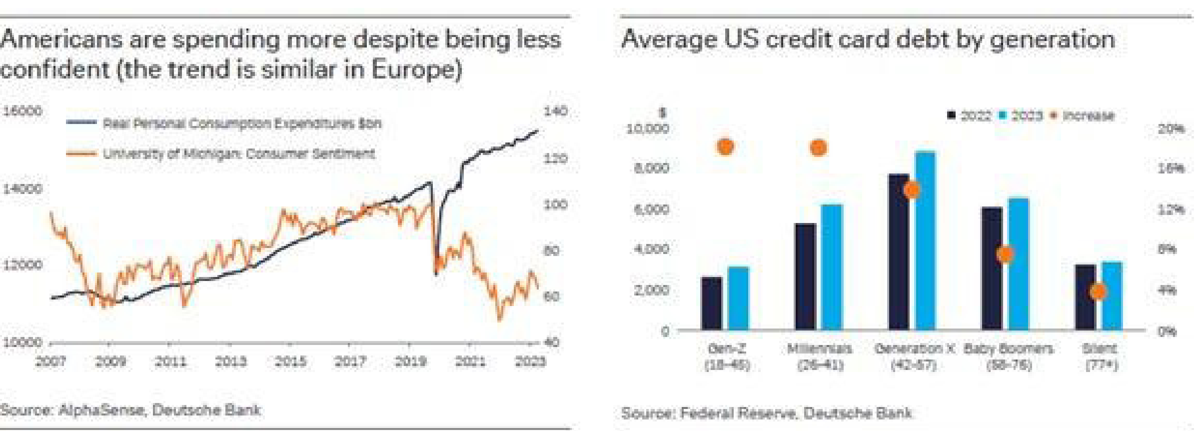
"For corporates and markets…In 2024, however, we expect more activity. Corporate uncertainty has dropped and there is greater visibility on the trajectory of economic and market indicators. The year may still include an economic slowdown but that may not be the key thing that drives markets.

"One of the main reasons why the US managed to avoid a recession in 2023 is because consumers continued to spend. Of course, low unemployment helped but, even so, peoples' desire to spend seemed to be in opposition to the concern they expressed in surveys."

*The US Consumer: Less Confident but I'm Still Spending*




*Source: Deutsche Bank*

"What appears odd is the large gap between spending and consumer confidence. First, spending has been unrelenting. In real terms, US personal consumption kept rising in 2023 in line with its pre- and post-covid trend. Yet, at the same time, consumer confidence is in the doldrums as people recognise the cost of living has jumped.

"When we look around markets now, it is hard to identify a specific major asset of consequence that may be in a bubble where investors are desperately trying to justify value. Sure, there are conversations to be had about weight loss drugs, olive oil, uranium, and bitcoin after their 2023 rallies. Yet, from a wider market standpoint, they are either niche assets or mere curiosities. Meanwhile, other major asset classes, such as certain equity indices, may have valuations that are 'high' by historic standards, but a 'high' valuation and a bubble valuation are two very different things.

"There are some more serious arguments for a bubble in private credit. But systemic issues are unlikely in the near term. The $1.6tn of private credit assets represents barely 12% of the private capital market and barely scrapes the surface of the approximately $500tn in global financial assets."





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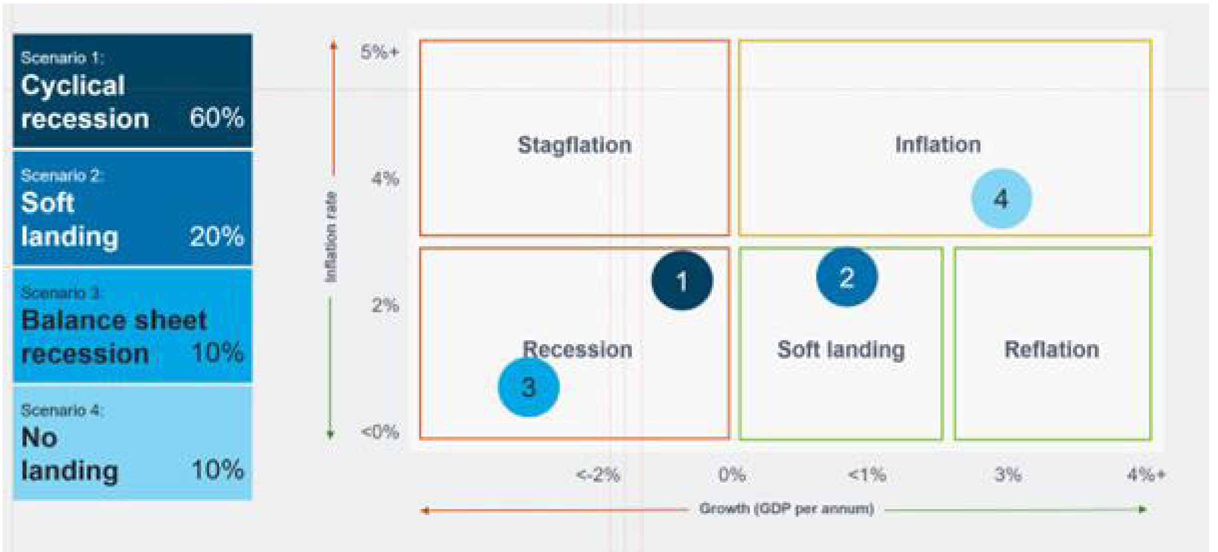
## Fidelity

Scenario analysis seems to be popular these days… This seems sensible to me and here is the Fidelity outlook:

*Fidelity's 4 scenarios for developed markets in 2024*




*Source: Fidelity International*

They provide further detail on each scenario in this chart:

*Fidelity's 4 Scenarios Detailed*

| | Growth | Inflation | Monetary policy | Fiscal policy |
|---|---|---|---|---|
| Scenario 1: Cyclical recession 60% | MODERATE RECESSION<br>DM economies go into contraction followed by recovery later in 2024/early 2025. Asynchronous timelines for different regions (EA/UK first, US later) | RECESSION BRINGS INFLATION BACK TO TARGET<br>Following a period of stickiness, core inflation falls back to target because of damage to the demand side of the economy | HIGHER FOR LONGER FOLLOWED BY A PIVOT<br>Inflation stickiness forces central banks to remain behind the curve of macro damage. They only start to cut rates when the labour market has definitively cracked. Real policy rates fall | NEUTRAL STANCE<br>No major shift in fiscal stance |
| Scenario 2: Soft landing 20% | SLIGHTLY BELOW-TREND SLOWDOWN<br>Growth in major economies settles at (or slightly below) trend | BACK TO TARGET<br>Disinflation brings core inflation back to target; no major additional shocks to headline rate | BACK TO NEUTRAL<br>Central banks start cutting rates, going back to historical levels of implied neutral rates | NEUTRAL STANCE<br>No major shift in fiscal stance |
| Scenario 3: Balance sheet recession 10% | DEEP RECESSION<br>DM and some EM economies see deep and prolonged recessions lasting through to year-end as serious default cycles take hold in corporates with vulnerable sovereigns also under pressure | REVERSAL OF INFLATIONARY TRENDS<br>Inflation reverses as debt deleveraging takes hold | SHARP PIVOTS FROM KEY CENTRAL BANKS<br>Central banks keep rates higher for too long and pivot too late. Lumpy transmission of monetary policy inadvertently triggers deleveraging | CONSTRAINED STIMULUS<br>Fiscal policy kicks in when growth outcomes become very painful, although monetary policy will still be the main backstop |
| Scenario 4: No landing 10% | CONTINUED RESILIENCE<br>Resilience in US growth continues and Europe's current slowdown reverses | ABOVE TARGET STICKY INFLATION<br>Following initial disinflation, core inflation remains sticky, settling 1-2 percentage points above central bank targets | HIGHER FOR LONGER<br>With resilient growth and Fed policy makers psychologically scarred by the 2021 experience, policy rates continue to be nudged up. Belated acceptance that neutral rate (R*) has risen | NEUTRAL TO MILDLY RESTRICTIVE<br>Divided government in Washington takes additional stimulus off the table – GOP control of Congress would inject a slow negative drag. In Europe, peripheral economies forced to retrench given negative debt dynamics |

*Source: Fidelity International*

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They justify the favoured relatively bearish outlook by looking at business activity trackers, a $2tn estimated drawdown in personal savings through 2022 and 2023 and by easing in their own US Labour Market Tightness Indicator, which usually predates a recession.

Fidelity also offers a simple analysis of their favoured asset classes depending on the scenario:

*Fidelity Favoured Asset Classes*

| | US Equities: Size matters | Style: Prefer quality | Inflation-linkage: Keep it real | Look for value | Opportunities have emerged |
|---|---|---|---|---|---|
| Scenario 1: **Cyclical recession** 60% | ++ US Mid-Caps<br>-- US Small-Caps | ++ Defensive EM: India, Asean<br>++ Select EM Fixed Income | ++ 'Low Vol', 'High Quality' Equity<br>+ IG credit, Government Bonds<br>-- Low-Quality Credit | ++ All Treasuries | ++ Liquid Alternatives: Renewables/ Infrastructure<br>++ Transition Materials (e.g. copper, uranium)<br>++ Chinese Consumer Equities |
| Scenario 2: **Soft landing** 20% | ++ US Mid-Caps | ++ Cyclical EM: North Asia, LatAm<br>++ EM Local Currency Debt | ++ High Quality HY Credit<br>- Government Bonds | + Inflation-Linked | |
| Scenario 3: **Balance sheet recession** 10% | -- US Small-Caps | ++ EM Investment Grade UST Bonds<br>+ High Quality Hedged EM Sovereign Debt | ++ 'Low Vol', 'High Quality' Equity<br>++ Government Bonds<br>-- Low-Quality Credit | ++ Nominal Bonds | ++ Japanese Yen |
| Scenario 4: **No landing** 10% | ++ US Mid-Caps<br>-- US Mega-Cap / Growth | ++ Cyclical EM: North Asia, LatAm<br>++ Select EM Currencies | ++ HY Credit<br>-- Government Bonds | ++ Inflation-Linked<br>-- Nominal Bonds | ++ Transition Materials (e.g. copper, uranium)<br>++ Chinese Consumer Equities<br>++ European and Japanese Banks |

Notes: '+' is a positive view; '-' is negative, reflects current positioning for each scenario at the start of 2024.
Source: Fidelity International, October 2023.

*Source: Fidelity International*

In their recession scenarios, all sectors look negative except consumer staples, utilities and real estate which are flat or positive.

**Goldman Sachs Asset Management**

Goldman Sachs Asset Management (GSAM) focuses on a few key themes for 2024.

In Fixed Income, they suggest that "Bonds are Back but Focus on Quality." Investors can earn 4-6% yield lending to high-quality companies, twice the 2009-2019 average, while they believe fundamentals in the US investment grade corporate credit market remain healthy.

They like disruptive technology, and believe that AI, Software, Healthcare, and Biotech hold promise:





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“When beta is less likely to drive returns, alpha generation becomes even more critical. Allocations to selected large-, mid-, and small-cap technology names may be able to find secular winners underappreciated by the broader market...

“Large pharmaceutical and biotech companies are outsourcing some core business functions...

In public markets, biotech has sold off indiscriminately, back to valuation levels not seen in 15 years. The number of small-cap biotech companies trading below balance sheet cash creates M&A targets for acquirers.

“Potential sustainable investment returns are...increasingly competitive. Transition and ‘improver’ funds are providing capital and financial incentives for high-carbon industry leaders to step up decarbonization efforts. Clean tech companies are compelling, particularly given the pull-back in valuations this year.”

GSAM is also promoting private equity and credit – fees are obviously a consideration.

**Goldman Sachs Economics**

Main points to take away:

- Inflation nearing target, no imminent US recession, but markets already priced for soft-ish landing.
- A benign growth backdrop in most places, but US looks to be the “surest thing.”
- Higher rates cause ongoing stress for some sovereigns and pockets of corporate and consumer sectors.
- Duration more attractive for portfolios.
- Equity valuations not uniformly stretched, potential upside if rates fall earlier.

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**The outlook for Bank of America continues to deteriorate (from JustDario via X)...**

While digging into $BAC's Q4-23 financial statements, I couldn't help but wonder if they had lost their minds during the last three months of 2023.

No, I am not referring to the "press release" or the "presentation," which are usually prepared to "feed" the media rather than provide transparency to the shareholders.

Hidden in plain sight within $BAC's "real" financial statements PDF are some incredible golden eggs that the press predictably overlooked.

GOLDEN EGG #1 - In Q4, $BAC's net increase of provisions for Credit Losses related to Commercial Real Estate was... ZERO!

Please examine the highlighted part in Picture 1. As you can see, the amount of allowances for credit losses related to Commercial Real Estate DECREASED from $1,393m in Q3-23 to $1,342m in Q4.

**Bank of America Corporation and Subsidiaries**

**Allocation of the Allowance for Credit Losses by Product Type**

(Dollars in millions)

| | December 31, 2023 | | September 30, 2023 | | December 31, 2022 | |
|---|---|---|---|---|---|---|
| | Amount | Percent of Loans and Leases Outstanding [1] | Amount | Percent of Loans and Leases Outstanding [1] | Amount | Percent of Loans and Leases Outstanding [1] |
| **Allowance for loan and lease losses** | | | | | | |
| Residential mortgage | $ 339 | 0.15% | $ 344 | 0.15% | $ 328 | 0.14% |
| Home equity | 47 | 0.19 | 68 | 0.27 | 92 | 0.35 |
| Credit card | 7,346 | 7.19 | 6,987 | 7.01 | 6,136 | 6.57 |
| Direct/Indirect consumer | 715 | 0.69 | 671 | 0.64 | 585 | 0.55 |
| Other consumer | 73 | n/m | 97 | n/m | 96 | n/m |
| **Total consumer** | 8,520 | 1.85 | 8,167 | 1.78 | 7,237 | 1.59 |
| U.S. commercial [2] | 2,600 | 0.69 | 2,764 | 0.74 | 3,007 | 0.80 |
| Non-U.S. commercial | 842 | 0.68 | 918 | 0.74 | 1,194 | 0.96 |
| Commercial real estate | 1,342 | 1.84 | 1,393 | 1.90 | 1,192 | 1.71 |
| Commercial lease financing | 38 | 0.26 | 45 | 0.33 | 52 | 0.38 |
| **Total commercial** | 4,822 | 0.82 | 5,120 | 0.87 | 5,445 | 0.93 |
| **Allowance for loan and lease losses** | 13,342 | 1.27 | 13,287 | 1.27 | 12,682 | 1.22 |
| **Reserve for unfunded lending commitments** | 1,209 | | 1,353 | | 1,540 | |
| **Allowance for credit losses** | $ 14,551 | | $ 14,640 | | $ 14,222 | |
| **Asset Quality Indicators** | | | | | | |
| Allowance for loan and lease losses/Total loans and leases [1] | | 1.27% | | 1.27% | | 1.22% |
| Allowance for loan and lease losses/Total nonperforming loans and leases | | 243 | | 275 | | 333 |
| Ratio of the allowance for loan and lease losses/Annualized net charge-offs | | 2.82 | | 3.60 | | 4.64 |

[1] Ratios are calculated as allowance for loan and lease losses as a percentage of loans and leases outstanding excluding loans accounted for under the fair value option. For fair value option amounts, see Outstanding Loans and Leases and related footnotes on page 25.
[2] Includes allowance for loan and lease losses for U.S. small business commercial loans of $1.0 billion, $983 million and $844 million at December 31, 2023, September 30, 2023 and December 31, 2022, respectively.
n/m = not meaningful

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Seemingly unbelievable, right? Has nobody at $BAC read the #WSJ, #CNBC, or at least the Onion reports about shopping malls and office buildings being dumped at a 50-75% loss in the US? Well, even if they haven't, their accountant should have a chat with their own credit risk department. Why?

GOLDEN EGG #2 - While $BAC doesn't expect an increase in #CRE losses, they reported a 43% increase of Non-Performing Loans for their #CRE exposure [Picture 2]

**Bank of America Corporation and Subsidiaries**

**Nonperforming Loans, Leases and Foreclosed Properties**

(Dollars in millions)

| | December 31 2023 | September 30 2023 | June 30 2023 | March 31 2023 | December 31 2022 |
|---|---|---|---|---|---|
| Residential mortgage | $ 2,114 | $ 2,185 | $ 2,140 | $ 2,125 | $ 2,167 |
| Home equity | 450 | 479 | 482 | 488 | 510 |
| Direct/Indirect consumer | 148 | 128 | 107 | 101 | 77 |
| Total consumer | 2,712 | 2,792 | 2,729 | 2,714 | 2,754 |
| U.S. commercial | 636 | 561 | 476 | 559 | 553 |
| Non-U.S. commercial | 175 | 102 | 84 | 125 | 212 |
| Commercial real estate | 1,927 | 1,343 | 816 | 502 | 271 |
| Commercial lease financing | 19 | 18 | 6 | 4 | 4 |
| | 2,757 | 2,024 | 1,382 | 1,190 | 1,040 |
| U.S. small business commercial | 16 | 17 | 15 | 14 | 14 |
| Total commercial | 2,773 | 2,041 | 1,397 | 1,204 | 1,054 |
| Total nonperforming loans and leases | 5,485 | 4,833 | 4,126 | 3,918 | 3,808 |
| Foreclosed properties [1] | 145 | 160 | 148 | 165 | 170 |
| **Total nonperforming loans, leases, and foreclosed properties**[2, 3] | $ 5,630 | $ 4,993 | $ 4,274 | $ 4,083 | $ 3,978 |
| | | | | | |
| Fully-insured home loans past due 30 days or more and still accruing | $ 527 | $ 523 | $ 525 | $ 580 | $ 627 |
| Consumer credit card past due 30 days or more and still accruing | 2,419 | 2,097 | 1,811 | 1,674 | 1,505 |
| Other loans past due 30 days or more and still accruing | 2,974 | 2,848 | 2,920 | 3,146 | 4,008 |
| **Total loans past due 30 days or more and still accruing** [4, 5] | $ 5,920 | $ 5,468 | $ 5,256 | $ 5,400 | $ 6,140 |
| | | | | | |
| Fully-insured home loans past due 90 days or more and still accruing | $ 252 | $ 265 | $ 288 | $ 338 | $ 368 |
| Consumer credit card past due 90 days or more and still accruing | 1,224 | 1,016 | 896 | 828 | 717 |
| Other loans past due 90 days or more and still accruing | 280 | 286 | 356 | 508 | 626 |
| **Total loans past due 90 days or more and still accruing** [5] | $ 1,756 | $ 1,567 | $ 1,540 | $ 1,674 | $ 1,711 |
| | | | | | |
| Nonperforming loans, leases and foreclosed properties/Total assets [6] | 0.18 % | 0.16 % | 0.14 % | 0.13 % | 0.13 % |
| Nonperforming loans, leases and foreclosed properties/Total loans, leases and foreclosed properties [5] | 0.54 | 0.48 | 0.41 | 0.39 | 0.38 |
| Nonperforming loans and leases/Total loans and leases [6] | 0.52 | 0.46 | 0.39 | 0.38 | 0.37 |
| | | | | | |
| Commercial reservable criticized utilized exposure [7] | $ 23,300 | $ 23,722 | $ 21,469 | $ 19,789 | $ 19,274 |
| Commercial reservable criticized utilized exposure/Commercial reservable utilized exposure [6] | 3.74 % | 3.83 % | 3.44 % | 3.17 % | 3.12 % |
| Total commercial criticized utilized exposure/Commercial utilized exposure [7] | 4.00 | 4.12 | 3.79 | 3.67 | 3.70 |

(1) Includes repossessed assets of $22 million and $20 million for the fourth and third quarters of 2023 and $0 for the remaining quarters.
(2) Balances do not include past due consumer credit card, consumer loans secured by real estate where repayments are insured by the FHA and individually insured long-term stand-by agreements (fully-insured home loans), and in general, other consumer and commercial loans not secured by real estate.
(3) Balances do not include nonperforming loans held-for-sale of $161 million, $173 million, $174 million, $250 million and $219 million at December 31, 2023, September 30, 2023, June 30, 2023, March 31, 2023 and December 31, 2022, respectively.
(4) Balances do not include loans held-for-sale past due 30 days or more and still accruing of $72 million, $22 million, $39 million, $36 million and $58 million at December 31, 2023, September 30, 2023, June 30, 2023, March 31, 2023 and December 31, 2022, respectively.
(5) These balances are excluded from total nonperforming loans, leases and foreclosed properties.
(6) Total assets and total loans and leases do not include loans accounted for under the fair value option of $3.6 billion, $4.3 billion, $4.3 billion, $4.4 billion and $5.8 billion at December 31, 2023, September 30, 2023, June 30, 2023, March 31, 2023 and December 31, 2022, respectively.
(7) Criticized exposure corresponds to the Special Mention, Substandard and Doubtful asset categories defined by regulatory authorities. The reservable criticized exposure excludes loans held-for-sale, exposure accounted for under the fair value option and other nonreservable exposure.

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GOLDEN EGG #3 - While EVERY category of Non-Performing Loans balances increased from Q3 to Q4, and all other banks that reported last Friday INCREASED their allowance for credit losses from Q3 to Q4, $BAC's total allowance for credit losses DECREASED to $1,104m in Q4 from $1,253m in Q3.

Consistent with its view of an (Ultra) "Soft Landing" ahead, it should surprise no one that $BAC placed a big bet in Q4.

GOLDEN EGG #4 - In Q4, $BAC bought $74.4bn more of US Treasuries! [Picture 3]

**Bank of America Corporation and Subsidiaries**

**Debt Securities**

(Dollars in millions)

| | December 31, 2023 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| **Available-for-sale debt securities** | | | | |
| Mortgage-backed securities: | | | | |
| Agency | $ 39,195 | $ 37 | $ (1,420) | $ 37,812 |
| Agency-collateralized mortgage obligations | 2,739 | 6 | (201) | 2,544 |
| Commercial | 10,909 | 40 | (514) | 10,435 |
| Non-agency residential | 449 | 3 | (70) | 382 |
| Total mortgage-backed securities | 53,292 | 86 | (2,205) | 51,173 |
| U.S. Treasury and government agencies | 179,108 | 19 | (1,461) | 177,666 |
| Non-U.S. securities | [illegible] | 27 | (20) | 22,875 |
| Other taxable securities | 4,910 | 1 | (76) | 4,835 |
| Tax-exempt securities | 10,304 | [illegible] | (221) | 10,100 |
| **Total available-for-sale debt securities** | 270,482 | [illegible] | (3,983) | 266,649 |
| **Other debt securities carried at fair value** [1] | 10,202 | 56 | (55) | 10,203 |
| **Total debt securities carried at fair value** | 280,684 | 206 | (4,038) | 276,852 |
| **Held-to-maturity debt securities** | | | | |
| Agency mortgage-backed securities | 465,456 | — | (78,930) | 386,526 |
| U.S. Treasury and government agencies | 121,645 | — | (17,963) | 103,682 |
| Other taxable securities | 7,490 | — | (1,101) | 6,389 |
| **Total held-to-maturity debt securities** | 594,591 | — | (97,994) | 496,597 |
| **Total debt securities** | $ 875,275 | $ 206 | $ (102,032) | $ 773,449 |
| | September 30, 2023 | | | |
| **Available-for-sale debt securities** | | | | |
| Mortgage-backed securities: | | | | |
| Agency | $ 22,435 | $ — | (1,931) | $ 20,504 |
| Agency-collateralized mortgage obligations | 1,964 | — | (266) | 1,698 |
| Commercial | 7,309 | 4 | (582) | 6,741 |
| Non-agency residential | 452 | 3 | (68) | 387 |
| Total mortgage-backed securities | 32,160 | 17 | (2,847) | 29,330 |
| U.S. Treasury and government agencies | 104,828 | 6 | (1,198) | 103,636 |
| Non-U.S. securities | [illegible] | 18 | (47) | 18,872 |
| Other taxable securities | 3,271 | 1 | (93) | 3,179 |
| Tax-exempt securities | 10,965 | — | (372) | 10,593 |
| **Total available-for-sale debt securities** | 170,125 | 42 | (4,557) | 165,610 |
| **Other debt securities carried at fair value** [1] | 9,933 | 56 | (59) | 9,930 |
| **Total debt securities carried at fair value** | 180,058 | 98 | (4,616) | 175,540 |
| **Held-to-maturity debt securities** | | | | |
| Agency mortgage-backed securities | [illegible] | — | (106,890) | 367,210 |
| U.S. Treasury and government agencies | 121,633 | — | (23,351) | 98,282 |
| Other taxable securities | 7,632 | — | (1,363) | 6,269 |
| **Total held-to-maturity debt securities** | 603,365 | — | (131,604) | 471,761 |
| **Total debt securities** | $ 783,423 | $ 98 | $ (136,220) | $ 647,301 |

[1] Primarily includes non-U.S. securities used to satisfy certain international regulatory requirements.

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So effectively, despite $100bn+ of “paper losses” already spread between its Available For Sale and Hold To Maturity books, $BAC “doubled down” betting rates have peaked and increased its overall exposure to US Treasuries to $300bn (cost basis) or +25% vs Q3.

Oh dear, in which direction did rates go so far in 2024? I believe now you understand why I see no chance the #FED will let the #BTFP expire in March (otherwise $BAC “paper losses” will instantly become frightful “losses”).

- Conclusion -

As we discussed above, while $BAC clearly perceives absolutely no risk in the credit market with only ~$14bn of total allowances for credit losses in balance sheet against ~$1.65T of total credit risk (both consumer and commercial segments, including committed but not disbursed corporate credit lines), bankruptcy filings keep increasing with Chapter 11 in the US 76% higher in 2023 than 2022 and expected to continue rising in 2024 [Reuters - Picture 4].

U.S. Markets

**US bankruptcies surged 18% in 2023 and seen rising again in 2024 -report**

**Reuters**

January 4, 2024 5:36 AM GMT+8 · Updated 11 days ago

The bank is clearly betting big that the #FED will deliver a great soft landing that will “wash” away both credit risk and “paper losses” resulting from the increase in rates and weakening economy. However, if the #FED fails $BAC shareholders better be ready for many surprises from a balance sheet that so far is screaming “everything is awesome” while the current reality isn’t really reflecting that.

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**Why the BRICS currencies are not an imminent threat to the U.S. dollar (from the American Institute for Economic Research)...**

BRICS is an acronym for Brazil, Russia, India, China, and South Africa, an intergovernmental organization headquartered in Shanghai. In January 2024, BRICS expanded to include Egypt, Ethiopia, Iran, Saudi Arabia, and the United Arab Emirates. Argentina was on track to join but withdrew its application. BRICS has evolved as a combination of US allies, non-allied nations, and avowed rivals or outright enemies. The one common denominator is that the BRICS nations are not included in the G7: Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States, with the EU being considered a "non-enumerated member" since France, Germany, and Italy are formal members.

BRICS announced the formation of the New Development Bank (NDB) in 2012 to augment lending to member nations. BRICS' perspective was that the World Bank, the IMF, and various other development lenders had failed to lend enough and focused available lending on priorities chosen by the US and other Western countries. The NDB began lending in 2016, particularly emphasizing green and environmentally friendly projects. The BRICS' 2015 summit announced they would explore creating a new reserve currency that they would use in preference to the dollar.

What is a reserve currency, and how did the dollar come to be one? Under the gold standard, virtually all payments for international trade were made in gold coin, making a reserve currency irrelevant. Nations often suspended the gold standard during times of conflict. The US, for example, went off in 1861 and was unable to resume until 1879. Most international payments still had to be made either in gold or equivalently in some gold-backed currency. During the First World War, virtually all belligerents went off the gold standard, but the US was an exception since it did not join the war until April 1917. By 1920 the dollar was replacing the British pound as a reserve currency. The dollar remained the reserve currency of choice through the Great Depression, even though it was devalued significantly in 1934 because all potential alternatives were performing even worse.

At the end of the Second World War, the 1944 Bretton Woods Conference envisioned the US remaining on a tenuous gold standard — the dollar had been legally defined as 1/35th of a gold ounce since 1935, even though since 1932 the dollar had not been convertible to gold. Under the Bretton Woods system, other countries would define their currency in terms of the dollar, which would put them on a technical and legal gold standard, but without any expectation of convertibility. Other countries could and did devalue at will, changing their dollar exchange rate. Devaluing made their exports cheaper for Americans to buy while protecting domestic industries from US imports that devaluation made more expensive.





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After about twenty years under the Bretton Woods system, the dollar faced the fiscal pressure of government budget deficits from President Johnson's Great Society programs and the Vietnam War. The last link to gold was lost in 1973 when President Nixon had the Treasury stop selling gold to foreign governments for $35 per troy ounce. The dollar persisted as a reserve currency largely because it generally depreciated more slowly than alternatives. The best candidates for alternative low-inflation, sound-money reserve currencies were the Deutsche Mark, the Japanese Yen, and the Swiss Franc. The Mark and its successor the Euro, have had some traction as an alternative to the dollar. The Yen outperformed the dollar in terms of retaining value until about 1990 when the Bank of Japan started to listen to American academic economists who counseled more inflationary policies. The Swiss Franc continues to be a better store of value than the dollar, but never became a reserve currency because it is not as widely used in world trade.

BRICS would have a strong case for replacing the dollar with a reserve currency of their own, except that the performance of their currencies has generally been even worse than the dollar as shown in Figure 1.

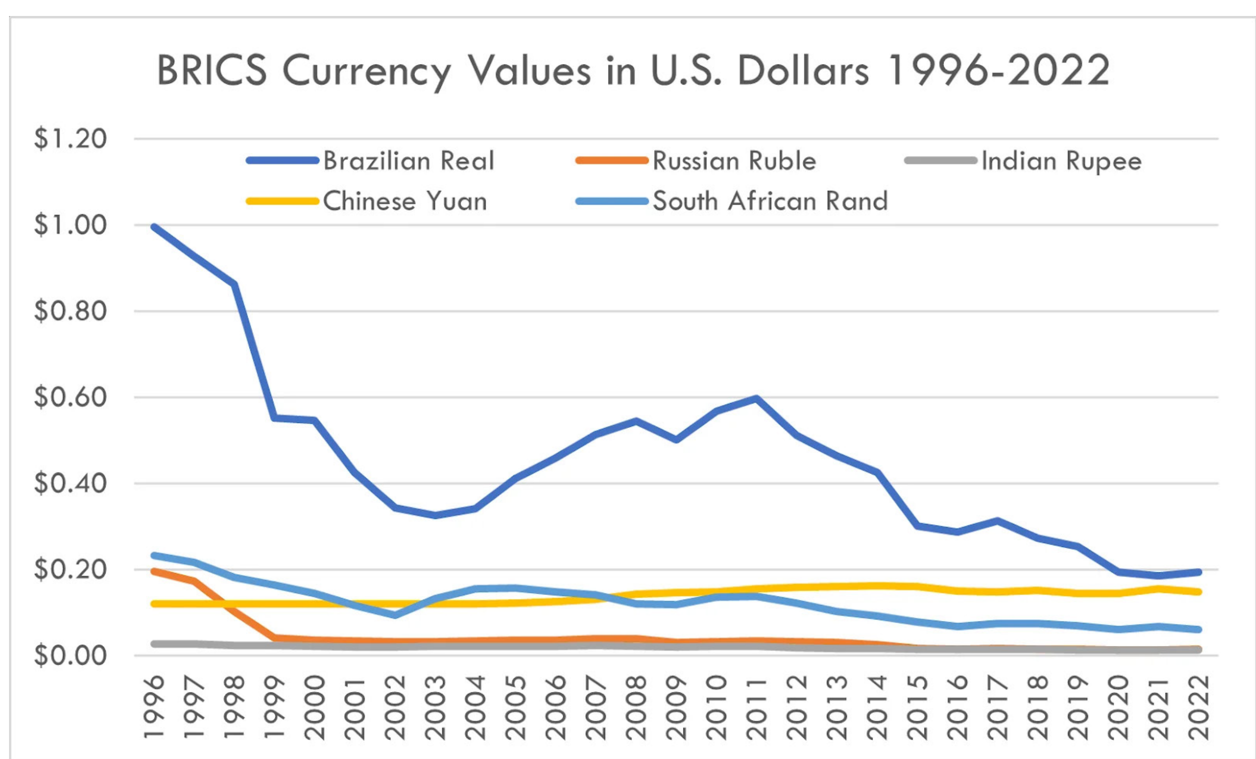


*Figure 1. BRICS Currency Values 1996-2022*
*(Exchange rates from the World Bank)*

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The ruble, rand, and real have all depreciated quite significantly against the dollar since 1996, but keep in mind that the dollar itself has depreciated markedly over the same period. This can be seen by comparing each currency's performance against gold since the end of the Great Recession in 2014. Taking the 2014 gold value of each currency as 100 percent, all have performed significantly worse than the dollar as shown in Figure 2. The dollar has been no great shakes but it beats the BRICS currencies.

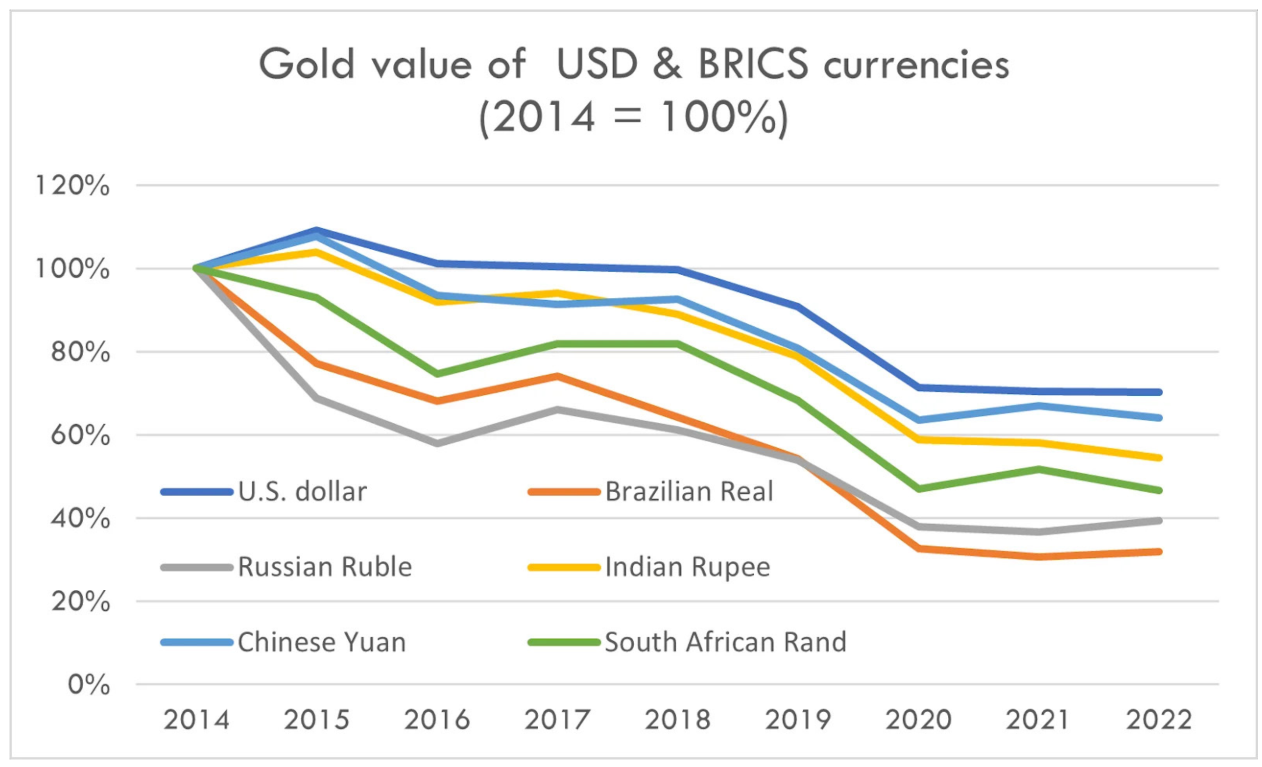


*Figure 2. Performance of the dollar and BRICS currency in terms of gold 2014-2022 (Gold prices from Macrotrends, exchange rates from the World Bank)*

The noise from BRICS about creating their own reserve currency and abandoning the dollar is little more than noise. As irresponsible as the Fed has been, BRICS policymakers apparently want to inflate faster than even the Fed will allow. They do so at their own risk. At least some BRICS nations could potentially outpace the G7 in growth and performance, but not by adopting monetary policies that are even more value-destroying than those of the European Central Bank and the Fed.





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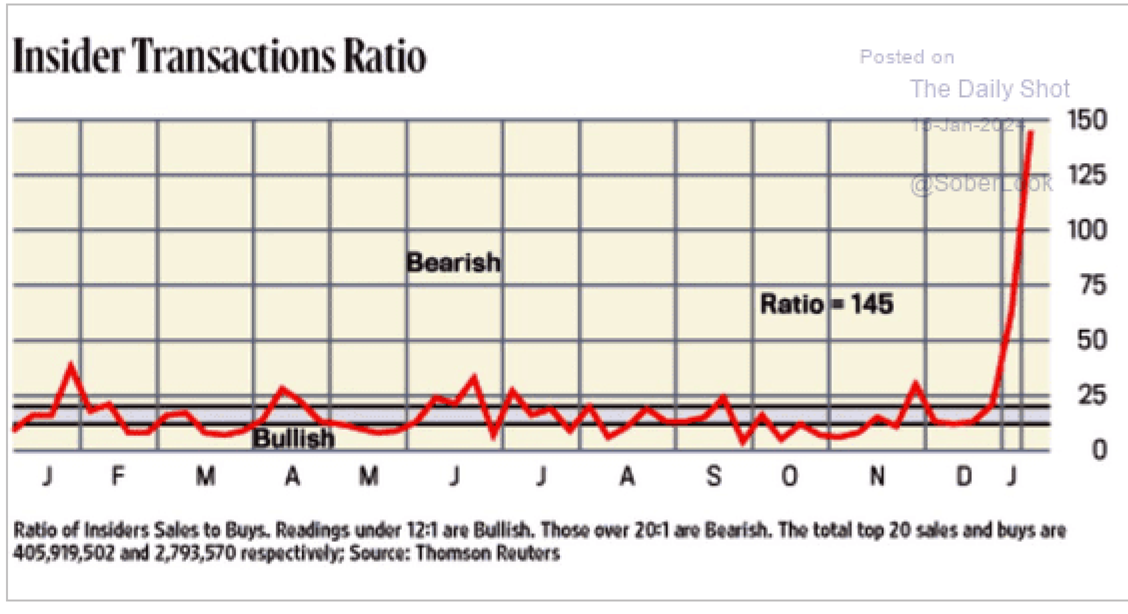
**Corporate insiders appear quite nervous (from The Daily Shot)...**



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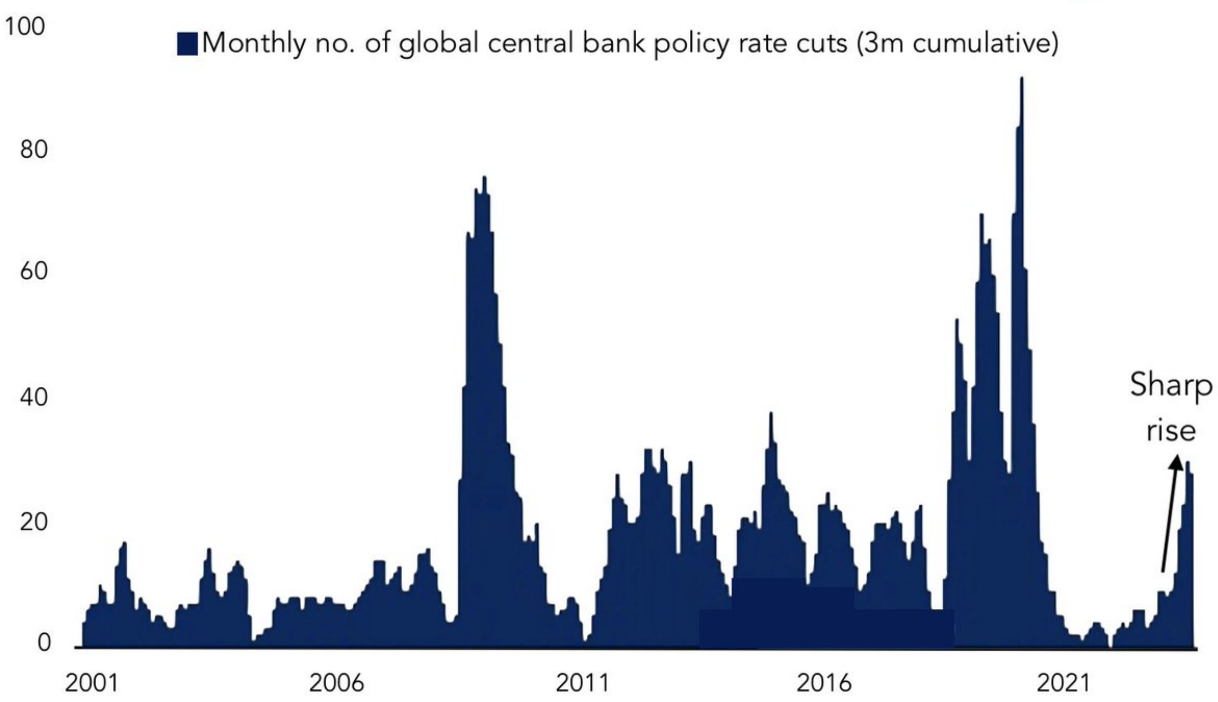
**A global easing cycle is expected to begin this year (from Game of Trades via X)...**

After an aggressive tightening cycle, 152 central banks around the world expect to cut rates in 2024, including the Fed.

Based on history, rate cuts are NOT bullish for the US stock market.

152 Global Central Banks Expect to Cut Rates in 2024




Source: BofA Global Investment Strategy, Bloomberg, Game of Trades.





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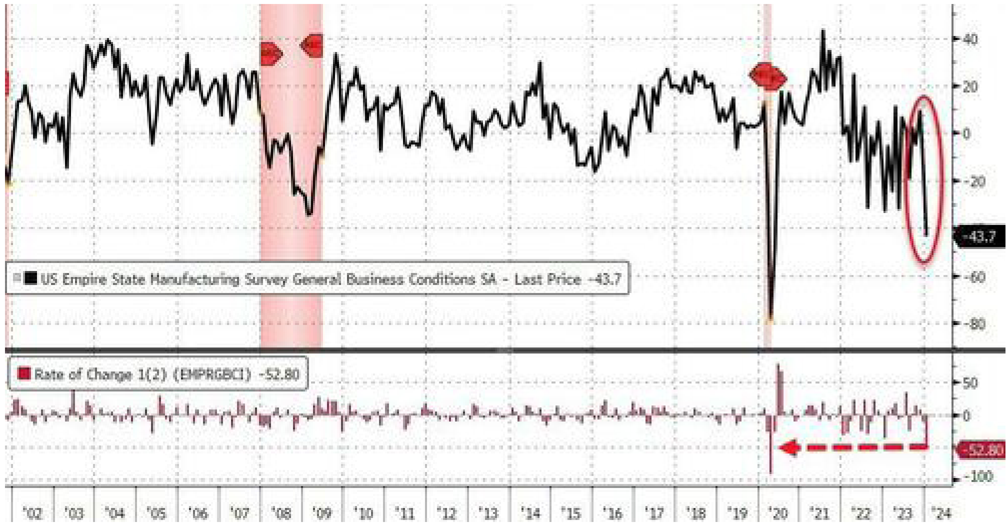
**The New York Fed's manufacturing index collapsed this month (from Zero Hedge)...**

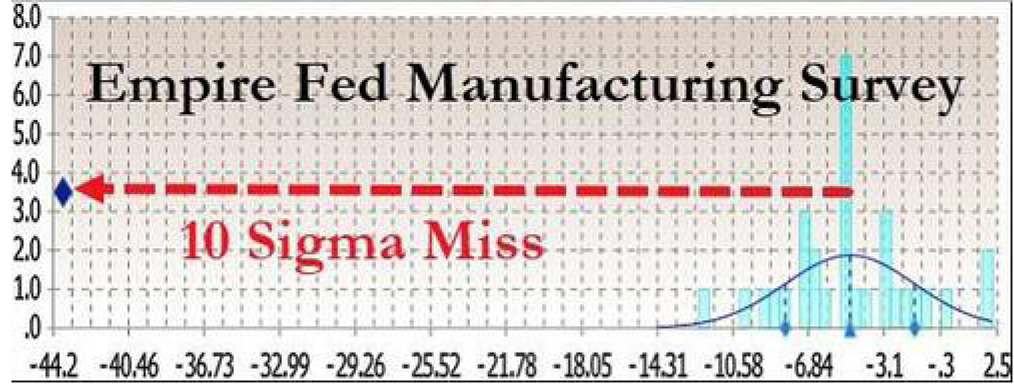
Well, no one saw that coming...

The New York Fed's Empire State Manufacturing Survey for January crashed from -14.5 to -43.7 - the worst print in the survey's history outside of the COVID lockdowns...




*Source: Bloomberg*

The -43.7 print was a stunning 10 standard deviations below expectations of a bounce to -5.0...




*Source: Bloomberg*

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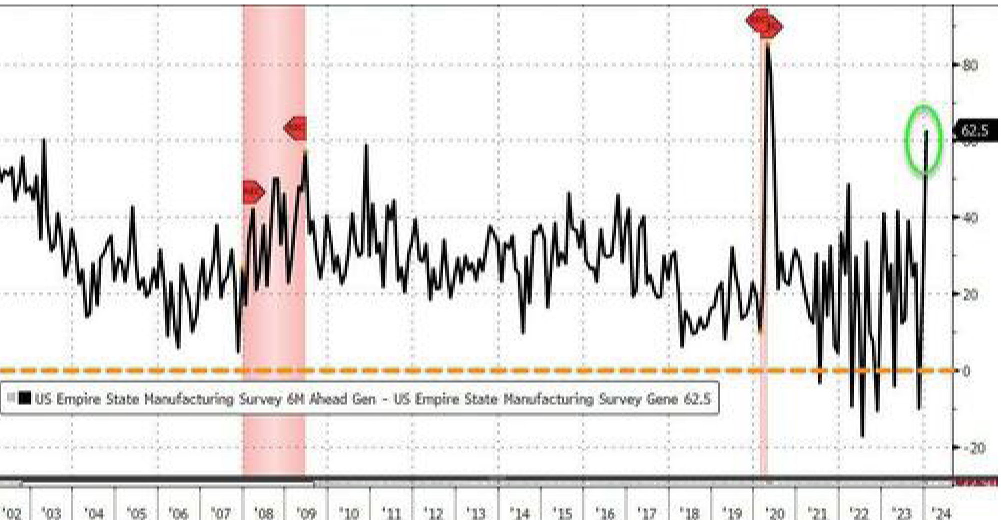
Under the hood, it was a bloodbath. **New orders slumped** more than 38 points to minus 49.4, the weakest since April 2020, while **shipments dropped** by the most since August. Worse still, the index of **prices paid for materials increased** to a three-month high.

But hope remains high as **the six-month outlook for overall activity improved to a three-month high,** suggesting manufacturing will stabilize at a weak level. The measure of the outlook for capital expenditures increased to the highest since April 2023, suggesting a pickup in investment.

However, the spread between current reality and a hopeful future is at near record highs (record Ex-COVID-lockdowns)...




*"Bidenomics" for the win...*





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**The Fed's media "mouthpiece" hints that the end of quantitative tightening (QT) is near (from Zero Hedge)...**

On December 13 the financial world was stunned when, just two weeks after Jerome Powell had said he it was ***"premature" to speculate on rate cuts,*** the Federal Reserve did a shocking U-turn and pivoted dovishly, ending the Fed's hiking cycle with inflation still running at double the Fed's target of 2%, and said that it had in fact discussed the start of rate cuts...

US Fed Chair Says 'Premature' To Speculate On Rate Cuts

By AFP - Agence France Presse December 1, 2023

Fed Policymakers Discussed Timeline To Start Rate Cuts: Powell

By AFP - Agence France Presse December 13, 2023

Or rather, we should say "the financial world that had not read Zero Hedge was stunned" because just one week ahead of the Fed's December FOMC meeting, we correctly predicted the Fed's pivot due to one simple reason: as we laid out in "*The Canary Just Died: Sudden Spike In SOFR Hints At Mounting Reserve Shortage, Early Restart Of QE*", the Fed no longer had a choice and was forced to pursue a dovish pivot because the liquidity in the all-important systemic and interbank plumbing had hit dangerously low levels, resulting in the highest SOFR print on record, and the biggest spike since the last time there was a repo market crisis in March 2020.

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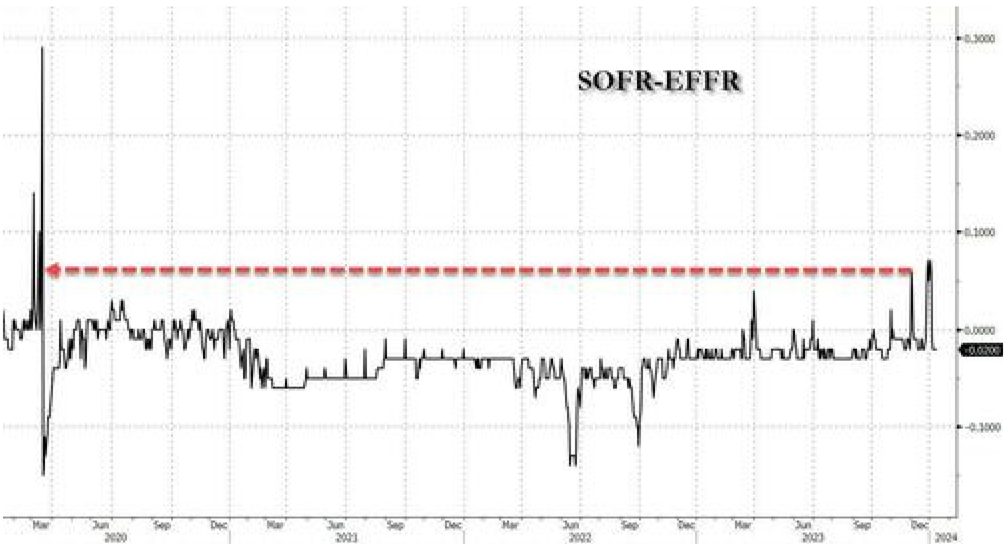


As we said at the time, "the spike caught almost everyone by surprise, even such Fed-watching luminaries as BofA's Marc Cabana because it was with "no new UST settlements, lower repo volumes, and lower sponsored bi-lateral volumes." And yet, the spike was clearly there and ominously it was consistent "*with the slow theme of less cash & more collateral in the system"* **-** i.e., **growing reserve scarcity -** and "may have been exacerbated by elevated dealer inventories, bi-lateral borrowing need, and limited excess cash to backstop repo."

And the punchline: **"If funding pressure persists, it risks Fed re-assessment of ample banking system reserves & potential early end to QT", and depending on how bad the funding shortage gets, an early restart of QE.**

One week later, the Fed capitulated on tight monetary policy and ushered in the era of rate cuts, just as we said it would. But more importantly, one month later it was Dallas Fed president (and former head of the NY Fed's plunge protection team) Lorie Logan who said the quiet part out loud when she confirmed our "canary in the coalmine" note, namely that the Fed's QT is effectively over due to the sudden, unexpected slide in systemic liquidity, primarily due to the rapid drain in the reverse repo facility which now has just $600 million left and is set to be fully drained some time in March...





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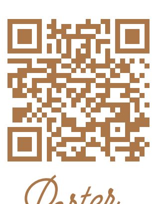
... and that by extension, another round of QE may be on deck.

Of course, it's one thing for a regional Fed president to opine on such things, it's something entirely different for Powell's preferred media leak conduit to confirm it, and yet this morning that's precisely what happened when Nick Timiraos, aka *Nikileaks*, aka Powell's favorite media mouthpiece confirmed that QT's days are now numbered writing that "***Fed officials are to start deliberations on slowing, though not ending, that so-called quantitative tightening as soon as their policy meeting this month. It could have important implications for financial markets.***"





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If that wasn't enough, Nikileaks also confirms our suspicion about the driver behind said QT runoff: the financial plumbing is starting to clog up:

> But whereas the Fed expects to cut short-term interest rates this year because inflation has fallen, **its rationale for tapering bond runoff is different: to prevent disruption to an obscure yet critical corner of the financial markets.**
>
> Five years ago, balance-sheet runoff sparked upheaval in those markets, forcing a messy U-turn. Officials are determined not to do that again.
>
> Several officials at the Fed's policy meeting last month suggested beginning formal conversations soon, so as to communicate their plans to the public well before any changes take effect, according to minutes of the meeting. Officials have indicated that changes aren't imminent and that they are focusing on slowing—not ending—the program.

As we first explained almost two months ago, the reason for the Fed's panic is that the central bank wants to avoid the same repo market cataclysm that market both the liquidity drain in Sept 2019 and the violent eruption in basis trades that sparked bond market contagion in March 2020; here is Timiraos confirming as much:

> ... in September 2019, a sharp, unexpected spike in a key overnight lending rate suggested reserves had windled to the point they were either too scarce or difficult to redistribute across the financial system. The Fed began buying Treasury bills to add reserves back to the system and avoid further instability.
>
> In 2020, the Covid-19 pandemic created a huge dash for dollars. To prevent markets from seizing up, the Fed resumed buying huge quantities of securities. It stopped buying in March 2022 and three months later set the process into reverse, once again shrinking the portfolio.

... which brings us to today, when the Fed did the math and realized that doing $60BN in QT per month once the reverse repo is fully drained will crash the market:

> Policymakers have several reasons to consider slowing runoff. First, the Fed is shrinking its Treasury holdings by $60 billion a month—twice as fast it did five years ago. Continuing to run at this rate raises the risk that the Fed drains reserves so quickly that money-market rates jump as banks struggle to redistribute a dwindling supply of reserves.
>
> Slowing the pace of the runoff later this year might allow the Fed to continue the program for longer than otherwise by "**reducing the likelihood that we'd have to stop prematurely**," Dallas Fed President Lorie Logan said in a recent speech.





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And by "stop prematurely" she of course means suffering a market crash in an election year, one which would drag the economy into a recession in days. And we all know by now (thanks to former NY president Bill Dudley) that is unacceptable, especially when the alternative is a Trump presidency.

Timiraos also confirms that we were right in cautioning that ***it's all about the accelerating rate of decline in the reverse repo facility***:

> **there are signs that the cash surplus in money markets is rapidly diminishing.** The Fed allows money-market firms and others to park extra cash that would otherwise end up in reserves in an overnight reverse repurchase facility. The facility has shrunk by around $1 trillion since late August to around $680 billion. Logan endorsed slowing runoff once that facility is nearly drained of cash because, after that, forecasting demand for bank reserves will be more uncertain.

This "faster-than-expected decline" in the overnight reverse repurchase facility's balances is spurring the Fed's movement toward contingency planning around how to slow runoff:

*"It has been a surprise to everyone that overnight reverse repurchase balances have fallen this quickly and that reserves have actually increased over this period,"* said Brian Sack, who managed the Fed's Plunge Protection Team at the New York Fed from 2009 to 2012.

Continue reading here.

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**Javier Milei – the newly elected libertarian president of Argentina – gave a jaw-dropping speech at the annual meeting of the World Economic Forum in Davos, Switzerland, earlier this month. Here are the highlights (from Milei Explains via X)...**

**Milei in Davos 2024: Summary in 20 quotes**

1: "Today I am here to tell you that the western world is in danger, and it's in danger because those who are supposed to defend the values of the west are co-opted by a vision of the world that inexorably leads to socialism, and thereby to poverty."

2: "Unfortunately, in recent decades, motivated by some well-meaning individuals willing to help others, and others motivated by the desire to belong to a privileged class, the main leaders of the western world have abandoned the model of freedom for different versions of what we call collectivism."

3: "We are here to tell you that collectivist experiments are never the solution to the problems that afflict the citizens of the world, rather they are the root cause."

4: "The problem with neoclassical (economists) is the model they love so much does not match reality, so they attribute their own mistakes to the supposed market failure, rather than reviewing the premises of their model."

5: "On the pretext of the supposed market failures, regulations are introduced, which only create distortions in the price system, preventing economic calculation, and therefore, also prevent savings, investment, and growth."

6: "Not even supposedly libertarian economists understand what the market is, because if they did understand it, they would quickly see that it's impossible for something along the lines of market failure to exist."

7: "Talking about market failure is an oxymoron, there are no market failures, if transactions are voluntary the only context where it can be a market failure is coercion, and the only one that is able to coerce is the state."

8: "Faced with the theoretical demonstration that state intervention is harmful, and the empirical evidence that it has failed, the solution proposed by the collectivists is not greater freedom but rather greater regulation.

“Greater regulation which creates a downward spiral until we are all poor, and the life of all of us depend on a bureaucrat sitting somewhere in a luxury office."

9: "Given the dismal failure of collectivist models, and the undeniable advances in the free world, socialists were led to change their agenda.





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“They left behind the class struggle based on the economic system, and replaced it with other supposed social conflicts, which are just as harmful to life as a community, and to economic growth."

10: "Today's states don't need to directly control the means of production to control every aspect of the life of individuals. With tools like printing money, debt, subsidies, control of the interest rate, price controls, and regulations to correct the so-called market failures, they can control the lives and fates of millions of individuals."

11: "They say that capitalism is evil because it's individualistic and that collectivism is good because it's altruistic, of course with the money of others."

12: "Those who promote social justice, they advocate the idea that the whole economy is a pie that can be shared in better ways, but that pie is not a fixed given, it's wealth that get generated in what Israel Kirzner for instance calls a Market Discovery Process."

13: "If the state punishes the capitalists when they are successful, and gets in the way of the (Market) Discovery Process, they will destroy their incentives and the consequence is that they will produce less, and the pie will be smaller, and this will harm society as a whole."

14: "Collectivism, by inhibiting the (Market) Discovery Process and hindering the appropriation of discoveries, ends up binding the hands of entrepreneurs and preventing them to provide better goods and services at a better price."

15: "Thanks to free enterprise capitalism, the world is now living its best moment, never in all of mankind's or humanity's history has there been a time of more prosperity than today.

“Today's world is more free, more rich, more peaceful, and more prosperous than in any other time of human history.

“And this is particularly true for those countries that respect economic freedom and the property rights of individuals."

16: "The capitalist, the successful entrepreneur, is a social benefactor, who far from appropriating the wealth of others, contributes to the general well-being of all.

“Ultimately, a successful entrepreneur is a hero."

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17: "Libertarianism is the unrestricted respect for the project of life of others, based on the non-aggression principle, in defense of the right to life, to liberty, and to property.

“With its fundamental institutions being: Private property, markets free from state intervention, free competition, the division of labor, and social cooperation.

“Where you can only be successful by serving others with goods of better quality at a best price."

18: "The impoverishment produced by collectivism is no fantasy, nor it is fatalism, it's a reality that we in Argentina have known very well for at least 100 years."

"We have lived through it, and we are here to warn you about what can happen if the countries in the western world -that became rich through the model of freedom-, stay on this road to serfdom."

19: "We come here today to invite other countries in the western world to return to the path of prosperity.

“Economic freedom, limited government, and the unrestricted respect for private property, are essential elements for economic growth."

20: "In concluding, I would like to leave a message for all entrepreneurs and business people here, and for those who are not here in person but are following from around the world:

Do not be intimidated either by the political caste nor by parasites who live off the state.

Do not surrender yourself to a political class that only wants to perpetuate itself in power and keep their privileges.

You are social benefactors, you are heroes, you are the creators of the most extraordinary period of prosperity we have ever seen.

Let no one tell you that your ambition is immoral.

If you make money, it's because you offer a better product at the best price, thereby contributing to the general well-being.

Do not yield to the advance of the state.

The state is not the solution, the state is the problem itself.

You are the true protagonists of this story.

And rest assured that starting today, you can count on Argentina as an unconditional ally.

Long Live Freedom, Dammit!"

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**Bullish investors may face a "reality check" this year (from Morgan Stanley Wealth Management)...**

The U.S. stock market's lackluster performance to date in 2024 has felt anti-climactic, coming off the dramatic surge at the end of 2023. Still, investors seem confident the U.S. economy will achieve a "soft landing" and the Federal Reserve will successfully tame inflation. As such, the equity market remains complacent, with investors' lofty expectations leaving little room for error.

However, Morgan Stanley's Global Investment Committee continues to see risks. As investors assess this year's potential market outcomes and position their portfolios accordingly, they should ask three key questions.

**1. Will companies deliver on ambitious earnings targets?**

Analysts currently expect a roughly 10% increase in S&P 500 Index company profits in 2024. However, we believe this outlook is overly ambitious. Profit margins appear to have already rebounded toward a pre-COVID peak, which suggests additional profitability gains are unlikely, in the absence of a major positive catalyst, such as technology-driven productivity gains and falling labor costs.

The economy may yet offer more such "gifts" for companies. However, we believe investors should be paying more attention to management skill as company executives deal with challenges such as softening growth in sales volumes, waning pricing power and a need to refinance debt at significantly higher rates.

**2. Will financial conditions continue to support lofty asset valuations?**

Despite rapid Fed rate hikes, financial conditions have remained loose, helping spur the market's recent gains. The reasons for such ample financial liquidity include massive federal deficit spending; regional-bank rescue programs; and powerful global currency dynamics that drew money borrowed from low-yielding currencies, such as the Japanese yen, into higher-yielding U.S. dollar-based assets.

We believe such tailwinds are likely to reverse in 2024, however. The U.S. government's emergency bank term-loan program expires in March, likely draining substantial liquidity from the financial system. Meanwhile, a potentially narrower differential between the U.S. dollar and the yen could direct the flow of investment capital back to Japan and out of the U.S. financial system.

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### 3. Will interest rates decline to pre-COVID levels?

Many U.S. equity investors assume the recent surge in the "real," or inflation-adjusted, 10-year Treasury yield, to about 2%, is temporary. They seem to hope this key rate will ultimately settle around 0.5%, which would support elevated stock valuations. (Generally, government bond yields and stock valuations have an inverse relationship: Lower yields tend to make the future cash flows expected from stocks appear more attractive in widely used pricing models.)

We believe, however, that the current yield level is the new normal, reflecting higher long-term U.S. economic growth and outsized federal deficits. If rates were to stay near the current level, they'd also be in line with the long-term average prior to the 2008 financial crisis, which touched off a decline in rates to ultra-low levels. If and when markets begin to factor in this higher-rates scenario, stock valuations will likely come under pressure.

### Investing in 2024

We believe the time may have passed for investors to make the "easy money" from U.S. stocks recouping their losses in the 2022-2023 bear market. Now, establishing a foundation for a new bull market will require some heavier lifting than what the market currently seems to be anticipating. In the meantime, we expect mid-single-digit returns in U.S. stocks and bonds, with markets likely trading without extreme sustained moves in either direction.

In this environment, we encourage investors to build highly diversified portfolios. Consider actively selecting stocks and bonds, with a focus on areas such as real estate investment trusts (REITs), gold, non-China emerging markets, Japan and hedge funds.





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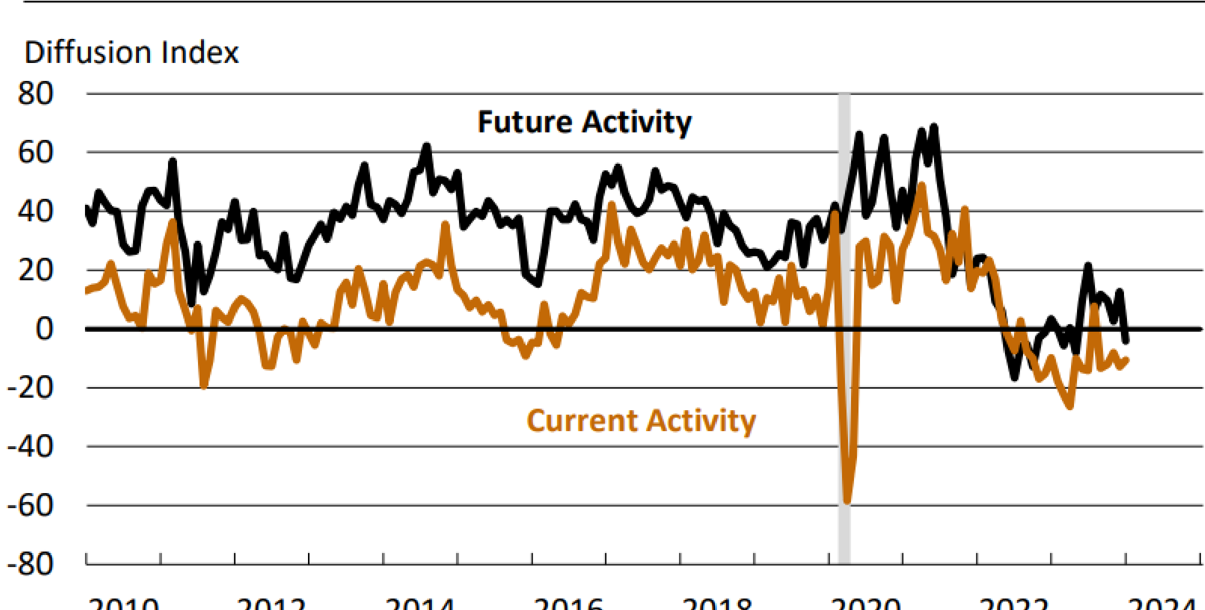
**The Philadelphia Fed manufacturing index also showed significant unexpected weakness this month (from JaguarAnalytics via X)...**

Philly Fed for Jan comes in at -10.6 vs -6.7 estimate and prior month reading revised lower to -12.8 from -10.5 originally.

Contrary to Empire, Philly shows future activity declined from +12.6 in Dec to -4.0 in Jan, lowest since May.

https://philadelphiafed.org/-/media/frbp/assets/surveys-and-data/mbos/2024/bos0124.pdf



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**U.S. regulators are preparing a new rule to force healthy banks to borrow from the Fed's discount window (from The Bitcoin Layer)...**

[In] an absolutely baffling 2008-esque move, Powell and the powers that be seem to want to normalize banks with impaired balance sheets; or at the very least hide them among the healthy ones.

The US is preparing a rule that would force banks to tap the Fed's discount window for emergency loans, even if they don't need one:

01/18/2024 18:21:18 [BN]

US Prepares Rule Forcing Banks to Tap Fed Discount Window (1)

- OCC chief says his agency, Fed and FDIC are crafting plan
- Michael Hsu says idea is to create a 'fire drill' for trouble

By Katanga Johnson

(Bloomberg) -- US regulators are preparing to introduce a plan to require that banks tap the Federal Reserve's discount window at least once a year to reduce the stigma and ensure lenders are ready for troubled times.

The proposal, which is being drafted behind closed doors by the Office of the Comptroller of the Currency, Fed and Federal Deposit Insurance Corp., is the latest response to last year's regional-bank crisis. The turmoil spotlighted that some lenders weren't even set up operationally to quickly borrow from the window in a pinch.

It is aimed to "reduce stigma and ensure lenders are ready for troubled times." That stigma is how other banks know who to avoid, and it can stop balance sheet contagion and therefore limit bank failures. Readying lenders for troubled times is the other reason cited, but is using the discount window really so complicated that it requires all US financial institutions to take out a real loan each year, even when they don't need it?

From the outside looking in, it seems that the Fed is attempting to normalize regular usage of the discount window so when times get rough and banks start using it because they're in a liquidity crunch, it doesn't seem as bad and gets buried in





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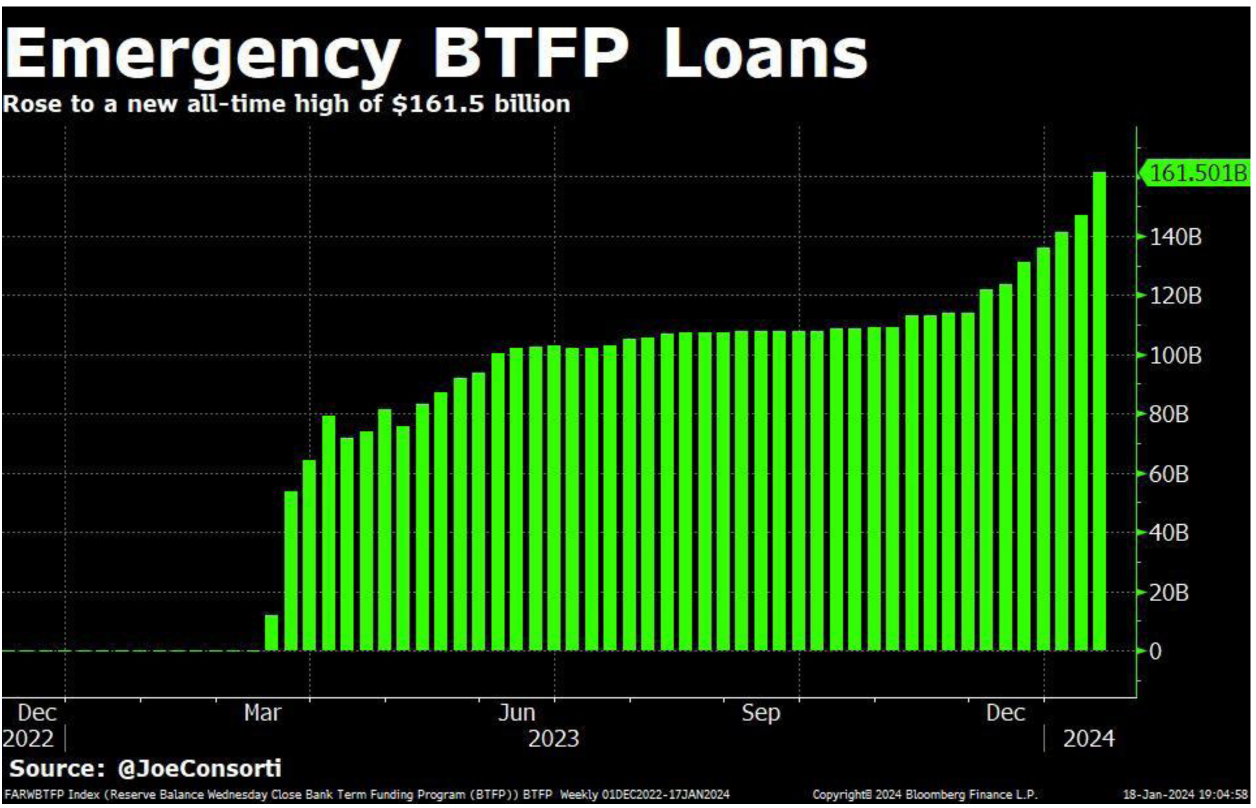
the billions of dollars in 'fire-drill loans' that are forced upon healthy banks. Considering the Fed's measures to limit panic and stop bank runs in their tracks, burying embattled banks in a slew of others following standard procedural drills is curious and has our attention.

Won't this only lead to more recklessness in lending standards? Probably. The Fed has already given banks a sweetheart facility in BTFP, which is being abused and arbitraged by healthy banks looking to make money in the Fed's overnight facilities. Total loans are accelerating, now at $161.5 billion this week:




Our longshot guess is when BTFP ends on March 11, 2024, the Fed is bracing for discount window usage, where troubled banks are not anonymous, to potentially rise substantially as poorly managed mid-size and small banks rush to it as their reserve constraint level is breached. Instead of letting banks avoid the junkies by knowing who they are, they're forcing everyone to take a hit. We are still waiting to see how BTFP loans are either extended, removed in favor of discount window loans, or eliminated without alternative:

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As per usual, you don't get access to these liquidity backstops. You will endure monetary tightening whether you like it or not, and there's no central entity waiting at the ready to socialize your losses for you.

@NorthmanTrader on X

Continue reading here (subscription may be required).



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**The divergence between large-cap and small-cap stocks has reached historic extremes (from Jason Goepfert via X)...**

The S&P 500 closed at an all-time high.

The Russell 2000 is still in a bear market*, down more than 20% from its high.

That's never happened before.

SPX Index 94) Discover 96) Actions 97) Edit Line Chart

01/20/2019 - 01/19/2024 Last Px Local CCY Mov Avgs Key Events

S&P 500 INDEX - Last Price 4839.81

Russell 2000 Index - Last Price 1944.391

-20.40%

2020 2021 2022 2023

Source: Bloomberg

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**This little-known seasonal indicator is sending a relatively bullish message for 2024 (from Wayne Whaley via X)...**

TOY is a "Turn Of the Year" Barometer based on the S&P's Nov19-Jan19 performance. The 2024 TOY is 7.22%. Since 1950 if TOY was > 3%, the next year (Jan19-Jan19) was 35-2 for an avg 16.5% gain with 2 single digit losses. Feb-April is 32-5 for an avg 3 mt gain of 4.23%

THE FOLLOWING YEAR (JAN19-JAN19) WHEN TOY2MT (NOV19-JAN19) IS GT THAN 3%

*waynewhaley.witterlester@gmail.com* *waynewhaley.com* *January 19, 2024*

| | TOY2MT | | THE FOLLOWING 12 MONTHS | | | | | | | | | | | TOYYR | MXDRW |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| # | YEAR | N19-J19 | FEB% | MAR% | APR% | MAY% | JUN% | JUL% | AUG% | SEP% | OCT% | NOV% | DEC% | JN19JN19 | DOWN |
| 01 | 1950 | 4.3 | 1.0 | 0.4 | 3.9 | 4.6 | -5.8 | 0.8 | 3.3 | 5.6 | 0.4 | -0.1 | 4.7 | 26.6 | -1.1 |
| 02 | 1951 | 7.6 | 0.6 | -1.5 | 4.4 | -4.1 | -2.6 | 6.9 | 3.9 | -0.1 | -1.4 | -0.3 | 3.9 | 13.5 | -1.9 |
| 03 | 1952 | 6.7 | -3.6 | 4.8 | -4.3 | 2.3 | 4.6 | 1.8 | -1.5 | -2.0 | -0.1 | 4.6 | 3.5 | 7.3 | -4.8 |
| 04 | 1954 | 5.2 | 0.3 | 3.0 | 4.9 | 3.3 | 0.1 | 5.7 | -3.4 | 8.3 | -1.9 | 8.1 | 5.1 | 36.1 | 0.0 |
| 05 | 1955 | 4.5 | 0.4 | -0.5 | 3.8 | -0.1 | 8.2 | 6.1 | -0.8 | 1.1 | -3.0 | 7.5 | -0.1 | 25.1 | 0.0 |
| 06 | 1958 | 3.2 | -2.1 | 3.1 | 3.2 | 1.5 | 2.6 | 4.3 | 1.2 | 4.8 | 2.5 | 2.2 | 5.2 | 35.5 | -1.2 |
| 07 | 1959 | 4.7 | -0.1 | 0.1 | 3.9 | 1.9 | -0.4 | 3.5 | -1.5 | -4.6 | 1.1 | 1.3 | 2.8 | 2.9 | -3.8 |
| 08 | 1961 | 7.1 | 2.7 | 2.6 | 0.4 | 1.9 | -2.9 | 3.3 | 2.0 | -2.0 | 2.8 | 3.9 | 0.3 | 15.0 | 0.0 |
| 09 | 1963 | 9.0 | -2.9 | 3.5 | 4.9 | 1.4 | -2.0 | -0.3 | 4.9 | -1.1 | 3.2 | -1.1 | 2.4 | 17.5 | -1.7 |
| 10 | 1964 | 6.5 | 1.0 | 1.5 | 0.6 | 1.1 | 1.6 | 1.8 | -1.6 | 2.9 | 0.8 | -0.5 | 0.4 | 13.2 | -0.2 |
| 11 | 1967 | 5.6 | 0.2 | 3.9 | 4.2 | -5.2 | 1.8 | 4.5 | -1.2 | 3.3 | -3.5 | 0.8 | 2.6 | 11.0 | 0.0 |
| 12 | 1971 | 13.1 | 0.9 | 3.7 | 3.6 | -4.2 | -0.9 | -3.2 | 3.6 | -0.7 | -4.2 | -0.3 | 8.6 | 10.8 | -3.8 |
| 13 | 1972 | 13.4 | 2.5 | 0.6 | 0.4 | 1.7 | -2.2 | 0.2 | 3.4 | -0.5 | 0.9 | 4.6 | 1.2 | 14.3 | -1.3 |
| 14 | 1975 | 4.0 | 6.0 | 2.2 | 4.7 | 4.4 | 4.4 | -6.8 | -2.1 | -3.5 | 6.2 | 2.5 | -1.2 | 38.6 | -0.4 |
| 15 | 1976 | 9.3 | -1.1 | 3.1 | -1.1 | -1.4 | 4.1 | -0.8 | -0.5 | 2.3 | -2.2 | -0.8 | 5.2 | 5.6 | -0.3 |
| 16 | 1979 | 5.6 | -3.7 | 5.5 | 0.2 | -2.6 | 3.9 | 0.9 | 5.3 | 0.0 | -6.9 | 4.3 | 1.7 | 11.3 | -3.6 |
| 17 | 1980 | 6.6 | -0.4 | -10.2 | 4.1 | 4.7 | 2.7 | 6.5 | 0.6 | 2.5 | 1.6 | 10.2 | -3.4 | 21.0 | -11.6 |
| 18 | 1983 | 6.0 | 1.9 | 3.3 | 7.5 | -1.2 | 3.5 | -3.3 | 1.1 | 1.0 | -1.5 | 1.7 | -0.9 | 15.0 | -3.6 |
| 19 | 1985 | 5.0 | 0.9 | -0.3 | -0.5 | 5.4 | 1.2 | -0.5 | -1.2 | -3.5 | 4.3 | 6.5 | 4.5 | 21.7 | 0.0 |
| 20 | 1986 | 4.9 | 7.1 | 5.3 | -1.4 | 5.0 | 1.4 | -5.9 | 7.1 | -8.5 | 5.5 | 2.1 | -2.8 | 29.2 | -2.4 |
| 21 | 1987 | 13.3 | 3.7 | 2.6 | -1.1 | 0.6 | 4.8 | 4.8 | 3.5 | -2.4 | -21.8 | -8.5 | 7.3 | -7.4 | -16.9 |
| 22 | 1988 | 3.9 | 4.2 | -3.3 | 0.9 | 0.3 | 4.3 | -0.5 | -3.9 | 4.0 | 2.6 | -1.9 | 1.5 | 15.1 | -2.7 |
| 23 | 1989 | 7.7 | -2.9 | 2.1 | 5.0 | 3.5 | -0.8 | 8.8 | 1.6 | -0.7 | -2.5 | 1.7 | 2.1 | 18.2 | -0.8 |
| 24 | 1991 | 4.0 | 6.7 | 2.2 | 0.0 | 3.9 | -4.8 | 4.5 | 2.0 | -1.9 | 1.2 | -4.4 | 11.2 | 26.1 | -1.2 |
| 25 | 1992 | 10.4 | 1.0 | -2.2 | 2.8 | 0.1 | -1.7 | 3.9 | -2.4 | 0.9 | 0.2 | 3.0 | 1.0 | 3.9 | -5.8 |
| 26 | 1997 | 4.6 | 0.6 | -4.3 | 5.8 | 5.9 | 4.3 | 7.8 | -5.7 | 5.3 | -3.4 | 4.5 | 1.6 | 23.9 | -5.0 |
| 27 | 1999 | 8.5 | -3.2 | 3.9 | 3.8 | -2.5 | 5.5 | -3.2 | -0.6 | -2.9 | 6.3 | 1.9 | 5.8 | 16.4 | -2.8 |
| 28 | 2004 | 9.3 | 1.2 | -1.6 | -1.7 | 1.2 | 1.8 | -3.4 | 0.2 | 0.9 | 1.4 | 3.9 | 3.2 | 3.9 | -6.7 |
| 29 | 2009 | 5.4 | -11.0 | 8.5 | 9.4 | 5.3 | 0.0 | 7.4 | 3.4 | 3.6 | -2.0 | 5.7 | 1.8 | 35.3 | -20.4 |
| 30 | 2010 | 5.1 | 2.9 | 5.9 | 1.5 | -8.2 | -5.4 | 6.9 | -4.7 | 8.8 | 3.7 | -0.2 | 6.5 | 11.4 | -11.1 |
| 31 | 2011 | 6.9 | 3.2 | -0.1 | 2.8 | -1.4 | -1.8 | -2.1 | -5.7 | -7.2 | 10.8 | -0.5 | 0.9 | 2.5 | -14.3 |
| 32 | 2012 | 8.1 | 4.1 | 3.1 | -0.7 | -6.3 | 4.0 | 1.3 | 2.0 | 2.4 | -2.0 | 0.3 | 0.7 | 13.0 | -2.8 |
| 33 | 2013 | 7.1 | 1.1 | 3.6 | 1.8 | 2.1 | -1.5 | 4.9 | -3.1 | 3.0 | 4.5 | 2.8 | 2.4 | 23.7 | 0.0 |
| 34 | 2017 | 3.7 | 3.7 | 0.0 | 0.9 | 1.2 | 0.5 | 1.9 | 0.1 | 1.9 | 2.2 | 2.8 | 1.0 | 24.1 | 0.0 |
| 35 | 2018 | 9.0 | -3.9 | -2.7 | 0.3 | 2.2 | 0.5 | 3.6 | 3.0 | 0.4 | -6.9 | 1.8 | -9.2 | -5.0 | -16.3 |
| 36 | 2020 | 6.7 | -8.4 | -12.5 | 12.7 | 4.5 | 1.8 | 5.5 | 7.0 | -3.9 | -2.8 | 10.8 | 3.7 | 14.1 | -32.8 |
| 37 | 2021 | 6.2 | 2.6 | 4.2 | 5.2 | 0.5 | 2.2 | 2.3 | 2.9 | -4.8 | 6.9 | -0.8 | 4.4 | 19.3 | -2.2 |
| 38 | 2024 | 7.2 | | | | | | | | | | | | | |
| | #UP-DWN= | | 2512 | 2512 | 30-7 | 2611 | 2413 | 2611 | 2116 | 2017 | 2116 | 2512 | 31-6 | 35-2 | |
| | 3%MOVES= | | 8-6 | 16-4 | 18-1 | 11-5 | 11-3 | 18-6 | 11-6 | 8-7 | 9-7 | 13-2 | 15-2 | 33-2 | |
| | AVG%CHG= | | 0.5 | 1.2 | 2.6 | 0.9 | 1.0 | 2.2 | 0.6 | 0.4 | 0.1 | 2.2 | 2.4 | 16.5 | |





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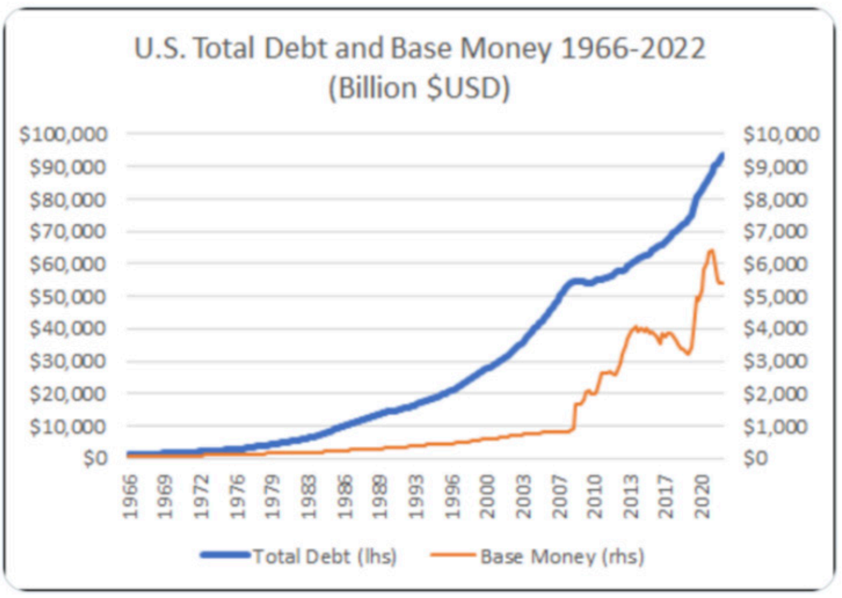
**The Fed and U.S. Treasury "blinked" last fall (from Lawrence Lepard/Equity Management Associates' Q4 2023 Letter)...**

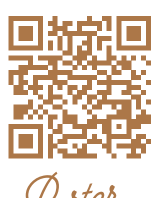
In [our Q3 report], we presented how the US Government Fiscal doom loop was getting

worse and how mathematically US Federal borrowings were crowding out the debt markets - sending interest rates higher. The nearly parabolic growth in US Federal interest costs is making the deficit worse and without monetary accommodation, we suggested that the debt and equity markets were headed for real trouble. Lyn Alden's chart (below) points out that it is only a matter of time before the Fed will be forced to grow its balance sheet again (print money). In a heavily indebted system, the supply of money needs to continually grow or the debt becomes unserviceable.




The Fed began to blink in Q4. This is enormously important and supports our thesis that the Fed and Treasury have no choice but to loosen monetary conditions (further debase the currency) in order to prevent market dysfunction. Let's review what happened.

The US 10 Year Treasury Bond yield broke a technically important level (4.368%) on September 20, 2023 and quickly rose to 5.00%. This rate increase drove the S&P 500 down 7% in a matter of weeks, and down 11% from the recent peak. Both events set off alarm bells at the Fed and the Treasury.



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The move in the US 10-year yield from September 1 to mid-October was dramatic, a 20% increase in the yield in roughly 6 weeks. We recall the vibe at this time, and it reminded us of the UK Gilt Crisis in the Fall of 2022 as UK bond yields began to spike.

The Fed quickly came with the fire trucks. In rapid succession, we got the following "dovish" comments out of no less than 8 Federal Reserve Governors:

Fed's Williams: central bank may be done with rate rises.

**Bloomberg 9/29/2023**

Fed's Logan: higher yields may mean less need to raise rates.

**Bloomberg, 10/9/23**

Fed's Daly: rise in bond yields may substitute for a rate hike.

**Bloomberg, 10/10/23**

Federal Reserve Bank of Atlanta President Ralph Bostic reiterated that he doesn't think policymakers need to raise interest rates any further and that policy is restrictive enough to bring inflation back to their 2% goal. "I think that our policy rate is at a sufficiently restrictive position to get inflation down to 2%," Bostic said Tuesday during a conversation held at the annual convention for the American Bankers Association. "I actually do not think that we need to increase rates anymore."

**Bloomberg 10/10/23**

"We are in a sensitive period of risk management, where we have to balance the risk of not having tightened enough, against the risk of policy being too restrictive" Fed Vice Chair Philip Jefferson said, nodding to the rise in US Treasury yields and the need for the central bank to "proceed carefully" with any further increases in the benchmark federal funds rate.

**Reuters 10/10/23**

Minneapolis Fed President Neel Kashkari noted it is "possible" that further rate hikes may not be required.

**Reuters 10/11/23**

U.S. Federal Reserve Governor Christopher Waller on Wednesday said higher market interest rates may help the Fed slow inflation and let the central bank "watch and see" if its own policy rate needs to rise again or not. Waller, who has been among the most vocal advocates for higher interest rates to fight inflation, said price data seem to now be moving back towards the Fed's 2% target, with financial markets adding further credit tightening on their own.





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**Reuters 10/11/23**

Fed's Harker says rate hikes likely over amid ongoing disinflation.

**Reuters 10/13/23**

*(h/t Luke Gromen, FFTT for summarizing these Fed comments)*

Based upon the number and consistency of these comments, we assume that it was a three-alarm fire that the Fed had detected in the bond market, as the Bond Volatility Move Index ramped up to levels which indicate severe stress. Several analysts have pointed out that bonds are now more volatile than gold. This is not supposed to happen.

But wait, there is more: The Fed Governors jawboning rates lower on the anticipation of no further rate increases, and possible rate cuts, was just the first act in a three-act play.

Act II opened up with US Treasury Secretary Janet Yellen upon the release of the Treasury Borrowing Advisory Committee (TBAC) report on November 1, 2023. This report comments on the market for US Treasury securities and estimates the amount and nature of the debt sales that the US Federal Government will conduct in order to fund its debt and deficits.

The TBAC report is highly technical with a lot of inside macro baseball. But several things in this most recent report stood out:

- First, a much larger percentage of the debt is now being bought by US hedge funds and others who are participating in the "basis trade."
- Second, the Treasury indicated that they intend to fund a much larger proportion of the debt via short term bills and notes as opposed to longer term bonds. This implies: (i) that the Treasury is having a hard time finding demand for longer term bonds (it is, we will discuss a recent 30-year auction below); and (ii), the market interprets the tilt toward shorter term notes to be an indication that the Treasury expects short duration yields to decrease soon. Markets viewed this as a sign of more monetary accommodation coming soon.

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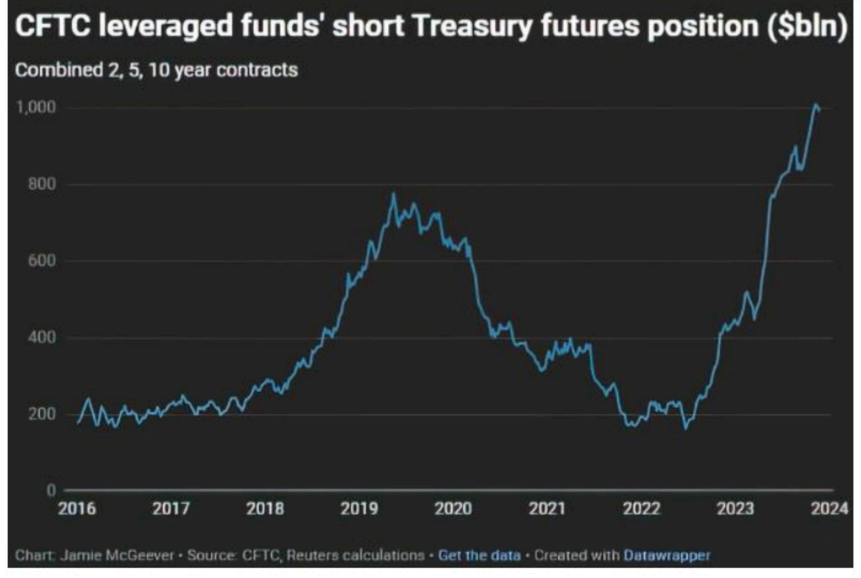
The Treasury has been worried about some weak government bond auctions in Q4 when the Bid to Cover was only 2.24x, much lighter demand than usual. Given this anemic demand, primary dealers (i.e., Wall Street banks) were forced to buy 25% of the bonds auctioned (vs. in normal times perhaps they only have to buy 10-15%). Many have realized that bonds are not a great investment in an inflationary world, where the US money supply has grown at 7% per year over the last 50 years, on average. So, we can debate whether CPI is < 3% or not, but the reality is – debasement is running at 7% on average! Higher interest rates will be needed to stimulate demand for US Treasuries. Watch for weak bond auctions as a major risk factor to global markets over the next few years.

The basis trade mentioned above is also a risk that bears watching given it's a small cadre of highly levered hedge funds playing this arbitrage game of shorting US Treasury Futures while buying US Treasury on-the-run bonds. Given the > 50x leverage employed, there is real risk if this basis trade went afoul. Recall, Long Term Capital Management was a "can't miss" back in 1998, until it wasn't. But, we are dealing with much larger sums of capital than LTCM's $1bn of equity levered 100x. As you can see in the following chart, there appears to be $1 Trillion of Levered Short US Treasury Futures positions.




Note in the above chart, as rates were rising in 2019/2020, this same levered basis trade was present and coincided with the September 2019 Repo rate blowout which led to the original Powell pivot. Furthermore, several hedge funds at that time were rumored to be insolvent and received emergency Fed swap lines. It would not shock us to see this movie come to a theater near you again soon.





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Act III began with the Federal Reserve meeting on December 13, 2023. As expected, they held the Fed Funds policy rate constant at 5.25%, but very importantly they adjusted the "dot plot" of expected future rate levels to reflect that a majority of the Fed Governors now believe the Fed will be cutting rates [this] year. Perhaps even more importantly, the following exchange took place in the Q&A session with Fed Chair Powell:

> **Jennifer Schonberger of Yahoo Finance:** You said back in July that you needed to start cutting rates before getting to 2% inflation. As you mentioned PCE inflation is now running at 3.5% on core. On a six-month annual basis, core PCE is running at 2.5%. Though when you look at supercore and shelter, they are, of course, stickier. So, when looking in the different components of the data, how much closer do you have to get to 2% percent before you consider cutting rates?
>
> **Chair Powell:** The reason you wouldn't wait to get to 2% to cut rates is that policy would be too late... you'd want to be reducing restriction on the economy well before (EMA emphasis added) 2%... so you don't overshoot, if we think of restrictive policy as weighing on economic activity. It takes a while for policy to get into the economy, affect economic activity, and affect inflation.

That, ladies and gentlemen, is the "Powell pivot" (notably the second one, since he also pivoted in 2019). Chair Powell is looking less like Paul Volcker and more like Arthur Burns.

The Chair of the Federal Reserve just told us that they will not wait for PCE to hit 2% before beginning to cut interest rates and loosen monetary policy. As we predicted, the Fed has once again changed the narrative to suit their purpose. And let's be clear, their purpose is to keep the bond and stock markets functioning well. So, we can add "higher for longer" to the prior Fed mis-directions of:

- Inflation is too low.
- Inflation is transitory.
- We are not even thinking about thinking about raising rates.
- We will stay higher for longer to make sure inflation is under control.

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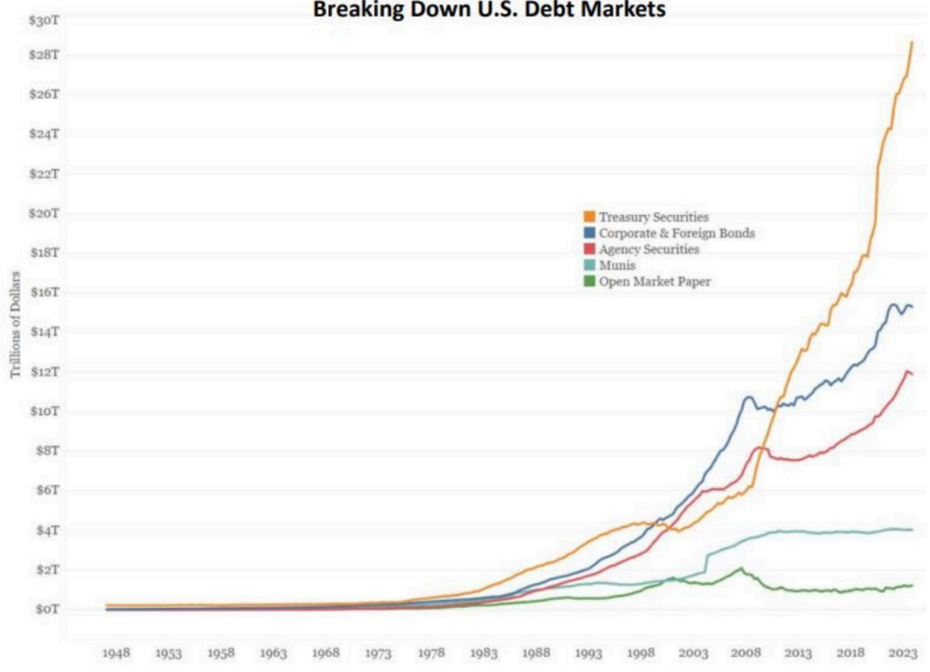
As we have said before, they have a tiger by the tail and are swerving between the two extremes of severe inflation and severe deflation. Given policy lags, they are making a mess of it.

All we can say is good luck, particularly when looking at the next chart below. Notice the parabolic increase in US Treasury issuance since 2009. In one snapshot here, we can see just how much the government not only has to finance its own increasing government expenditures, but also the back door assistance it has increasingly needed to provide over the past 14 years to support this levered system we have. This is only going to compound even more rapidly, and God help us in the next crisis. Again, debt is debt and math is math.



Source: DoubleLine Capital, Bianco Research, Federal Reserve

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**The largest U.S. public pensions are increasingly turning to leverage to boost returns and liquidity. What could go wrong? (from *The Financial Times*)...**

US public pension plans that manage hundreds of billions of dollars of assets are increasingly turning to risky leverage strategies as burgeoning private market holdings create cash flow strains.

At least eight very large US public pension funds are using borrowed cash or other leverage strategies, now that the board of Calstrs, one of the largest US retirement funds, this month voted to allow the fund to borrow as much as $30bn, or 10 percent of its portfolio.

The strategy has risen in prominence as these giant funds have tied up a larger and larger share of their assets in illiquid investments such as private equity, infrastructure and real estate. Using borrowed money and derivatives can help boost returns, rebalance portfolios and give the funds access to cash without having to resort to fire sales of illiquid assets during times of market stress.

But use of leverage can backfire, as it did during the 2022 gilt markets crisis, when forced selling by UK pension funds led to an emergency intervention by the Bank of England. Global regulators have recently stepped up scrutiny of the practice as well as broader systemic risks posed by nonbank financial institutions.

“If you are borrowing money to help avoid fire sales then this is a risky strategy because the money still needs to be paid back,” said Alasdair Macdonald, head of investment strategy with WTW, a global professional services firm.

“There is still a risk that assets will have to be sold at low prices, to repay the borrowing, locking in losses.”

Continue reading here (subscription may be required).

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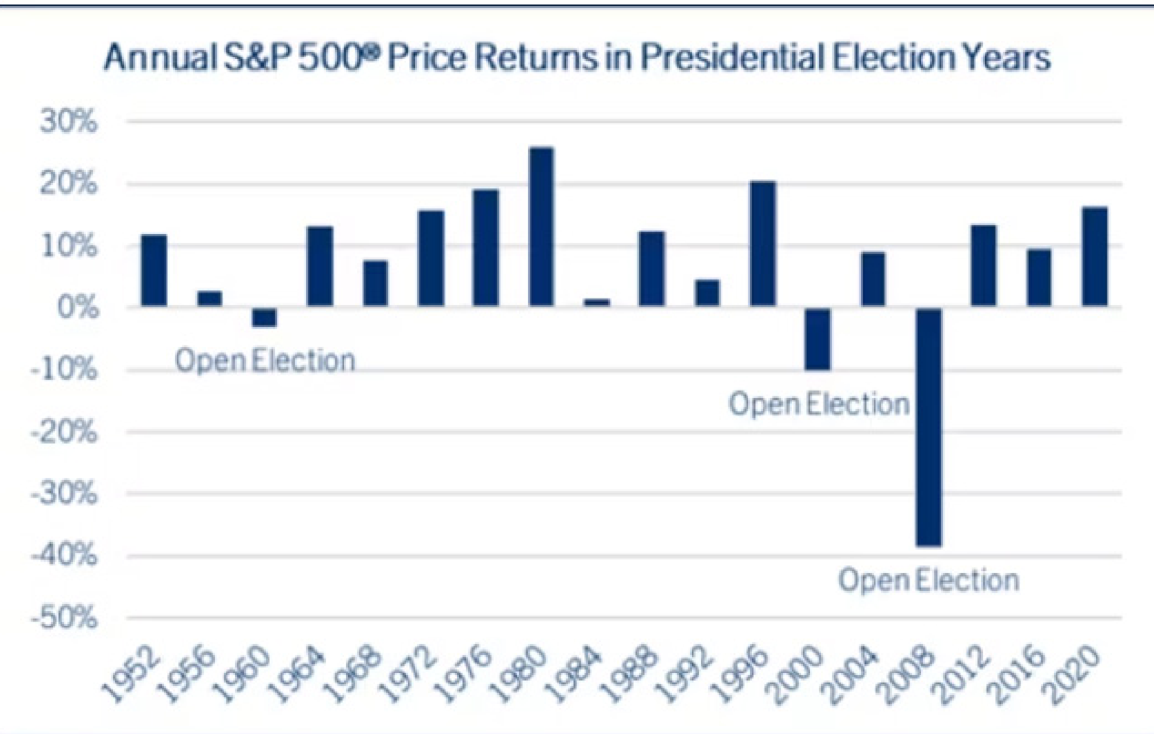
**History shows the stock market tends to do well in U.S. presidential election years like this one (from Barchart via X)...**

Since 1952, the S&P 500 has finished each presidential election year in the green except 3 times.  And each of those was an open election without an incumbent running.

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**The S&P 500 is making new highs, but market "breadth" is not confirming so far (from Hi Mount Research)...**

**What:** The S&P 500 made its first new high in more than 500 days on Friday – snapping what had been the 6th longest streak on record (back to 1950) without a new high.

At the same time, the number of stocks making new lows (on both the NYSE and NASDAQ) has expanded every week this year and now exceeds the number of stocks making new highs for the first time in 9 weeks.

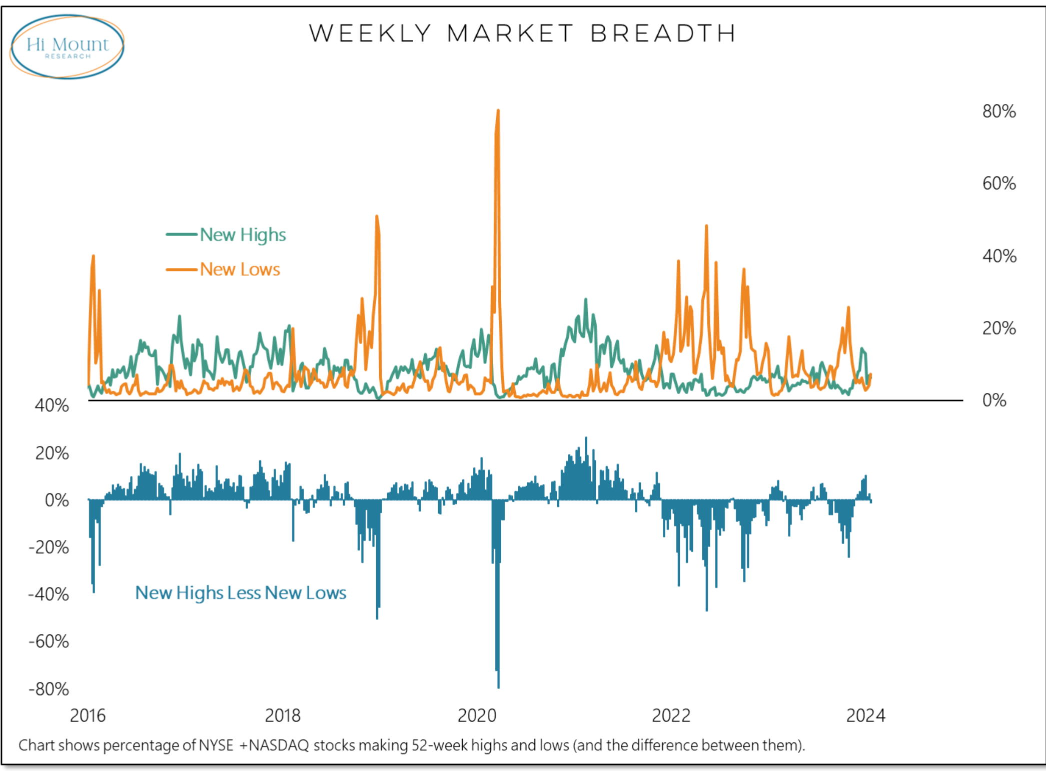

Chart shows percentage of NYSE +NASDAQ stocks making 52-week highs and lows (and the difference between them).

**So what:** Price trends remain robust, but breadth is getting more ragged. This is reflected in the mixed readings on our Bull Market Behavior Checklist.

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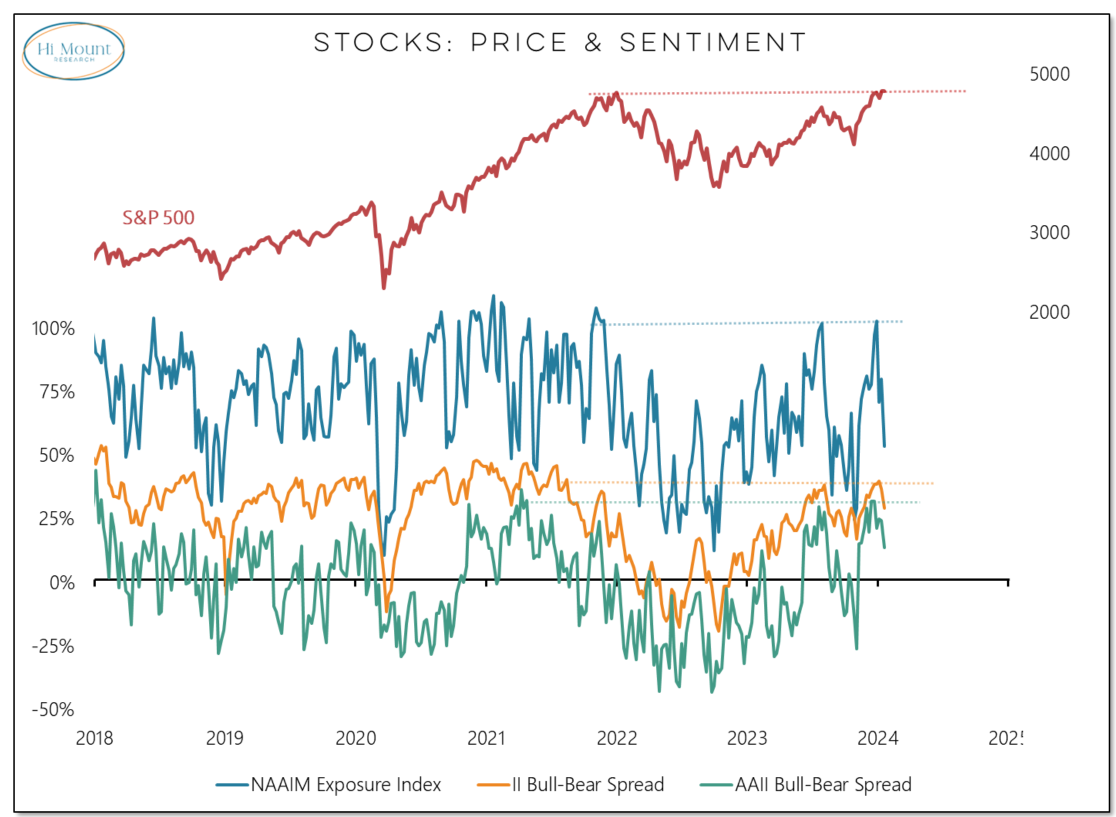
| BULL MARKET BEHAVIOR CHECKLIST | | | |
|---|---|---|---|
| | Bull Market Criteria | Current Reading | Bull Market Behavior? |
| Weekly New High - New Lows (As % of NYSE + NASDAQ Issues Traded) | Greater Than 0 | Less Than 0 (1 Consecutive Week) | No |
| Net New High A/D Line NYSE + NASDAQ | Rising | Falling (3 Days in a Row) | No |
| % of Global Markets Above Their 50-Day Average | Greater Than 70% | Less Than 70% (3 Days in a Row) | No |
| ACWI Long-Term Trend | Rising | Rising (39 Consecutive Weeks) | Yes |
| S&P 500 200-Day Average (Level vs 10-Days Ago) | Rising | Rising (154 Days in a Row) | Yes |
| Value Line Geometric Index Long-Term Trend | Rising | Rising (10 Consecutive Weeks) | Yes |

(data as of 1/19/2024) Total: 3/6

**Now what**: New highs tend to be followed by strength but with optimism cooling and breadth not confirming, some consolidation here would not be too surprising. Downside risks rise if investors turn pessimistic or if breadth continues to deteriorate.



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**No, "taxing the rich" won't solve the U.S. government's debt problem (from *The Wall Street Journal*)...**

As budget deficits surge toward the stratosphere, Congress will soon have to get serious about savings proposals. Yet reforming Social Security and Medicare—the leading drivers of long-term deficits—remains a political nonstarter. Neither party is willing to raise middle-class taxes. And cutting defense and social spending would save at most $200 billion annually from deficits that are projected to approach $3 trillion by 2034.

There are a few excessive tax loopholes and undertaxed corporations that lawmakers could address. It's farcical, however, to suggest that the tax-the-rich pot of gold is large enough to rein in our deficits and finance new spending programs. Seizing every dollar of income earned over $500,000 wouldn't balance the budget. Liquidating every dollar of billionaire wealth would fund the federal government for only nine months.

In a study for the Manhattan Institute, I set upper-income tax rates at their revenue-maximizing level, while paring back tax loopholes and fighting tax evasion. As background, the Congressional Budget Office projects that our budget deficits—which currently exceed 7% of gross domestic project—will surpass 10% of GDP over the next three decades. My research shows that the "tax the rich" model would raise at most 2% of GDP in additional revenue over the long term.

If this seems low, it's because the U.S. tax code is already the most progressive of the 38 Organization for Economic Cooperation and Development member countries. The U.S. taxes the wealthy at European rates, while taxing the middle class at considerably lower rates.

The CBO calculates that the top-earning quintile, which accounts for 58% of all income in the U.S., paid 69% of all federal taxes and 90% of all income taxes in 2019. The top-earning 1%, which makes 18% of all income, paid 25% of all federal taxes and 40% of all income taxes. The bottom-earning 60% earned 23% of income but paid only 13% of federal taxes. That population included the bottom-earning 40%, which had a combined average income-tax rate of negative 6.4%.

America's top tax rates often exceed international norms. Our top income-tax bracket of 43.7%—including typical state taxes—exceeds that of the standard

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OECD nation (40.4%). Our top capital-gains tax rate is 10 points above the OECD average, and our corporate tax rate exceeds not only the OECD mean but that of every Scandinavian nation. America's effective corporate tax rate is also above average, as are its estate and inheritance taxes.

Continue reading here (subscription may be required).





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**Reminder: Recession risks remain (from Albert Edwards via X)...**

Celebrating the S&P record high? Recession averted?

Gerard Minack notes "The SPX is typically within 2% of its cycle high 2 months before the start of a recession."

Going into recession, the equity market collapse comes AFTER the Fed starts cutting rates as profits collapse.

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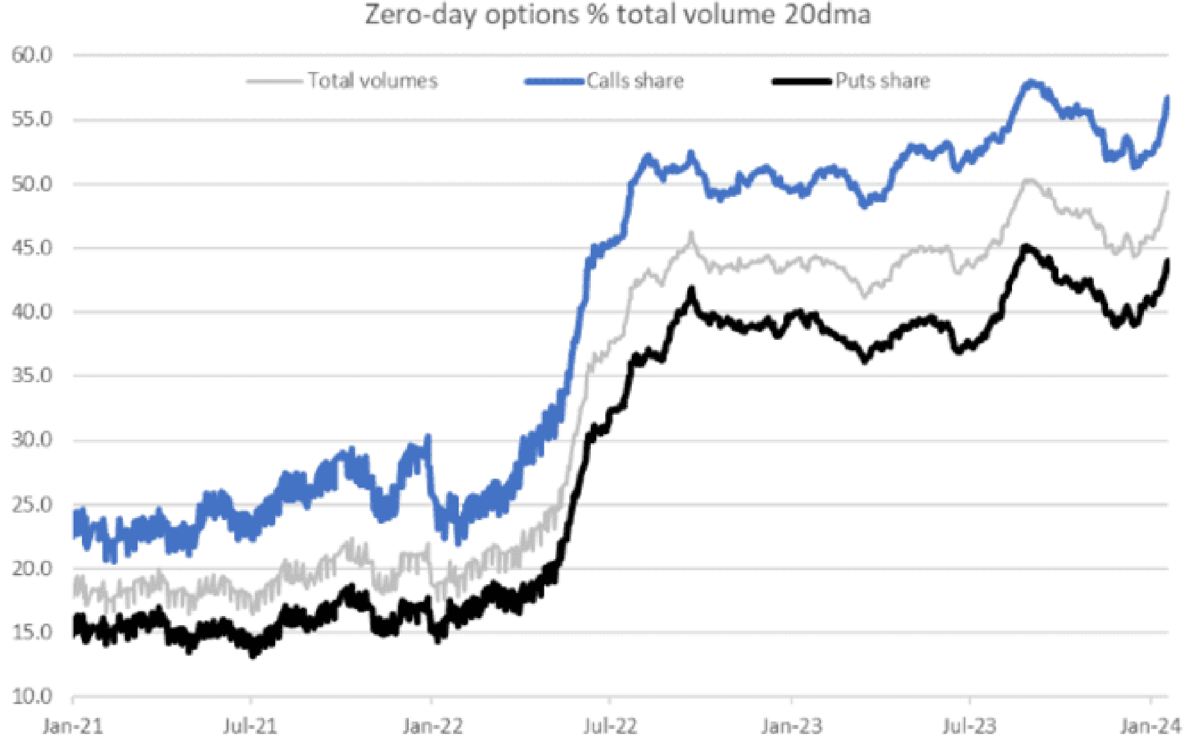
**Speculators are rushing back into the riskiest options again (from MarketWatch)...**

Trading in options contracts on the verge of expiration surged last week, just as the S&P 500 logged its first record close in two years, according to data shared by a top U.S. equity market strategist at Citigroup.

Options contracts with 24 hours or less left until expiration saw a spike in trading volume last week that coincided with Friday's record close for the S&P 500. According to data cited by Citi, an average of 1.8 million contracts fitting this description changed hands on average every day over the past five trading sessions. All told, 0DTE options accounted for 49% of total trading volume during this period, Citi added.

The surge coincided with a broader bump in options-market activity, according to the Citigroup report.

"The nominal volumes are a new record but the share is slightly below the August peak of 50.4%," said Stuart Kaiser, head of U.S. equity trading strategy at Citigroup, in a report viewed by MarketWatch.




*Source: Optionmetrics, Citi Global Markets*





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Trading volumes likely received a boost last week from the fact that monthly contracts attached to major equity indexes, exchange-traded funds and individual stocks all expired on Friday.

These so-called zero-days to expiration options have seen their popularity explode since early 2022 as options exchange operators like Cboe Global Markets have rolled out more weekly options products attached to the S&P 500 index and the SPDR S&P 500 Trust (SPY), an ETF that tracks the index, along with other popular index-tracking products.

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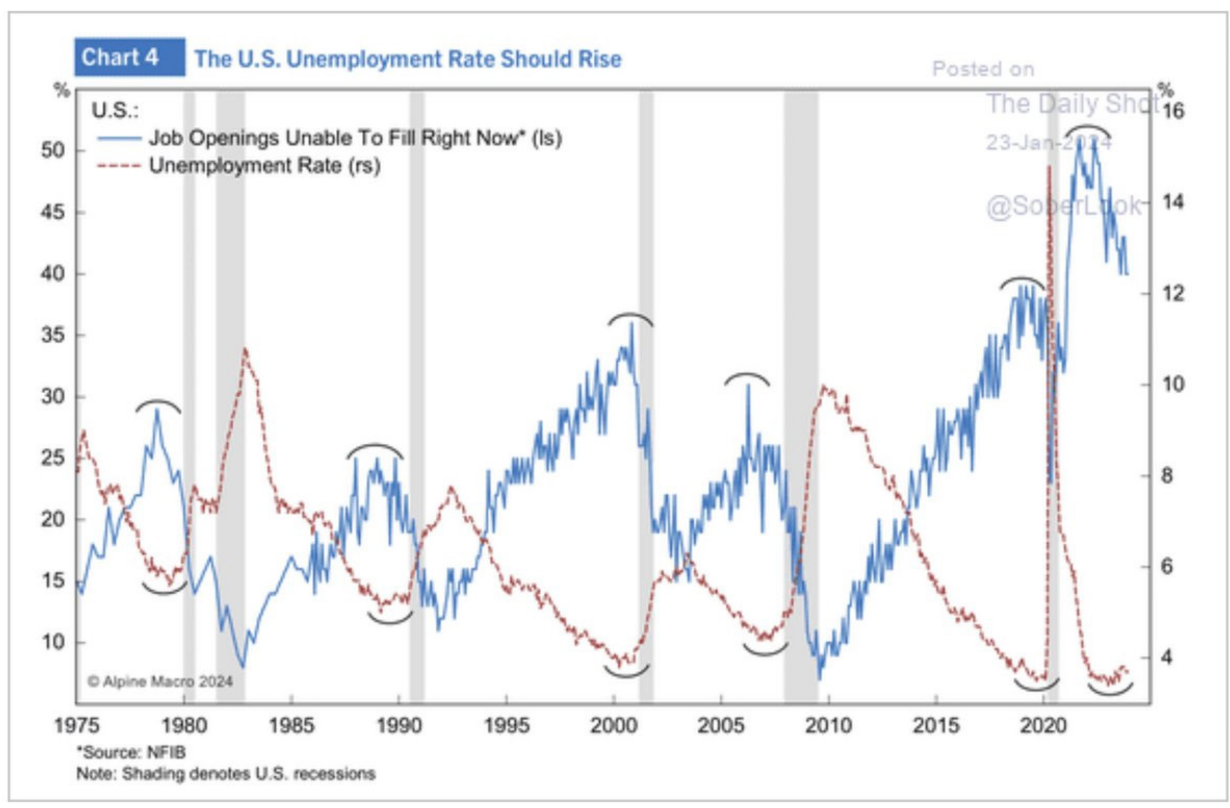
**The continuing decline in job openings suggests unemployment could soon begin to rise ([from Win Smart, CFA via X](#))...**





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# THE LEGENDS SPEAK

## Wisdom and Insight from the World's Greatest Investors

**Fifteen top lessons from Warren Buffett's annual shareholder letters (from The Value Investor)...**

Warren Buffett and Charlie Munger's annual letters to Berkshire Hathaway shareholders are a treasure trove of wisdom, offering insights into their investment strategies, philosophy, and views on the market. Over the years, these letters have provided key takeaways that are valuable for any investor. Here's an analysis of the most significant lessons drawn from these letters, complete with quotes and explanations.

### 1. A Few Good Decisions Is Enough

Buffett acknowledges that a majority of his investment decisions have been mediocre, but it's the handful of great calls that have driven spectacular long-term performance. He cites investments in Coca-Cola and American Express as prime examples, highlighting the importance of patience and investing for the long run. As Buffett said,

"The weeds wither away in significance as the flowers bloom. Over time, it takes just a few winners to work wonders."

### 2. Stock Buybacks as a Strategy

Buffett's approach to using Berkshire's cash stockpile includes stock buybacks, emphasizing their value as long as purchases are made at the right prices. He articulates that when the share count goes down, the investor's interest in the businesses goes up, benefiting from value-accretive prices.

### 3. The Endurance of Charlie Munger

Buffett dedicates significant respect to his long-time partner, Charlie Munger, emphasizing their shared focus on long-term investing over market froth. Munger's quote,

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"The world is full of foolish gamblers, and they will not do as well as the patient investor,"

resonates with their investment ethos.

**4. Never Bet Against America**

Buffett's investment strategy is deeply rooted in his belief in the American economy's potential. He has historically invested in quintessential American companies, reflecting his faith in the nation's economic progress and its ability to unleash human potential.

**5. Beware of Overvalued Stocks**

Buffett warns against investing in overvalued growth stocks and conglomerates, emphasizing the importance of fundamentals. He cautions investors to be wary of 'business emperors' without substantial underlying value.

**6. Ditch Bonds for Bleak Returns**

Buffett critiques the bond market, especially in low-yield environments, advising investors against settling for *'pathetic returns'* and taking on increasing risk for minimal gains.

**7. Admitting Mistakes Is Crucial**

Buffett openly admits his mistakes, such as the overvalued purchase of Precision Castparts, leading to a significant write-down. This humility and transparency is a key aspect of his investment approach.

**8. Apple as a 'Family Jewel'**

Buffett refers to a few companies, including Apple, as 'family jewels' of Berkshire's portfolio. These investments are significant, not just in terms of value but also due to their role in Berkshire's overall investment strategy.

**9. Executives Should Earn Their Keep**

Buffett advocates for performance-based executive compensation, distinct from most organizations that might use stock price as a primary measure. He believes in rewarding actual company performance, encouraging responsible capital allocation.

**10. Invest for Ownership, Not Speculation**

Buffett advises investors to buy stocks with an ownership mentality. His 1996 letter included the famous quote,





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"If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes."

**11. The Value of Intangible Assets**

Buffett highlights the importance of intangible assets, as seen in the acquisition of See's Candy Stores. This investment changed his outlook on the value of goodwill and non-tangible assets in business valuation.

**12. Be Contrarian in Market Sentiment**

Buffett advises being

"fearful when others are greedy and greedy only when others are fearful."

This approach involves looking at fundamental company values and going against market herd mentality for potential profit.

**13. Avoid Overly Complex Investments**

Buffett cautions against investing in businesses that are too complex to understand fully. His stance on technology evolved over time, leading to significant investments in companies like Apple only after understanding their growth potential and competitive advantages.

**14. Value Over Price**

Buffett learned that investing merely because a company seems cheap can be a mistake. His focus is on the quality of the business and its return on capital, not just its market price.

**15. The Virtue of Investment Inaction**

Buffett emphasizes a passive approach to investing, arguing that

"returns decrease as motion increases."

This philosophy advocates for a long-term, steady approach to investing, as opposed to frequent trading or reacting to market fluctuations.

Continue reading here.

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**Distressed-investing legend Howard Marks' latest memo on "easy money" is a must read (from OakTree Capital Management)...**

*The backstory: I began writing these memos in 1990 and continued to do so for ten years despite never receiving a single response. Then, on the first business day of 2000, I published bubble.com, a memo with warnings about excesses in the tech sector that turned out to be timely. The inspiration for the memo came from a book I'd read the preceding autumn: Devil Take the Hindmost: A History of Financial Speculation, by Edward Chancellor, an account of speculative excesses starting with the South Sea Bubble of the early 1700s. The book's description of behavior surrounding the mania for the South Sea Company jibed with what I was seeing in the tech/media/telecom bubble that was underway. I received excellent feedback on the memo from clients – encouragement that prompted the many memos that have followed.*

*I consider it highly coincidental that 24 years later, I devoted another autumn to reading another Chancellor book, The Price of Time: The Real Story of Interest, his history of interest rates and central bank behavior. I thank Zach Kessler, a regular memo reader, for sending it. The relevance of The Price of Time to the trends I've been discussing for the last year occasions this memo.*

*   *   *

In December 2022, I published Sea Change, a memo that primarily discussed the 13-year period from the end of 2008, when the U.S. Federal Reserve cut the fed funds rate to zero to counter the effects of the Global Financial Crisis, to the end of 2021, when the Fed abandoned the idea that inflation was transitory and readied what turned out to be a rapid-fire succession of interest rate increases. The memo concentrated on the impact that this lengthy period of unusually low interest rates had on the economy, the financial markets, and investment outcomes. I followed this up with the memo Further Thoughts on Sea Change, which Oaktree released to clients in May 2023 and to the public in October. In the latter memo and subsequent conversations with clients, I've emphasized the significant impact of low interest rates on the behavior of participants in the economy and the markets.

Easy Times

In *Sea Change*, I likened the effect of low interest rates to the moving walkway at the airport. If you walk while on it, you move ahead faster than you would on solid ground. But you mustn't attribute this rapid pace to your physical fitness and overlook the contribution from the walkway.

In much the same way, declining and ultra-low interest rates had a huge but underrated influence on the period in question. They made it:





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- easy to run a business, with the stimulated economy growing unabated for more than a decade;
- easy for investors to enjoy asset appreciation;
- easy and cheap to lever investments;
- easy and cheap for businesses to obtain financing; and
- easy to avoid default and bankruptcy.

In short, these were easy times, fueled by easy money. Like travelers on the moving walkway, it was easy for businesspeople and investors to think they were doing a great job all on their own. In particular, market participants got a lot of help in this period as they rode the 10-year-plus bull market, the longest in U.S. history. Many disregarded the benefits that ensued from low interest rates. But as one of the oldest investment adages says, we should never confuse brains with a bull market.

As I've continued to think and talk about the switch from declining and/or ultra-low interest rates to more normal, stable ones, I've emphasized the fact that low rates alter investor behavior, distorting it in ways that have serious consequences.

Thinking about the change in interest rates sensitized me to media mentions of low rates, and I've noticed many. This was particularly true following Silicon Valley Bank's meltdown last March, which many articles attributed to faulty managerial decisions made "during the preceding period of easy money." More recently, there's been much discussion of the less-favorable outlook for private equity, usually related to expectations that interest rates aren't going to return to the low levels of the recent past.

The effects of low interest rates are multi-faceted and ubiquitous, yet frequently overlooked. I became more conscious of them as I read *The Price of Time*, and I want to catalog them here:

i. <u>Low interest rates stimulate the economy</u>

   Everyone knows that when central banks want to stimulate their countries' economies, they cut interest rates. Lower rates reduce costs for

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businesses and put money into the hands of consumers. For example, since most people buy cars on credit or lease them, lower interest rates make cars more affordable, increasing demand. The result is typically good for automakers, their suppliers, and their workers, and thus for the economy in general.

It's important to realize that easy money keeps the economy aloft, at least temporarily. But low interest rates can make the economy grow too fast, bringing on higher inflation and increasing the probability that rates will have to be raised to fight it, discouraging further economic activity. This oscillation of interest rates between extremes can have effects and encourage behavior that natural/neutral rates (see p. 13) would be less likely to induce.

ii. Low interest rates reduce perceived opportunity costs

Opportunity cost is a major consideration in most financial decisions. But in low-interest-rate environments, the rate earned on cash balances is minimal. Thus, you don't forgo much interest by withdrawing money from the bank to buy a house or boat (or make an investment), which makes doing so seem painless. For example, if someone's thinking about taking $1 million out of savings for a purchase at a time when savings accounts pay 5% interest, they're likely to understand that doing so will cost them $50,000 per year in forgone income. But when the rate is zero, there is no opportunity cost. This makes the transaction more likely to occur.

iii. Low interest rates lift asset prices

In finance theory, the value of an asset is defined as the discounted present value of its future cash flows. We discount future cash flows when calculating present value because we must wait to receive them, so they're less valuable than cash flows received today. The lower the rate at which future cash flows are discounted, the higher the present value, as investors have noted for centuries:

In the [18th] century, Adam Smith described how the price of land depended on the market rate of interest. In *The Wealth of Nations* (published in 1776) Smith noted that land prices had risen in recent decades, as interest rates declined. (*The Price of Time, or "TPOT"*)

By placing too low a discount on the future earnings of companies, investors [in the 1920s] ended up paying too much. (*TPOT*)





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In real life, investments are evaluated primarily on a relative basis. The return demanded on each investment is largely a function of the prospective returns on other investments and differences in these investments' respective levels of risk. Low interest rates lower the "relative bar," making the higher returns offered on riskier assets appear relatively attractive even if they're low in the absolute.

In this vein, *The Price of Time* describes the thought process that made "iffy" loans to the government of Argentina acceptable in the low-rate environment of the late 1880s:

Buenos Aires "took advantage of the low rate of interest and the abundance of money in Europe to contract as many loans as possible, new loans often being made in order to pay the interest on former ones." Some Argentine loans paid as little as 5 percent – low in absolute terms or relative to their risk but still a couple of points above the measly yield on [consols, or perpetual British government debt] . . . (*TPOT*, emphasis added)

When bond yields decline, bonds present less competition for riskier assets. Thus, low yields on bonds lead to lower demanded returns – and higher valuations – on other asset classes, such as equities, real estate, and private equity. For these reasons, low interest rates lead to asset inflation and sometimes asset bubbles like those we saw in late 2020 and throughout 2021.

iv. Low interest rates encourage risk taking, leading to potentially unwise investments

Low interest rates create a "low-return world" marked by paltry prospective returns on safe investments. At the same time, investors' required returns or desired returns typically don't decline (or they decline by much less), meaning investors face a shortfall. The ultra-low returns on safe assets cause some investors to take additional risks to access higher returns. Thus, these investors become what my late father-in-law called "handcuff volunteers" – they move further out on the risk curve not because they want to, but because they believe it's the only way to achieve the returns they seek.

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In this way, capital moves out of low-return, safe assets and in the direction of riskier opportunities, resulting in strong demand for the latter and rising asset prices. Riskier investments perform well for a while under these conditions, encouraging further risk taking and speculation:

> In his 1844 book *On the Regulation of Currencies* [banker John Fullarton] observed that at times of low interest, “everything in the nature of value puts on an aspect of bloated magnitude,” and every article becomes an object of speculation. Long periods of easy money, wrote Fullarton, engender “a wild spirit of speculation and adventure.” Fullarton noted that financial euphoria occurred after a period of falling interest rates: “From the Bubble year [i.e., the South Sea Bubble of 1720] downwards, I question much if an instance could be shown of any great or concurrent speculative movement on the part of capitalists, which had not been preceded by a marked decline of the current rate of interest.” (*TPOT*)

The risk-free rate is the point of origin, or jumping-off point, for returns and risk premia. When a central bank cuts the risk-free rate:

- the rest of the yield curve usually follows;
- the capital market line governing asset-class returns also shifts downward, especially if the desire for higher returns in the low-return environment causes riskier investments to be aggressively pursued as described above;
- in addition to moving lower, the capital market line also can flatten, reducing risk premia, if investors are paying little heed to fundamental/credit risk; and
- the liquidity premium – the increment in expected return for owning illiquid rather than readily saleable assets – can also shrink, as return-seeking investors embrace illiquid investments.

In all these ways, the return increments associated with longer-term, riskier, or less-liquid assets can become inadequate to fully compensate for the increase in risk. Nevertheless, the low prospective returns on safe securities cause investors to look past these factors and lower their standards, encouraging speculation and causing questionable investments to be made in pursuit of higher returns:





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> For [Austrian-school economist Friedrich] Hayek, it was axiomatic, but all too often overlooked, that "all economic activity is carried out through time." When interest rates decline, he said, businesses are inclined to invest in projects with more distant payoffs – in Hayek's terminology, the "structure of production" lengthens. If interest rates are kept below their natural level [see p. 13], misguided investments occur: too much time is used in production, or, put another way, the investment returns don't justify the initial outlay. "Malinvestment", to use a term popularized by Austrian economists, comes in many shapes and sizes. It might involve some expensive white-elephant project, such as constructing a tunnel under the sea, or a pie-in-the-sky technology scheme with no serious prospect of ever turning a profit. (*TPOT*, emphasis added; the quotation is from 1928)

I'll provide a few examples of imprudent investments made during the recent easy money period:

- In the low-return environment of 2017, Argentina once again became the poster child for questionable investment opportunities, when it offered 100-year bonds. As I asked at the time in my memo *There They Go Again . . . Again* (July 2017), "Is Argentina, a country that defaulted five times in the last hundred years (and once in the last five), likely to get through the next hundred without a rerun?" Argentina's checkered history as a borrower was ignored in the low-return environment, and the bonds were oversubscribed thanks to their having a yield of 7.85% at a time when 30-year Treasurys offered only 2.77%. It took less than a year for Argentina to request a loan from the International Monetary Fund and less than three years for it to default on the bonds. When the 100-year bonds were restructured in 2020, holders received new bonds with an expected recovery value of roughly 54.5 cents on the dollar, according to *The Wall Street Journal* of August 31, 2020. Aptly, that same *Journal* article quoted Piotr Matys of Rabobank Group NV, as saying, "Treasury yields are so low, it's forcing investors into risk. That's why people are buying crazy stuff."

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- In the 2010s, investors eagerly snapped up leveraged buyout loans bearing historically low yields of around 6%. The buyers included CLOs, which are structured to give relatively high yields to the investors in their lower-rated tranches, as well as private credit lenders that levered up the prospective returns to roughly 9%.
- While "zombie" companies that burn cash haven't historically been considered creditworthy, many were able to borrow easily in the pro-risk times through 2021. But as financial conditions have tightened, these companies have seen their cost to borrow rise and/or the amounts they can borrow shrink.
- The craving for good returns in low-return times can enable scams. Theranos (the medical technology company) and FTX (the cryptocurrency exchange) were the most prominent examples in recent years. Such scandals are less likely to happen in times of economic and capital market stringency, when investors are less eager and more careful.

Under easy-money conditions, long-dated bonds may appear particularly desirable; since the yield curve usually slopes upward, they typically offer higher yields. It should be noted, however, that long bonds are more rate-sensitive than short ones, meaning their prices change more in response to a given change in interest rates. As a result, the higher yields on more-volatile long bonds can attract capital in times of low rates, just when the odds usually favor a subsequent increase in yields (and thus a rapid decline in long bond prices).

It seems to me that there's often a similar movement of capital toward "long stocks" when interest rates are low. By this I mean the stocks of companies believed to have many years of rapid growth ahead. For these companies, more of the projected cash flows are, by definition, in the distant future. Yet, investors may become more attracted to these stocks when rates are low because they want the higher returns that such rapid growth would bring, and there's less opportunity cost associated with the long wait for the relevant cash flows. (These sound like Hayek's "projects with more distant payoffs." See the quote on the previous page.) Just as the prices of longer bonds fluctuate more in response to a given change in interest rates, so-called "growth stocks" usually rise more than others in times of easy money and fall more when money dries up. The former was certainly the case in late 2020 and in 2021 . . . and the latter in 2022.





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I love Hayek's word "malinvestment," because of the validity of the idea behind it: in low-return times, investments are made that shouldn't be made; buildings are built that shouldn't be built; and risks are borne that shouldn't be borne. People with money feel they must put it to work, since cash yields little or nothing. They drop their risk aversion and, as discussed below, compete spiritedly for lending or investing opportunities with higher potential returns. The investment process becomes all about flexibility and aggressiveness, rather than thorough diligence, high standards, and appropriate risk aversion.

Skimpy return prospects on safe assets lead to elevated risk taking – sometimes abetted by widespread optimism and/or the suspension of disbelief – and thus to the approval of investments that would likely be greeted with skepticism in normal times. Many of the risky assets people invest in out of presumed necessity are deemed less palatable and less valuable under tougher market conditions, when they can only be sold at lower prices.

v. Low rates enable deals to be financed readily and cheaply

Related to the above, low rates make people more willing to lend for risky propositions. Providers of capital vie to be the one who gets the deal. To compete for deals, the "winner" must be willing to accept low returns from possibly questionable projects and reduced safety, including weaker documentation. For this reason, it's often said that "the worst of loans are made at the best of times."

The availability of capital fluctuates radically. Whereas in times of stringency, capital may not be available even to quality borrowers for valid purposes, in periods of easy money, capital typically becomes available to weaker borrowers, in large amounts, for almost any purpose. Things that couldn't be financed in tighter times are deemed acceptable.

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For one example, consider the shifting perception of high-tech companies. Prior to roughly 2005, they were usually considered too undependable to be creditworthy, since outcomes for tech investments are generally asymmetric. If the company succeeds, the equity owners get rich. If it fails, there's little asset value for creditors to recover. But in the years following the tech/media/telecom meltdown of 2000-02, when interest in public equities declined and large sums flooded into private equity funds, tech companies began to be bought out, often with financing from the newly popular field of private credit.

vi. Low interest rates encourage greater use of leverage, increasing fragility

Borrowed money – leverage – is the mother's milk of rapid expansion and speculation. In my memo *It's All Good* (July 2007), I compared leverage to ketchup: "I was a picky eater when I was a kid, but I loved ketchup, and my pickiness could be overcome with ketchup." Ketchup got me to eat food I otherwise would have considered inedible. In much the same way, leverage can make otherwise unattractive investments investible. Let's say you're offered a low-rated loan yielding 6%. "No way," you say, "I'd never buy a security that risky at such a low yield." But what if you're told you can borrow the money to buy it at 4%? "Oh, that's a different story. I'll take all I can get." But it must be noted that cheap leverage doesn't make investments better; it merely amplifies the results.

In times of low interest rates, absolute prospective returns are low and leverage is cheap. Why not use a lot of leverage to increase expected returns? In the late 2010s, money flowed to both private equity, given its emphasis on leveraged returns from company ownership, and private credit, which primarily provides debt capital to private equity deals. These trends complemented each other and led to a significant upswing in levered investing.

But in the last decade, some companies acquired by private equity funds were saddled with capital structures that failed to anticipate the increase in interest rates of 400-500 basis-points. Having to pay interest at higher rates has reduced these companies' cash flows and interest coverage ratios. Thus, companies that took on as much debt as possible – based on their former levels of earnings and the prevailing low interest rates – may now be unable to service their debt or roll it over in a higher-rate environment.





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Finally, all else being equal, the more leverage that's piled on a company, the lower the probability it'll be able to survive a rough patch. This is one of the foremost reasons for the adage "never forget the six-foot-tall man who drowned crossing the stream that was five feet deep on average." Heavy leverage can render companies fragile and make it hard for them to get through the proverbial low spots in the stream. Take, for example, Signa, a large privately owned property company in Europe, which announced in November of last year that it was beginning insolvency proceedings:

The decision to go all-out during the era of cheap money left Signa dangerously exposed to the sharp rise of interest rates this year. . . . And rising interest rates have hammered commercial property values across the market, reducing the value of the assets used to secure Signa's loans. (*FT Asset Management Newsletter*, December 11, 2023, emphasis added)

vii. Low interest rates can lead to financial mismatches

Easy-money episodes make it particularly attractive to borrow short at low rates in order to make long-term investments or loans with higher prospective returns. This is the other classic reason why, in the investment world, proverbial six-footers often drown. (Investors with liability maturities that match the duration of their assets make it across the river much more regularly.) In tougher times, if lenders demand their money back or decline to roll over existing debt when it comes due, debtors can find themselves holding discounted or illiquid assets – just when cash is needed. This is a familiar theme that frequently marks the turn of the cycle from benign to nasty. Chancellor provides an example from 1866 in connection with the failure of Overend Gurney, a London broker:

> Lending against long dated and illiquid collateral was not a suitable business for Overend, which normally discounted three-month commercial paper financed with daily cash calls on the money market. *The Times* [*of London*] described how Overend had erred:

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> A Discount Company which had forsaken the business of discount brokers for that of "financing", which had locked up its assets in securities promising to repay a high rate of interest, but incapable of conversion into cash on an emergency, had found its resources too limited to meet the calls upon them except at a ruinous sacrifice of its property, and had, therefore, suspended payment. (*TPOT*)

viii. Low interest rates give rise to expectations of continued low rates

It's common for people to conclude that the environment they've lived through for a while is "normal," and that the future will entail more of the same. For this reason, people who have gotten used to low interest rates may think rates will always be low and make decisions based on that assumption. As a result, investor due diligence or corporate planning may assume that the cost of capital will remain low. This can become a source of trouble if rates are higher when financing is actually sought.

For example, in recent months, I've noted a number of lots in midtown Manhattan that have been cleared for the construction of new buildings. Given the lengthy planning and approval process involved with such projects, these buildings were undoubtedly greenlit in the low-interest-rate environment that preceded 2022. Will they be built if the actual financing costs are higher than those that were assumed? Or will they be abandoned at significant cost?

When the pandemic year of 2020 came to a close, the recovering economy, rallying stock market, and low interest rates put investors in a good mood, and there was widespread belief that the Fed would keep rates "lower for longer," supporting the economy and stock market for years to come. However, investors learned a lesson that has been repeated throughout financial history: catalysts for interest rate increases inevitably pop up, and thus perpetual prosperity and "the end of cycles" turn out to be nothing but wishful thinking. Consider another example from Chancellor:

> One of the aims of U.S. monetary policy in the 1920s was to dampen the seasonal fluctuations of interest rates caused by the agricultural cycle, which led to money being tight at certain times of the year. The Fed was so successful at this that Treasury Secretary Andrew Mellon went so far as to hail an end to the cycle of boom and bust. "We are no longer the victim of the vagaries of business cycles... As economist Perry Mehring writes [in *The New Lombard Street*]: "Intervention to stabilize seasonal and cyclical

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> fluctuations produced low and stable money rates of interest, which supported the investment boom that fueled the Roaring Twenties but also produced an unstable asset price bubble." (*TPOT*, emphasis added)

ix. Low interest rates bestow benefits and penalties, creating winners and losers

Importantly, low interest rates subsidize borrowers at the expense of savers and lenders. Does it make sense to reduce the revenues of lenders so that investors can lever their investments cheaply?

> [In the mid-17th century,] Thomas Manley added that lowering the rate of interest would involve robbing Peter (the creditor) to pay Paul (the borrower). (*TPOT*)

Doing so is a policy decision, or more likely the consequence of a decision to stimulate the economy. But it can have many other effects.

When the rate of interest on savings is 4%, a retiree fortunate enough to have saved up $500,000 will earn $20,000 per year on her bank balance. But when the interest rate on a savings account is near zero, as we saw for much of the last 14 years, she gets essentially nothing. Is it good for society to make her settle for zero? Or would it be better if she put the money into the stock market in an effort to make more?

While discussing the ramifications of policy decisions, let's consider the impact of low rates on the distribution of income and wealth.

> … because assets like stocks and real estate are disproportionately held by the rich, ZIRP [the "zero interest-rate policy" that was introduced in December 2008] helped produce the largest spike in wealth inequality in postwar American history. From 2007 to 2019… the wealthiest 1 percent of Americans saw their net worth increase by 46 percent, while the bottom half saw only an 8 percent increase. A report from McKinsey Global Institute, not exactly known as a bastion of economic populism, calculated that from 2007 to 2012, the Fed's policies created a benefit for corporate borrowers worth about $310 billion, whereas households that tried to save money were penalized by about $360 billion. (*The Atlantic*, December 11, 2023, emphasis added)

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The yawning economic gap is one of the biggest problems the U.S. faces, and it's probably responsible for a fair bit of the extreme divisiveness we see every day in the media and in politics. A central bank's decision to set rates that subsidize some and penalize others clearly has consequences.

x. Low rates induce optimistic behavior that lays the groundwork for the next crisis

Elevated risk taking, underestimating future financing costs, and increased use of leverage often lie behind investments that fail when tested in subsequent periods of stringency, bringing on the next crisis and perhaps the need for the next rescue. In this way, excesses in one direction typically precede excesses in the other direction.

> In October 1889, the Governor of the Bank of England, William Lidderdale, delivered a stern warning to the City:
>
> > The present tendency of finance . . . is distinctly in the direction of danger, too much capital is being forced into industrial developments, financiers are taking larger & larger risks in securities which require prosperity & easy money to carry without becoming a burden, & an increased number of investments have been driven up in price by the combined efforts of a long period of cheap money & depression in trade . . . we have most of the elements of a Crisis. (*TPOT*)

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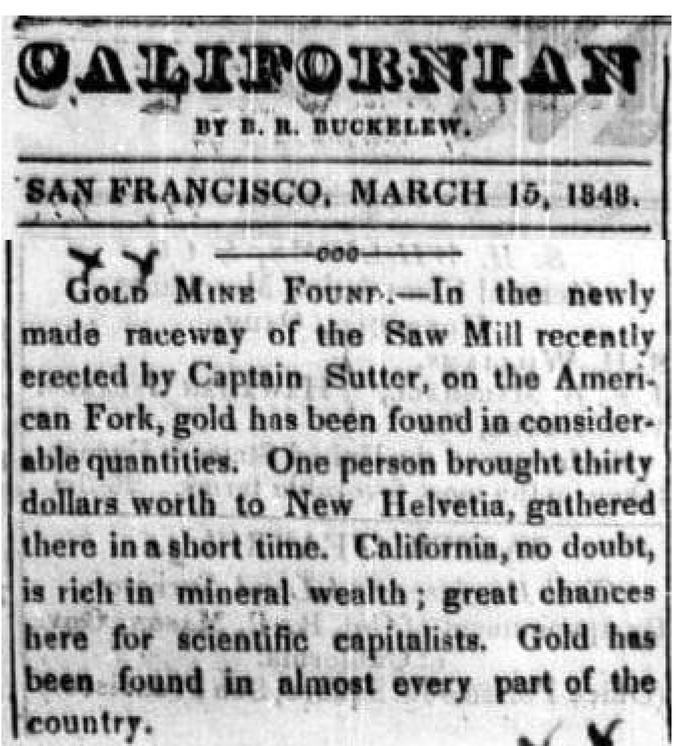
**What every investor can learn from legendary gold miner John Mackay (from Ian Cassel via MicroCapClub)...**

John Mackay was born in Dublin, Ireland in 1831. At the age of 9, the Mackay family immigrated to the US, living in the notorious Five Points in lower Manhattan, which was known as the worst slum in the United States.

John was lucky in that his parents scraped together enough money to send him to school, only him. His schooling only lasted for two years, when his father suddenly died, and John, at age 11 had to quit school to work to support the family. He was somewhat lucky in those two years because he learned how to read and write. This was the only formal education he would ever receive in his life. He would work selling newspapers for the next four years and then became an apprentice at a ship builder for another four years.

The Mexican–American War took place from 1846 to 1848. Nine days before the treaty was signed between to the two countries whereby the US was given California and New Mexico, gold was found in a riverbed in California that would spark the greatest gold rush in history.

Gold was discovered on January 24, 1848 by John W. Marshall, a carpenter and sawmill operator who worked at Sutter's Mill, owned by pioneer and German-born immigrant John Sutter. Sutter tried to keep it quiet but the news broke by March.



CALIFORNIAN

BY B. R. BUCKELEW.

SAN FRANCISCO, MARCH 15, 1848.

GOLD MINE FOUND.—In the newly made raceway of the Saw Mill recently erected by Captain Sutter, on the American Fork, gold has been found in considerable quantities. One person brought thirty dollars worth to New Helvetia, gathered there in a short time. California, no doubt, is rich in mineral wealth; great chances here for scientific capitalists. Gold has been found in almost every part of the country.

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On March 15, 1848 the *Californian* newspaper published the news, although many were skeptical that there was anything much in the report. It would be another two months before the rush to the hills began.

It would be a few months until news of the gold discovery hit New York, and a few months more before the excitement really hit. The trigger point were articles written about mining laborers making $50-70 per day which was 50x what a normal unskilled laborer made in the United States.

Tens of thousands of people started flooding into California and the gold rush was the main catalyst that kickstarted people moving from East to West during that time period. But during this time Mackay stayed at the shipyard earning $1-2 per day.

When you think about the California Gold Rush and how it ignited an excitement that pulled so many people West I think it's easy to think these people were dumb, undisciplined gamblers. But put yourself in the position of a common unskilled laborer making $1-2 per day here in the United States in the early 1850's. There were no advancement opportunities. Your best case scenario as an unskilled laborer was in 10 years you would be doing the exact same thing making the same amount of money. That was your upside.

What would you do? Stay at home making $1-2 per day for the rest of your life or go west and see if you can make 50x more. You too would be on the next horse/boat out of town.

By late 1851, a solid 2-3 years into the gold rush, Mackay quit his apprenticeship, boarded a ship, and headed for the west coast. He was late to the gold rush. By this time there would have been thousands of people already coming back East from the Sierra foothills empty handed. The easy pickings were picked and by late 1851 the cost of living had exploded in and around the gold rush.

In three years, San Francisco went from 800 people to 35,000 and became the fastest growing city in America. San Francisco became the melting pot of culture – you could hear English, Spanish, French, German, Chinese, Malay, and Hawaiian all spoken on the same city block. San Francisco was a place of new beginnings, because the city itself had no past.

But at the same time, anyone that came west with a moral compass, left it on the boat. Mining was extremely hard, and the outcome was much more like gambling. Many people went broke. Disease was rampant in mining towns. Alcohol and gambling were the main distractions. Violence and murder were common day behavior. Drinking, gambling, and gold were the top three endeavors. California quickly became the devil's playground.

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When Mackay landed in San Francisco in late 1851 he went straight to Downieville, California (100 miles north of Sacramento). He lived there for seven years mining gold in the gulches. He never made a big strike during these years, but he earned enough to support himself and send what he could back to his mother and sister.

Mackay actually loved the life – the outdoors, the physical work, the camaraderie, the chaotic menacing life of the mining camps. In his first few years Mackay built a hard working reputation. No one worked harder than he did. He was well liked among his peers. What made him different was at night when everyone drank and gambled, he stayed home and read about mining, geology, and also studied great men. He visualized himself in situations competing and winning.

In Downieville, at the start of the gold rush if you worked with a good team, you made $20 per day. But the pay was steadily coming down as the easy gold was taken out of the earth. By 1855 miners made $5 per day, and by 1858, you were lucky to make $3 per day.

By 1858, Mackay was 27 years old and had been mining seven years with nothing to show for it. He was working hand to mouth just like the first day he arrived. The Downieville gold district was dying, and it was time to make a move. Mackay and a friend packed up and literally walked 110 miles to Virginia City in Nevada that would later become the Comstock Lode.

It's hard to imagine that within 20 years John Mackay would own the entire district and become one of the richest men in the world. If you would like to learn more about John Mackay read this amazing book.


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John William Mackay (1831 - 1902)

I often think about the perseverance it takes to become who you want to be, and how it doesn't happen by accident. It is the result of deliberate thought, effort, and discipline. Mackay studied while everyone else drank and gambled. His effort in self-improvement wasn't a guarantee he would become successful. But he would have surely guaranteed himself to be poor if he hadn't put in the hours that others wasted.



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I think this is a valuable lesson for life, business, and investing. I was reminded again by this after watching this wonderful presentation by Shyam Sekhar. He outlines his maturation as a stock picker over the past 30-years.

*"When you make a lot of money ahead of when you should have it is your duty to grow yourself first and then handle that money. You need to grow yourself ahead of your portfolio." - Shyam Sekhar*

I love the concept of growing yourself ahead of your portfolio. It reminded me of an article I wrote seven years ago, The Maturation of an Investor. We all want instant fame and fortune, but the problem with instant success is you rarely have the power to keep what you haven't earned. Almost all successful people went through incredible hardship, obstacles, and challenges. The ability to grow yourself and prepare for success ahead of it occurring is the winner's quality.

The hardest part of achieving a great long-term investment track record is over half the time your returns will look average. You can go years where it feels like you are working hard for mediocre returns. Then all of a sudden it changes and the previous year's efforts, perhaps helped by a better macro environment create circumstances where you don't have to work as hard for your returns. The world works for you and pulls forward 5-10 years' worth of returns and riches in a single year.

Then it's up to you if this will be a permanent step change in knowledge and wealth. Is this your new base in which to grow from? Or will you stop growing yourself by letting your ego take control thinking you know everything. Will you revert slowly and then quickly back to immature tendencies? If so, your wealth will revert slowly and then quickly.

The growth and maturity to manage $1,000,000 is different than $100,000. The growth and maturity to manage $10,000,000 is different than $1,000,000. You must always be growing yourself ahead of your portfolio.

Grow yourself.

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**Terry Smith is known as "the Warren Buffett of Britain." Here are some highlights of his 2023 annual letter to shareholders (from Fundsmith)...**

This is the fourteenth annual letter to owners of Fundsmith Equity Fund ('Fund')...

The T Class Accumulation shares, the most commonly held share class and one in which I am invested... rose by 12.4% in 2023.

This compares with a rise of 16.8% for the MSCI World Index in sterling with dividends reinvested. The Fund therefore underperformed this comparator in 2023 but a longer-term perspective may be useful and is certainly more consistent with our investment aims and strategy. Since inception, the Fund has returned nearly 4% p.a. more than the MSCI World Index and has done so with significantly less downside price volatility as shown by the Sortino Ratio of 0.83 versus 0.51 for the Index. This simply means that the Fund has returned about 63%, ((0.83÷0.51)-1)x100, more than the Index for each unit of price volatility.

Our Fund is still the best performer since its inception in November 2010 in the Investment Association Global sector of 165 funds, with a return 335 percentage points above the sector average which has delivered just 215% over the same timeframe.

Outperforming the market or even making a positive return is not something you should expect from our Fund in every year or reporting period, and outperforming the market was more than usually challenging in 2023. The performance of the Nasdaq Composite Index, which was up 43% in USD in 2023, was dominated by a few companies, the so-called Magnificent Seven — Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla — which accounted for 68% of that Index's gains. Nvidia, the designer of chips for use in AI applications, alone accounted for 11% of the 43% gain.

We do not own all the Magnificent Seven and would probably not be willing to take the risk of doing so, even if all of them fitted our investment criteria...

We continue to apply a simple three step investment strategy:

- Buy good companies
- Don't overpay
- Do nothing

I will review how we are doing against each of those in turn.

As usual we seek to give some insight into the first and most important of these — whether we own good companies — by giving you the following table which shows what Fundsmith Equity Fund would be like if instead of being a fund it was a company and

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accounted for the stakes which it owns in the portfolio on a 'look-through' basis, and compares this with the market, in this case the FTSE 100 and the S&P 500 Index (S&P 500). This also shows you how the portfolio has evolved over time.

| | Fundsmith Equity Fund Portfolio | | | | | | | | S&P 500 | FTSE 100 |
|---|---|---|---|---|---|---|---|---|---|---|
| Year ended | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2023 | 2023 |
| ROCE | 27% | 28% | 29% | 29% | 25% | 28% | 32% | 32% | 18% | 17% |
| Gross Margin | 62% | 63% | 65% | 66% | 65% | 64% | 64% | 63% | 45% | 41% |
| Operating Margin | 26% | 26% | 28% | 27% | 23% | 26% | 28% | 29% | 16% | 15% |
| Cash Conversion | 99% | 102% | 95% | 97% | 101% | 95% | 88% | 91% | 76% | 85% |
| Interest Cover | 17x | 17x | 17x | 16x | 16x | 23x | 20x | 20x | 11x | 10x |

Source: Fundsmith LLP/Bloomberg.
ROCE, Gross Margin, Operating Margin and Cash Conversion are the weighted mean of the underlying companies invested in by the Fundsmith Equity Fund and mean for the FTSE 100 and S&P 500 Indices. The FTSE 100 and S&P 500 numbers exclude financial stocks. Interest Cover is median.
2016–2019 ratios are based on last reported fiscal year accounts as of 31st December and for 2020–23 are Trailing Twelve Months and as defined by Bloomberg.
Cash Conversion compares Free Cash Flow per Share with Net Income per Share.

In 2023 returns on capital and operating profit margins were higher in the portfolio companies than in the past. Gross margins were steady. Importantly all of these metrics remain significantly better than the companies in the main indices (which include our companies). Moreover, if you own shares in companies during a period of inflation it is better to own those with high returns and gross margins.

Consistently high returns on capital are one sign we look for when seeking companies to invest in. Another is a source of growth — high returns are not much use if the business is not able to grow and deploy more capital at these high rates. So how did our companies fare in that respect in 2023? The weighted average free cash flow (the cash the companies generate after paying for everything except the dividend, and our preferred measure) grew by 14% in 2023.

The only metric which continues to lag its historical performance is cash conversion — the degree to which profits are delivered in cash. Although this recovered slightly to 91% in 2023, this is still below its historical level of around 100% as a result of unusual events affecting a handful of our companies which we expect to largely unwind to their benefit in 2024.

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The average year of foundation of our portfolio companies at the year-end was 1916. Collectively they are over a century old.

The second leg of our strategy is about valuation. The weighted average free cash flow ('FCF') yield (the free cash flow generated as a percentage of the market value) of the portfolio at the outset of the year was 3.2% and ended it at 3.0%. The year-end median FCF yield on the S&P 500 was 3.7%.

Our portfolio consists of companies that are fundamentally a lot better than the average of those in the S&P 500 so it is no surprise that they are valued more highly than the average S&P 500 company. In itself this does not necessarily make the stocks expensive, any more than a lowly rating makes a stock cheap. However, we expect some of this disparity in valuation to be eradicated in 2024 if, as we expect, the cash conversion of our portfolio companies improves.

Turning to the third leg of our strategy, which we succinctly describe as 'Do nothing', minimising portfolio turnover remains one of our objectives and this was again achieved with a portfolio turnover of 11.1% during the period, a little higher than usual. It is perhaps more helpful to know that we spent a total of just 0.008% (just under one basis point) of the Fund's average value over the year on voluntary dealing (which excludes dealing costs associated with subscriptions and redemptions as these are involuntary). We sold our stakes in Adobe, Amazon and Estée Lauder and purchased stakes in Procter & Gamble, Marriott and Fortinet. As last year this may seem a lot of names for what is not a lot of turnover as in some cases the size of the holding sold or bought was small. We have held ten of our companies for more than 10 years, five of which since inception in 2010.

Why is this important? It helps to minimise costs and minimising the costs of investment is a vital contribution to achieving a satisfactory outcome as an investor. Too often investors, commentators and advisers focus on, or in some cases obsess about, the Annual Management Charge ('AMC') or the Ongoing Charges Figure ('OCF'), which includes some costs over and above the AMC, which are charged to the Fund. The OCF for 2023 for the T Class Accumulation shares was 1.04%. The trouble is that the OCF does not include an important element of costs — the costs of dealing. When a fund manager deals by buying or selling, the fund typically incurs the cost of commission paid to a broker, the bid-offer spread on the stocks dealt in and, in some cases, transaction taxes such as stamp duty in the UK. This can add significantly to the costs of a fund, yet it is not included in the OCF.

We provide our own version of this total cost including dealing costs, which we have termed the Total Cost of Investment ('TCI'). For the T Class Accumulation shares in 2023 the TCI was 1.05%, including all costs of dealing for flows into and out of the Fund, not

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just our voluntary dealing. We are pleased that our TCI is just 0.01% (1 basis point) above our OCF when transaction costs are taken into account.

However, we would again caution against becoming obsessed with charges to such an extent that you lose focus on the performance of funds. It is worth pointing out that the performance of our Fund tabled at the beginning of this letter is after charging all fees which should surely be the main focus.

Continue reading here.

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**An investment framework from Amazon founder Jeff Bezos (from Kevin Gee via X)...**

*An investment framework*

In every annual letter (including this one), we attach a copy of our original 1997 letter to shareholders to help investors decide if Amazon.com is the right kind of investment for them, and to help us determine if we have remained true to our original goals and values. I think we have.

In that 1997 letter, we wrote, "When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows."

Why focus on cash flows? Because a share of stock is a share of a company's future cash flows, and, as a result, cash flows more than any other single variable seem to do the best job of explaining a company's stock price over the long term.

If you could know for certain just two things--a company's future cash flows and its future number of shares outstanding--you would have an excellent idea of the fair value of a share of that company's stock today. (You'd also need to know appropriate discount rates, but if you knew the future cash flows *for certain*, it would also be reasonably easy to know which discount rates to use.) It's not easy, but you can make an informed forecast of future cash flows by examining a company's performance in the past and by looking at factors such as the leverage points and scalability in that company's model. Estimating the number of shares outstanding in the future requires you to forecast items such as option grants to employees or other potential capital transactions. Ultimately, your determination of cash flow per share will be a strong indicator of the price you might be willing to pay for a share of ownership in any company.

Since we expect to keep our fixed costs largely fixed, even at significantly higher unit volumes, we believe Amazon.com is poised over the coming years to generate meaningful, sustained, free cash flow. Our goal for 2002 reflects just that. As we said in January when we reported our fourth quarter results, we plan this year to generate positive operating cash flow, leading to free cash flow (the difference between the two is up to $75 million of planned capital expenditures). Our trailing twelve-month pro forma net income should, roughly but not perfectly, trend like trailing twelve-month cash flow.

Limiting share count means more cash flow per share and more long-term value for owners. Our current objective is to target net dilution from employee stock options (grants net of cancellations) to an average of 3% per year over the next five years, although in any given year it might be higher or lower.





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**How one small investment partnership earned 82% returns in high-quality stocks last year (from Sohra Peak Capital Partners)...**

Our partnership delivered a gain of +82.0% net of all fees, expenses, and allocations for the full year 2023. This year's returns were unusually strong. While the laws of probability would suggest that we are unlikely to repeat annual returns of this magnitude ever again, I am nonetheless happy to share this update and to have created meaningful economic value for our partners.

Our performance this year was driven by strong collective share price appreciation across many of our core holdings. Auto Partner and Mader Group shares each appreciated by +90-95%, and Duratec Limited and American Coastal Insurance Corporation each saw their share prices increase multiple-fold. Although we had a collection of "winners" and "losers" among the remainder of our portfolio, our holdings were generally most concentrated in what became our biggest winners.

During a recent call with one of our investors, I was asked if I was surprised by our partnership's returns this year. My answer was that I was not surprised that any of our individual holdings had appreciated by as much as they did given our views on price and intrinsic value. Rather, if anything, I would not have expected to have as many as four of our core holdings appreciate by close to +100% or greater in a single year.

In my experience, an investor can stack the odds of success in their favor by making sound investments, but even if you are correct in your thesis, predicting exactly when those companies' share prices will converge with intrinsic value is closer to unknowable. I certainly did not know, at least. By understanding this and focusing on what is knowable, we continue to remain committed to our investment process, finding the best investment opportunities available to us, and over time letting the chips fall where they may.

While I often have reasonable conviction as to our eventual collection of those chips, I have far lower conviction as to the timing of when those chips may be collected. Accordingly, in our pursuit of exceptional long-term returns, if we do in fact achieve our goal of delivering returns anywhere in the realm of "exceptional," I hope to remind you that our returns are highly likely to be volatile. We will inevitably experience bad years as well as good years. What is important to us is appreciating that we must endure the bad years in order to reap the rewards of

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the good years, and compounding our partners' capital at the highest rate of return that we responsibly can. We endeavor to build upon our early results in the years to come...

**Not Letting "Good Enough" Get in the Way of "Perfect"**

In our Q4 letter a year ago under a section titled Our Competitive Edge, we discussed the key high-level elements that we seek in our ideal portfolio company: a high quality business operated by a high quality management team, a demonstrated history of growing revenues and profits, an opportunity to continue organically compounding profits over a long horizon, and an attractive price relative to intrinsic value.

The below matrix, although imperfectly plotting three axes on a two-dimensional visual, illustrates our ideal portfolio company along these three variables of quality, growth, and present free cash flow yield:

In that same letter, I also examined the scarcity of public companies that exist with all three such elements intact, and the corners of the market where we usually hunt for these businesses and occasionally find them:





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> There are generally two types of situations in our experience where a quality company with durable, rapidly growing profits can be purchased at absolute bargain prices. The first situation is a company that is deeply out of favor, or in some cases outright hated, for the wrong reasons, where developing a correct contrarian view can provide the opportunity to purchase a great company at a giveaway price. The second situation is a company that can be bought at an absolute bargain price for the simple reason that it has not yet been widely discovered by the investing world.
>
> ... I believe our competitive edge lies in our ability to correctly identify companies that fit the second type of situation and in our willingness to be the only investors that we know of who own shares. We believe we have been able to make investments where this situation was apparent, and we also believe that these have been our best performing investments to date.

The above discussion I believe helps provide a high-level framework as to how we approach opportunity in the investment world. Through this framework, if our thesis in any given investment is correct, we believe our upside can be significant, and if we are wrong, we believe our downside is generally limited. This is also a method that we are comfortable with. We remind ourselves that there are many roads to Jerusalem; we are journeying along just one.

However, I think presenting a standalone framework misses other important aspects of the investment process that are necessary to best apply that framework, where the rubber meets the road. I often look back at my own mistakes that I have made as an investor over the years. One mistake which I have repeated often and have actively sought to correct (yet still make!), and which I believe is relevant and important to this conversation, is the mistake of letting "good enough" get in the way of "perfect" when seeking outstanding investments. The old adage advocates for not letting "perfect" get in the way of "good enough," but in my experience, it is the inverse of this adage which provides the more cautionary tale.

If we define "perfect" here as a prospective investment which ranks highly on all three elements of quality, growth, and valuation, then we can define "good enough" as a prospective investment that compromises on one or more of those elements to varying degrees. Over time, even as I had honed my framework closer towards my idea of "perfect" today, I would still frequently find myself recommending or investing in companies which in hindsight were only "good enough."

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I think there are a handful of reasons why settling for "good enough" in the context of any investment framework can occur, and not all are necessarily bad. For one, sourcing excellent investments is difficult, and is made even more challenging under liquidity, sector, or other standard investment constraints. Depending on one's mandate, satisficing can be the only way forward. It is also true that a portfolio of "good enough" companies can still deliver above-average returns and ultimately be good investments, even if they are not among the best possible investments available.

Commitment bias is another reason, and I would wager an underappreciated one, why an investor might select a "good enough" investment rather than discard it in lieu of finding a "perfect" one. After dozens of hours spent performing primary research, conducting calls, and building Excel models, it is easy to see how an investor might feel committed to that company as long as there is a reasonable argument to be made for its investment merits. I have certainly found myself in this scenario, particularly in my earlier years.

While there are numerous reasons why one's portfolio may not encompass an entire collection of ideal investments, each person and their portfolio is characterized by a set of reasons specific to them. For me, recognizing my own specific set of reasons that, over the years, have led me to allow "good enough" to get in the way of "perfect," has helped me better commit to demonstrating more patience, persistence, and discernment in my capital allocation decisions today. As a result, the correspondence between our "ideal" portfolio companies and our "actual" portfolio companies only continues to improve, in my view. We don't have all the answers, but we attempt to improve our processes as best and as frequently as we can.

One of Buffett's better known maxims is his analogy comparing investing to baseball, with the difference being that investing is a "no-called-strike game." Many important investing lessons really do come back to Buffett, with everything discussed here summed up nicely in Buffett's words, "you don't have to swing at everything. You can wait for your pitch." I firmly believe we are more patient than ever in waiting for our pitch. In the long run, our partnership should be better off for it.

Continue reading here.





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**How the "Coffee Can" approach can improve your investment returns (from The Rational Walk)...**

It has been nearly a half century since Jack Bogle launched the first index fund available to individual investors, a revolution that took many years to gain traction. Today, *trillions* of dollars are managed using passive strategies that attempt to merely achieve the average return of a targeted index. An investment policy that was once seen as defeatist has been embraced by millions of investors. Even Warren Buffett has embraced indexing for the management of his wife's portfolio following his death.

I have always believed that those who are *most* likely to dollar cost average into index funds over a long lifetime are the people who know the *least* about business and investing. Such people keep themselves occupied with their jobs and families and are much less likely to think that they are capable of selecting investments. Ego is less of a barrier when you know that you know nothing about business and investing!

For those of us who do try to pick individual stocks, it is important to have a long-term mentality but this is far easier said than done. This is especially true for value investors who buy companies at a discount to their assessment of intrinsic value. In cases where the stock advances to the investor's intrinsic value estimate, a decision must be made to continue holding the stock, to lighten up, or to sell entirely.

**I suspect that most value investors have experienced the agony of...**

- Buying a cheap stock.
- Patiently holding the stock while it remains stubbornly unrecognized.
- Selling the stock when it finally hits estimated intrinsic value.
- Watching in dismay as the stock suddenly gets popular and rockets higher.

For those with a value mindset, it can be more difficult to keep holding a stock that appears to be richly valued than to adopt a stoic attitude holding an unloved stock below your cost basis for a long period of time. There is a tendency to fret more about a richly valued stock declining. Many long term winners have been lost in this manner.

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One of my more popular articles in 2020 was My $2 Million Apple Mistake, a real life account of how I purchased 500 shares of Apple at $18 when it was statistically very cheap in the fall of 2000, only to sell the position in early 2001 at $20 for a $1,000 profit. At an intellectual level, I know that there was no possible way to know what the future would bring in early 2001. The *iPod* wasn't even released yet!

**But at an emotional level, what is now over $5 million in foregone gains stings!**

As ridiculous as it sounds today, bankruptcy was not out of the question for Apple during the first few years after Steve Jobs returned to the company. *But all I could have lost with my investment was $9,000. My potential gain was effectively infinite.* This asymmetry in common stock investing is not considered often enough. Losing $9,000 in 2000 would have certainly stung since it represented nearly a fifth of what I was saving and investing each year, but it would have hardly been catastrophic.

**What if I had adopted a strategy of just picking the best investment I could find every year and then doing absolutely nothing for at least ten years?**

This would combine *active* stock picking with a *passive* hold strategy for at least a decade. In practice, what would have happened is that some selections would have worked out far better than others. But just having one massive winner, such as Apple, would have dominated my results. I would have been content to "admire the flowers" while just stoically allowing the weeds to wither away or even die.

Let's take a closer look at the concept of "coffee can investing", an approach that is very simple in theory but harder to implement in practice. After some background on the concept, I will present a proposed variation on the strategy inspired by a practice that both T. Rowe Price and Peter Cundill adopted during their successful careers.



**Passively Active**

In 1984, Robert G. Kirby published The Coffee Can Portfolio in The Journal of Portfolio Management. While admitting that *in aggregate*, professional money managers do not produce returns superior to an unmanaged portfolio, Kirby believed that it was possible for skilled active managers to produce superior returns if not hindered by high transaction costs. In order to achieve high returns, such managers had to think like *investors* with a multi-year time horizon. In other words, *active* stock selection had to be coupled with a *passive* buy-and-hold mentality once the selection was made.



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**How does the "Coffee Can" come into play here?**

> *"The Coffee Can portfolio concept harkens back to the Old West, when people put their valuable possessions in a coffee can and kept it under the mattress. That coffee can involved no transaction costs, administrative costs, or any other costs. The success of the program depended entirely on the wisdom and foresight used to select the objects to be placed in the coffee can to begin with."*

Back when investors received a physical certificate after buying stock, they would often place the certificate in a safe deposit box rather than a literal coffee can. When Warren Buffett started giving away his massive fortune in 2006, he literally went to his local bank to retrieve a certificate for 121,737 Class A shares of Berkshire Hathaway which he gave to a courier to transport to the transfer agent. That certificate, issued in 1979, was in a "coffee can" for 27 years.

**How would Kirby's coffee can approach work in practice?**

> *"Take the example of constructing a new common stock portfolio of $100 million. The average, orthodox, professional money manager would build a portfolio of something like fifty $2 million commitments, each representing 2% of the fund. If that portfolio were then buried and forgotten for a while, several obvious conditions would apply. First, the most that could be lost in any one holding would be 2% of the fund. Second, the most that the portfolio could gain from any one holding would be unlimited."*

From an individual investor's standpoint, it is more useful to think of funds being saved over many decades rather than as a lump sum being deployed all at once. One reason for the success of index funds is that a typical individual investor is putting money into the index every month for many decades, taking advantage of the general tendency of stocks to rise over time as well as periodic bear markets in which more stock can be purchased for a fixed monthly investment.

Kirby thought of the Coffee Can concept in the mid-1950s based on an experience with a client he had worked with for about ten years. During that period, Kirby's firm would advise this client regarding stocks to buy and sell based on a conservative strategy focused on high quality companies. When the client's husband suddenly died, Kirby's firm was hired to manage the additional assets that his client inherited.

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**To Kirby's surprise, the husband had "piggy backed" on his buy recommendations but had totally ignored the sell recommendations.**

The client's husband had invested about $5,000 in every purchase recommendation, put the stock certificate in his safe deposit box, and took no other actions. Upon his death, the man owned several small holdings worth under $2,000, several large holdings worth over $100,000, and one huge holding worth over $800,000 that exceeded the entire value of his widow's portfolio!

By ignoring Kirby's sell advice on several stocks, the man had suffered losses represented by the small positions worth under $2,000, but the impact of those small losses absolutely paled in comparison to the big winners which were only achieved by *ignoring* Kirby's advice to sell. While Kirby's client dutifully followed his advice, her husband only followed *half* of his advice and ended up far richer due to his passivity.

### Did He Really Forget

In the article, Robert Kirby writes that the man "would toss the certificate in his safe-deposit box and forget it" but I assume that he means this figuratively. Most people don't just forget what they own. It is likely that this man simply had an unusual mindset when it came to investing and had the intestinal fortitude to see his portfolio become extremely "unbalanced". The fact that a few positions came to dominate did not bother him at all. How many investors could adopt such a disciplined approach?

It is only natural to want to take some "chips" off the table when you have a big winner even if you continue to believe in the long-run success of an investment. This is even more true when a winner becomes dominant.

When I write about Apple being a "$5 million mistake", this assumes that I would have held the stock for the past twenty-three years through all of the news cycles and fluctuations, as it grew to dominate my portfolio. However, I know that even if I had not sold in early 2001, there is no way I would have held the entire position until now.

But is this really an all-or-nothing proposition? Could there be a variation of the "Coffee Can" approach that would allow investors to benefit from big winners while also satisfying a natural tendency to want to take "chips" off the table? I think that there is one approach, but it seems unintuitive and even illogical at first glance.

### A Rational Interlude

From a strictly rational perspective, investors should not focus on the *cost basis* of their investments with the exception of considering tax consequences, particularly when it comes to short term vs. long term gains. What one pays for a stock is obviously relevant at the time it is purchased, but what matters on an ongoing basis is the price of the stock relative to the investor's *current* assessment of intrinsic value.





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For example, if I purchase a stock today for $100 and it gets cut in half tomorrow due to a negative event, the fact that I paid $100 today has no rational bearing on whether I should hold it at $50 tomorrow. Assume that my assessment of intrinsic value was $150 when I bought the stock for $100. When the bad news comes out, I reassess my estimate of intrinsic value to $90. The fact that I paid $100 *yesterday* is not relevant when it comes to deciding whether to hold the stock. What matters is the level of confidence I have in the stock being worth $90 *today* relative to the $50 stock price.

The same logic applies to stocks that go up. If the stock that I purchase for $100 today is trading at $200 in one year, what matters is whether my assessment of intrinsic value a year from now is materially above the stock price. I should not anchor to my cost basis or my estimate of intrinsic value when I bought the stock. Intrinsic value is an estimate that must evolve over time. Cost basis is a historical artifact.

### Selling Half After a Double

The approach that I am proposing is admittedly *irrational* when viewed from a strictly economic perspective, but I believe it could be *rational* when one considers human nature. Few active investors have the ability to operate in a completely rational manner because emotion always comes into play. Financial gains and losses are not seen as sterile figures on paper but as hopes and dreams fulfilled or lost.

When a stock rallies strongly, it is natural to worry about giving back your gains, and this is true for most investors even when the intrinsic value of the business has demonstrably increased. What if an investor decides that after a stock doubles in price, he will sell half of the position to recover his entire cost basis? If so, he might regard the remaining half of the position as "house money."

For example, my position in Apple purchased on November 28, 2000 would have approximately doubled by September 8, 2004. What if I had sold 250 shares on September 8, 2004 and held the remaining 250 shares in a coffee can? Well, those 250 shares would have turned into 14,000 shares worth approximately $2.7 million today, plus I would have received substantial dividends over the years.

A similar exercise could be done with the shares of Costco that I owned all too briefly in 2003 and the much more substantial positions in Microsoft that I owned

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in the early 2010s. The only stock that I truly coffee canned during that timeframe was my longstanding ownership in Berkshire Hathaway which turned out well, but not nearly as spectacularly as the results that Apple and Microsoft would have delivered!

Of course, adopting the coffee can approach would have led to losses as well as winners, but would it matter? I have not gone through the "coffee can" exercise with all stocks I've owned over the years but it's clear that the impact of the losses would have paled in comparison to the winners of a "sell half and let the rest ride" strategy.

**This Isn't An Original Idea**

The concept of taking your cost basis out of a position by selling half after a double is not an original idea. I have seen this approach mentioned by investors many times in the past and some very successful investors apparently used it.

Peter Cundill is well-known in the investing community primarily because of Christopher Risso-Gill's excellent book, There's Always Something to Do, which I reviewed six years ago. The author was a director of the Cundill Value Fund for a decade and had access to Peter Cundill's journals from 1963 to 2007. These journals contain a wealth of information about decisions made in real-time.

One of the experiences early in Cundill's career involved buying Tiffany shares during the 1973-74 bear market. The company was selling for less than the fixed assets on its balance sheet including the flagship Fifth Avenue location in Manhattan. The brand was being given away for free, so Cundill eventually accumulated three percent of the stock at an average cost of $8 per share. The entire position was sold within a year at $19 per share, only to see Tiffany acquired by Avon Products soon after for $50!

Later in his career, Peter Cundill reflected on the problem of selling too soon:

> *"This is a recurring problem for most value investors — that tendency to buy and to sell too early. The virtues of patience are severely tested and you get to thinking it's never going to work and then finally your ship comes home and you're so relieved that you sell before it's time. What we ought to do is go off to Bali or some such place and sit in the sun to avoid the temptation to sell too early."*

The temptation to sell can be very strong. Cundill Value Fund board members debated the question of when to sell a position that rallies strongly and eventually they came to the conclusion that they would sell half of the position after a double:

> *"In the end the solution turned out to be something of a compromise: the fund would automatically sell half of any given position when it had doubled, in effect thereby writing down the cost of the remainder to zero with the fund manager then left with the full discretion as to when to sell the balance."*





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In the case of the Cundill Value Fund, the remaining fifty percent was not put in a "coffee can", but maintained at the discretion of the manager. However, the basic principle of taking the cost basis out of the position is the same.

Thomas Rowe Price Jr. was known as "The Sage of Baltimore" during his long and successful career. Price was a proponent of investing in growth stocks, "defined as a share in a business enterprise which has demonstrated long-term growth of earnings, reaching a new high level per share at the peak of each succeeding business cycle, and which gives indications of reaching new high earnings at the peaks of future business cycles." Cornelius C. Bond's biography of Price, which I reviewed in 2019, provides insight into his overall philosophy and track record.

Like Cundill, Price also adopted a variation of recovering the cost basis of a position that has appreciated significantly:

> *"Once a position is established, if a stock then moved to a significant premium over what it is deemed to be worth, he suggested that the stock be sold until the total cost of the stock position, plus capital gains taxes, is realized. The profit, he believed should be reinvested in long-term government bonds, or good-quality corporate bonds for safety and income. The profit represented by the shares left in the portfolio should be allowed to continue to grow in value until the company matures and is no longer considered to be a growth company. These shares effectively have no cost."*

Price's version of the rule is slightly different because he suggests trimming a position after it becomes overvalued rather than when it doubles. However, the basic premise is the same. By recovering the cost of the position, plus capital gains taxes owed, the remainder is regarded as having "no cost" and can be left in the portfolio as long as it continues to be a growth company.

Continue reading here.

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**Nick Sleep earned 21% compounded returns for more than a decade. Here are the details on his investment approach (from Invest in Quality)...**

### Nick Sleep beat the market by a mile for 13 years

His fund returned 921% vs. 117% for the MSCI world index, which is almost a 9X better result than the index. Sleep compounded shareholders' capital by 20.8% annually (18.4% net of fees) while running Nomad Capital. This is a spectacular result. Let's dive into what we can learn from Nick Sleep's investing approach.

| To December 31st, 2013: | Nomad Investment Partnership | MSCI World Index (net) US$ |
|---|---|---|
| Trailing: | % | % |
| One year | 62.2 | 26.7 |
| Two years | 126.8 | 46.7 |
| Three years | 104.3 | 38.6 |
| Four years | 194.0 | 54.9 |
| Five years | 404.1 | 101.3 |
| Six years | 176.6 | 19.4 |
| Seven years | 235.3 | 30.2 |
| Eight years | 280.9 | 56.3 |
| Nine years | 316.5 | 71.1 |
| Ten years | 409.8 | 96.3 |
| Eleven years | 815.5 | 161.3 |
| Twelve years | 827.4 | 109.3 |
| Since inception (September 10th, 2001) | 921.1 | 116.9 |
| | | |
| Annualized since inception: | % | % |
| Before performance fees | 20.8 | 6.5 |
| After performance fees | 18.4 | |
| | | |
| Value of a dollar invested at inception (pre-fees) | $10.21 | $2.17 |





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## Nick Sleep's strategy and leading principles

### Compounders that turned into multi-baggers

Nick Sleep is known for having an immense eye for detail and quality and going deep into the information with the longest shelf life. He wanted to understand the DNA of the business, the "deep realities" that made one business successful. By going a mile deep into understanding the businesses, he achieved an edge over other managers who would go a mile wide and only an inch deep. He got to know these compounders at their deepest levels; the culture, the unit economics, the business model, the deep-seated competitive advantage and so much more.

### Founders & Managers

Nick Sleep understood the importance of incentive alignment. Therefore, he paid close attention to founder-les businesses, and managers with significant ownership stakes. He realized that the best entrepreneurs did not care about their salary. So-called "hired guns" often care more about their interest, than that of the shareholder. This can be dangerous as it means that the manager might make acquisitions or other capital allocation moves that dilute the shareholders and ruin the business' quality.

As an example, Buffett, Bezos, and Mark Leonard have all waivered their salaries at some point. Just the type of managers Sleep was looking for.

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### Destination Analysis

Sleep did not focus on the next few quarters, he often discounted quarterly reports. He wanted to know where the business was going in 10-20 years. He wanted to know the destination so that he could make an educated guess about the potential returns he would receive from jumping on board.

To help him get this information when he talked to management, he used the 3 following questions:

1. *Where will the business be in 10-20 years?*
2. *What must management do now to reach that destination?*
3. *What circumstances could prevent the business from reaching its destination?*

Sleep would know quickly if a management team had thought of these questions beforehand. It would indicate a long-term mindset, and a management team that Sleep was looking to invest with if these questions were answered thoughtfully.





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### Long-term oriented

Sleep understood compounding, and that the interruption of compounding was the biggest threat to his returns. Therefore, he wanted to keep the compounding effect rolling and stuck to his winners. After determining the business' destination and that the management team was competent and had a clear and realistic plan to reach the destination, Nick Sleep let the business run.

He is notorious for ignoring short-term noise. News and quarterly earnings will not make Sleep change his mind on a specific business. The elements he looks for and analyzes unfold themselves on a much longer time scale than 3 months.

Financial news sources are incentivized to make you click their articles, as this provides them with more ad revenue. Therefore, they are likely to sensationalize small and insignificant events, even if the effect on the business is almost 0. Sleep would avoid this kind of news like the plague.

### Scale Economics Shared

This is a concept that Sleep came up with to explain some of the best business models in the world. Take Costco as an example, they offer products for the cheapest price in the market. They can do this because they buy at scale from suppliers. When they buy at scale, they can negotiate better prices from suppliers – most companies will take this cost savings and add it to their profit margin, but Costco transfers this cost saving directly to their customers. Costco's business model is to only take ~14% margin on the products they sell, and if they get better prices, they share it with their customers. This has proven to create a deep-seated loyalty in Costco customers, and it creates a natural moat around Costco.

Sleep recognized that companies that had a business model that was centered around the customer, where the customer got the better deal from a structural part of the business (its scale), were superior businesses.

Sleep released a write-up on Costco in 2005, that is pure brilliance, a highly recommended read: https://aksjefokus.no/wp-content/uploads/2020/08/Nick-Sleep-Costco.pdf

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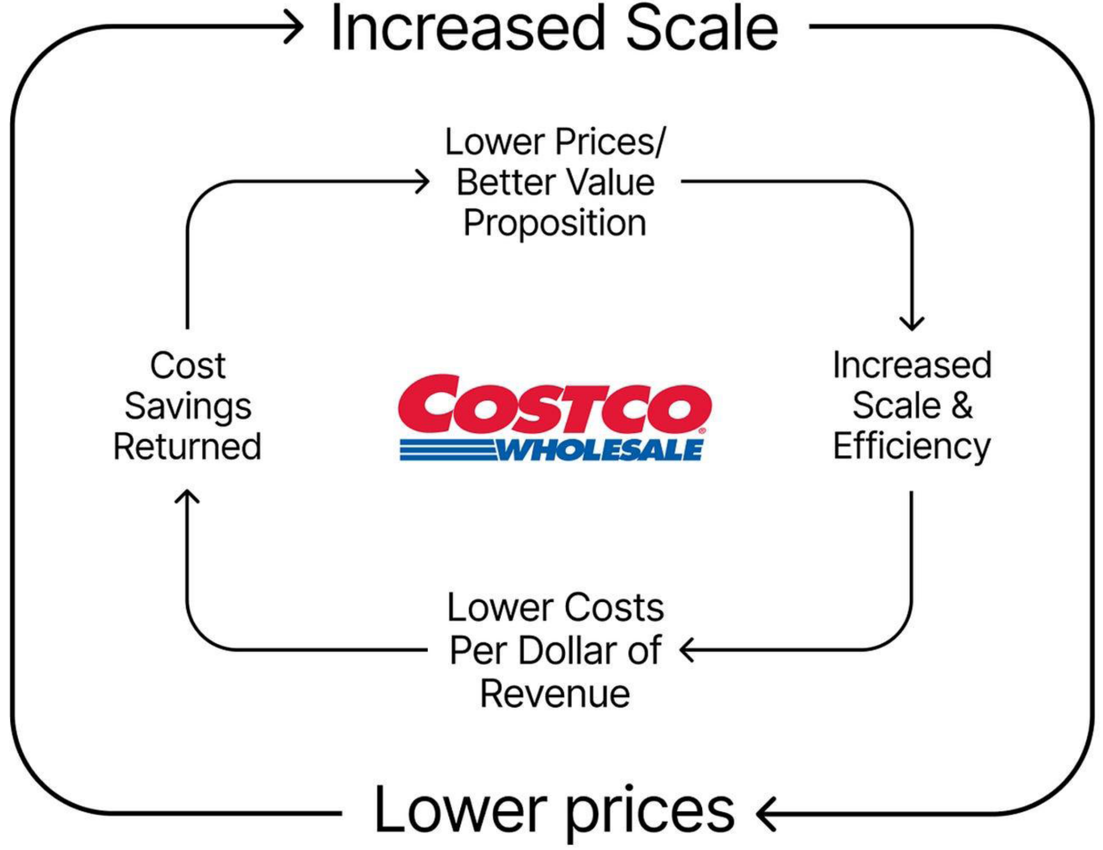


**Price Giveback**

Another strategy that Sleep looked for in the businesses he invested in was what he called “Price Giveback”. These businesses would give back 2%-10% of what the customers bought to the customer. Sleep thought that this was a powerful tactic that would build customers’ habits and loyalty, providing an incentive to come back again and again.

The strategy would give the customers positive associations with the brand, which in turn became a widening moat.

Today, it feels like almost every retail store has adopted this tactic (Guess it works). However, it can be argued that if everyone is doing the same thing, it is no longer a unique tactic that can provide an edge.





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### Lollapalooza moat

Companies that do one thing well and rely heavily on that one thing can pose a huge risk. What if that one thing starts to deteriorate? This is why Sleep preferred companies that did many things well. It is almost impossible to replicate the success of some companies – Both Ikea and Costco are great examples: A competitor must do 1 million small things just right or better to get an edge. From Costco's $1 hot dogs to the strategic way Ikea stores are set up to make us feel good & buy more.

Lollapalooza moat can be seen in several dimensions, for example, the culture of a company will play into this. The distribution network, their hiring processes, how they keep talent on board, how they give compensation, how they create alignment in the organization, how they make sure strategic initiatives are executed, and so on.

This type of moat requires deep insights into the business to determine, it is not enough to read the 10K and expect to get a deeper understanding of the "deeper realities" of a business.

### Do nothing

Sleep was a fan of portfolio inactivity. He realized that humans are predisposed to "take action", but action from a portfolio perspective often leads to sub-optimal returns. Humans need to feel productive, and like we are making progress towards a goal, but this is often counterproductive when it comes to long-term investing in "compounders."

Sleep wanted to benefit from the compounding effect, and realized that by using an immense amount of time to analyze what kinds of companies he let into his portfolio, he could hold them for longer periods and therefore extract the big returns that come from holding fantastic companies over 10+ years. He held Berkshire Hathaway, Costco Wholesale, and Amazon.com for a long time which represents a lot of the results for his fund.

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A study from Fidelity found,

From 2003-2013, the best performing accounts were from investors who were dead...

What about the second best performing accounts?

Investors who had forgotten they had an account...

Buy, hold, and be patient!

**Don't pick the flowers and water the weeds.**

Volatility is inevitable for investors. It can be physically painful to watch your portfolio and certain positions go down by more than 50%, but if you want to invest in individual stocks over a long time frame, it will happen at some point.

One of the drivers of Sleep's success is that he managed to identify truly fantastic businesses and hold on to them. He owned Costco for 18 years, through ups and downs, and he held onto Amazon and Berkshire Hathaway for more than 10 years. Just these 3 investments provided one hell of a result. Imagine if he had sold Amazon early due to a temporary high valuation without the foresight to see what Amazon could become down the line.

Continue reading here.





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## INVESTMENT IDEAS

**Speculators are holding the largest short U.S. dollar position since 2020 (and one of the largest in history) (from Barchart via X)...**

Source: Macrobond, Morgan Stanley Research

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**Why share buybacks can be more lucrative than dividends (from Special Situation Investing)...**

On the surface, it would seem that a dollar earned is a dollar earned, and that shareholders benefit the same from both dividend and share buyback strategies. But the math behind how those earnings translate to shareholder returns can be quite staggering. Warren Buffett himself covered this topic in more than one shareholder letter, but, as with most profound concepts, it's worth revisiting from time to time even if you're already familiar with the topic.

To illustrate how much the means by which a company returns capital to shareholders matters, let's investigate the same hypothetical company under two different capital allocating models. In both scenarios the imaginary company will earn $10,000,000 per year and experience no change in earnings. Next, the company will start with 1,000,000 shares outstanding in both scenarios but will see the share count steadily drop under the buyback scenario. The companies' P/E ratio will also remain constant at five throughout both scenarios.

**Scenario One**

In Scenario One, management decides to repay shareholders through dividends alone. The company distributes 100% of its annual earnings to shareholders via a dividend for each of ten years. The company's management realizes that capital can't be effectively employed within the business, growth can't be obtained via acquisitions or mergers, and there is no debt to repay, which leads them to the conclusion that the most shareholder-minded path forward is to distribute all of the earnings to shareholders via dividends.

Ten years of after-tax dividend distributions added to the after-tax proceeds of a share sold in the tenth year will, when compared with the starting amount payed for the first share, reveal our imaginary investor's total return for Scenario One. For simplicity sake, a 15% tax rate will be used on both dividend distributions and the sale of stock in both scenarios.

Armed with that background information, how did our imaginary investor fare in the dividend-only scenario? We can see based on the chart below that he initially purchased a $50 share in the company that was earning $10 per share. The full $10 in earnings was paid out to investors as a dividend but of course the investor paid a 15% tax on the distribution leaving him with $8.50. This initial return sees our investor feeling pretty good about himself as he's earned a respectable 17% on his investment in year one and was able to beat the S&P 500.





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| | Shares | Earnings | EPS | P/E | Share Price | Dividend | Dividend After 15% Tax |
|---|---|---|---|---|---|---|---|
| | | | | | | | |
| 1 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| 2 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| 3 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| 4 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| 5 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| 6 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| 7 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| 8 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| 9 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| 10 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | $10.00 | $8.50 |
| | | | | | | | |
| | | | | | | | $85.00 |

Because the company experiences no growth over a ten year period, we can easily calculate our investor earns $85 dollars in dividends over a ten year period. And because earnings and P/E remain constant, the shares still trade for $50 dollars at the end of a ten year years.

Our investor sells his $50 share at the end of ten years and nets $42.50 after paying a 15% tax which when added to his $85 in dividend income leaves him with a total of $127.50. Not too bad given his initial investment of $50 but because there was no growth in the underlying share price, and because of the effect of taxes on his investment, his compounded annual growth rate (CAGR) at the end of 10 years amounts to only 9.81%. A solid return to be sure but nothing that will land you in the fund manager hall of fame with the likes of Sir John Templeton and Warren Buffett.

### Scenario Two

In Scenario Two the company returns all of its earnings to shareholders via share buybacks and pays no dividend. The management in this scenario also sees that the company can't grow internally, and that it can't grow through mergers or acquisitions, and that no debt repayments are required. But instead of paying out earnings as a dividend, they believe shareholders will benefit most from buybacks.

In year one the company earns $10,000,000 and each of its 1,000,000 shares trades for $50 per share meaning that it can use the earnings to repurchase 200,000 shares of stock. What's interesting is how non-linear the share

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repurchases are with each passing year. This is because the $10,000,000 in earnings, which remains flat throughout, is divided among fewer and fewer shares outstanding so that the earnings per share rise even while the company's actual earnings remain flat. The flat P/E multiple of five is applied to an ever increasing earnings per share which makes each share more expensive and leads to less shares being repurchased each year. The math is Occam's Razor-like in its outcome in that you continue to buyback shares but never quite repurchase all of them.

In any case, a quick glance at the included chart shows that the company's price per share increases exponentially under the share repurchase only strategy. In fact, the shares come close to doubling in price every three years which should set off alarm bells in the head of any investor. Doubling every three years indicates that you are in fact now approaching hall of fame level growth rates.

The precise return on investment in Scenario Two can be calculated as follows.

| | Shares | Earnings | EPS | P/E | Share Price | Total Shares Repurchased |
|---|---|---|---|---|---|---|
| 1 | 1,000,000.00 | $10,000,000.00 | $10.00 | 5 | $50.00 | 200,000.00 |
| 2 | 800,000.00 | $10,000,000.00 | $12.50 | 5 | $62.50 | 160,000.00 |
| 3 | 640,000.00 | $10,000,000.00 | $15.62 | 5 | $78.12 | 128,008.00 |
| 4 | 511,992.00 | $10,000,000.00 | $19.53 | 5 | $97.66 | 102,396.00 |
| 5 | 409,596.00 | $10,000,000.00 | $24.41 | 5 | $122.07 | 81,920.00 |
| 6 | 327,676.00 | $10,000,000.00 | $30.52 | 5 | $152.59 | 65,535.00 |
| 7 | 262,141.00 | $10,000,000.00 | $38.15 | 5 | $190.73 | 52,430.00 |
| 8 | 209,711.00 | $10,000,000.00 | $47.68 | 5 | $238.42 | 41,942.00 |
| 9 | 167,769.00 | $10,000,000.00 | $59.61 | 5 | $298.03 | 33,554.00 |
| 10 | 134,215.00 | $10,000,000.00 | $74.51 | 5 | $372.54 | 26,843.00 |

No dividends are paid but due to share repurchases the stagnant $10,000,000 in earnings leads to ever increasing earning per share, and an ever increasing share price, ending with a price per share in year ten of $372.54. After applying a 15% tax to the final share price the investor has $316.66 from a starting investment of $50 or a 20.27% CAGR.

The difference between Scenario One and Scenario Two is staggering, especially given that the company's fundamental performance didn't change in either case. To further highlight the difference, it's worth noting that $10,000 invested in Scenario One would end up as $25,492 in ten years while in Scenario Two an investor would end up with a whopping $63,325. More than double the total return in Scenario Two given no other variable than the capital allocations decision of management.





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### Retained Earnings Valued Higher Than Dividends

One key reason buybacks yield higher returns than dividends is because retained earnings are multiplied by the price to earning multiple which, in effect, makes each retained dollar worth more to the investor. Let's use the company in our previous two examples to illustrate the point. We see that a single dollar of earnings, if retained, can be sold for $5.00 because it is multiplied by the P/E ratio of five. While the $1.00 in earnings as a dividend is worth less than a single dollar because no multiple is applied, and the 15% capital gains tax applies to it, leaving the investor with only $0.85.

As more shares are repurchased the company's earnings per share also increase which further compounds the benefit of retained earnings mentioned above. Put simply, retained earnings are worth more, all else being equal, than earnings payed out as dividends. Share repurchases compound this effect by increasing the multiplier with which the already superior retained earnings are multiplied.

### Real-World Complications

Of course nothing in the real world is ever so static as the simplistic examples used in today's discussion. Multiple variables can effect results in either direction. For example, paying out a large dividend can by itself drive the stock's price higher. This is because the high dividend yield of the stock might attract other investors seeking steady income and their purchasing of the stock could drive the price higher. In both of our scenarios, the P/E multiple remained flat at five but a sizable and steady dividend payment could increase the price of the stock and in turn increase an investor's CAGR in that circumstance.

Furthermore, a combined strategy of dividends and buybacks can be applied to the same company. The capital allocation decisions of management don't have to be fully dividends or buybacks as outlined in the scenarios above but could be a combination of both.

Interestingly, a static dividend payout when combined with share repurchases, will result in an ever increasing per-share dividend without having to increase the actual dividend payout at the corporate level. In this case, share repurchases would both increase the stock's earnings per share and its dividend payout and would have a different overall effect on investment performance than either scenario would in isolation.

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One key to remember, in the case of the buyback scenario, is that the total share count must go down over time. Many companies virtue signal by engaging in share buybacks only to turn around and issue the same shares in the form of executive stock compensation. In this case the share repurchase doesn't benefit you, the owner, but rather underwrite the executive suites compensation package. A consistent policy of share repurchases should see the company's total shares outstanding shrink commensurately over time if the investor is to have any hope of securing the benefit of the buybacks in the form of investment returns.

**One Size Doesn't Fit All**

It should be remembered that there is no-one-size-fits-all strategy in investing. If a company can compound capital through internal investment at a higher rate than it could through either dividend payouts, or share repurchases, then it should take that course. The end goal should be the highest CAGR for investors regardless of the tactics used to accomplish the goal. But for some companies, compounding capital internally isn't an option, and deciding what combination of dividends and share buybacks to pursue is of the highest importance to shareholders.

Many of the companies we review on this podcast are in just such a situation. Orphaned by ESG policies many natural resource companies are cut off from traditional financing and growth opportunities. These companies earn high returns on capital employed but have limited means by which they can internally employ the capital they produce. Understanding the math that drives shareholder returns for both dividend strategies and share buyback strategies can help investors determine which companies are most intelligently managing the hand they've been dealt and which companies will yield the highest return to investors.

Continue reading here.





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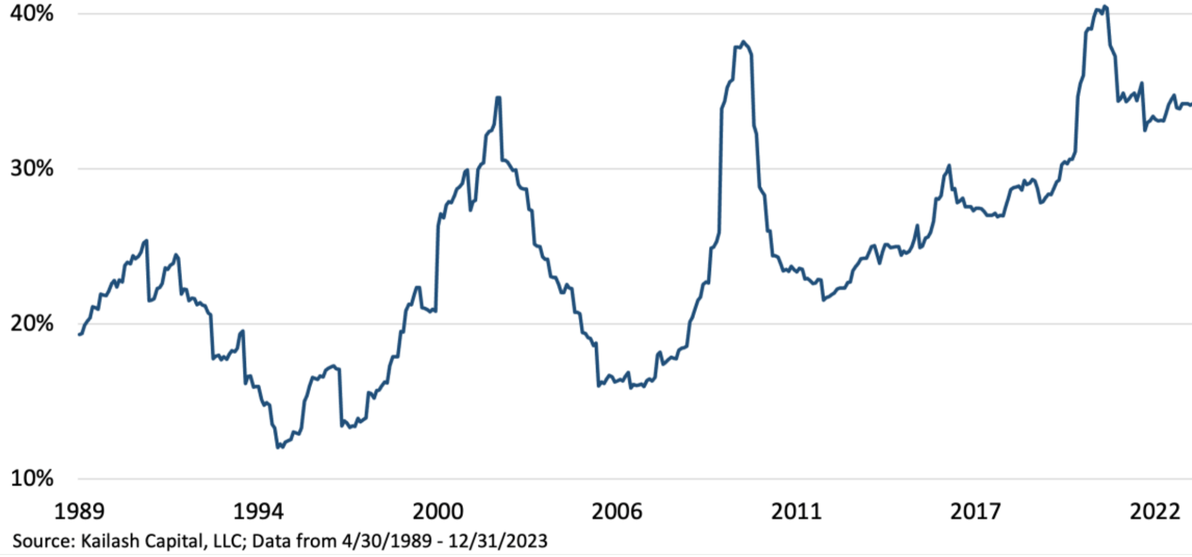
**Avoiding "zombies" is a simple but powerful way to improve your investment returns (from Kailash Capital Research)...**

The chart below shows the percentage of the Russell 3000 that either lose money or can't afford to pay the interest expense on their debt. We dubbed this group the "Loss Makers and Zombies."

Over 33%, or ~1,000 of America's listed companies qualify.

This is happening against a backdrop of corporate profit margins shattering the record last seen in 1929.




The [next] chart below shows the compound return on $1 of loss makers & zombies vs. all other stocks.

We believe avoiding the zombies seems like an obvious first step to better long-term returns. To each their own.

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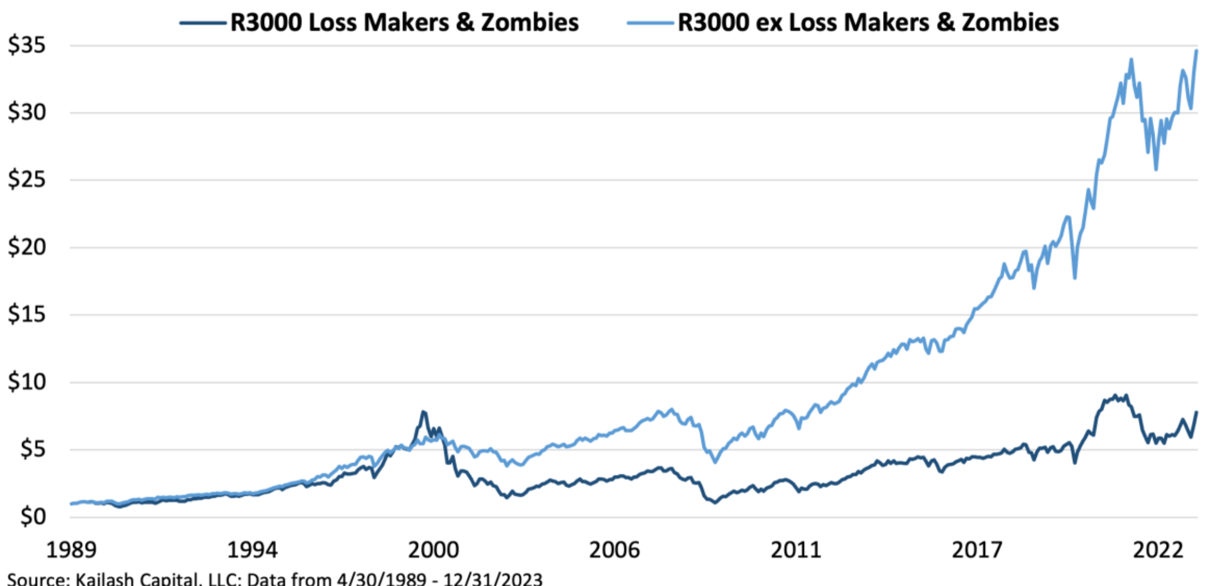






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**A relatively low-risk opportunity in a sector few investors are interested in today (from Wall St Gunslinger)...**

I've decided to make the first pick of my new "paid" tier free to give everyone a sense of what they can expect.

So let's get into the idea I like the most this month.

When deciding which name I wanted to highlight, my mind kept wandering back to the idea that I have recently participated in, plus will be participating in after this is sent to everyone. (I always buy the name or in this case, names, after I send out the pick each month.)

It stuck out to me because I see a risk-reward return profile that I find attractive. It will bore most of the growth investors as it deals with an asset-heavy business and IRRs that are not eye-popping.

But R/R works on a sliding scale and if I can achieve these satisfactory rates of return with a below-average risk profile, I will take the bet every time.

This month my picks are a small basket of Multifamily REITs, more specifically:

1. Mid-America Apartment Communities (MAA)
2. Camden Property Trust (CPT)
3. Equity Residential (EQR)

This is the basket I own and these are the horses I'm betting on.

You should know as the reader I am return agnostic. If I feel confident in my ability to analyze the cash flows, it can come from a portfolio of Real Estate or an Oil well. The money is green either way and if the price is attractive enough, I am willing to look at anything I feel I can understand.

I feel comfortable with these.

I can't take credit for the originality of this pick, Bill Chen of Rhizome Partners, introduced me to the idea when he did a podcast with Bill Brewster. At first, it didn't stick out to me but as time went on it began to age in my mind and I began to find it more and more attractive for a few reasons.

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**Why I Like It**

**1) An Asset like Multifamily Real Estate comes with a different risk-to-reward profile than a normal "Stock"**

One of the first questions I like to ask myself when thinking about an idea is, "How durable are the assets and the cash flows."

You don't get much more durable than owning real estate. In exchange for this enhanced durability, you have to be willing to give up some returns.

Bill likes to call these REITs your "left tackle" of the portfolio and I fall in line with that assessment. Making an investment like this is not going to give you Hall of Fame returns but from where they trade today, I think they offer the ability to put money to work in one of the more durable asset classes and achieve acceptable rates of return.

This could also be known as a satisfactory return like the great Mr. Graham has instructed us all to seek. You are not going to shoot the lights out but you are also not going to shoot your foot off.

With this opportunity set, I believe you could build a solid backbone of a portfolio.

What gives me the confidence?

**2) These REITs own hard assets in popular cities where long-term supply is falling off.**

Real Estate is an asset that comes with inflation protection as the buildings were built in yesterday's dollars, so it is normal for the value of real estate, in most cases, to drift in an upward movement with time.

If you are lucky enough to own property in a place where the demand to live there is outpacing the new supply, then you have a serious appreciation in the asset value over time. (We will get to the bear's point on new supply killing demand later on)

You don't need to venture far to run into the biggest determination of value: Location, Location, Location

Here are the top 5 cities for each name in the basket





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| Ticker | Top Cities |
|---|---|
| **MAA** | Atlanta, Dallas, Tampa, Orlando, Charlotte |
| **CPT** | D.C., Houston, Phoenix, Atlanta, Southeast Florida |
| **EQR** | So Cal, San Fran, D.C., New York, Boston |

WSGreserach.com / @Wallstgunslingr

*Source: Company Filings*

Here is a population migration chart from CPT that I found helpful.

## Focus on High-Growth Markets

**Population Growth — Estimated Gain 2023-2025**

| # | City | Gain |
|---|---|---|
| 1 | Houston | 332,000 |
| 2 | Dallas | 252,000 |
| 3 | Atlanta | 233,000 |
| 4 | Phoenix | 199,000 |
| 5 | Austin | 146,000 |
| 6 | Charlotte | 137,000 |
| 7 | Orlando | 131,000 |
| 8 | Tampa | 113,000 |
| 9 | Raleigh | 106,000 |
| 10 | Riverside | 102,000 |
| 11 | Fort Worth | 99,000 |
| 12 | Seattle | 84,000 |
| 13 | Las Vegas | 79,000 |
| 14 | San Antonio | 79,000 |
| 15 | Nashville | 78,000 |
| 16 | Jacksonville | 77,000 |
| 17 | Washington D.C. | 72,000 |
| 18 | Minneapolis | 66,000 |
| 19 | Columbus | 61,000 |
| 20 | Indianapolis | 57,000 |
| 21 | Fort Lauderdale | 45,000 |
| 22 | Denver | 42,000 |
| 23 | Kansas City | 41,000 |
| 24 | Sacramento | 37,000 |
| 25 | West Palm Beach | 34,000 |

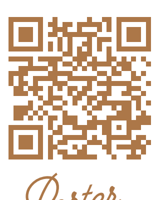
**Employment Growth — Estimated Gain 2023-2025**

| # | City | Gain |
|---|---|---|
| 1 | Dallas | 158,000 |
| 2 | Phoenix | 117,000 |
| 3 | Austin | 113,000 |
| 4 | Houston | 106,000 |
| 5 | Atlanta | 97,000 |
| 6 | Charlotte | 76,000 |
| 7 | Nashville | 76,000 |
| 8 | Orlando | 76,000 |
| 9 | Tampa | 72,000 |
| 10 | Riverside | 71,000 |
| 11 | Fort Worth | 55,000 |
| 12 | Seattle | 55,000 |
| 13 | Raleigh | 47,000 |
| 14 | Las Vegas | 41,000 |
| 15 | Salt Lake City | 40,000 |
| 16 | New York City | 38,000 |
| 17 | Philadelphia | 36,000 |
| 18 | Washington D.C. | 34,000 |
| 19 | West Palm Beach | 34,000 |
| 20 | San Antonio | 32,000 |
| 21 | Sacramento | 29,000 |
| 22 | Denver | 27,000 |
| 23 | Fort Lauderdale | 24,000 |
| 24 | Jacksonville | 23,000 |
| 25 | Portland | 23,000 |

**Total Migration**

| # | City | Migration |
|---|---|---|
| **Actual 2021-2022** | | |
| 1 | Phoenix | 143,000 |
| 2 | Dallas | 113,000 |
| 3 | Austin | 101,000 |
| 4 | Tampa | 98,000 |
| 5 | Houston | 89,000 |
| 6 | Atlanta | 81,000 |
| 7 | Raleigh | 66,000 |
| 8 | Charlotte | 55,000 |
| 9 | San Antonio | 54,000 |
| 10 | Las Vegas | 51,000 |
| **Estimated 2023-2025** | | |
| 1 | Houston | 197,000 |
| 2 | Atlanta | 167,000 |
| 3 | Phoenix | 165,000 |
| 4 | Dallas | 157,000 |
| 5 | Tampa | 127,000 |
| 6 | Charlotte | 111,000 |
| 7 | Orlando | 110,000 |
| 8 | Austin | 102,000 |
| 9 | Raleigh | 79,000 |
| 10 | Jacksonville | 71,000 |

CPT Investor Presentation





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It would be easy to make this more complicated but I keep coming back to the simplicity of the idea of owning Class A buildings in high-demand cities is something I find very attractive, throw in the embedded inflation protection and natural appreciation of value, and it's a cherry on top.

But it's not the only thing that gives me confidence.

**3) They have a long track record of FFO growth.**

Here are the 11-year FFO CAGRs for each.

| Multifamily REITs FFO 11YR CAGR | | | |
|---|---|---|---|
| **Ticker** | **FFO 2013** | **Est. FFO 2023** | **CAGR** |
| MAA | $ 4.35 | $ 9.14 | **6.9%** |
| CPT | $ 4.11 | $ 6.78 | **4.6%** |
| EQR | $ 2.35 | $ 3.75 | **4.3%** |
| | | **AVG** | **5.3%** |

WSGresearch.com / @Wallstgunslingr

*Numbers are in per share amounts

If we use the simple, Yield plus growth formula this basket would produce an annual IRR of ~12% before any multiple expansion.

Which I think is a nice kicker.

**4) Right now these are cheap from both a replacement and historical perspective.**

Here are the current cap rates for each name in the basket:





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| Current Multifamily REIT Cap Rates (Using FFO per share) | | | |
|---|---|---|---|
| Ticker | Est. '23 FFO / Share | Current Price | Yield |
| MAA | $ 9.14 | $ 134.03 | 6.8% |
| CPT | $ 6.78 | $ 99.22 | 6.8% |
| EQR | $ 3.75 | $ 62.16 | 6.0% |
| | | AVG | 6.6% |

WSGresearch.com / @Wallstgunslingr

*Numbers are in per share amounts

*Prices as of market close January 12, 2024

Source: Company Filings

One of the points above spoke to the inflation-protection nature of these assets and how they were built in yesterday's dollars. Right now these REITs are priced below what it would cost to rebuild them in their locations. Why?

The IRRs for ground-up development have changed dramatically since the rise in interest rates began in 2022.

From what I have been able to gather, developers aim for an exit cap rate of 6%. Two years ago, in a ZIRP world, the returns of developing ground-up were large enough to compensate for the inherent risk that comes from developing.

But the borrowing environment has changed.

The rise in interest rates has pushed both the borrowing cost up and has brought down exit multiples. MAA for example traded at a 3% yield ~2 years ago and now trades closer to 7%, which is over a 50% cut in multiple.

If I am a developer now, my speculative returns have decreased dramatically and it's much harder to raise money for the same amount of risk with a forecast of lower returns.

From a historical perspective, these REITs are cheap too. Cap rates on multifamily REITs on average have traded in a range of 100-200bps above the 10-YR, over the past few months we have seen the spread widen to 300-400 bps.

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With this information I am betting that the odds weigh in favor of these assets trading on the cheaper side than not, giving me a comfortable margin of safety.

**5) A rising tide of demand for apartments**

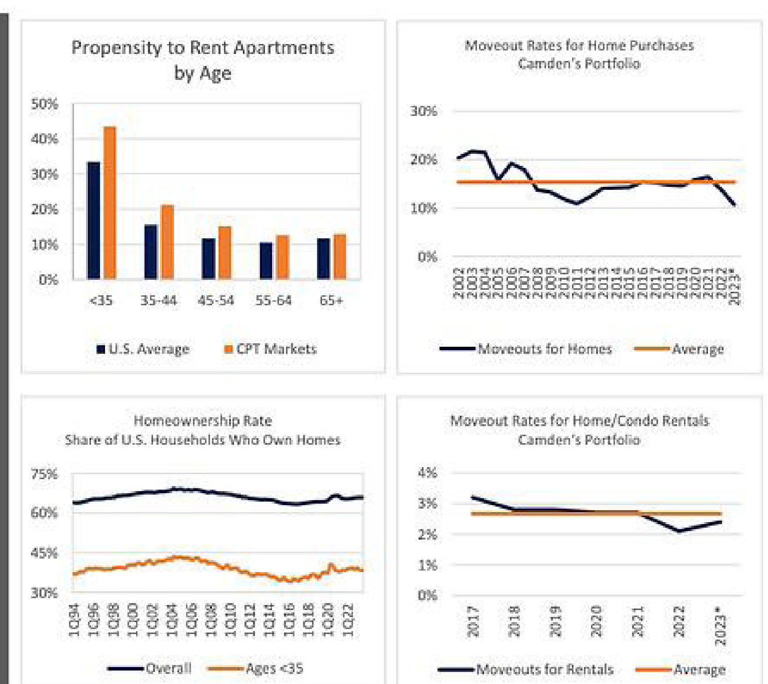
It is much easier to invest in situations where the wind is at your back for the demand.

In this case, we have two gusts, one with the population migration into the cities that the basket represents, and two with the ongoing demand for rental properties instead of occupants choosing home ownership.

I will leave some charts here for you to ponder but the conclusion remains the same. Along with other large life events such as marriage and deciding to have a family, becoming a homeowner is one of those events individuals are willing to push off. Creating more rental demand.

## Higher Propensity to Rent

- Many people still choosing to rent rather than buy
- Higher propensity to rent in CPT markets vs. U.S. average
- Homeownership rate overall remains near long-term average of 66%
- Homeownership rate significantly lower for young adults, averaging 38%
- Moveout rates for home purchases remain low at 10.7% in YTD 23 vs. Camden's portfolio peak of 23%




*2023 data through 10/31/2023
Source: Witten Advisors – seasonally adjusted homeownership rate; Ages <35 homeownership rate not seasonally adjusted.

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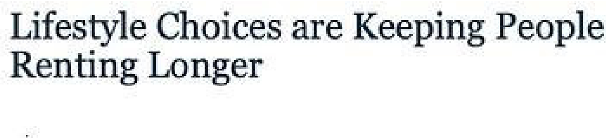


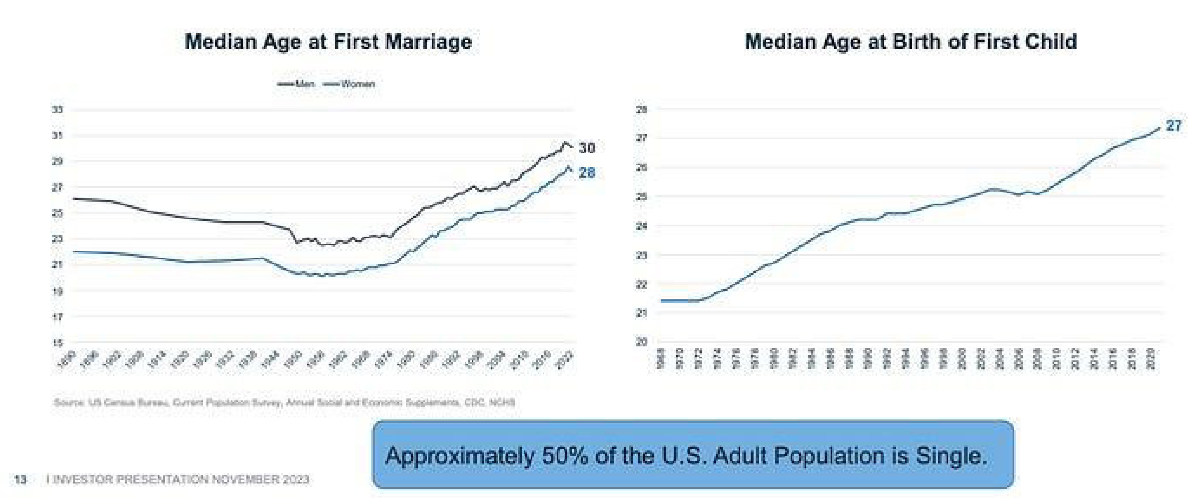


Source: CPT and EQR investor presentations

I think this small detail only strengthens the argument for the premium value these assets can show in a few years.

But, this doesn't come risk-free.

**The Bear Case**

From where I see things 2 huge risks come along with these.

- Overwhelming New Supply
- Increasing interest rates

**Let's start with supply.**

The rent market for these REITs has turned a bit soft and in 2023, new multifamily deliveries totaled over 565K which is the highest level the industry has seen since 1980. In 2024, Co-Star expects deliveries to pull back to around 444K.

Nobody wants to stand in front of this oncoming supply and the softening rent market, which is why these trade at historically low valuations.

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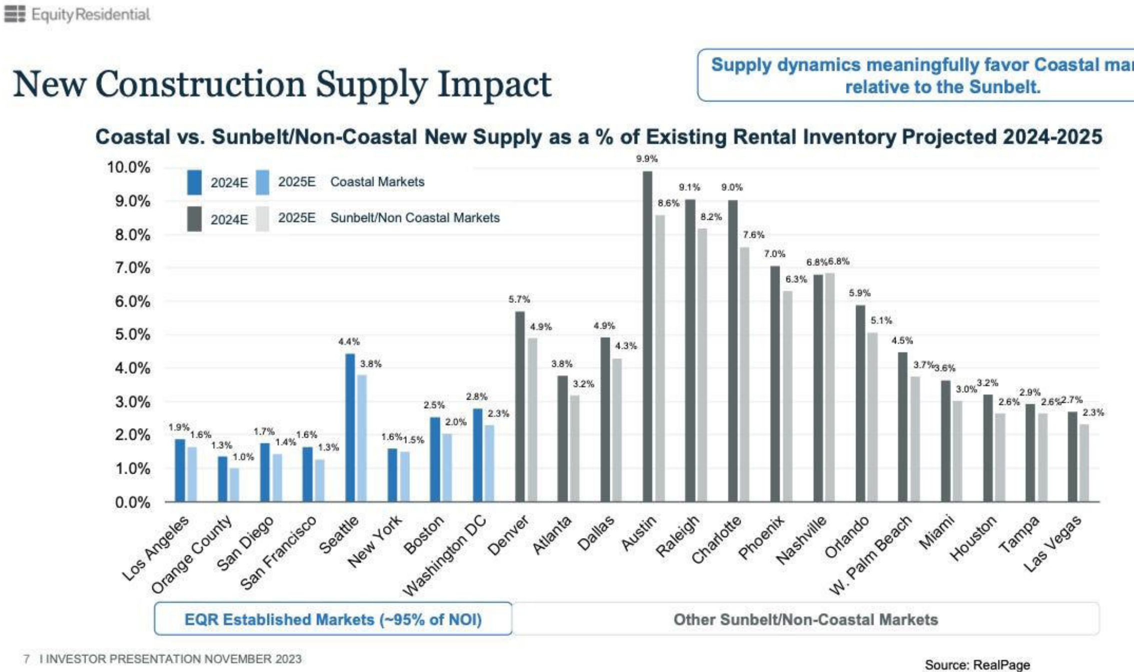


EQR Investor Presentation

Supply by itself isn't scary, it is only when the supply overshoots demand to a point of suffocation. I don't think that is what will happen here.

If we reflect on the chart above and compare it to the top 5 cities for each of our REITs there is a minimal amount of overlap in the highest areas of new supply but we should also remember that the companies themselves only have a portion of their FFO come from these cities.

Even if they experience oversupply and softer rents in certain markets the diversification of their portfolio will hold them up.

Plus, if we reflect on the migration trends I believe the new supply will not have trouble being absorbed. Will it cause some short-term rent pain? Probably. But when we stretch the timeline out past the current supply wave, I don't think it destroys long-term FFO growth.

I wouldn't be surprised if the basket above has flat FFO growth over the next two years but what happens after this supply is worked through the system?

New development, as measured by multifamily starts, has fallen off since rates have begun to increase.





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Source: CBRE

These assets take 3-4 years to build, giving us a runway to about the middle of '27 if interest rates fell today. The longer the rate stays up here the longer this timeline stretches out only enhancing the competitive position of these REITs once this new wave of supply passes.

Rents might stay flattish over the near term but once this supply is worked through, these premier assets, in strong cities, will likely have some pricing power and it is in these later years that this basket grows in value as they can raise rents.

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## Interest Rates

I am not naive to the reality that Real Estate is an asset class that is extremely sensitive to interest rate movements. I am not an economist and I have no view on the direction of rates but here is how I see the range of outcomes for this basket if rates move in either direction.

If They Move Up:

The cap rates on these assets continue to increase and, likely, the price continues downward.

However, the effects of this increase will only make it a stronger reason to cut off more supply and thus lengthen the timeline for new supply to enter the market only putting these current assets in a stronger position.

If They Move Down:

These assets likely re-rate to a higher multiple and we get nice price appreciation in the short term.

We have a strong amount of loosening to go before development becomes attractive again but if rates fall to that level then these REITs do not trade where they stand today and we still have a good runway before new development hits the market again.

If They Stay the Same:

Supply continues to stay on the sideline and let's say the price of these don't move, we collect a 4%+ dividend and wait through the new supply wave. Each passing month keeps new supply off the field and only lengthens the amount of time these assets have pricing power in the later years.

Even if FFO stagnates or decreases, we have a strong 6.5-7% yield today, which is a strong return given the R/R here.

## In Closing

I put my initial REIT position on about a month and a half ago but still find the opportunity set to be attractive even after a small price appreciation.

I will be buying at the higher prices because I will never write about a name I won't buy myself.

If rates increase and these prices come down I would be open to adding more as it only strengthens the competitive position over the long term. This basket of REITs represents a portfolio of quality apartments in some of the most popular cities in America that are trading below replacement cost.





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To me, this is a simple proposition where I am forcing myself not to make it complicated.

Over the next 5 years, I wouldn't be surprised to see mid-teen to high-teen IRRs at the current prices.

I expect to see flattish rent stability over the next 18 months based on a blended rate, (new rents combine with renewal rates) then see pricing power come through in about 2-3 years as new supply thins out.

Based on a yield plus growth formula I think you can hit a mid-teens IRR, multiple expansion would be the cherry on top. If cap rates move back to 5 instead of ~7% where they are today, that is like going from a 14x to a 20x multiple on earnings, a nice tailwind.

I chose a small basket approach here because I believe multifamily apartments as a whole are on the cheaper side and it gives me an added layer of protection on incentives for each management team.

I am confident that I can say this pack of "horses" is fast but less confident in my ability to pick the one who will win the race. In this scenario, I don't feel the need to, they will all likely trade in the same return range anyway.

Continue reading here.

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**An off-the-radar AI-related opportunity (from Crescat Capital)...**

The current macro environment across global equity markets presents a sharply divided investment setup for 2024 and the remainder of the decade. While our concerns are fueled by the pervasive speculation in the US stock market, there also exists a parallel narrative where long-neglected economies present themselves with exceptional value and promising growth opportunities.

Utilizing Warren Buffett's preferred valuation indicator, it becomes unmistakable that US stocks not only sit at historically expensive levels but also are the most overvalued among 28 of the world's largest economies. In our strong view, investors buying US equities are currently undertaking unjustified risks amid dangerously inflated valuations.

Equally relevant, but on the positive side, observe the prevalence of economies with notably low valuations that also possess substantial exposure to broad commodities that have a favorable supply and demand outlook. South America, in this context, stands out as a resource-rich region with incredibly undervalued markets, especially when juxtaposed with the US.

***We would much rather own growing businesses at low single-digit P/E multiples than hyped-up US mega-cap technology stocks, such as the Magnificent 7, which at the mean are trading at an exuberant 48 times annual trailing profits with questionable potential to sustain their past growth rates.***





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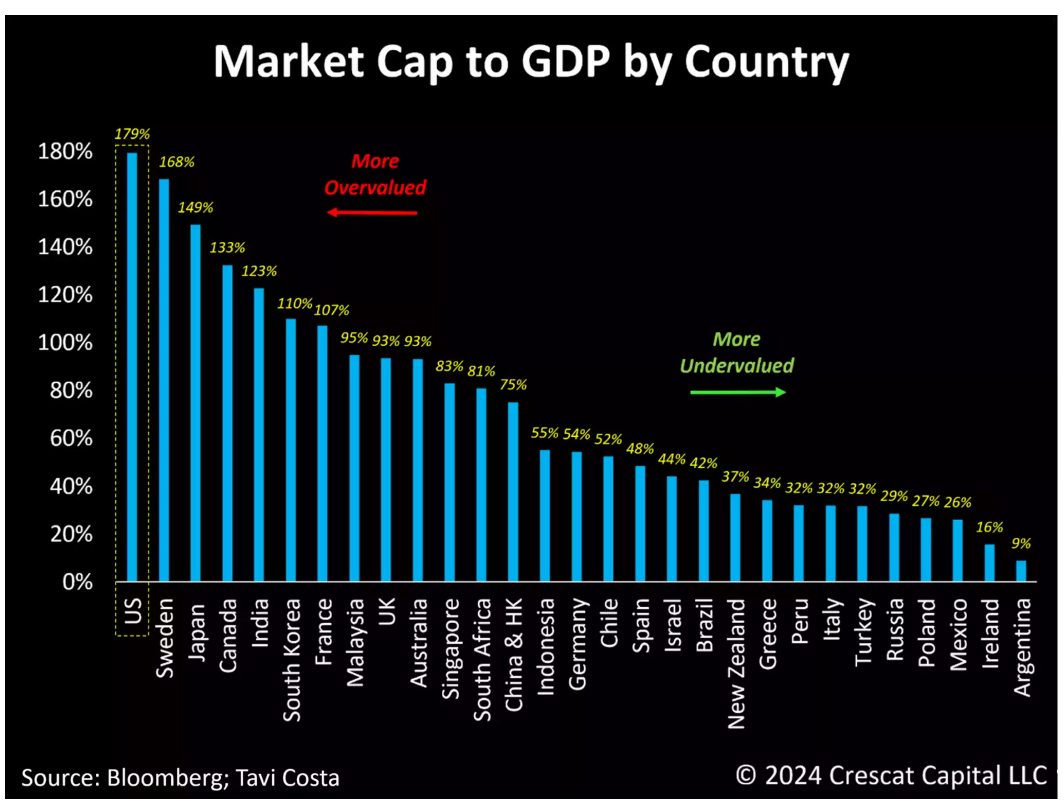


### The AI Paradox

Today's stark divergence in valuation metrics globally highlights the potential for investors to uncover compelling opportunities in undervalued regions and industries. This challenges the prevailing trend characterized by crowded optimism in US technology companies, which presently constitute more than one-third of the overall equity market – an extent of dominance not seen since the peak of the tech bubble.

***More interestingly, the recent advancements in artificial intelligence could paradoxically have highly positive implications for emerging markets that have long grappled with a low-quality labor force.***

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Examining the evolution of entrepreneurship, the internet has enabled individuals to start businesses without the need for a physical location, significantly lowering barriers to entry for new enterprises. Tools like ChatGPT, even in their early stages, act as true capability enablers. Now, individuals can not only launch businesses from their dorm rooms but also access high-quality personal assistants, programmers, mathematicians, writers, historians, biologists, and more at virtually no cost.

When extrapolating this phenomenon globally, less developed economies gain access to the same tools, leveling the playing field in terms of labor quality. The United States has historically benefited tremendously from having top-tier school systems and attracting students and workers from around the world. However, these transformative changes suggest that the gap in company valuations between developed and less developed economies will likely shrink significantly. The market, in our view, is underestimating these changes, especially at a time when the valuation of a US company has never been more expensive relative to an emerging market.

This idea can be extended further to posit that these new tools generate highly innovative and disruptive technologies that will also narrow the valuation gap between larger and smaller companies. Concurrently, today's market exhibits an unprecedented level of dominance by mega-cap technology stocks, which in our view is completely unsustainable.

An alternative representation of the opportunity to buy undervalued Latin American businesses and short overpriced US stocks is depicted in this chart. The relative performance between these two regions is currently re-testing the levels we experienced in the early 2000s, a time that marked a major bottom for emerging versus developed markets. We believe the current investment landscape is remarkably similar to that period, and potentially even more compelling now.

Given our conviction in this thesis, our Global Macro Fund currently has a 37% weight in South American companies, mostly through mining businesses. Furthermore, we pair that exposure with a substantial short position in US markets through a diversified basket of thematic ideas: mega-cap growth ceiling, ESG re-think, private equity mismatch, and mispriced cost of capital. These are all research-driven themes that are strongly supported by our fundamental quant models.





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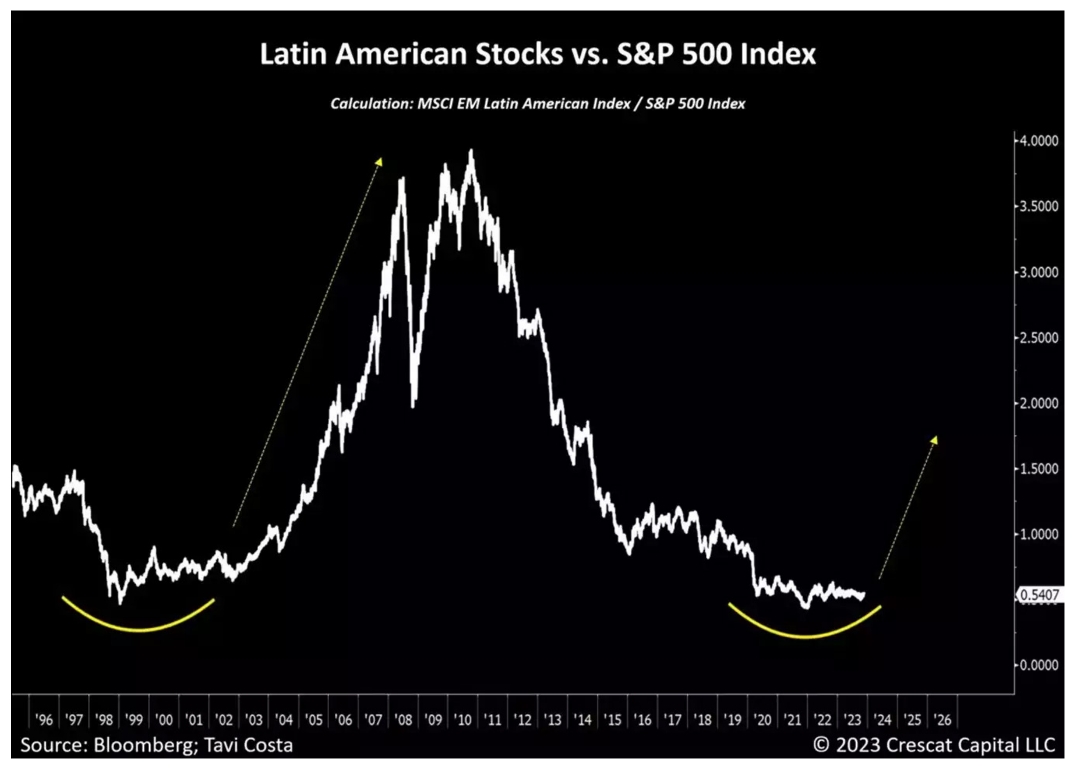

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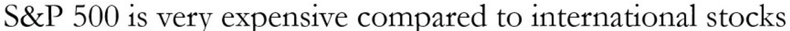
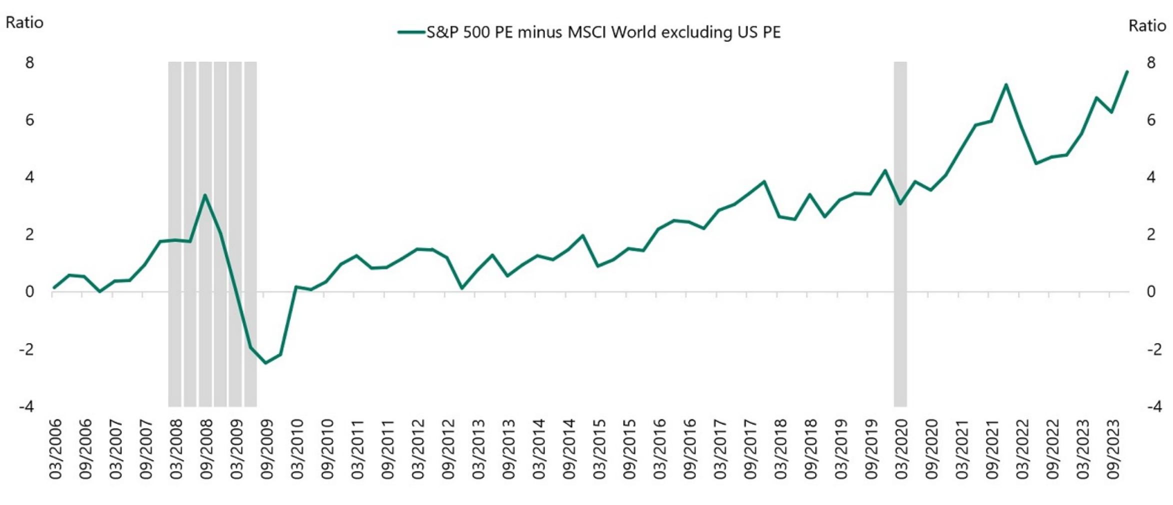
**International equities appear extremely cheap relative to the U.S. (from The Daily Spark)...**

Comparing the P/E ratio of the S&P 500 with the P/E ratio of the rest of the world shows a record difference, see chart below.

In other words, US equities have never been more expensive relative to international equities.




Source: Bloomberg, Apollo Chief Economist (Note: BEst PE ratio using 12-month forward earnings; BEst = Bloomberg estimates)





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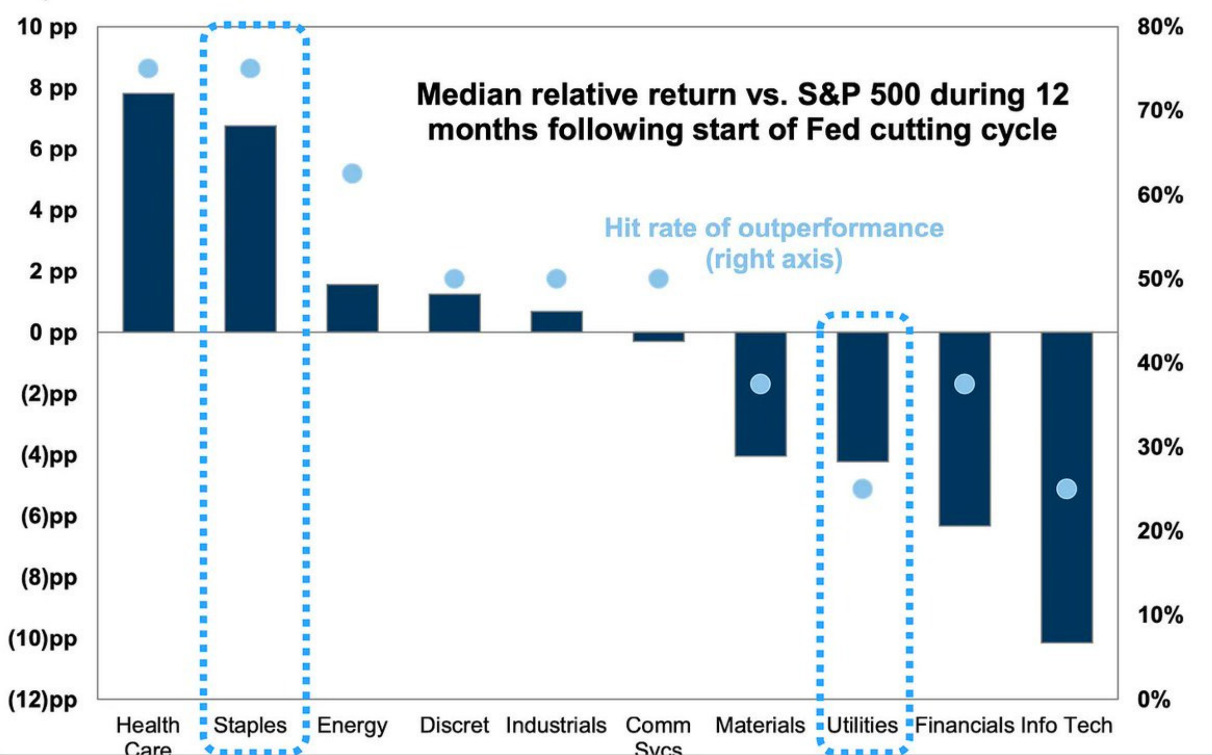
**These sectors historically perform the best following the Fed's first rate cut ([from Jesse Felder via X]( ))...**

'Healthcare, Staples, and Energy are typically the best-performing sectors in the months following the Fed's first cut.' https://dailychartbook.com/p/daily-chartbook-361 via @dailychartbook



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**Here are the cheapest markets in the world today (from The Idea Farm)...**

Quarterly CAPE Ratio Updates

Median CAPE Ratio: 16
25% cheapest: 11
25% most expensive: 26

Average of Foreign Developed: 19
Average of Foreign Emerging: 15

We've mentioned this note in every update but it bears repeating. We use the MSCI Investable Market Indices (IMI) below, but MSCI also calculates their Standard Indices too. IMI includes more companies and in general, is more representative of the entire market. It makes no difference for any countries except the very smallest ones, such as Greece and Egypt. For both series, the CAPE ratios are almost always near identical.

So, this is one reason we have always used a valuation composite across the variables below. If one is giving a screwy result, or perhaps a market has a structural bias to one variable, we want to average it out.

Since we get asked this question a lot, in addition to The Idea Farm, here are a few great free resources for global stock market valuations...

1. Research Affiliates
2. Barclays
3. Professor Shiller
4. Professors French & Fama
5. Professor Damodaran

A few great paid choices include Global Financial Data and Ned Davis Research. Let us know if we're missing any!





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| | CAPE | CAPD | CAPCF | CAPB | Average Rank | Dev or Emerging | Drawdown % |
|---|---|---|---|---|---|---|---|
| Colombia | 7.8 | 16.2 | 4.5 | 0.7 | 2 | E | -49.32 |
| China | 9.6 | 31.6 | 7.6 | 1.1 | 11 | E | -54.68 |
| Hungary | 9.7 | 53.5 | 4.1 | 1.2 | 12 | E | -25.08 |
| Poland | 10.3 | 29 | 4.6 | 1 | 8 | E | -47.12 |
| Turkey | 10.5 | 43 | 8.7 | 1.6 | 20 | E | -25.08 |
| Chile | 11.4 | 20.4 | 6.4 | 1.1 | 6 | E | -46.04 |
| Hong Kong | 11.4 | 23.9 | 7.7 | 0.9 | 8 | D | -34.5 |
| Austria | 11.4 | 32.8 | 5.7 | 1 | 10 | D | -39.96 |
| Singapore | 11.5 | 18.9 | 9 | 0.9 | 10 | D | -23.16 |
| Egypt | 12.1 | 37.3 | 7.4 | 1.7 | 18 | E | -60.75 |
| Czech Republic | 12.2 | 14.7 | 5.5 | 1.4 | 8 | E | -23.58 |
| Brazil | 12.2 | 20.4 | 7.2 | 1.6 | 12 | E | -12.64 |
| Korea | 13.8 | 62.2 | 7 | 1.2 | 18 | D | -22.17 |
| Philippines | 13.9 | 43.2 | 8.5 | 1.5 | 21 | E | -51.08 |
| Malaysia | 14.3 | 25 | 8.8 | 1.3 | 15 | E | -12.07 |
| U.K. | 14.4 | 24 | 7.8 | 1.6 | 15 | D | -5.51 |
| Thailand | 14.4 | 27.3 | 7.9 | 1.6 | 18 | E | -27.11 |
| South Africa | 14.6 | 28.1 | 9.3 | 1.8 | 21 | E | -12.39 |
| Spain | 15.3 | 24.2 | 7.6 | 1.3 | 13 | D | -16.26 |
| Israel | 15.7 | 45.5 | 10.4 | 1.6 | 27 | D | -19.56 |
| Germany | 16 | 34.1 | 7.5 | 1.6 | 19 | D | -16.56 |
| Norway | 16.1 | 26.4 | 7.1 | 1.6 | 16 | D | -9.32 |
| Indonesia | 16.1 | 34.5 | 9.4 | 2.2 | 27 | E | -13.68 |
| Belgium | 16.3 | 28.1 | 10.1 | 1.5 | 21 | D | -25.77 |
| Finland | 17.3 | 24.8 | 10.4 | 1.9 | 23 | D | -49.02 |
| Peru | 17.4 | 40.7 | 17.3 | 2 | 32 | E | -24.01 |
| Australia | 18.3 | 25.1 | 12.1 | 2.1 | 27 | D | -3.03 |
| Mexico | 18.3 | 40.3 | 8.8 | 2.1 | 28 | E | -1.89 |
| Italy | 18.5 | 33.5 | 6.6 | 1.3 | 17 | D | -21.88 |
| Sweden | 18.7 | 39.5 | 13.5 | 2.4 | 33 | D | -21.01 |
| Canada | 20.8 | 37.3 | 11.2 | 2 | 29 | D | -8.18 |
| Japan | 20.9 | 60.8 | 11 | 1.7 | 31 | D | -2.57 |
| New Zealand | 21.1 | 28.1 | 12 | 2 | 29 | D | -28.83 |
| Portugal | 21.6 | 24.7 | 6.6 | 1.6 | 17 | D | -48.3 |
| Switzerland | 22 | 36.5 | 15.8 | 3 | 34 | D | -17.28 |
| Taiwan | 22.3 | 40.6 | 13.4 | 2.8 | 35 | E | -3.53 |
| France | 22.7 | 41.6 | 11.5 | 2 | 33 | D | -4.84 |
| Ireland | 24.4 | 70.1 | 14.8 | 2.1 | 38 | D | -17.5 |
| Netherlands | 26.2 | 56.9 | 17.2 | 2.8 | 38 | D | -22.5 |
| U.S. | 31.4 | 76.8 | 19.6 | 4.4 | 41 | D | -9.07 |
| India | 36.5 | 121.8 | 23.1 | 4.5 | 42 | E | 0 |
| Denmark | 37.8 | 94.8 | 26.4 | 6.5 | 43 | D | 0 |
| Greece | 457.5 | 64 | 7.8 | 0.9 | 26 | E | -94.51 |
| Russia | 😱 | 😱 | 😱 | 😱 | 😱 | E | 😱 |

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*Abbreviations:
CAPE: Cyclically Adjusted Price Earnings - a valuation measure that uses real earnings per share (EPS) over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle.
CAPD: Cyclically Adjusted Price Dividends - a valuation measure that uses dividends over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle.
CAPCF: Cyclically Adjusted Price Cash Flow - a valuation measure that uses cash flow over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle.
CAPB: Cyclically Adjusted Price Book - a valuation measure that uses book value over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle.





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**This micro-cap cannabis company still looks attractive today (from Mindset Value)...**

*Warning: The following column is about a microcap company. Microcaps by definition can be illiquid and experience wild gyrations. It is important to do your own due diligence, rely on your own research and understand that microcaps can be very volatile. Please proceed reading using your highest levels of caution. That being said...*

Grown Rogue (Canada: GRIN, OTC: GRUSF) is blazing a trail showing the cannabis industry how focus, discipline and operational excellence can lead to free cash flow, growth and excellent investor returns. I first wrote about the company in December of 2022.

The company's sole focus is on craft cannabis flower cultivation, which has led to Grown Rogue being the #1 flower in the fiercely competitive Oregon market and a top 5 indoor brand in Michigan.

Now the company is about to enter New Jersey, which has limited supply, sky high prices and mediocre quality flower.

And on top of that Grown Rogue just announced that they are getting involved in retail dispensaries as well. Could this cause the company to lose the focus that has been the key to its success?

Obie Strickler, Grown Rogue's founder and CEO, agreed to a follow-up to last year's interview. Despite no analysts covering the best performing cannabis stock for the last two years, I continue to believe the company should be studied and analyzed for their success, which I think is only just getting started.

Here is what I learned in our interview:

1. Grown Rogue is investing in retail but is not in charge operationally and thus will not lose focus of its mission.
2. The company gets guaranteed distribution and improved economics without sacrificing company bandwidth
3. This may be the first of up to 6 to 7 dispensaries in New Jersey that Grown Rogue invests in

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4. Both the New Jersey dispensary and the cultivation facility will open in Q2, with the cultivation facility seeing the first sales in Q3.
5. Grown Rogue is close to entering an additional limited license state as well
6. I now believe that Grown Rogue should put up eye-popping growth numbers in Q3 and Q4, with Q4 possibly showing cash flow growth of more than 200% year over year.
7. I think the company has the potential to end the year at a $20-$25 million EBITDA run rate and get to around $40 million in EBITDA in 2025. This is up from $7-$8 million in 2023.
8. What makes this remarkable is that the fully diluted market cap for all options, warrants and convertible debt is approximately $70 million. And that gives the company no credit for the cash that the options and warrants would bring, so the enterprise value is probably less than $60 million.
9. And don't sleep on Grown Rogue's partnership with Goodness Growth (OTC: GDNSF). Not only is Grown Rogue helping in Maryland, but the big impact will be when Minnesota goes full adult use in 2025 and Grown Rogue shares in the upside when that happens.

The company's mission of becoming the first national craft brand is coming into focus as they will have a presence in six states by year end and with more states on the way in the future.

Continue reading here.





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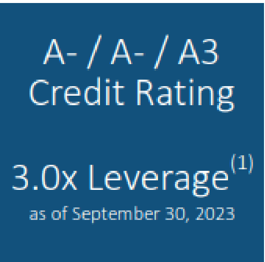
**A "deep dive" into leading energy pipeline firm Enterprise Products Partners (EPD) (from Lyn Alden Investment Strategy)...**

With asset prices in general being very rangebound, inexpensive dividend-paying assets continue to be an attractive option. And my benchmark example for that continues to be Enterprise Products Partners (EPD). Oftentimes, the best places to put new capital is into investments that are already in your portfolio.

Enterprise operates over 50,000 miles of pipelines as well as large amounts of other key infrastructure including natural gas processing plants, storage facilities, and deep water docks.

Why EPD?

Built for the Long Run




Average Return on Invested Capital[1]
12%
Over the Last 10 Years
2024 Growth Capex Estimate
≈$3.0–3.5B

History of Unitholder Alignment Through Actions & Ownership
≈32%
of Common Units Owned by EPCO & Affiliates[2]

$2.00/unit
3Q23 Distribution Annualized
1.7x TTM 3Q 2023 Distribution Coverage
$823MM Repurchased[2]
of $2B Buyback Program

$8.0B TTM 3Q 2023 Adjusted CFFO[3]
$5.0B TTM 3Q 2023 Adjusted FCF[3]
Responsibly Returning Capital to Investors
Adjusted CFFO Payout Ratio[1]: 56%
Adjusted FCF Payout Ratio[1]: 90%

Source: December 2023 EPD Investor Presentation

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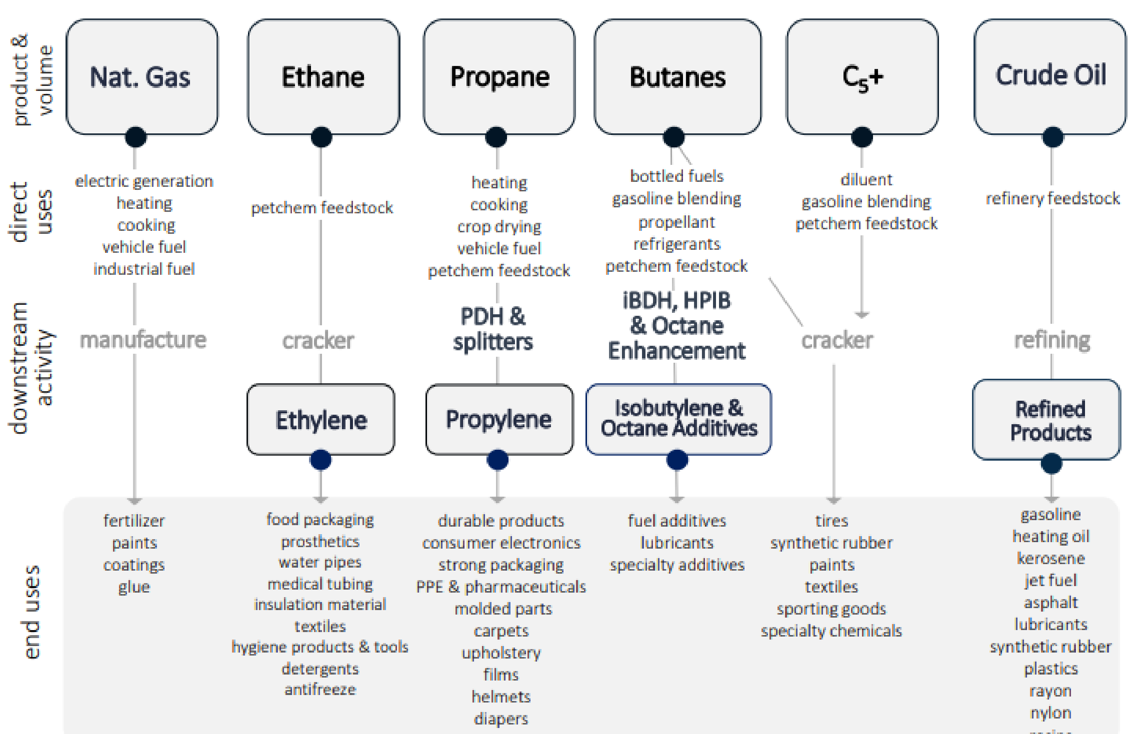
Enterprise has 25 consecutive years of annual distribution increases, and they have the highest credit rating among all pipeline operators in the country. They currently yield 7.7%, so if they are able to raise the distribution and other per-share growth metrics by 3% per year on average going forward, they can deliver 10.7% annualized returns at a constant equity valuation. And this is with minimal direct commodity price exposure; it's mostly a toll-road type of business.

Enterprise transports crude, natural gas, natural gas liquids, and petrochemicals. When people think of oil they mainly think of gasoline in their cars, but in reality everything from the plastic on your monitor or phone as you read this, to the Tylenol you take if you have a headache, to the fertilizer used to grow your lunch, is made from products that Enterprise transports around.




Like many publicly-traded partnerships, Enterprise's early growth period involved constant equity issuance along with constant debt issuance. Whereas many other partnerships eventually blew up during the industry downturns in 2015/2016 and 2020, Enterprise instead transitioned gradually toward a more self-financing model.



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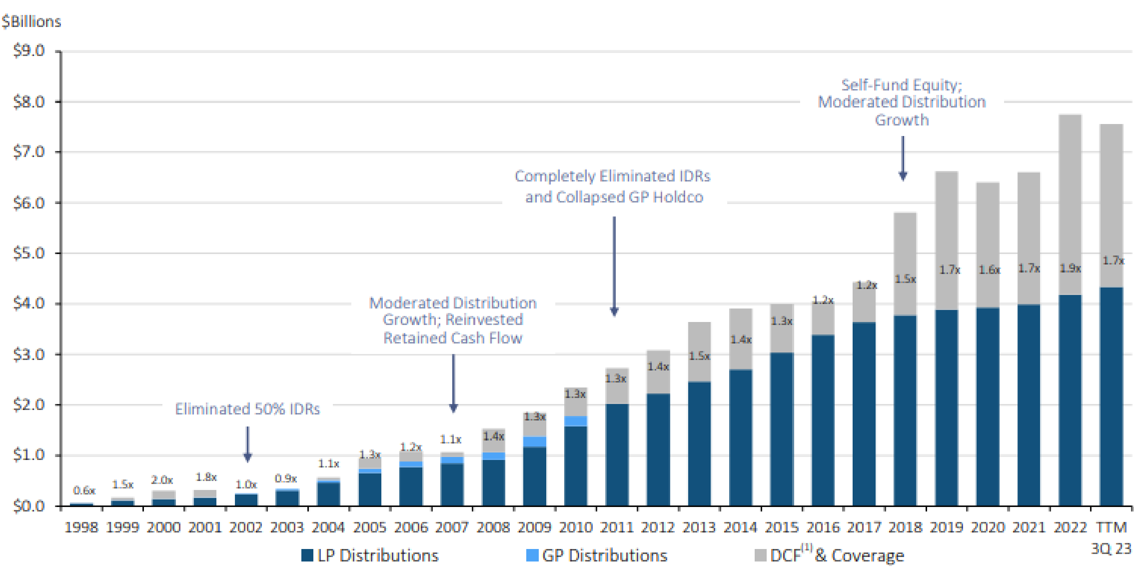
- They eliminated 50% incentive distribution rights, and then collapsed the whole general partner into a flatter structure.
- They began slowing down their distribution growth compared to their cash flow growth, to reduce the payout ratio and thus be able to finance more of their own projects internally from spare cashflow.

This chart shows the cash flow in gray, and the part that is paid out in distributions in blue. The multiple has improved substantially in recent years. And they no longer have to grow distributions faster than cash flows because they have reached their target payout ratio by this point.

Consistently Returning Capital to Unitholders

Distribution Stability and Growth Remains a Core Focus

25 consecutive years of distribution growth and $51 Billion returned to unitholders via LP distributions & unit buybacks




This chart shows their shares/units outstanding. As the company reduced their payout ratio, they no longer needed to issue more shares:

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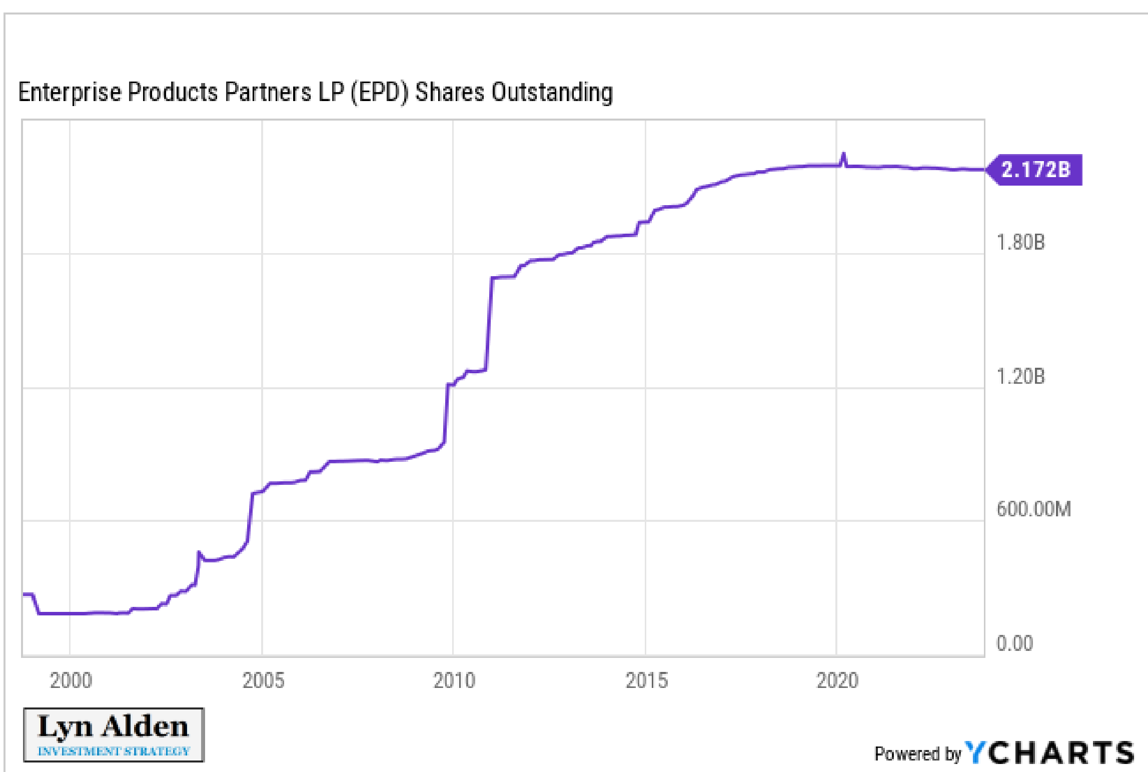


The company still issues some debt, but only when it makes economic sense for them to do so. Their projects typically give them 12% ROI, and they historically have been able to borrow at sub-5%, which means borrowing is lucrative for equity holders. Going forward, borrowing costs are likely to remain higher, but their debt is mostly fixed-rate, with an average yield of 4.6% and an average duration of 19.3 years.





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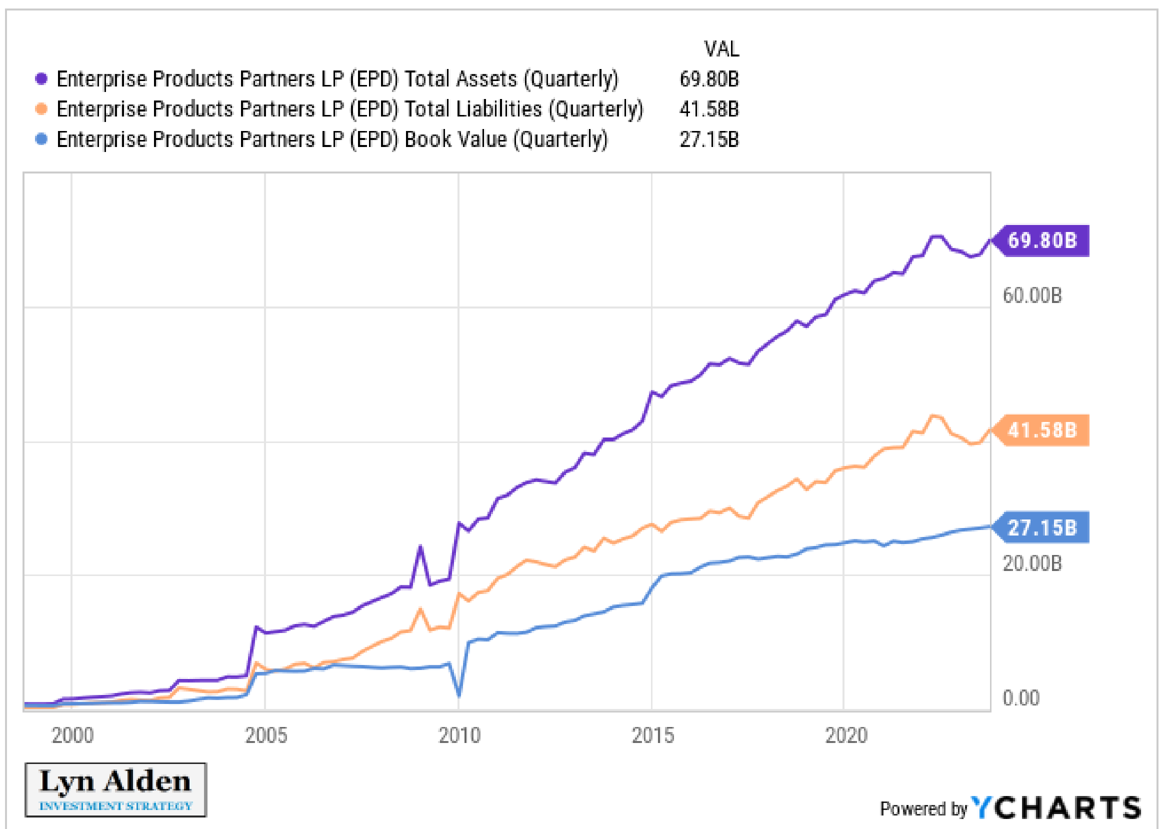


Enterprise's distribution yield is currently 3.37% higher than the yield on a 10-year Treasury. In addition, Enterprise's distribution grows each year. Despite higher 10-year Treasury yields today, Enterprise's distribution yield spread over the 10-year Treasury yield remains moderately above its two decade average, meaning that on this metric Enterprise remains inexpensive:

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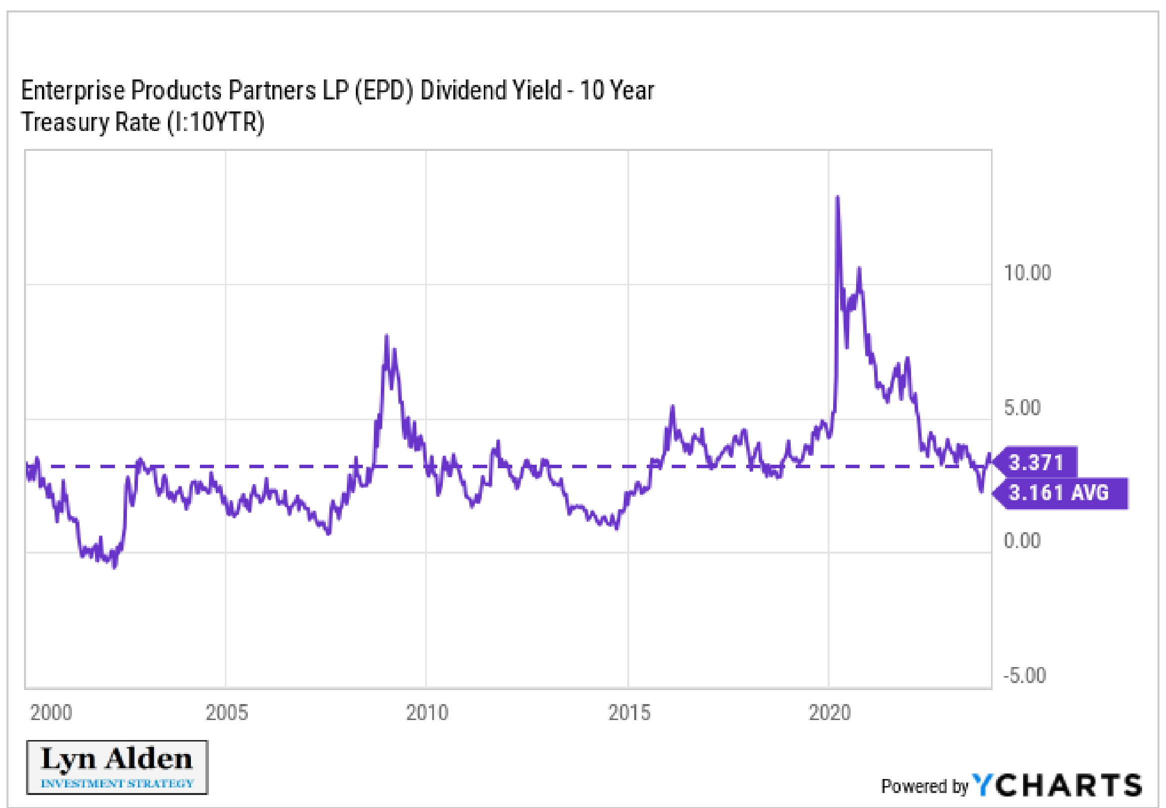


Overall, I view 3.37% as a very reasonable equity risk premium, and that only counts the distribution rather than all distributable cash flow per share. With the combination of higher yield and annual growth, Enterprise unitholders can expect to earn more than double the returns of Treasuries in a relatively low risk package, albeit with more volatility and tail risk than Treasuries along the way.





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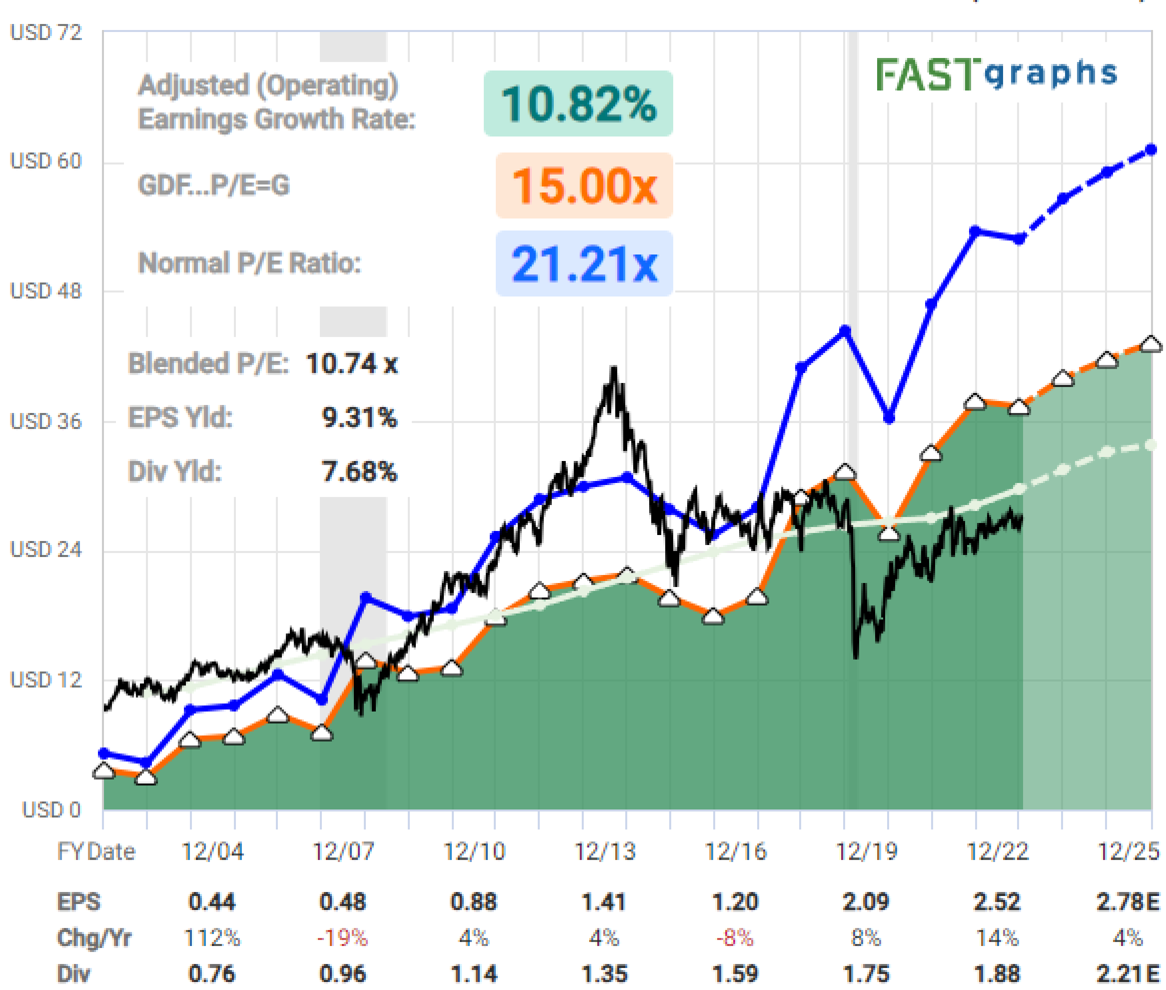


**F.A.S.T. Graphs 101:**

- black line: the current and historical stock price
- blue line: what the stock price would be if were at its historically average price/earnings ratio
- orange line: a conservative measure of valuation (a 15x price/earnings in this case)
- white line: dividends paid that year (and the payout ratio is relative to the orange line)

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- dark/light green: the transition between historical earnings numbers and consensus analysts' forecast earnings numbers

**Enterprise Risks**

As a large infrastructure business, Enterprise is vulnerable to major changes in regulation, and its assets can be disrupted by natural catastrophes or terrorist attacks.

Over the next few years, the United States' ability to export natural gas liquids to Europe and other parts of the world is a key driver of new infrastructure projects. If the United States becomes more protective and restricts exports, it could materially harm the business interests of many of these infrastructure operators.

Over the long term, Enterprise's business would stagnate if U.S. energy production stagnates. However, at under 11x earnings and geared toward sending a lot of its cash flow back to unitholders, Enterprise is currently priced for no growth, even as it grows mildly.

Enterprise is a publicly-traded partnership rather than a corporation, and so it issues a K-1 during tax season. This comes with tax advantages for U.S. investors but requires filling out an additional form during tax season. Non-US investors face more challenges with publicly-traded partnerships like Enterprise because they face distribution withholding taxes, and thus should talk to their tax specialist before investing. I believe this is a reason why MLP-structured midstream businesses tend to trade at a discount to similar midstream businesses that are structured as corporations.

I view Enterprise as the ideal complement to growth assets. Many tech stocks or hard monies do not pay a yield, but instead appreciate in price over time. A mix of assets like Enterprise that pay regular high income, and growth assets or store-of-value assets that appreciate over time, helps investors meet income needs while also participating in growth and/or protecting against long-run monetary debasement.

Continue reading here (subscription required).





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**Details on a "more profitable" junior gold miner (from Special Situation Investing)...**

Saying Fortitude Gold (OTCQB: FTCO) has been on my watch list for years would be an overstatement. More accurately, I noticed it as a new spin-off in mid 2021, saw it had spiked right out of the gate, and casually concluded the opportunity had passed. With my preference for asset-light royalty companies over capital-intensive miners, I gave the company little attention over the years since. That was until a random conversation on Christmas day prompted a few questions about the company. I finally dug deeper and what I found was not what I expected.

**The Company**

Fortitude Gold was originally part of Gold Resource Corporation (GORO). It was spun-out to shareholders on December 31, 2020. Shareholders received one share of Fortitude for every 3.5 shares held of GORO as of December 28, 2020.

Today's focus is not the spin-off transaction, but a few details help understand the company as it stands three years later.

For starters, the company was a natural candidate to be split up with two very different sections—two gold mines in Mexico and a handful of gold mining properties in Nevada, USA. Post spinoff, Fortitude owned the Nevada properties and GORO owned the assets in Mexico.

As is always the case with spin-offs, it's insightful to see what company the original management ended up in. In this case, three of Fortitude's four executive officers all came over from Gold Resources. Fortitude's vice president of corporate development, chief financial officer and CEO, all once filled those roles at GORO. During one interview, the CEO, Jason Reid, said the original plan was for him to be CEO of both companies. But in order for the companies to be distinct enough to allow the spin-off to be a tax-free distribution, he could only be CEO of one.

If the stock price action between the two companies is any indication, it appears he chose wisely. The chart below shows Fortitude starting at $3.30, increasing to $8.45, and currently sitting at $6.26. GORO, on the other hand, steadily decreased from $2.77 to $0.29, nearly a 90% decrease.

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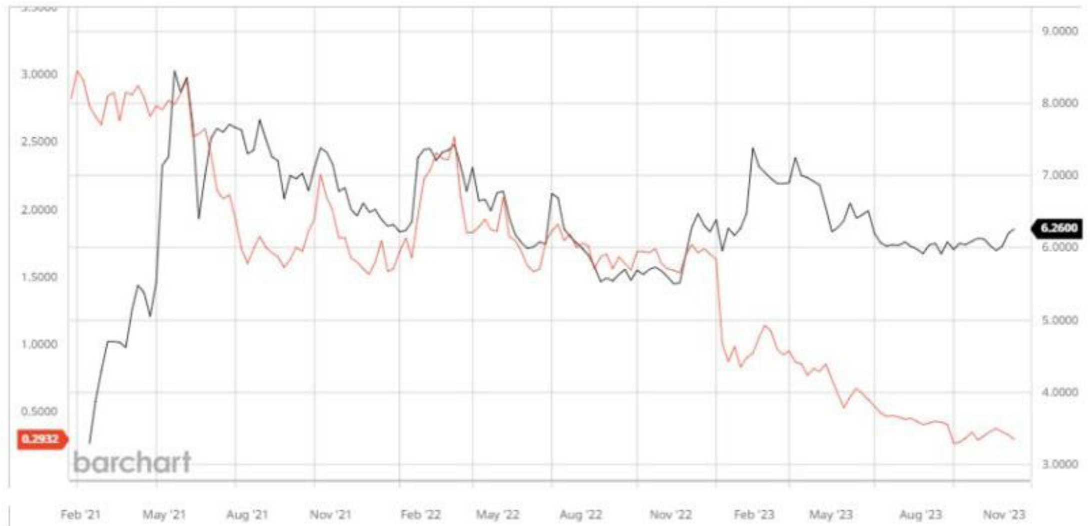


GORO (red) vs FTCO (black) | barchart.com

So what is Fortitude Gold?

Here's a slightly condenseD version of how the company describes itself on its website:

> Fortitude Gold is a junior gold producer with operations in Nevada, U.S.A, one of the world's premier mining friendly jurisdictions. The Company is led by an industry experienced and proven management team who previously directed Gold Resource Corporation...
>
> Fortitude Gold targets high-grade gold open pit heap leach operations averaging one gram per tonne gold or greater. Our flagship Isabella Pearl mine reached first gold production in April of 2019 just over 10 months from project groundbreaking. The deposit's proven and probable gold grade average is estimated at 3.05 grams per tonne gold with the high-grade Pearl zone of the deposit estimated to average ~4 grams per tonne gold. At December 30, 2019, total mine life of the Isabella Pearl deposit was estimated at 4 ½ years at an average ~40,000 gold ounce per year production run rate, after the initial twelve month production ramp-up.
>
> The Company's property portfolio consists of 100% ownership of five high-grade gold properties. All five properties are within an approximate 30-mile radius of one another within the prolific Walker Lane Mineral Belt. [Note: a sixth property since this section of its website was updated.]...Our business strategy is to grow organically, remain debt-free and distribute substantial dividends.





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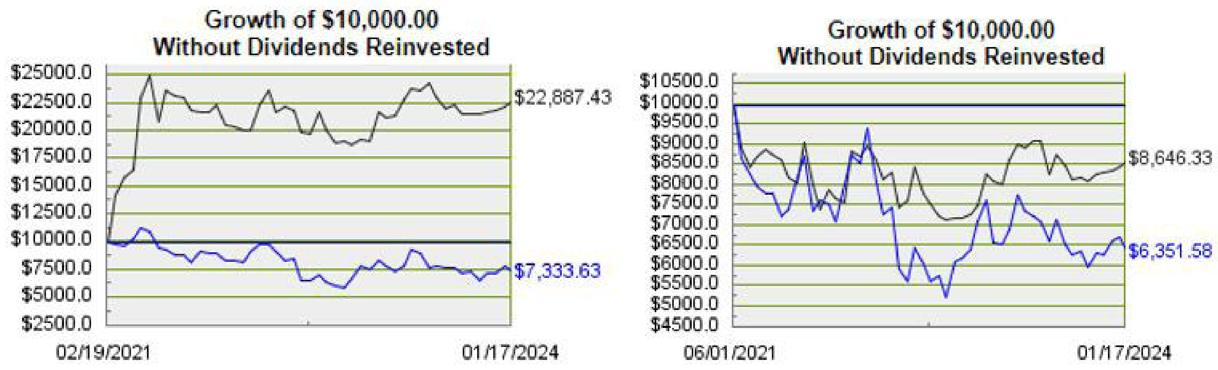
In summary, Fortitude is a junior gold miner. Perhaps you, like us, don't usually care for miners, or maybe you do. Either way, here's a few of the things that caught our attention.

## A Different Strategy

Fortitude Gold's strategy differs from most junior gold miners. In addition to attracting investors looking for exposure to gold, it draws in those seeking yield by distributing a sector-leading dividend.

Attracting a larger pool of investors, Fortitude seeks to outperform its peers both with greater potential upside and less downside. So far the strategy appears effective. Take a look at the two charts below. The left one shows Fortitude outperformed its peer group ETF, the GDXJ, since being spun-out. The one on the right shows a time frame that eliminates the large spike Fortitude had right after the spin-off. It shows that even while decreasing, it decreased less than its peers.




FTCO (black) vs GDXJ (blue) | dividendchannel.com

Management plans to maintain this differentiation between Fortitude and its peers by focusing on profitability not growth. This quote by Reid stood out:

> If you step back and look at Fortitude Gold in the broader spectrum of the mining space and producers, 40,000 ounces a year isn't impressing anybody. I don't mind that because I'm not trying to impress anybody with the amount of ounces we produce. I don't want to ever be the largest producer. I don't want to just grow. I want to be one of the more profitable producers.

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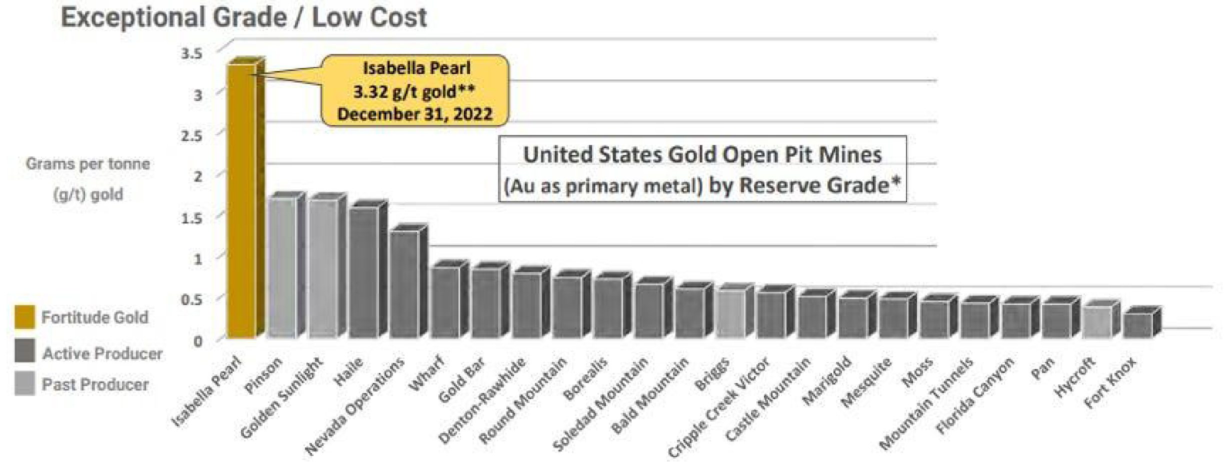
So far the company is proving quite profitable. It has an average net margin of 22% over the past three years. This has allowed the company to build up cash of $52 million on a $142 million market cap and employ an average combined $20 million in drilling and capex each year, all while maintaining an average dividend yield of 7%. Supporting all of this is the fact that Fortitude has one of the lowest all in sustaining costs (AISC) in the industry—only $625 per ounce compared to the global average of $1350. In today's gold market, Fortitude can produce an ounce of gold for $625 and sell it for over $2000. Quite impressive.

At this point, one should be asking: how does Fortitude maintain this outstanding performance and can it continue? The key to answering both questions lies in understanding Fortitude's properties.

### Unique Properties

Fortitude's crown jewel—the Isabella Pearl mine—is currently the company's only producing mine. That this mine was up and running in only ten months and has low-cost economics is what allowed Fortitude to quickly meet its dividend goal. The Isabella Pearl is low cost because it is an open pit mine—which is cheaper than underground mining—and because it has exceptionally high grade, compared to other U.S. open pit mines. Grade, for those who don't know, is how the industry quantifies the amount of product—in this case gold—in each tonne of earth mined. Isabella Pearl has grades north of three grams per tonne compared to comparable U.S. open pit mines, most of which have grades of less than 0.5 g/t.




Isabella Pearl Grade | fortitudegold.com



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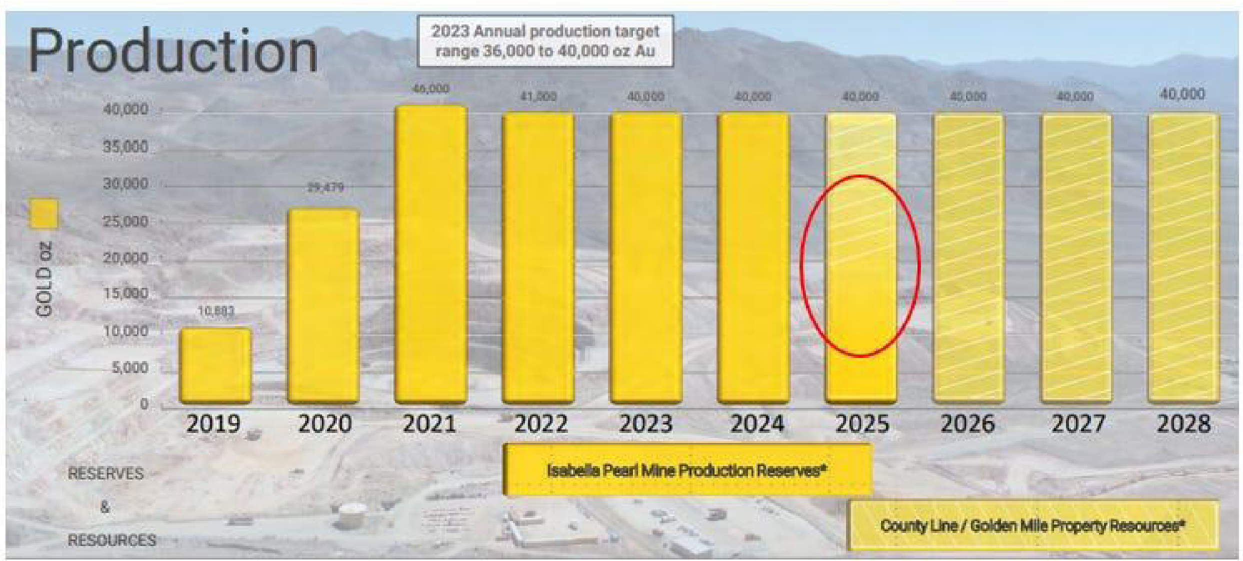
So the Isabella Pearl is the answer to how Fortitude has provided its outstanding results thus far. But unfortunately the mine's days are numbered. In 2019, its total mine life was projected to end in mid 2024. Due to further discoveries on site, production is now expected to continue through mid 2025, with the potential for more extensions.

To maintain the production past 2025, the plan initially depends on production from two other properties—County Line and Golden Mile. Both properties have been extensively drilled with promising results and both have permits waiting approval from the Bureau of Land Management.




FTCO's Production Plan (red added) | fortitudegold.com

Both County Line and Golden Mile are geographically close to Isabella Pearl. As a result, management plans to use what it calls a "hub-and-spoke method" by which it will utilize Isabella Peal's infrastructure as much as possible while extracting from these other mines. This will limit the need to build full mines at the other two sites. As an example, the County Line property is just fourteen miles from Isabella Pearl. The plan is to truck the aggregate from County Line to Isabella Pearl necessitating only minimal infrastructure on site. This should have two affects: quicker approval by the BLM (since there's less to approve) and cheaper production.

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FTCO's Properties | fortitudegold.com

While County Line is the closest property to Isabella Pearl, the plan is similar for the other mining properties—use the hub-and-spoke method to efficiently mine 40,000 ounces per year while maintaining Fortitude's low AISC and high dividend.

While they are not yet in production, drilling confirms all of Fortitude's properties have grades above 1%.

Since its properties have respectably high grades and can benefit from economies of scale due to close proximity, a path to maintaining low costs and high dividends and remaining a "more profitable miner" appears possible.

### A Few Additional Points

Here's a quick bullet point list of a few other things that stood out about Fortitude:

1. Unlike many mining companies, juniors in particular, that use dilutive share issuances to fund growth, Fortitude funds its exploration and mine development with its cashflow. It has kept its share count at 24 million since inception. It plans to maintain this track record moving forward.

2. Management showed that they are invested in the company when they left Gold Resource Corporation and joined Fortitude. Additionally, all four executives own common stock ranging from the CEO's ownership of 6% of shares outstanding, another owns 3%, another owns 2%, and the last two each own 1%. This ownership is not as high as we'd like to see but it's better than nothing.

3. Even though it's a miner, Fortitude doesn't have thousands or even hundreds of employees. At the time of its last annual report, it employed sixty full-time employees, including the four executive officers, and employed approximately thirty-five individuals through third parties. Additionally, services such as environmental permitting, mining, surface exploration drilling and trucking are contracted out on a case-by-case basis. Low headcount decreases the chance of high inflation impacting the company's bottom line too hard.





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4. Here's one that blew my mind. The company actually has a small, but growing, stash of gold and silver bullion that it builds by keeping some of its own product. In the latest earnings call, the CEO said that he believes all gold miners should "put their money where their mouth is," if they think gold is such a great investment, they should own it. He added the following:

    > We took advantage of the volatility in the gold price during the quarter to add to our growing physical metal bullion holdings as part of our treasury diversification program. We now hold both physical gold and physical silver bullion in our treasury.

    The bullion in treasury now totals close to $1 million as recorded in Fortitude's latest reports. Another reason he said they own the bullion is the threat of inflation.

5. Before we leave the inflation topic, Fortitude's management has also stocked up on much of the supplies need to build out their next two mines. They said they saw the prices of everything going up and noticed cracks in supply chains and they thought it best to get things while they could. This is just one example of many of management running the company in a very common sense manner.

**Conclusion**

There's much more that could be said about Fortitude Gold. I didn't even get to talk about one of its properties that potentially has a multi-million ounce deposit. No joke. But I'm okay with that because that's not what impressed me about the company. I was impressed by its unique, straightforward strategy for rewarding shareholders. The company is officially on the watchlist but neither my co-host or I are shareholders at present.

Continue reading here.

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**Chinese e-commerce firm Alibaba (BABA) is now the cheapest it's ever been by virtually every common metric (from Swordfishvegetable via X)...**

10Y | 20Y | Country | Region | Global

| | Current | vs. 10-Year History |
|---|---|---|
| **Valuation Multiples** | | |
| Price / Earnings - P/E (NTM) | 7.7x | 0 |
| Price / Earnings - P/E (LTM) | 9.9x | 0 |
| Price / Sales - P/S (NTM) | 1.3x | 0 |
| Price / Sales - P/S (LTM) | 1.4x | 0 |
| Price / Book - P/B (LTM) | 1.2x | 0 |
| Price / Tangible Book Value - P/TBV (LTM) | 1.7x | 0 |
| Price / Free Cash Flow (LTM) | 7.1x | 0 |
| Price / Gross Profit (LTM) | 3.7x | 0 |
| EV / Sales (NTM) | 1.0x | 0 |
| EV / Sales (LTM) | 1.1x | 0 |
| EV / EBITDA (NTM) | 4.7x | 0 |
| EV / EBITDA (LTM) | 5.5x | 0 |
| EV / EBIT (NTM) | 7.2x | 0 |
| EV / EBIT (LTM) | 7.7x | 0 |
| EV / Gross Profit (LTM) | 3.0x | 0 |





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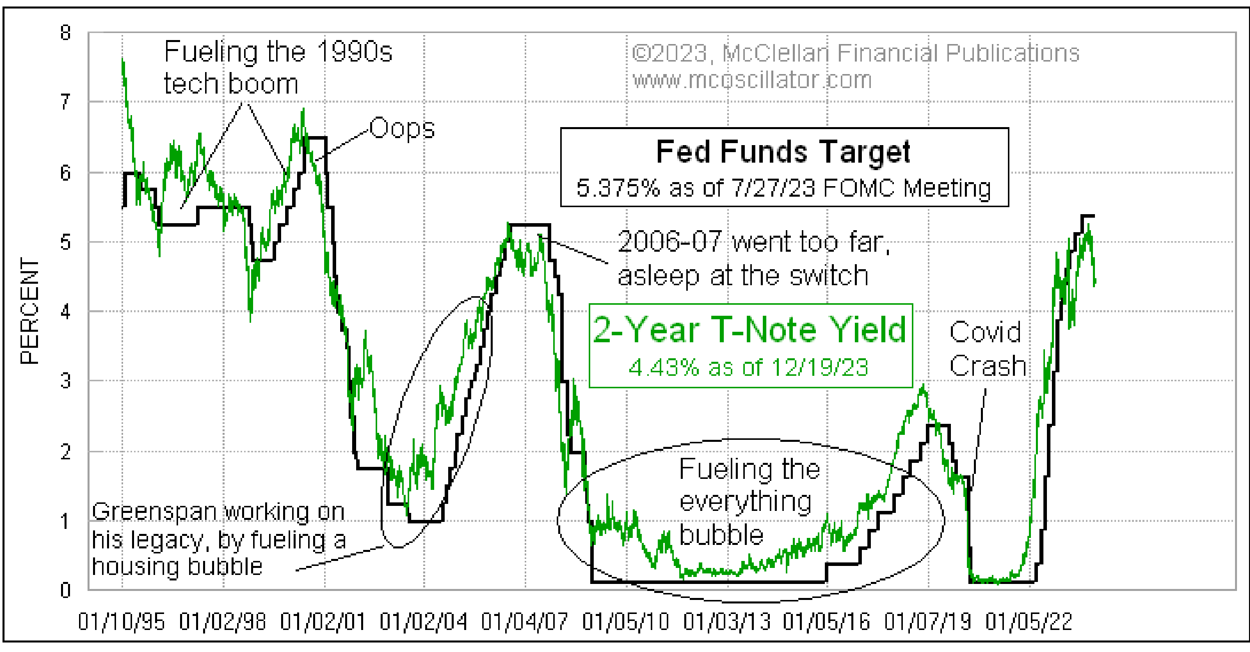
# SOVEREIGN/GOVERNMENT BONDS AND CREDIT

**The yield on the two-year U.S. Treasury note suggests the Federal Reserve has already over-tightened (from Tom McClellan via X)...**

The Fed Funds rate is now almost a full point above the 2-year yield, reflecting an immense amount of overly tight monetary policy from the Fed. They were slow to respond just like this in 2001 and 2007, and each time it caused big problems.



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**Wall Street forecaster Jim Bianco expects 10-year Treasury yields to reach 5.5% this year (from CNBC)...**

It's a level not seen since George W. Bush was president.

Wall Street forecaster Jim Bianco is predicting the benchmark 10-year Treasury note yield will hit 5.5% this year — its highest level since May 2001.

A major part of his thesis is built on the economy's strength and resiliency.

"I don't think the economy is hurt by 5% interest rates. I don't think the economy is really hurt by 7%, maybe high 7%, mortgages," the Bianco Research president said on CNBC's "Fast Money" on Wednesday. "I don't think something is broken because of these rates."

Bianco sees inflation bottoming around 3% and demand holding stable as catalysts for rebounding yields.

"You add the two together, you get 5.5%," he said. "That's where I come up with 5.5% for the yield. That's nominal GDP. The 10-year yield should approximate where nominal GDP is."

Bianco thinks the rate on the 10-year Treasury will reach 5.5% as early as summer. He correctly predicted last fall's yield spike above 5%.

Continue reading here.





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**The recent bond market rally is overlooking a serious debt problem (from *Bloomberg*)...**

Right around the start of November, two words suddenly disappeared from the chatter in the bond market: debt supply. As bond prices surged across the developed world day after day, sending yields tumbling and handing investors some much-needed profits, the angst about soaring budget deficits melted away.

But for how long?

Over the next several weeks, governments from the US, UK and the eurozone will start flooding the market with bonds at a clip rarely seen before. Saddled with the kind of bloated deficits that were once unthinkable, these countries — along with Japan — will sell a net $2.1 trillion of new bonds to finance their 2024 spending plans, a 7% increase from last year, according to estimates from Bloomberg Intelligence.

With most central banks no longer hoovering up bonds to bolster economic growth, governments must now entice more buy orders out of investors around the world. To do so, the thinking goes, they will have to dangle higher yields, just as they did when concern about ballooning government debt loads was amplified this summer by Fitch Ratings' move to strip the US of its AAA credit rating. The rout that resulted sent the rate on benchmark 10-year Treasuries above 5% for the first time in 16 years.

Those jitters may have faded of late — primarily because slowing inflation prompted investors to suddenly fixate on the idea that central banks will start cutting interest rates — but many bond-market analysts argue that, given the current supply-and-demand dynamics, it's only a matter of time before the nervous chatter picks up. Indeed, bond yields have already lurched higher this year and the 10-year rate is now about 4%.

"Right now, the market is just obsessed with the Fed rate cycle," says Padhraic Garvey, head of global debt and rates strategy at ING Financial Markets. "Once the novelty of that fades away, we'll start to worry more about the deficit."

Public debt across advanced economies has soared to more than 112% of GDP from about 75% two decades ago, data from the International Monetary Fund show, as governments ramped up borrowing to finance pandemic stimulus programs, health care and pensions for aging populations and the transition away from fossil fuels.

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Will aging society increase or decrease global demand for bonds? Share your views in the latest MLIV Pulse survey.

It's hard to know exactly how much these soaring debt loads drive up borrowing costs. Researchers at the Bank of England and Harvard University took a stab at it a few years ago. Their joint study concluded that each percentage-point increase in a country's debt-to-GDP ratio pushes up market rates by 0.35 percentage point.

The math certainly hasn't worked out that way in recent years. (Treasury yields, for instance, have fallen this century as US debt-to-GDP spiraled higher.)

Imperfections and all, Garvey says the study's findings should be heeded. With the US now running annual deficits equal to 6 percent of GDP, about double the historical norm, he figures that'll tack another percentage point onto yields. Not only would that swell the government's interest tab and deepen the deficit further, creating a vicious cycle of sorts, but it would drive up borrowing costs for companies and consumers and curb economic growth.

Public finances aren't quite as bleak elsewhere but countries including the UK, Italy and France are all expected to post larger-than-normal deficits again this year. And a plethora of elections will keep those shortfalls in focus; BlackRock Inc. this week warned that Britain's politicians could spark a selloff in the nation's bonds if they try to win votes by pledging greater spending.

"It's difficult," Garvey says, "to argue that this is inconsequential."

And yet bond bulls essentially do just that.

Continue reading here (subscription may be required).





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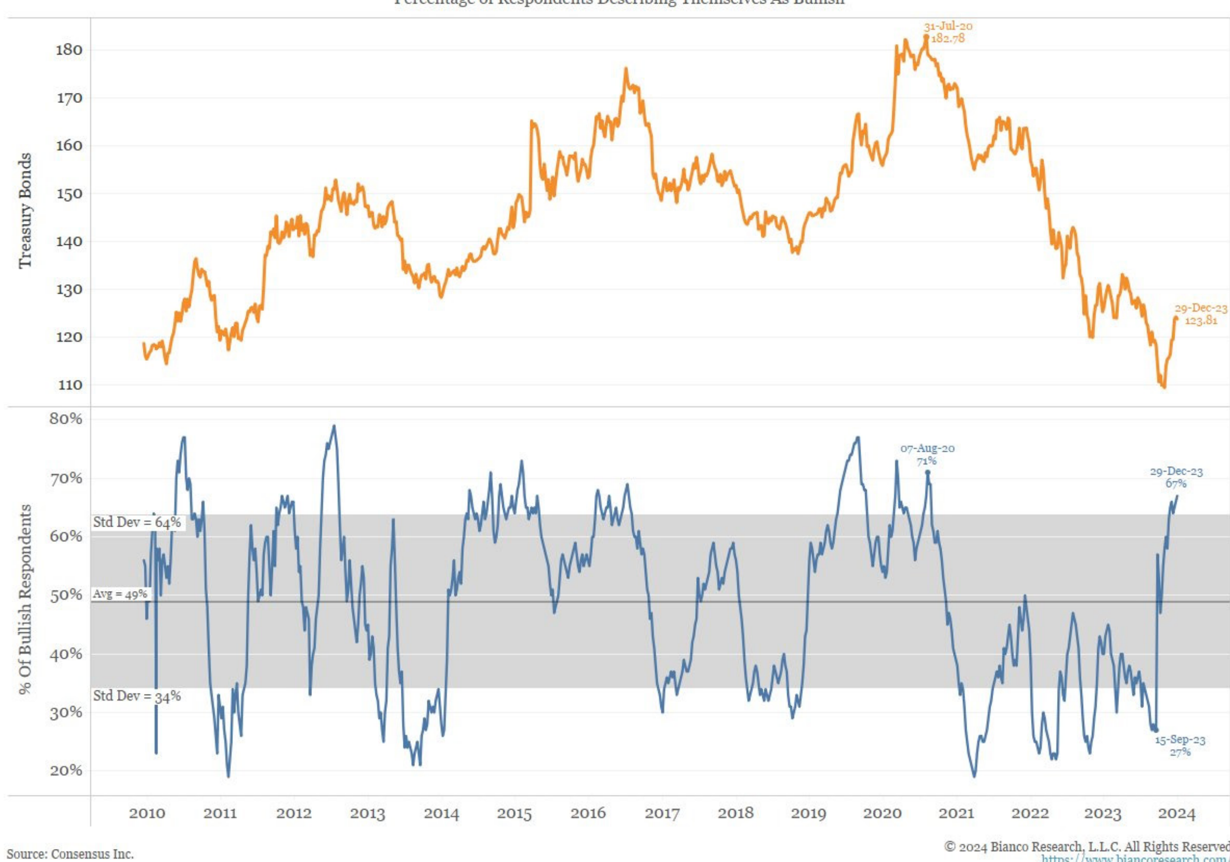
**Investors are the most bullish on Treasury bonds since the August 2020 peak (from Jim Bianco via X)...**

Treasury bond Sentiment is at its highest level since August 2020, the all-time peak in bond prices and the middle of the lockdowns.

Sentiment had been bearish on bonds as late as September but made a strong move higher on the back of the Fed's pivot heading into 2024.



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**The current yield-curve inversion is now the longest in history (from Barchart via X)...**

The 10-Year minus 3-Month Treasury Yield Curve has been inverted for 293 consecutive trading days, the longest stretch of time in history.

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**Forecasters are strongly divided on the outlook for long-term rates (from The Daily Spark)...**

Some forecasters are currently predicting that 10-year rates will end the year above 5%, others are predicting a level below 3%, and the chart below shows the standard deviation of the 12-month ahead forecast for 10-year Treasury yields for 26 private sector forecasters since 2019.

The rising trend in the standard deviation of forecasts shows a very high level of disagreement among forecasters about what will happen to long-term interest rates in 2024.

This is not surprising because some would argue that a soft landing with Fed cuts and lower inflation would result in lower long-term interest rates. Others would argue that a soft landing with no recession and the risk of reacceleration will push rates higher.

On a different note, others would argue that the key driver of rates in 2024 will be a higher term premium, driven by the coming massive increase in the supply of Treasuries.

What is most remarkable about the high level of disagreement among forecasters is that the same elevated level of uncertainty is entirely absent in the MOVE Index and the VIX Index.

The bottom line is that we have a busy year ahead of us in markets with extreme disagreement about the forces driving longer-term interest rates.

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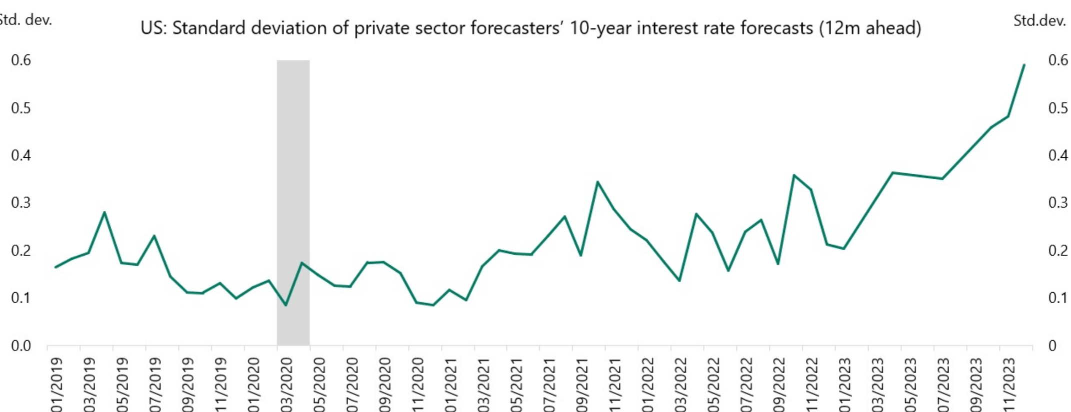


Source: Bloomberg, Apollo Chief Economist. (Note: We calculated standard deviation of individual analyst's forecast for 12 months ahead for every month starting January 2019. The list of contributors in our calculation: UBS, Citigroup, HSBC holdings, Wells Fargo & Co, University Of Texas At El Paso, RBC Financial Group, Natixis SA, Naroff Economic Advisors, Mortgage Bankers Association, MacroFin Analytics LLC, Kasikornbank PCL, ING Groep NV, First Trust Advisors LP, Fannie Mae, Desjardins Securities Inc, Dai-ichi Life Research Institute Inc, Commerzbank, Action Economics, ABN Amro, Bank of Montreal, TD securities, Nomura, Barclays, Goldman Sachs, Bank of America, and Hamburg Commercial Bank AG.)





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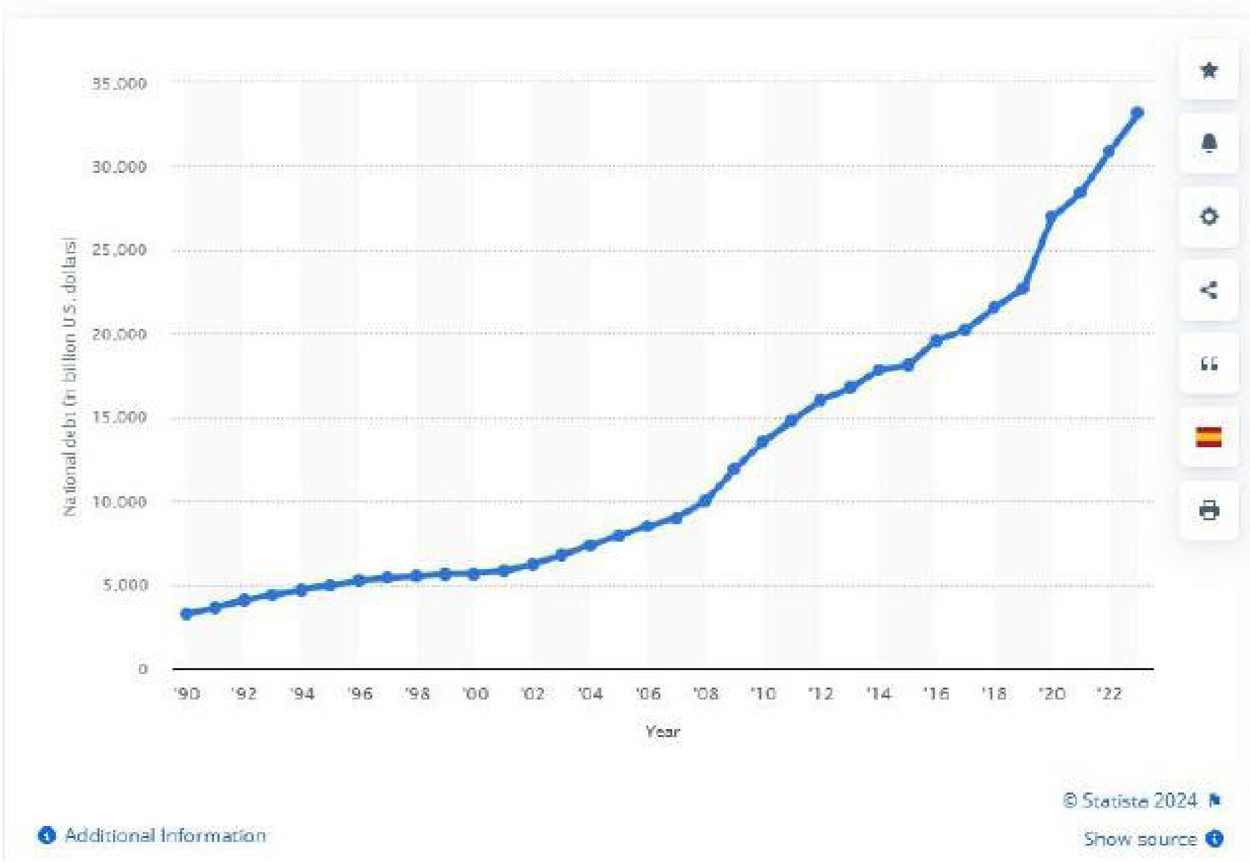
**Who buys $9 trillion of Treasuries this year? (from Grahams Benjamins)...**

There are three numbers worsth watching this year: $34 trillion, $1.7 trillion and $1 trillion.

This time last year, US government debt was below $31 trillion. This means that in 2023 alone, debt grew by more than $3 trillion, or 10%. Since the outbreak of COVID, the chart of US debt growth has been parabolic:

## Public debt of the United States from 1990 to 2023

*(in billion U.S. dollars)*




It is mind-boggling to think that US debt has tripled in the past 15 years. For decades now there has been a chorus of debt doomsdayers, warning of the unsustainability of US debt growth. To date, the counterargument has held sway, being that as long as the USD remains the world's sovereign currency, debt levels matter little.

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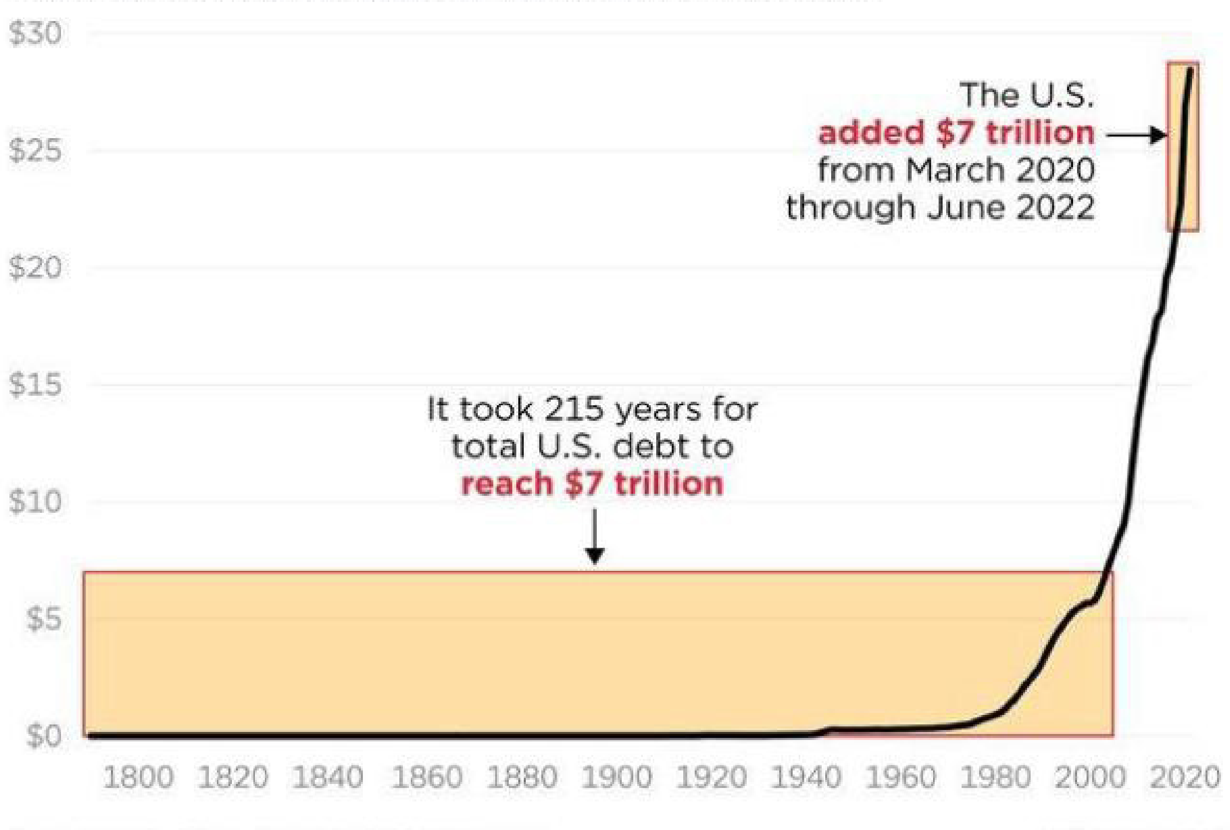


At the same time, last year's fiscal deficit of $1.7 trillion helped run the US economy hot, with unemployment in the mid-3% range for most of the year. It is difficult to imagine the White House instigating a bout of budget austerity during this election year. If they do not, then debt growth will continue at the current pace.

Where things are beginning to get challenging for the US government is the issue of debt servicing costs. Suddenly, the numbers are getting very large. Debt servicing costs now exceed $1 trillion, making it the second largest expenditure item behind social security.

Trees do not grow to the sky, meaning there will be some point at which this becomes a significant problem. Perhaps the pressure on debt servicing will be eased by lower interest rates, should the US experience a recession this year. But as long as the US government runs substantially stimulatory deficits, the underlying inflationary pressures will be a headwind for lower debt servicing costs, and the neutral level of interest rates will steadily increase.





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But there is also a more pressing problem right now for the US Treasury – they have a lot of issuance coming up, and the two largest holders of Treasuries are both now sellers, in China and Japan. Nearly $9 trillion of US debt matures this year, which amounts to a staggeringly high 36% of US GDP:



When the Federal Reserve manufactured the lowest interest rates in history, it is astounding the Federal Reserve did not issue as far out the yield curve as they could.

Stan Druckenmiller called this a monumental mistake. With bond yields considerably higher than zero now, recent attempts to issue longer dated bonds have not been well received by the market, meaning they have been ongoingly forced to issue shorter dated Treasury Bonds and Treasury Bills.

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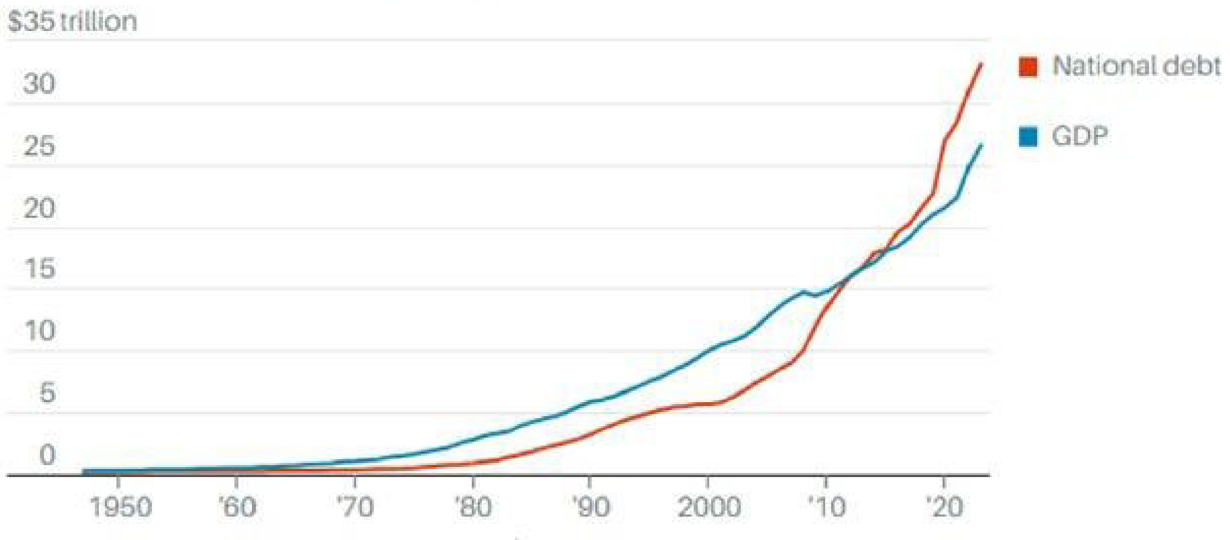
Meanwhile, US debt growth significantly exceeds economic growth:




Such a trend inevitably places downward pressure on growth and upward pressure on interest rates, all other things being equal.

But in the eyes of the US Treasury, these things can wait. Before then, they need to issue nearly $9 trillion of debt this year, just to roll over existing maturities, and not counting any new debt issuance.

And if they do not issue longer-dated maturities, they will have the same problem next year - only with more debt.

Continue reading here.





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**A portion of the yield curve has now “un-inverted” (from Otavio Costa via X)...**

The spread between 2 vs. 30-year yields just turned positive.

Last time this happened from deeply inverted levels was in late 2000, right after the S&P 500 also marked a double top that resulted in the tech bust.

US 2 vs. 30-Year Yield Spread

400
300
200
100
6.816
-100
Tech Bust
GFC
?
1995-1999
2000-2004
2005-2009
2010-2014
2015-2019
2020-2024

Source: Bloomberg; Tavi Costa © 2024 Crescat Capital LLC

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# CORPORATE BONDS AND CREDIT

**U.S. companies have been piling into convertible debt to hold down interest costs (from *The Financial Times*)...**

US companies have been piling into the market for convertible bonds as they search for ways to keep their interest costs down, in a rare flurry of activity in otherwise subdued corporate fundraising markets.

Issuance of convertible debt climbed by 77 per cent last year to $48bn, according to data from LSEG, making it one of the only areas of capital markets to return to pre-pandemic averages after 2022's market downturn.

Experts say the boom in convertibles, a type of bond that can be swapped for shares if a company's stock price hits a pre-agreed level, is likely to continue this year as companies refinance a wave of maturing debt.

The debt has traditionally been popular with younger technology and biotech groups that struggle to access mainstream bond markets. But more established companies have also dived in as the Federal Reserve's interest rate hikes have driven up borrowing costs even for investment-grade companies.

"Historically converts had sometimes been seen as one of those spivvier products that investment-grade names stayed away from," said Bryan Goldstein, who advises companies on convertible deals at Matthews South. "Now some big name issuers have come to the market, that narrative has shifted — it is seen as an attractive product on its own merits."

Convertibles offer borrowers lower interest rates than traditional bonds without the immediate dilution for shareholders that would come through selling new stock. While 2023's total issuance was lower than the record levels hit in 2020 and 2021, when companies took advantage of net-zero interest rates to shore up their balance sheets, it was well above the average of $34bn for the decade to 2019.

That is a stark contrast to the markets for initial public offerings, follow-on share sales, high-yield debt and leveraged loans, where volumes are still languishing well below pre-pandemic levels.





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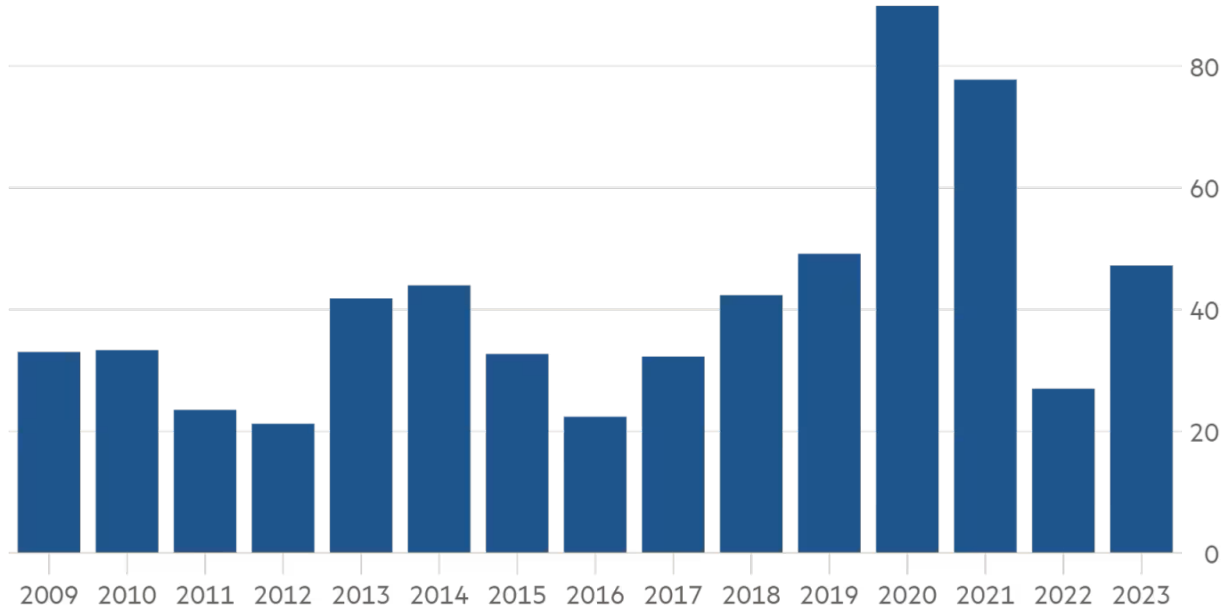


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**Private credit is having a "golden moment" – here's what investors should know (from VettaFi Advisor Perspectives)...**

According to Jonathan Gray, the president of Blackstone, this is a "golden moment" for the private credit asset class. After quoting Gray, the Financial Times' Robin Wigglesworth noted that "BlackRock's alternatives investment supremo, Edwin Conway, is 'confident about (its) future'.1 Apollo's Marc Rowan sees 'a good time for the private credit product set'." Scarcely concealing his disdain, Wigglesworth closes by saying, "Another day, another asset manager jostling for a bigger slice of the investment industry's hottest neighbourhood."

All this excitement and hype has usually – OK, almost always – meant trouble for the asset class being discussed. I'm a generation older than Wigglesworth, so I've experienced golden moments for more asset classes and strategies than he has: small-cap stocks, oil stocks, real estate, gold, portfolio insurance, Japan, China, mortgage-backed securities, hedge funds, private equity, and tech circuses #1 and #2.

These booms didn't all end in ashes, but the odds are not good. Now comes private debt, smartly rebranded as private credit (doesn't that just sound better?) and packaged into funds aimed at retail investors, whom I define as those with $10 million or less in investable assets. These are typically people who are saving for retirement or already retired, and for whom a large drawdown would mean hardship, not just inconvenience.

The private credit boom is not ephemeral or a niche phenomenon. According to The Wall Street Journal, it is a major secular trend: "A boom in private credit has been moving a huge portion of corporate borrowing away from public view, taking it from the world of banks and the bond market and into the more opaque realm of private funds."2 Private credit funds now manage about $1.4 trillion, which is expected to grow to $2.3 trillion by 2027.3

Those high yields – a riddle wrapped in a mystery inside an enigma

So – should retail investors partake of the very attractive yields promised by private credit fund managers?

First, let's see if we can figure out what the yields are. Winston Churchill's famous description of the Soviet Union in 1939 – a riddle wrapped in a mystery inside an enigma – applies here. Look at Exhibit 1, which shows data for six private credit funds.4





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***Exhibit 1***
***Current yields on selected private credit funds***
***Data as of December 2023***

| Fund name | Ticker | Morningstar category | Yield as reported by manager | Morningstar yield |
|---|---|---|---|---|
| PIMCO Flexible Credit Income Fund | PFLEX | US multisector bond | 6.06%* | 9.42% |
| Virtus Private Credit ETF | VPC | US nontraditional bond | 11.99% | 5.45% |
| Calamos Aksia Alternative Credit and Income Fund | CAPIX | US nontraditional bond | 12.23%** | No data |
| BlackRock Credit Strategies Fund | CREDX | US bank loan | 12.41% | 6.31% |
| Carlyle Tactical Private Credit Fund | TAKIX | US nontraditional bond | 10.46%*** | 8.63% |
| XAI Octagon Floating Rate & Alternative Income Term Trust | XFLT | US bank loan | 14.68% | 6.88% |

* Yield appears to be calculated on a different basis than the other funds

** Average (unweighted, unleveraged) of yields of portfolio holdings

*** Leveraged 21.2%. Leverage for other funds in this table is unknown

*Source: Web sites of each fund, except Calamos Aksia (explained in notes); Morningstar Direct.*

The manager-reported and Morningstar yields are completely unrelated. They are not even of the same order of magnitude. They are not rank-ordered in anything like the same way. The two sets of numbers seem to come from different planets. So, let's dig deeper.

## Yields as reported on the fund websites

The "manager-reported" yields are extraordinary and would tempt even a cynical investor like me – surely not all these large payouts will be offset by future defaults! Let's look at the choices facing a fixed-income investor: Treasury bonds yield 4.26%, AA-rated bonds 4.94%, and high-yield bonds 8.05%.5 The average of the manager-reported yields on private credit is 11.31%, more than three percentage points higher than "junk."

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While today's publicly traded high-yield bonds do not quite deserve the junk moniker they acquired in the 1980s, they are far riskier than any other widely held bond category.6 High-yield bond yields spiked from 5.02% before the COVID crash of 2020 to 11.38% at the bottom, causing the prices of those bonds to fall by 20.5% over that unfortunate period, compared with a 31.8% loss for the S&P 500. Worse yet, high-yield bonds fell 34.9% in the global financial crisis of 2007-2008.7

These results show that a publicly traded high-yield bond is more stock than bond when times get tough. Yet the manager-reported private credit yields shown in Exhibit 1 are, on average, more than 300 basis points higher than high-yields, almost as large a spread over high-yields as that of high-yields over Treasuries.

Thus, if risk is related to return, which it surely must be on average over time, private credit must be very risky indeed (despite the smoothing of apparent return caused by the absence of market prices). There's no other plausible explanation for borrowers having to pay that much for money.

Continue reading here.





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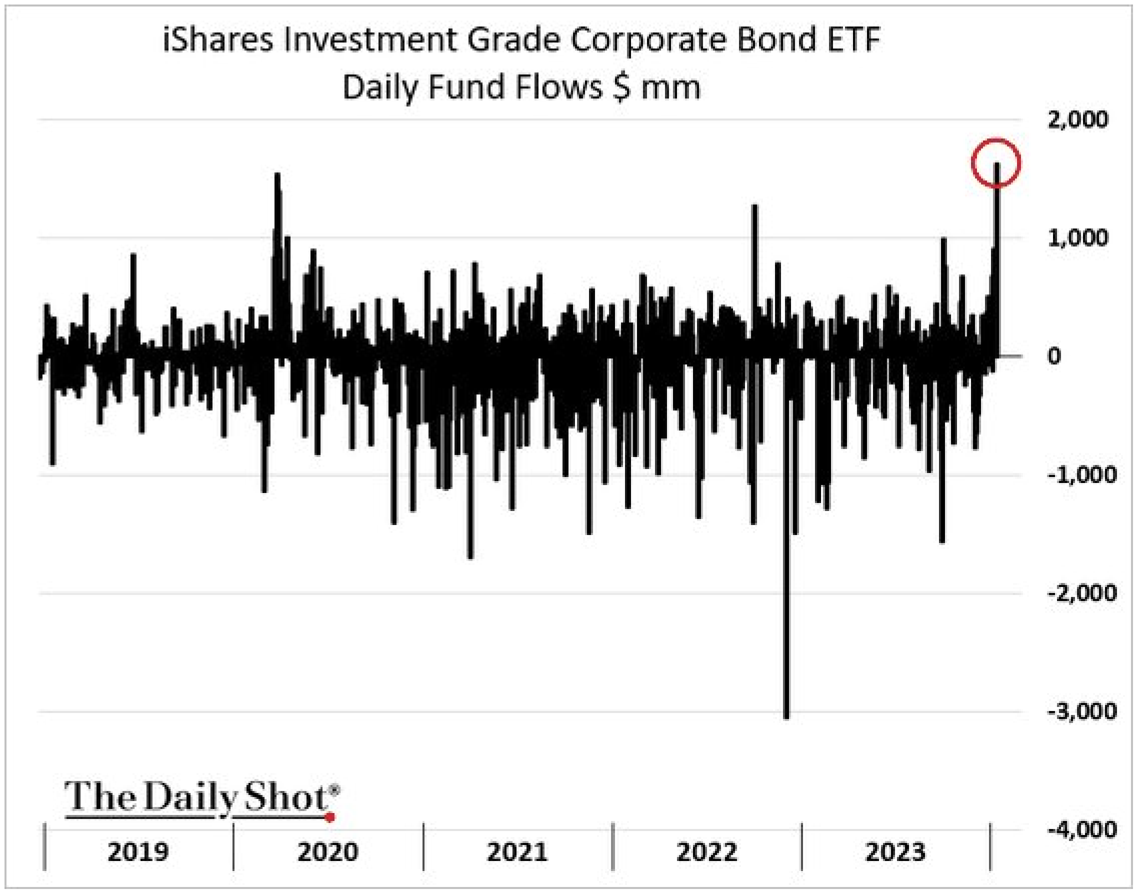
**Investment-grade bond funds have seen massive inflows this month (from The Daily Shot)...**



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**Rating agency Moody's warns of rising corporate defaults (*from The Financial Times*)...**

Global corporate defaults surged in December, according to a report by rating agency Moody's, setting the stage for more missed debt payments ahead as low-grade, highly leveraged businesses grapple with a prolonged period of steep funding costs.

Twenty companies rated by Moody's defaulted on their debt last month, up from four in November, lifting the annual count to 159. That took the global 12-month trailing corporate default rate to 4.8 per cent by December, the highest rate since the year to May 2021 — a period that included bankruptcies linked to the economic fallout from the coronavirus pandemic.

"High funding costs, together with tighter financing conditions . . . prompted a rise in corporate defaults during 2023," wrote Moody's.

More than half of December's defaults related to US-based companies, but a further eight were in Europe. That is the highest count for the region since the global financial crisis 15 years ago, excluding war and sanction-related corporate failures in Russia and Ukraine.

The latest default tally underscores the challenges still facing lowly rated borrowers across the globe, after interest rates in the US rose from near-zero two years ago to more than 5 per cent last year. The sharp increase has put particular pressure on loan issuers, whose debt payments typically float up and down with prevailing borrowing costs.

"Caution is still required because the market embodies a very optimistic view of rate cuts, by the Federal Reserve in particular," said Marty Fridson, chief investment officer of Lehmann, Livian, Fridson Advisors. "There are sectors of the economy for which complacency would be a dangerous stance."

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**Ten key takeaways on the credit markets today (from Oaktree Capital Management)...**

In December 2023, Oaktree's incoming co-CEOs Armen Panossian (Head of Performing Credit) and Bob O'Leary (Portfolio Manager, Global Opportunities) took part in a webcast for Oaktree clients that explored the state of performing and opportunistic credit markets and what we might expect to see moving forward. They argued that the current environment for credit investors is the most attractive since the Global Financial Crisis – based on the enormous size of today's markets as well as the elevated yields and reasonable investor protections being offered. Below are the top ten takeaways from the conversation.

1. THE SIZE OF THE OPPORTUNISTIC CREDIT UNIVERSE HAS BALLOONED

Bob O'Leary: The most striking thing on the opportunistic credit side is the sheer enormity of the market right now. We think about the addressable market for opportunistic credit in four buckets: high yield bonds, BBB-rated bonds, leveraged loans, and private credit. The size of those four categories just prior to the financial crisis was about $3 trillion. Today, it stands at roughly $13 trillion, so that's a 4x increase – staggering growth in those categories.

2. SKILLED PERFORMING CREDIT INVESTORS CAN POTENTIALLY EARN HIGH YIELDS WHILE AVOIDING DEFAULTS

Armen Panossian: We're really excited about the current performing credit market. We recognize the risks. We recognize that we need to avoid defaults and losses, which are likely going to tick up in the broad market over the next couple of years. And we're monitoring the growing risk related to floating-rate borrowers that need debt or equity capital and are struggling to access it. We understand that this tail risk is certainly fattening.

However, in the context of the roughly 1,500 U.S. high yield bond and leveraged loan issuers, there are several hundred that are going to be just fine – even if defaults rise in the market broadly. So if you're a skilled credit picker who has managed capital through cycles, you may potentially be able to put together a portfolio of hundreds of broadly syndicated loans and high yield bonds that are going to perform quite well and generate an attractive yield.

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### 3. LARGE-CAP PRIVATE CREDIT OPPORTUNITIES EXPANDED SIGNIFICANTLY IN 2023

AP: In 2023, investment banks were stuck with about $40 billion of debt on their balance sheets that they had to clear at a discount. As a result of these losses, banks didn't syndicate or originate very much debt in 2023, likely because their risk managers, their capital markets teams, and their leveraged finance desks were told to watch what they did with their balance sheets.

As a result, we saw a significant expansion in the large-cap end of private credit. Companies that have $100 million of EBITDA or more – or enterprise values of one billion dollars or more (and oftentimes six, seven, eight, or nine billion dollars) – were bought using private credit as the financing tool.

What we're finding in large-cap sponsored lending is that its pricing is wider than in traditional middle-market private credit deals. To put some numbers on it, we're seeing spreads for large-cap lending in the 550-650 basis point range.

Spreads have been a little bit tighter in the last three or four months. But with base rates where they are, private credit firms can potentially earn 11.5% or 12.0% coupons while lending to multibillion-dollar businesses, in situations where a private equity sponsor is writing a multibillion dollar check, usually to the tune of about 60-70% of the total capital needed to buy the company. That's a very attractive risk-adjusted return.

### 4. LOOMING MATURITIES MAY CREATE SIGNIFICANT REFINANCING RISK IN LEVERAGED CREDIT MARKETS

BOL: Maturities are going to start to ramp up over the next several years in a very meaningful fashion. You have over $800 billion of U.S. high yield bond and leveraged loan debt that is coming due in 2024, 2025, and 2026 – and roughly $1.4 trillion globally.

All that debt needs to be refinanced in some way. Historically, the easiest way to do that has been by using the syndicated market. However, the syndicated market has become increasingly selective about which borrowers it will support. We can all look at credit spreads and say those are well within historical norms, but those credit spreads are available only to the best borrowers.

More and more, there are a lot of companies being left out that are looking for alternative solutions. Without those solutions, most of these companies will end up in a restructuring.

### 5. WE'RE LIKELY TO SEE A DIVERSE ARRAY OF RISKS EMERGE IN THE COMING YEARS

AP: Clearly, the most acute area of risk right now is commercial real estate. That's because the maturity wall is already upon us and it's not going to abate for several years.





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There's a need for capital, especially for office properties where there are vacancies, rental growth hasn't materialized, or the rate of borrowing has gone up materially over the last three years. This capital may or may not be readily available, and for certain types of office properties, it absolutely isn't available.

As we roll forward in time, different pockets of risk – or different dimensions of risk – may develop. We're probably at the beginning of a cyclical downturn, so we don't believe it's a good time to go heavy into cyclicals or interest-rate-sensitive asset classes, like, for example, homebuilding and building products.

Another area where we see risk increasing is among floating-rate borrowers broadly, specifically those that took on debt in 2018-21 when base rates were zero and the cost of borrowing was 5-7%. The costs for those same borrowers are now more like 11-13%.

Generally speaking, when these companies took on this debt, the sponsors and borrowers assumed that they would see synergies or increased growth and cash flows. Most of this hasn't materialized. Some businesses have grown, but they typically haven't grown to the level that they or their owners thought they would.

Therefore, in addition to seeing a meaningful escalation in their cost of borrowing, these floating-rate borrowers have also been negatively impacted by the economy and therefore haven't been able to grow into their capital structures.

6. CREDIT INVESTORS SHOULD BE PREPARED FOR MORE AGGRESSIVE LIABILITY MANAGEMENT EXERCISES

BOL: From my perspective, in opportunistic credit, what you're going to see over the next three years is an unprecedented wave of liability management driven by the really poor debt documents that were written over the last five years. That is a big risk that I don't think the market fully appreciates.

Those structures are perfectly positioned for predatory sponsor action, more commonly known as "creditor-on-creditor violence." If you're in those structures and you're not aware of what's going to happen, you're likely going to have a rude awakening.

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We've seen this trend emerge to a very limited degree in 2023. But it's likely going to tick up in 2024, precisely because maturities are going to start to ramp up, and borrowers aren't going to have the ability to address them through the syndicated market. Sponsors who are backed into a corner are likely going to try everything at their disposal to save their equity. The easiest way to do that is to pit creditors against each other and to advantage a certain set of those creditors to create liquidity for the company.

This is not like the distressed market we saw in 2007, where you could go out and buy a loan and expect to get the same treatment that you would in a normal bankruptcy or restructuring process. These sponsors will act. There are few sponsors who are going to be above aggressive liability management, so you should be ready for that.

7. WE BELIEVE WE COULD CONTINUE TO SEE VOLATILITY AROUND TREASURY AUCTIONS

AP: We saw a nice rally in duration during late 2023. The 10-year Treasury yield hit a high of about 5% in mid-October. It then fell back down to closer to 4% in less than six weeks. But this rally may not be repeated.

Moving forward, we believe we're going to test the domestic market for treasuries. I would pay close attention to Treasury auctions. How do they go? How well do they clear? How do new Treasurys get placed, and who is buying those Treasurys? The foreign buyers of Treasurys, which were the largest owners in prior years, may be tapped out.

Given the quantum of debt the U.S holds and the budget deficit that is upon us, it's hard to imagine a scenario where the dollar value of Treasurys that need to be rolled every quarter or every month would actually decline. Thus, we're somewhat concerned about where the 10-year Treasury yield goes from here, given supply and demand imbalances.

8. WE EXPECT TO SEE OPPORTUNITIES INCREASE IN LOAN PORTFOLIO SALES AND RISK TRANSFER TRANSACTIONS

BOL: Some really poorly underwritten debt was issued over the five years leading up to 2022. A lot of it found its way into the banking sector. A lot of those banks, including both regional and large banks, are sitting with big embedded losses on their balance sheets. These losses might not have to be recognized immediately, but the people running the risk books for those banks probably feel pretty uncomfortable. They'll likely look to shed that risk.

They can shed it directly through loan portfolio sales. After the financial crisis, Oaktree's Opportunities group bought roughly 60 different pools of non-performing loans involving over $2 billion of equity capital deployment.8 We may not see an opportunity of that size this time around, but there will be pools for sale out there.





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A more elegant way to reduce risk is risk transfer. We're seeing an increase in the number of banks interested in talking to us about risk transfer involving high-quality assets that are simply mispriced – they were just purchased in an era that doesn't exist right now. We're very excited about this growing opportunity.

9. WE BELIEVE THE COMPETITIVE DYNAMICS IN RESCUE LENDING WILL BENEFIT CREDITORS

BOL: Rescue lending refers to a consensual loan between the borrower and the lender and is therefore viewed as a valuable capital solution by the owners of those businesses, including private equity firms.

Competitive dynamics are always a question of supply of capital versus demand for it. Right now – and I think for the foreseeable future – demand will outstrip supply in rescue lending. Demand for capital from sponsors is strong. And, importantly, we haven't yet seen the teeth of the maturity wall that's going to ramp up starting in 2024.

CFOs typically begin seeking refinancing solutions at least a year in advance of maturities. As we flip the calendar to 2024, a lot of people are going to start looking at 2025 maturities and are going to be trying to find ways to address them. Thus, we expect to see a big uptick in the demand for rescue capital, especially once CFOs start to focus on 2026 maturities.

Supply of capital is very constrained right now. Many of the LPs that would typically provide capital to the sector are currently restrained by legacy portfolio issues and the fact that they're not getting the distributions they anticipated. So we except the supply of capital in this area to remain very constrained, creating attractive competitive dynamics for us.

10. ACCESSING PREMIER OPPORTUNITIES IN THIS ENVIRONMENT WILL LIKELY REQUIRE A DISTINCTIVE SKILLSET

AP: We think well over half of the opportunistic credit investments that Oaktree will make over the next two years will be large rescue financings in which speed, size, and certainty of execution are key. Therefore, we expect to be in a good position to dictate pricing and legal terms.

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On the performing credit side, we believe we're well situated to be a very important counterparty for private equity firms and other business owners in both good times and bad times – and especially in bad times. When we're in a downcycle, most performing credit investment managers aren't in a position to support a business. The average manager doesn't have the ability to offer capital solutions with the size, speed, and depth that we're able to.

We believe that Oaktree's reputation, history, capabilities in the market – both on the performing and on the opportunistic side – are advantages we have that others don't. We look to leverage that in our sourcing every day.





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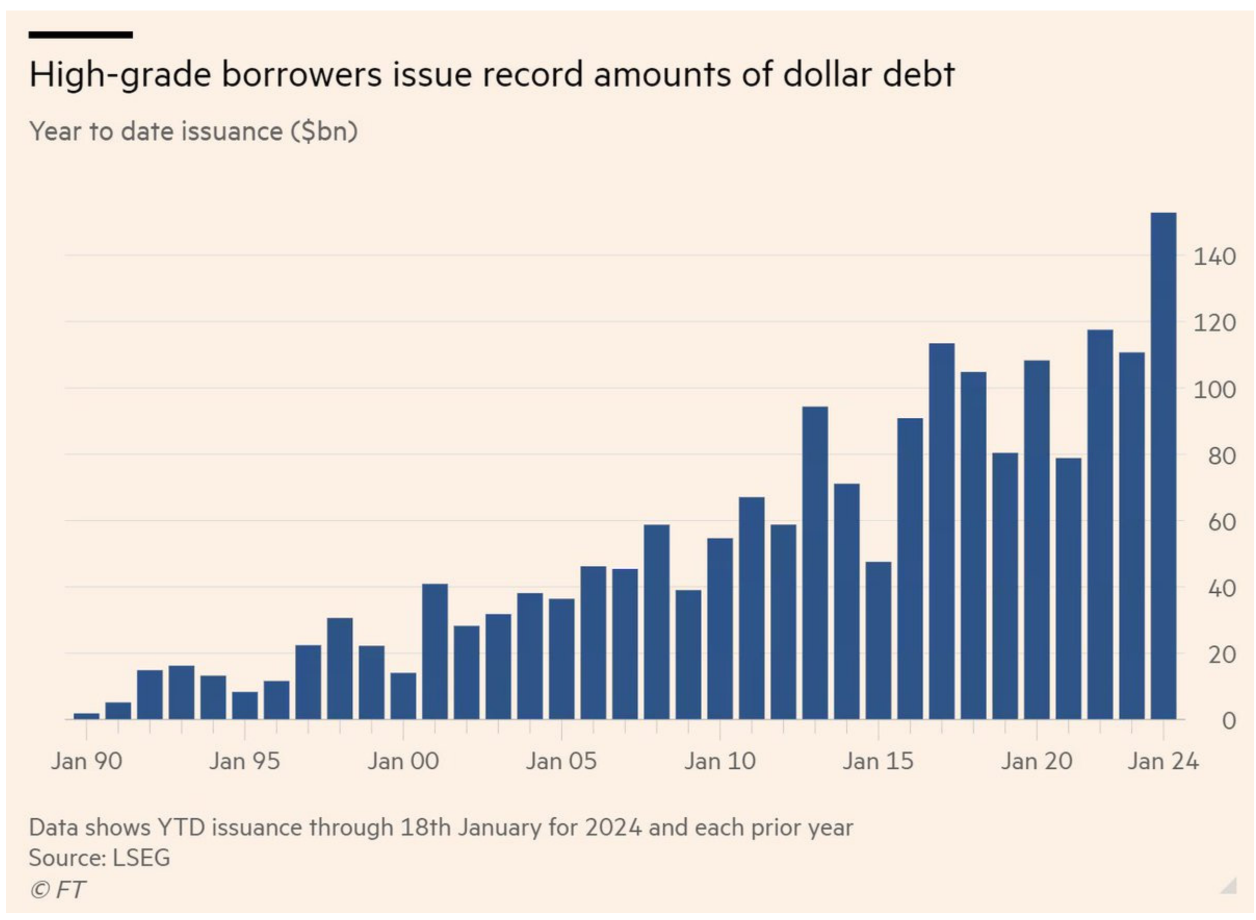
**U.S. corporate bond markets are "on fire" to start 2024 (from Jesse Felder via X)...**

Companies have sold a record $150bn of debt since the start of this month, the busiest opening to the year for more than three decades.



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# CONSUMER CREDIT

**What is the impact of the recent Fed pivot on consumers? (from The Daily Spark)...**

Data covering the period after the Fed pivot shows that US consumers significantly changed their expectations to interest rates after the December FOMC meeting. Specifically, the share of consumers expecting interest rates to go down jumped to levels last seen during the pandemic and during the financial crisis in 2008, see chart below. With almost 30% of households expecting interest rates to go down, it would make sense if consumers now start borrowing and spending at a faster pace.

Source: U. of Michigan Survey, Haver Analytics, Apollo Chief Economist





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**U.S. consumer credit surpassed $5 trillion for the first time in November (from MarketWatch)...**

The numbers: Total consumer credit rose $23.7 billion in November, up from a $5.8 billion increase in the prior month, the Federal Reserve said Monday. That translates into a 5.7% annual rate, up from a revised 1.4% rise in the prior month.

That was the biggest gain since November 2022, and puts total consumer credit above $5 trillion for the first time ever. The data is not adjusted for inflation.

Economists had been expecting an $8 billion increase, according to the Wall Street Journal forecast.

Key data: Revolving credit, like credit cards, rose sharply at a 17.7% rate after a 2.7% gain in the prior month. That was the biggest gain since March 2022.

Nonrevolving credit, typically auto and student loans,  rose at a 1.5% rate after a 0.9% rise in the prior month. That category of credit is typically much less volatile. The Fed's data does not include mortgage loans, which is the largest category of household debt.

Big picture: The sharp pickup in consumer credit growth was likely due to the start of the holiday shopping season, economists said.

Stepping back, consumer credit has been on a downward trend in the wake of the Fed's aggressive rate hikes. Banks have also been tightening their standards. Now that the market expects the Fed to start cutting rates, consumers might borrow at a faster pace.

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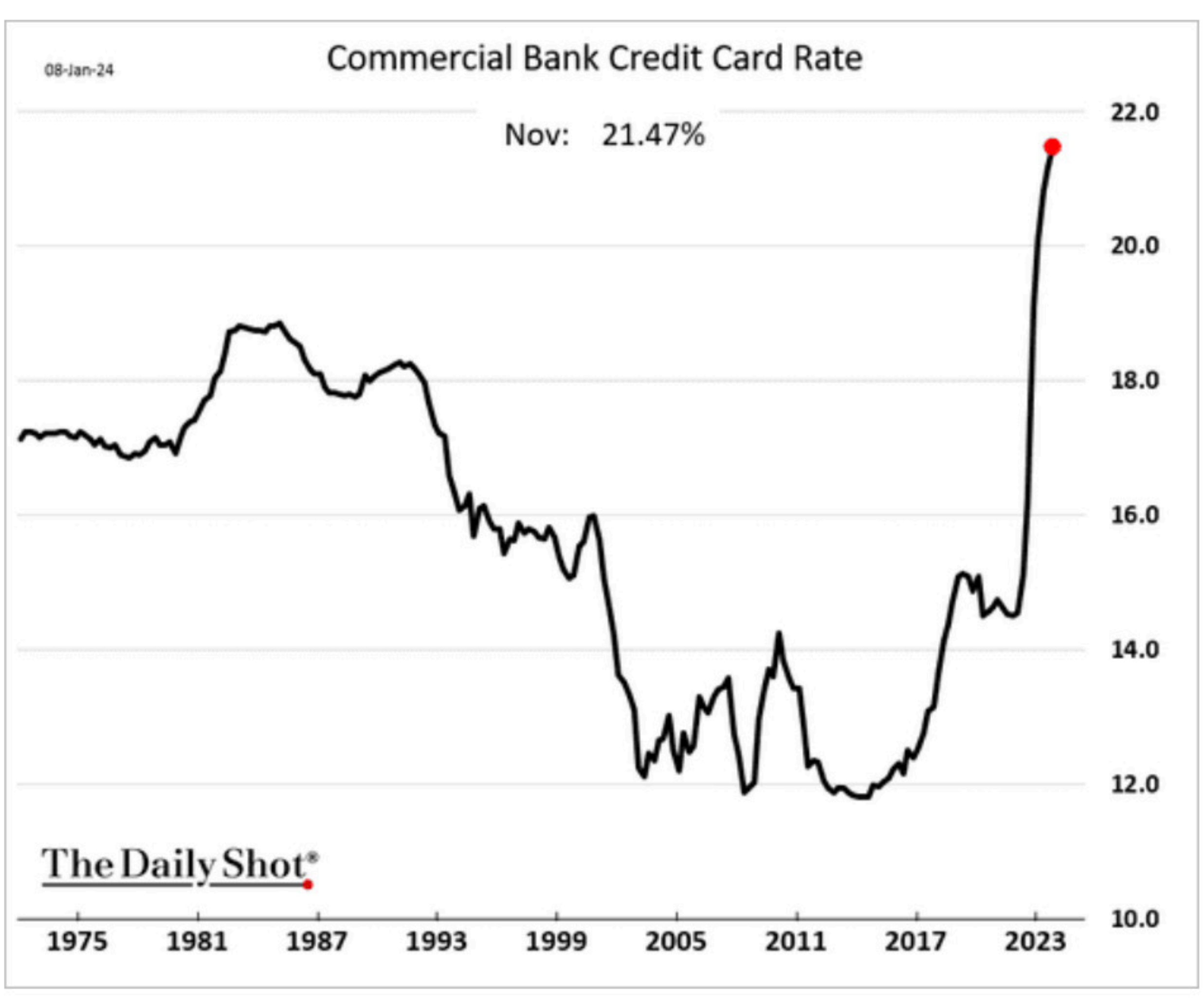
**Credit card rates hit another new record high last month (from The Daily Shot)...**





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**Discover Financial Services could be a canary in the coal mine for the consumer credit markets (*from Barron's*)...**

Discover Financial Services stock tumbled 8% in early trading Thursday after the company missed earnings estimates and set aside more money to cover bad loans.

Discover said its provision for credit losses was $1.9 billion in the fourth quarter, an increase of $1 billion from the previous year. The increase included a $305 million higher reserve build and a $717 million increase in net-charge offs—debt that a lender deems unlikely to be repaid.

The lender's net charge-off rate rose to 4.11% from 2.13% in the same period last year. For the full-year 2024, Discover expects a net charge-off rate of between 4.9% and 5.3%.

It's a sign that higher interest rates are impacting consumers and households.

Continue reading here (subscription may be required).

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**The buy now, pay later "holiday hangover" has arrived (from CNBC)...**

When she started shopping for the holidays late last year, Kelly Andersen was struggling to buy her loved ones gifts. So she turned to a novel solution to get through the season: Buy now, pay later.

The 31-year-old freelance copywriter from Los Angeles used Klarna and PayPal to split a variety of purchases into four interest-free payments spread out over a series of weeks. At the time, her upfront cost was about a quarter of the overall purchase price.

But now that January has arrived and the other installments are starting, Andersen isn't sure how she's going to pay them off. She's never missed a payment before and treats debt seriously but has found herself buried under a mountain of micropayments, wondering how she's going to cover her bills.

"I've definitely been selling clothes ... if I have to go sell a pair of shoes to make a payment, I will," Andersen told CNBC of the roughly $1,700 she racked up in buy now, pay later debt. "I'm definitely worried about [the payments]. It's definitely a concern and I'm definitely going to have to find a way to come up with the money."

Andersen is one of many Americans who turned to buy now, pay later to fund their holiday shopping last year to avoid credit card debt but are now having trouble paying off those bills.

In an era where persistent inflation and record-high interest rates are shaping financial decisions for many shoppers, the service helped fuel a boom in overall online spending that topped out at $222 billion from Nov. 1 through the end of December. During the season, buy now, pay later usage hit an all-time high, rising a staggering 14% from the prior year and contributing $16.6 billion to online spending.

On Cyber Monday alone, buy now, pay later use spiked nearly 43%, Adobe said.

"Sales, especially online sales, were probably juiced to some extent because of buy now, pay later usage," said Ted Rossman, senior analyst at Bankrate. "A lot of people are drawn to this financing method as an alternative to something like a credit card where the average interest rate is a record high 20.74%. I would caution that you can still get into trouble with buy now, pay later... it can still encourage you to overspend and kind of trick yourself."





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The surge in use of buy now, pay later comes as credit card debt hits a record high and delinquency rates have nearly doubled over the past two years. While delinquencies were at historic lows during the Covid-19 pandemic, the rate of people who've gone more than 30 days without paying their credit card bill recently topped pre-pandemic levels, according to the Federal Reserve.

It's tough to say how buy now, pay later fits into the country's overall debt picture. Providers that offer the service don't typically disclose how often those bills go unpaid, and the debts aren't reported to credit bureaus. Klarna, PayPal, and Affirm all declined to share buy now, pay later delinquency rates with CNBC.

Continue reading here.

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# REAL ESTATE

**Nearly half of office commercial real estate (CRE) loans are now at risk of default (from The Commercial Observer)...**

The outlook is ugly, and the numbers are even uglier.

A new paper from four economists at the National Bureau of Economic Research argues that 14 percent of the $2.7 trillion commercial real estate loan market — and 44 percent of office loans — currently carry outstanding loan balances higher than property values and are at risk of immediate default.

The paper also calculated that a 10 percent default rate on all CRE loans could trigger up to $80 billion in bank losses and dozens of potential bank failures. On the brighter side, however, the authors argued interest rate declines engineered by the Federal Reserve could stave off further distress.

Authored by Erica Xuewei Jiang of the University of Southern California, Gregor Matvos of Northwestern University, Tomasz Piskorski of Columbia, and Amit Seru of Stanford, the economic study analyzed 35,253 outstanding loans totaling $825 billion in aggregate value from the December 2023 CMBS market using data from DRBS Morningstar.

The economists found that while the average CRE loan was underwritten at a 61 percent loan-to-value (LTV) ratio, 29 percent of outstanding CRE loans — and 56 percent of office loans — currently hold LTVs higher than 80 percent. That means the property value behind the loan has declined from the underwritten value by at least 19 percent, thus creating likely refinancing challenges in the event of further property value declines.

Even more concerning, the economists found that 14.3 percent of all loans, and 44.6 percent of office loans, presently exceed the current property value underlying the loan, meaning the LTV exceeds 100 percent and the loans are at risk of imminent default.

"We tried to assess how big the issue of CRE distress is, so we quantified how many loans are underwater, and because of the decline in property values, the outstanding debt is more than current value," Piskorski told CO. "I'd say that 14 percent [of loans in negative equity] is a reasonable number, and that doesn't mean all loans will necessarily default, but there will be potential workouts and it very much depends on the interest rates path."

The economists also studied the debt service coverage ratios (DSCR) to further quantify the current health of the CRE loan universe.

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The study found that lenders originated the average CRE loan at a 3.97 percent interest rate, but today an average refinancing rate would rise to 6.71 percent. (For office loans, the average rate jumps to 7.42 percent.) And while the average CRE loan was underwritten to achieve a healthy DSCR of 2.3 (2.7 for the average office loan), today approximately 6.4 percent of all CRE loans (and 6.6 percent of office loans) have DSCR less than 1, indicating that cash flow cannot support underwritten debt service.

If these same loans were asked to refinance today at the current interest rate of 6.71 percent, a whopping 17.2 percent of all CRE loans (and 24.3 percent of all office loans) would not be able to pay their obligations, as their DSCR would be less than 1.

"The DSCR situation is very important, so we look at how many loans there are where net cash flow can't cover the loan balance, and we see what happens if they have to refinance to current rates," explained Piskorski. "A good chunk comes to maturity in the next few years, and if rates remain elevated, of course, the cash flow situation will deteriorate."

Continue reading here (subscription may be required).

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**CRE office vacancies are now at a record high (from CNN Business)...**

More office space is currently sitting empty in the United States than at any point since 1979, said Moody's Analytics, which began tracking office leasing vacancies that year.

The surplus of office space is mainly due to the massive shift in how employees show up for their jobs following the COVID-19 pandemic.

For many workers, the traditional five-day-a-week, 9-5 office life has been replaced by hybrid work from the comfort of their home. This massive cultural change also exacerbated an overabundance of supply that had been built in the 1980s and 1990s, according to the report, released Monday.

The national office vacancy rate rose to a record-breaking 19.6% in the fourth quarter of 2023, Moody's Analytics said. That's the largest quarterly increase since the first quarter of 2021, and larger than the 19.3% level reached twice in 40 years.

The average pre-pandemic office vacancy rate was around 16.8%.

A high office vacancy rate is bad news for landlords and developers eager to fill their buildings, and also for the restaurants, retailers and other small businesses whose livelihoods depend on office workers.

In the face of the dwindling demand for office space, new construction has cooled to the lowest levels since 2012.

Continue reading here.





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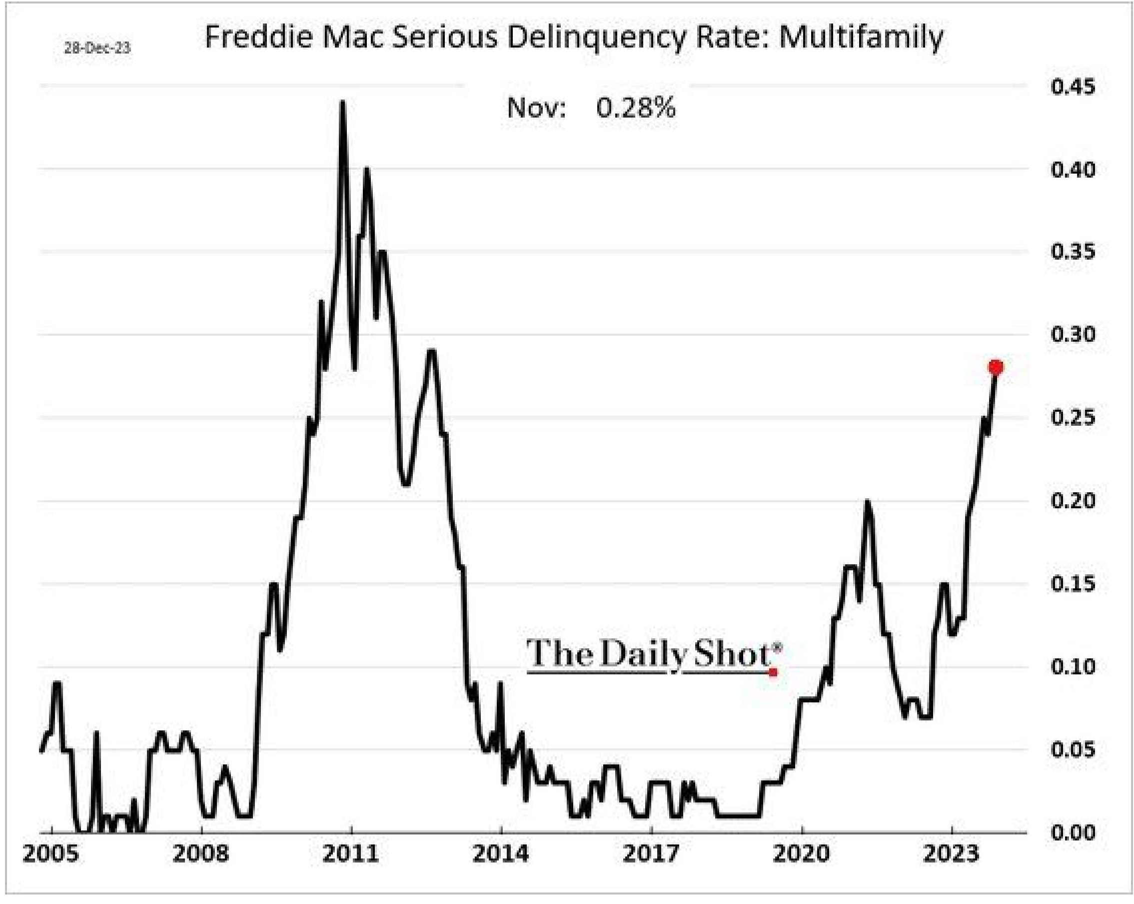
### Delinquencies on multifamily CRE are surging (from The Daily Shot)...



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**And the bill is coming due on a record amount of additional CRE debt over the next few years (from *The Wall Street Journal*)...**

The troubled commercial real estate market is bracing for a record amount of maturing loans, boosting the prospect of a surge in defaults as property owners are forced to refinance at higher rates.

In 2023, $541 billion in debt backed by office buildings, hotels, apartments and other types of commercial real estate came due, the highest amount ever for a single year, according to the data firm Trepp. Commercial-debt maturities are expected to continue rising, with more than $2.2 trillion coming due between now and the end of 2027, Trepp said.

Most of these loans have so far been repaid or extended. In 2022 and 2023, many owners were able to exercise one- or two-year extensions built into their original loans.

Now, those extensions are burning off. That is compelling many borrowers to confront the higher rate environment—along with higher vacancies and weakening cash flows—which is depressing property values. Some owners and creditors are also grappling with the expirations of deals they made early on during the pandemic to delay payments until the worst of the health crisis passed.

“Borrowers have simply been unwilling to accept reality,” said Gwen Roush, senior vice president at DBRS Morningstar. “But reality has to come due at some point.”

Unlike home mortgages, whose principal is paid off over time, most commercial mortgages are interest only. That means that when the debt matures, the borrower has to refinance or pay off the principal.

While office-building owners have been especially hard-hit from remote and hybrid work, the damage to the commercial real estate sector is widespread. Vacancy rates are increasing in some multifamily markets, making it harder for many of those landlords to raise rents or make payments on floating-rate debt. Industrial space, long the darling of Wall Street for its use as e-commerce hubs, is also showing signs of weakness.

Continue reading here (subscription may be required).





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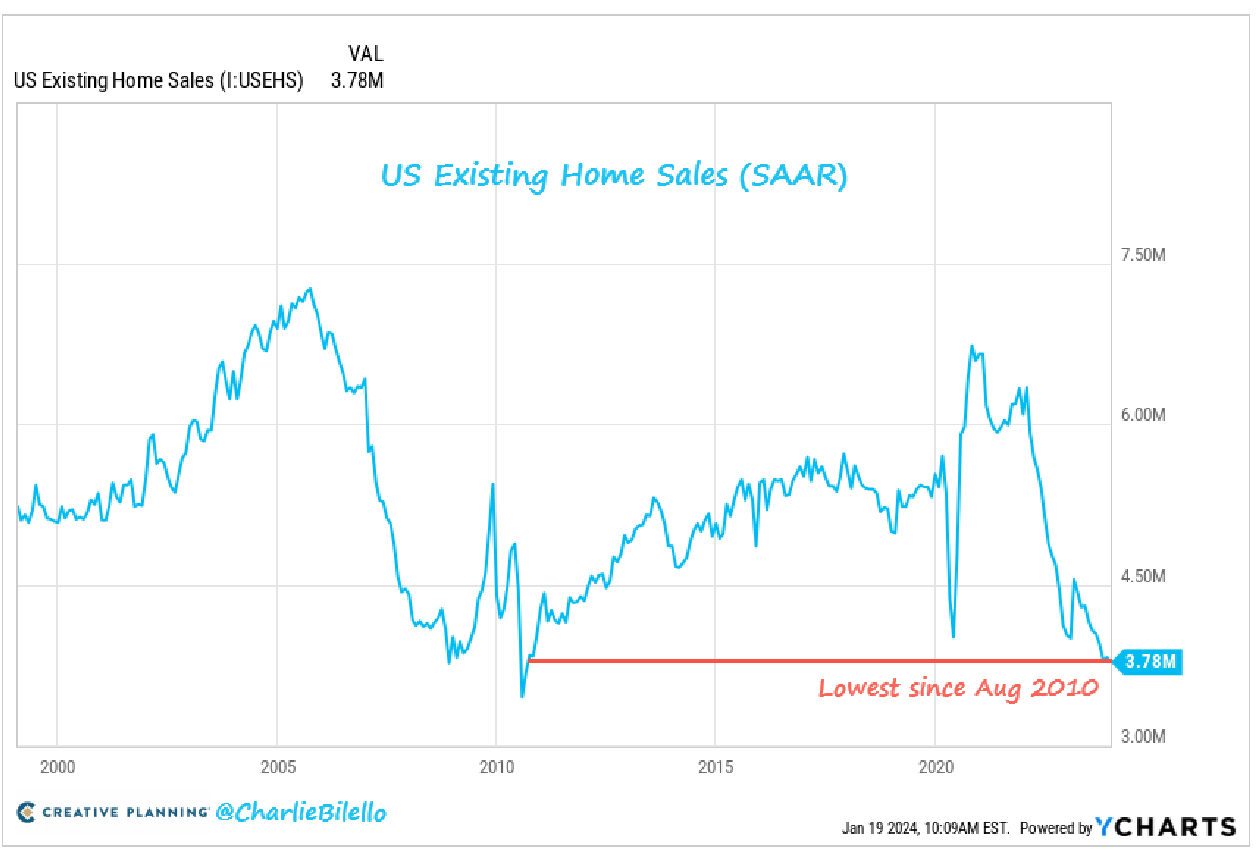
**The housing market "deep freeze" continues (from Charlie Bilello)...**

Fewer US existing homes are selling today than at any point since 2010. The 3.78 million annual rate from December was even below the lowest level of sales during the 2020 covid shutdowns (4.01 million). The 4.09 million existing homes sold during 2023 was the lowest activity we've seen since 1995.




Why are home sales so low?

**a) Lack of Affordability (Low Demand)**

US housing affordability is worse today than the peak of the last housing bubble. The median American household would need to spend 45.3% of their income to afford the median priced home, a record high.

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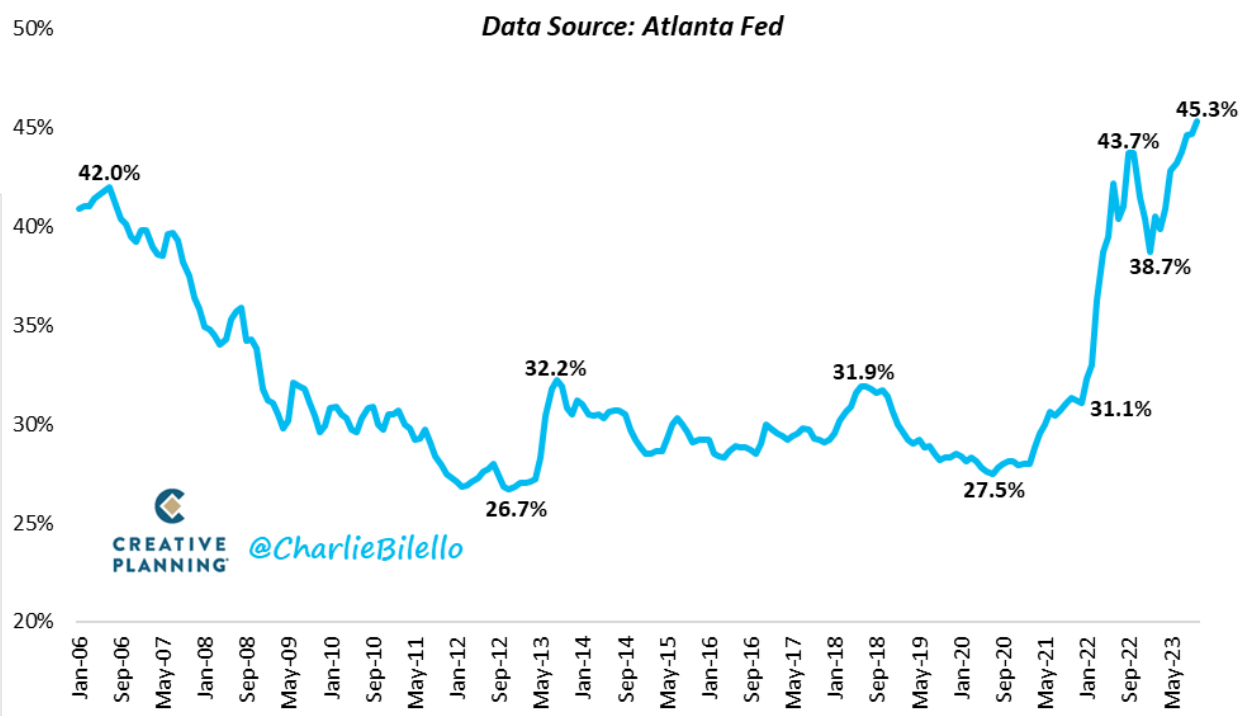


### b) Lack of Inventory (Low Supply)

59% of US mortgage holders have a rate below 4% and 89% have a rate below 6%. With current mortgage rates at 6.6%, many existing homeowners are staying put, leading to a massive shortage of homes for sale.





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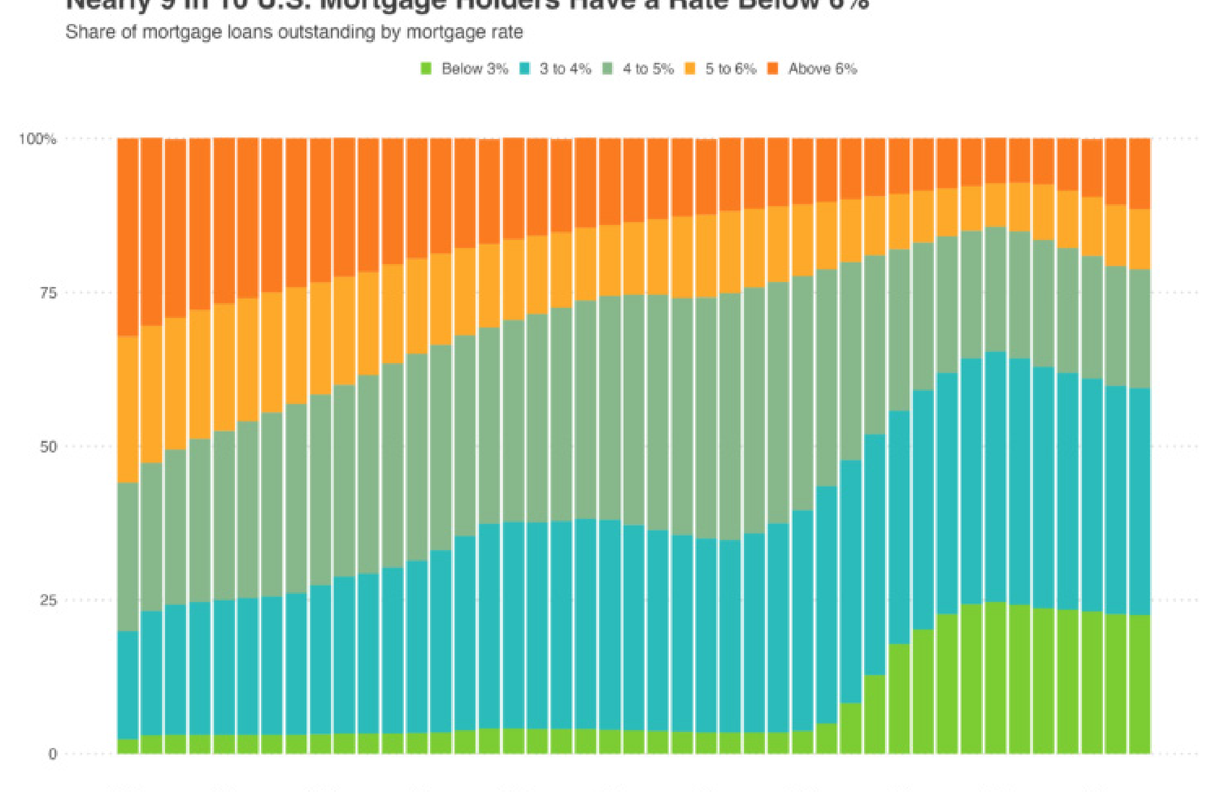


And so, while demand has plummeted over the last year, supply has plummeted even more. The result: home prices in the U.S. actually increased 4% in 2023.

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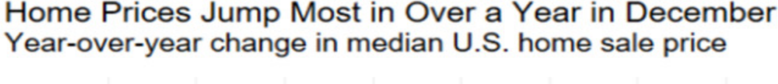

This has been a great environment for homebuilders as their share of the overall market has increased significantly given the low supply of existing homes. Over the past five years, the homebuilders ETF (XHB) has increased 184% vs. a 97% gain for the S&P 500 ETF ($SPY). Most estimates point to a deficit of single family homes in the millions, meaning a secular trend of more home building to come.





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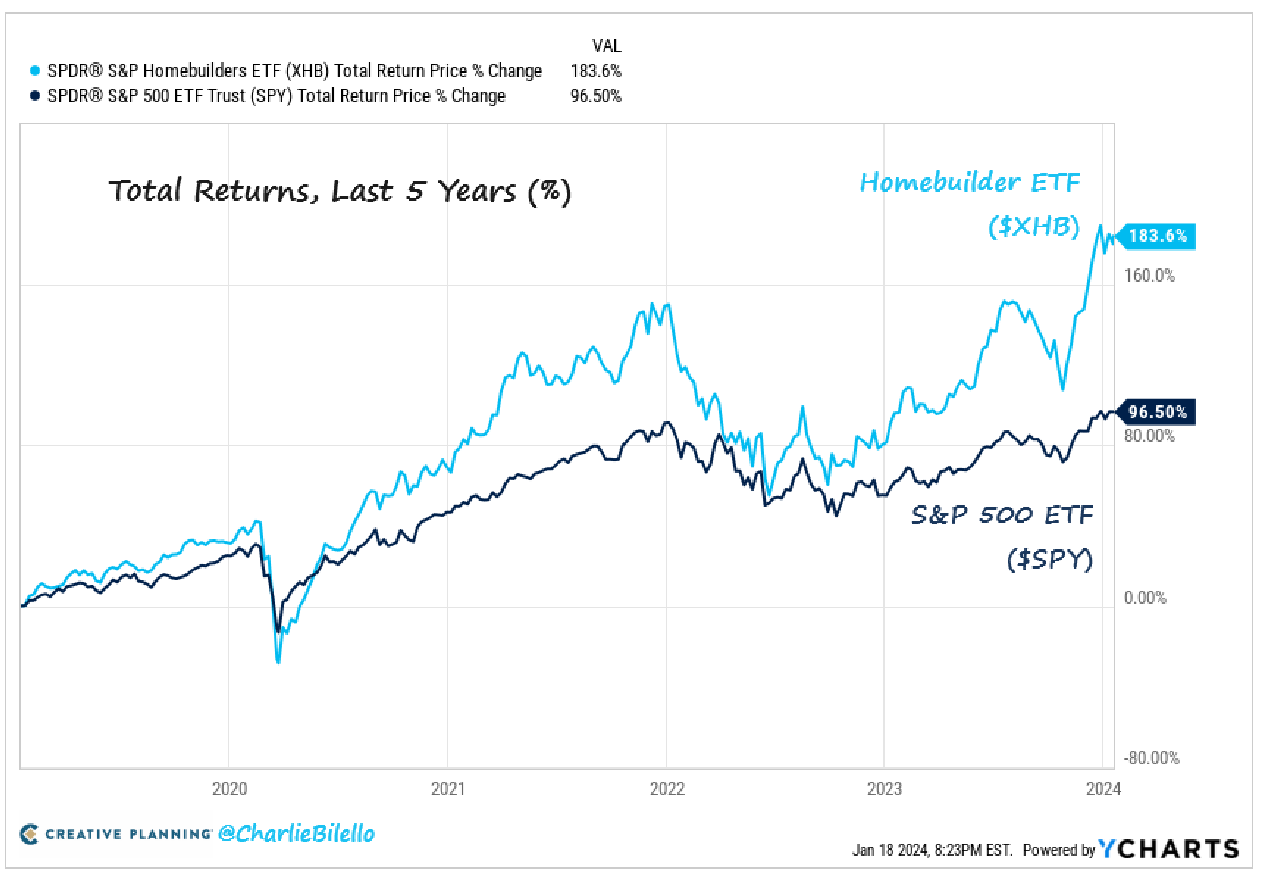

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# SPECIAL SITUATIONS

## Activist Investing, Spinoffs, Arbitrage, Mergers & Acquisitions (M&A), and More

### A small-cap merger arbitrage opportunity with double-digit upside potential (from Special Situation Investments)...

### Neighbourly Pharmacy (NBLY) - Merger Arbitrage - 16% Upside

This is an intriguing non-binding stage merger arbitrage opportunity in Canada. While the market is skeptical about transaction closing, I think there is a solid chance that the situation will successfully play out in the coming weeks or months.

NBLY is a C$700m market cap Canadian roll-up of independent pharmacies, mainly focusing on small underserved areas in the country where there is less competition. In Oct'23, the company received a non-binding takeover proposal from its controlling shareholder PE firm Persistence Capital Partners (owns 50%) at C$20.5/share. NBLY's special committee was prepared to agree to a definitive agreement at these terms, however, last month PCP revised its bid downwards to C$18.5/share, citing "difficult market conditions and views from our committed financing sources."

NBLY shares have fallen 11% since the announcement and there is currently a 16% spread to the revised offer.

The key uncertainty now is whether NBLY's special committee will agree to the lower offer or will end the company sale process without any transaction. I think the former is more likely. PCP has stated that they are not interested in any alternative transactions and will not sell its stake to other parties. Thus the current offer is the only viable option on the table. PCP's initial bid was at the lower end of the fairness opinion issued by NBLY's financial advisor, however, the financial advisor will likely easily find a way to justify an even lower fair value. As for PCP, I do not believe that the potential acquirer will walk away, as PCP's efforts invested into this deal over the recent months suggest that it is a committed buyer.

The offer to buyout minority shareholders comes at an opportunistic timing as NBLY shares have drifted down over 60% over the last two years due to a combination of margin pressure from increasing labor costs, high leverage, and ongoing integrations of the 2023 acquisition spree. The revised bid values NBLY at a 12x TTM EBITDA





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multiple vs 19x multiple at the time of the IPO. PCP's potential playbook could be to acquire NBLY, finalize integration of the recent acquisitions, sort out the operational matters, and bring the business back to the public markets at a later stage.

NBLY was pitched to SSI subscribers on October 14. Since then, PCP has lowered the offer and NBLY's share price has declined, making the spread wider and the situation more attractive vs when I first shared it.

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**Here's a list of event-driven trade ideas that are potentially actionable today (from ToffCap)...**

- ***Webcentral (5GN Australia)***. Now 5G Networks. Recently announced the sale of core business. Stock price was up sharply, but market seems to underestimate SOTP value. Current share price ~28ct vs potentially >45ct per share SOTP. Buyback announced (10%), to commence as soon as Dec. 22, after completion of the sale of the Domains business (expected Dec. 20).
  **UPDATE: Our friend @ClarkSquareCap has provided an update on the case. Remains a very compelling opportunity; looking for a target price of 35ct (vs current share price of 18.5ct).**

- ***EML Payments (EML Australia)***. Interesting SOTP investment thesis from @ puppyeh1. EML appears to have relatively inefficient assets that could be sold off, or the company as a whole. STOP value / share could be >$1.70 vs $1.09 current share price (October 30). Strong indications of near-term catalysts. Refer to @ puppyeh1 thread (Oct. 26) for a more detailed explanation.
  **UPDATE: announced a full exit from PCSIL. Strategic review ongoing. Other assets could be next (Sentennial, perhaps clean pieces too). H/t @puppyeh1 and @TheRealDavey2 for updates.**

- ***Homestreet (HMST US)***. Merger agreement with Firstsun (FSUN). Seems like an interesting merger: combination appears very accretive, will strongly improve liquidity, uplisting to Nasdaq, fee income will be 20-25% of revenue (should earn higher multiple). Projection of >$6 eps in 2025 (~2.5x p/e on 2025e on $14.5 share price).

- ***Genetron (GTH US)***. Dalius @InvestSpecial has an interesting privatization of a US-listed Chinese company that is expected to close shortly, with minimal risk. Refer to Dalius for more background; merger spread ~8%, but given short timeframe, a nice IRR.

- ***Kingdom Capital (not a company).*** We provide a link to @kingdomcapadv who's been looking into quite a few interesting special sits, some which we have covered here as well. Link to the list is here.

- ***eHealth (EHTH US)***. Very strong price reaction from Craig Hallum downgrade in a story that could be close to reverting back to growth now that growth is not determined anymore by AEP or enrollment. Might be an interesting opportunity.





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- ***Flame Acquisition (FLME US).*** SPAC Flame Acquisition is very near to close a deal with Sable Offshore. The details and valuations seem attractive (though will depend on the share redemption). Very strong pre-close SPAC share price action. H/t @CorneliaLake for more background (incl. a spaces on X).

- **Sodexo (SW France)**. Sodexo to spin-off Pluxee in early 2024. Pluxee current growing much more rapidly at much higher margins than Sodexo. Might be interesting to keep an eye on. Pluxee spin to be completed by February 1. Sodexo will hold a Capital Markets Day where medium-term guidance will be provided.
  **UPDATE: Sodexo held a capital markets day with an update of its strategy and releasing medium-term targets. Ebitda projected to grow mid-teens% pa + strong cash flow generation. Might be interesting to keep an eye on.**

- ***Walgreens Boots Alliance (WBA US)***. Reviewing strategic options + insider purchases. Share price almost at 52wk lows.

- ***Core Scientific (CORZQ US)***. To emerge from bankruptcy in Jan. 2024 + right offering announced. Lots going on which will create volatility (hence opportunity).
  **UPDATE: Court approved plan of reorganization. Core to emerge and relist on Nasdaq on Jan. 23.**

- ***Athens Airport***. Greek government to sell 30% stake. IPO in February 2024. These government divestments tend to come relatively cheap on the market + Athens stock exchange index is at multi-year highs.

- ***Surgepays (SURG US).*** Getting VERY close to the shut-down of ACP finding (funding depleted by April). Company recently raised $15m, probably as a defensive move in order to fund the growth of its wireless mobile product. This one will remain volatile (which means opportunity; check our blog for background on the thesis)

- ***Magnora (MGN Norway).*** Will spin its legacy oil divisions from the 'green' divisions. These kinds of splits are generally very good opportunities, as one of the two parts could be pressured a lot. Extra AGM in mid-Feb.

- ***Worthington Steel (WS US)***. Decent insider buying into this recent spin of Worthington Industries (WOR).

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- ***Reddit.*** Reddit intends to IPO in March. Will be an interesting one to keep an eye on.
- ***Amer Sports (AS US).*** Another interesting upcoming IPO by the end of January. Amer will probably get quite some interest as it owns a.o. Arc'teryx.
- ***SoftwareOne (SWON Switzerland)***. Rejected the Bain offer. Stock pressured. Might be an interesting opportunity; not the highest quality business, but will continue to focus on core products + very profitable.
- ***Pulmatrics (PULM US).*** Busted net cash biotech pico-cap Pulmatrics announced strategic alternatives.
- ***Camping World (CHW US).*** Reviewing strategic options for its Good Sam division, incl. a potential sale or spin.
- ***Kinnate Biopharma (KNTE US).*** And another busted, negative EV biotech reviewing strategic alternatives. $112m market cap (19 Jan.) and -$52m EV.
- ***Comet Lithium (CLIC Canada).*** Decent insider buying in this pico-cap explorer.
- ***State Street (STT US)***. Announced a $5bn buyback, on a $23bn market cap.
- ***LQR House (LQR US)***. Announced a $3m buyback on a $8m market cap. If Bloomberg ccs is to be believed, this pico-cap is set to grow very rapidly.
- ***Adtalem Global Education (ATGE US)***. Announced a $300m buyback (roughly 12% of shares outstanding).
- ***Parks! America (PRKA US)***. Interesting action at cool micro-cap Parks America. Activist Focused Compounding is actively pursuing a board takeover (reduction from 7 to 3). A special shareholders meeting will be held next month. The business operates three drive through safari parks; one is very profitable while two struggle. They could sell off the unprofitable parks and turn it into a cash cow (or other). H/t @MoS_Investing for the idea.
**UPDATE: Besides all the ongoing action here, to note that PRKA will hold its first ever investor day on June 6. This promises some action.**
- ***Whirlpool (WHR US).*** Will host a capital markets day on Feb 27. The last one was roughly 5 years ago, and the stock has been performing poorly. Promising set-up.
- ***BJ's Restaurants (BJRI US).*** Shareholder Fund 1 (~5.6%) is pushing for a sale. The fund is of the opinion that BJ would be of interest to many parties.





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- ***Kingsland Minerals (KNG Australia)***. Strategic review of its uranium project. We've not assessed this one, but Bloomberg is giving is a $17m market cap and -$5bn (not million) EV (?!)
- ***Zenith Minerals (ZNC Australia)***. Reviewing its lithium operations.
- ***Smith Douglas Homes (SDHC US)***. We flag the upcoming IPO of home builder Smith Douglas Homes. Market cap targeted around $1bn (mid-range); estimated p/e around 7-8x, which screens well given the profitability and relatively strong growth. IPO over next week. **UPDATE: IPO completed. Classic pre-coverage period. Interesting to keep an eye on.**

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**Activist short seller Culper Research alleges fraud in a Chinese medical-supply firm (from Culper via X)...**

1) We are short Jin Medical International Ltd $ZJYL, a China Hustle-style charade. Jin sells wheelchairs and parts in China. In 2022, its revenues fell 8% to just $19M. $ZJYL trades at ~45x revenues. At reasonable "peer" levels of 1-6x sales, $ZJYL shares fall 90% or more.

2) $ZJYL went public in March 2023, underwritten by China-focused chop shop, Prime Number Capital. Prime Number is headquartered in a Long Beach home and has already been sued by investors at least twice for alleged roles in other China frauds. Their track record is horrific.

Case 1:21-cv-00317-LDH-PK Document 1 Filed 01/20/21 Page 1 of 20 PageID #: 1

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*Counsel for Plaintiff*

**UNITED STATES DISTRICT COURT**
**EASTERN DISTRICT OF NEW YORK**

| | |
|---|---|
| YOAV GUTMAN, Individually and on behalf of all others similarly situated,<br><br>Plaintiff,<br><br>v.<br><br>LIZHI INC., JINNAN LAI, NING DING, ZELONG LI, XI CHEN, TAO HUANG, YE YUAN, RICHARD ARTHUR, COLLEEN A. DE VRIES, CITIGROUP GLOBAL MARKETS INC., HAITONG INTERNATIONAL SECURITIES COMPANY LIMITED, AMTD GLOBAL MARKETS LIMITED, NEEDHAM & COMPANY, LLC, TIGER BROKERS (NZ) LIMITED, CHINA MERCHANTS SECURITIES (HK) CO., LIMITED, VALUABLE CAPITAL LIMITED, PRIME NUMBER CAPITAL LLC, and, COGENCY GLOBAL INC.,<br><br>Defendants. | Case No.<br><br>CLASS ACTION COMPLAINT FOR VIOLATION OF THE FEDERAL SECURITIES LAWS<br><br>JURY TRIAL DEMANDED<br><br>CLASS ACTION |





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3) In Sept 2023, $ZJYL faced a NASDAQ delisting notice as it fell under the 300 shareholder threshold required for continued listing. On October 24, $ZJYL CEO Erqi Wang filed a Form 144 to sell 545,893 shares. Then $ZJYL fired its auditor, MarcumAsia, and hired DNTW Toronto.

**Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard**

On September 25, 2023, Jin Medical International Ltd. (the "Company") received a letter from the Listing Qualifications Department of The Nasdaq Stock Market ("Nasdaq") indicating that the Company was not in compliance with Listing Rule 5550(a)(3), which requires the Company to have at least 300 public holders for continued listing by Nasdaq. On December 18, 2023, the Company received a letter (the "Delisting Letter") from Nasdaq notifying the Company that it had failed to provide a detailed plan to support a decision for further time for compliance. Additionally, Nasdaq staff (the "Staff") determined that the Company did not meet the 300 Round Lot Holder requirement for initial listing on the Nasdaq Capital Market. Nasdaq Staff has determined to initiate procedures to delist the Company's securities from Nasdaq. Unless the Company requests an appeal of that determination, trading of the Company's ordinary shares will be suspended at the opening of business on December 28, 2023.

The Company has submitted a request for a hearing before the Nasdaq Hearings Panel (the "Panel"), which request will stay the suspension of the Company's securities pending the Panel's decision. Subsequently on December 20, 2023, the Company received a letter from Nasdaq indicating that the delisting action has been stayed, pending a final written decision by the Panel. The hearing before the Panel will be held on March 14, 2024. At the hearing, the Company must demonstrate its ability to regain compliance with the particular deficiencies cited by Staff, as well as its ability to sustain long-term compliance with all applicable maintenance criteria.

The Company is presently conducting an internal review with its management and external advisors and is exploring various remedial actions to regain compliance with the requirements set out above.

If at any point before the hearing the Company believes it has regained compliance with all criteria for continued listing, the Company will notify Nasdaq Staff and also inform the Hearings Department. If Nasdaq Staff determines that the Company has regained compliance, the Hearings Department will advise the Company by letter that the hearing is cancelled.

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| Form 144 Filer Information | UNITED STATES<br>SECURITIES AND EXCHANGE COMMISSION<br>Washington, D.C. 20549 |
|---|---|
| FORM 144 | Form 144<br>NOTICE OF PROPOSED SALE OF SECURITIES<br>PURSUANT TO RULE 144 UNDER THE SECURITIES ACT OF 1933 |

## 144: Filer Information

| | |
|---|---|
| Filer CIK | 0001998398 |
| Filer CCC | XXXXXXXX |
| Is this a LIVE or TEST Filing? | ◉ LIVE ○ TEST |

***Submission Contact Information***

| | |
|---|---|
| Name | |
| Phone | |
| E-Mail Address | |

## 144: Issuer Information

| | |
|---|---|
| Name of Issuer | JIN MEDICAL INTERNATIONAL LTD |
| SEC File Number | 001-41661 |
| Address of Issuer | NO.33 Lingxiang Road<br>Changzhou<br>CHINA<br>213149 |
| Phone | 8613380606195 |

4) Current $ZJYL auditor DNTW appears to have been previously shut down and its partners charged by the SEC for its role in another China fraud, Subaye, which claimed to be running a cloud business that didn't exist. We think the $ZJYL story will end similarly...





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U.S. SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 22698 / May 8, 2013

Accounting and Auditing Enforcement Release No. 3458 / May 8, 2013

*Securities and Exchange Commission v. Subaye, Inc. and James T. Crane*, Civil Action No. 13 CIV 3114 (S.D.N.Y.)

SEC Charges China-based Company and Former Chief Financial Officer in Fraudulent Scheme involving Non-Existent Computing Business

The Securities and Exchange Commission announced today that it filed an enforcement action on May 8, 2013, in federal court in New York City charging Subaye, Inc., a company based in China whose stock trades in the U.S., and James T. Crane, its former Chief Financial Officer and a U.S. citizen believed to be recently living in southern California, with engaging in a fraudulent scheme during 2010-2011. The Commission alleges that Subaye and Crane misrepresented the company's business and operations, deceived the company's auditors, and misled investors about the company's true status and revenues. According to the complaint, Subaye claimed to be operating a cloud computing business but investigations found no evidence of such a business. Subaye has offered to settle the case, while the action against Crane is unsettled.

The Commission's complaint, filed in the U.S. District Court for the Southern District of New York, alleges that Subaye began promoting itself during 2010 as a provider of cloud computing services to Chinese businesses. According to the complaint, Subaye claimed to have over 1,400 sales and marketing employees in 2010, with reported revenues of $39 million that fiscal year and projected revenues of more than $71 million for 2011. However, by May 2011, according to the complaint, and Subaye was revealed to be a company with no verifiable revenues, few, if any, real customers, and no infrastructure to support its claimed cloud computing business. The complaint alleges that the business that Subaye had presented to investors and described in filings with the Commission was imaginary and non-existent.

5) We think $ZJYL's recent announcements coinciding with the stock's 10x rise are likely conjured up solely to pump shares and avoid pending delisting. We uncovered that each of Jin's December 11 and December 14 "deals" are with related parties - namely CEO Erqi Wang himself.

6) On December 11, $ZJYL claimed it won a 66M RMB ($9M USD) order to sell oxygen chambers to "Conlo Industrial Development." However, Conlo's records show that Conlo is majority-owned by $ZJYL CEO Wang, while records also name $ZJYL CFO Ziqiang Wang and an $ZJYL email address.

often Changzhou Zhongjianjian Road Technology Co., Ltd. Legal person enterprise in camp

Legal representative: Wang Erqi | Registered capital: RMB 9.196 million | Date of establishment: 2016-01-21

| | | | |
|---|---|---|---|
| company profile | Changzhou Zhongjianjian Road Technology Co., Ltd. was established on January 21, 2016. Its registered address is No. 1, Xinghu Road, Wujin Economic Development Zone, Jiangsu Province. The legal representative is Wang Erqi. The business scope includes: R&D, manufacturing and sales of energy-saving shading and insulation screens for greenhouses; R&D, technology transfer, technical consultat… | | |
| Industry categories | Water conservancy, environment and public facilities management industry | Telepho | (0519)85162121 |
| Industry subcategory | Ecological protection and environmental management industry | Mail | zhangyan@zhjmedical.com |
| address | No. 1, Xinghu Road, Wujin Economic Development Zone, Jiangsu Province | URL | - |

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Conlo's Chinese name is 中健康路实业发展(上海)有限公司 which Translates to Zhongjian Road Industrial Development (Shanghai) Co.

Corporate records show that this entity is wholly owned by Changzhou Zhoungjianjian Road Technology Co., Ltd., ("Road Tech") with just $1.4 million USD in capital:

Shareholder Information (1)

| Shareholder name | Shareholder type | Amount of capital subscribed | Shareholding ratio |
|---|---|---|---|
| Changzhou Zhongjianjian Road Technology Co., Ltd. | Corporate | 10 million yuan | 100.0% |

Corporate records then show that ZJYL CEO Wang Erqi owns 78.74% of Road Tech, as well as 67.0% of "Changzhou Erpu Investment Management Center (Limited Partnership), which in turn owns a minor stake in Road Tech, bringing Erqi's total effective stake in Conlo to 84.57%:

| serial number | final beneficiary name | Shareholding ratio | Equity chain |
|---|---|---|---|
| 1 | king Wang Erqi | 84.57% | Equity path 1 (accounting for 78.74%)<br>Wang Erqi —78.74%→ Changzhou Zhongjianjian Road Technology Co., Ltd. —100.0%→ Zhongjianjian Road Industrial Development (Shanghai) Co., Ltd.<br>Equity path 2 (accounting for 5.83%)<br>Wang Erqi —67.0%→ Changzhou Erpu Investment Management Center (Limited Partnership) —8.7%→ Changzhou Zhongjianjian Road Technology Co., Ltd. —100.0%→ Zhongjianjian Road Industrial Development (Shanghai) Co., Ltd. |

ZJYL CFO Wang Ziqiang is also named as the supervisor of Road Tech, as shown below:

| Position | Personnel name |
|---|---|
| executive Director | Wang Erqi |
| supervisor | Wang Ziqiang |

Road Tech also shows an email address "zhangyan@zhjmedical.com", tying this entity once again directly back to the Company.

7) Similarly, on December 14, $ZJYL claimed to enter an MOU to acquire all or a part of Juangsu Zhongjin Kanglu Information Tech Co. ("Kanglu"). Yet again, Kanglu is controlled by $ZJYL CEO Erqi Wang, and Kanglu owes $4.8M to $ZJYL. In this light, the "MOU" looks like a bailout.





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*b. Due from related parties*

Due from related parties consists of the following:

Link Download

| Name | Related party relationship | March 31, 2023 | September 30, 2022 |
|---|---|---|---|
| Jiangsu Zhongjin Kanglu Information Technology Co., Ltd. ("Zhongjin Kanglu") (1) | An entity controlled by the CEO | $ 4,835,861 | $ - |
| Huaniaoyuan Catering Management (Changzhou) Co. Ltd. | An entity controlled by the CEO | 31,628 | 33,285 |
| Other | Director of the Company | 6,933 | 2,972 |
| Total due from related parties | | $ 4,874,422 | $ 36,257 |

(1) As of March 31, 2023, the balance due from a related party, Zhongjin Kanglu, was $4,835,861. During the six months ended March 31, 2023, as a business collaboration, the Company made advances to Zhongjin Kanglu in the amount of $4,804,800 (RMB33.0 million) as for its temporary working capital needs during the normal course of business. As of the date of this report, the $4,804,800 advance made to Zhongjin Kanglu has been fully collected. The Company expects to make no such advances to its related parties in the future.

8) $ZJYL hasn't filed results since 3/31 and reported material weaknesses in each 2020, 2021, and 2022. $ZJYL makes related party loans to its CEO Erqi Wang and guarantees loans to Wang's outside entities. To us, $ZJYL's public listing looks like an insider enrichment scheme.

9) On December 26, $ZYJL disclosed that its audit committee chair, Jing Chen, resigned. Chen's resignation is especially concerning given Chen previously served numerous other China frauds. $ZJYL must be especially spoiled if Chen can no longer stand the stench.

10) $ZJYL cleverly reassured investors that Chen's resignation was not due to "disagreement with the Company's accounting policies," but $ZJYL has yet to file financials since the bogus deals, and the notice excludes standard language covering general business disagreements.

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**Resignation of Jing Chen as Chairman of Audit Committee and Board Member**

On December 21, 2023, Jing Chen, the chairperson of the audit committee and an independent director of Jin Medical International Ltd. (the "Company"), resigned from her positions with the Company, effective as of such date. The resignation of Jing Chen was not related to any disagreement with the Company's accounting policies.

1

**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

JIN MEDICAL INTERNATIONAL LTD.

Date: December 26, 2023

By: /s/ Erqi Wang
Erqi Wang
Chief Executive Officer

11/11) $ZJYL has an appeal hearing set with the NASDAQ for March 14 to stave off delisting. We see no reason that $ZJYL ought to continue trading. We think that NASDAQ and the SEC ought to halt shares to protect investors from yet another obvious China-based con. @NasdaqExchange





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**With the imminent rescheduling of cannabis from from a Schedule III to Schedule I drug, insiders have perked up in the stocks (from Kuppy's Event Driven Monitor)...**

We saw Jason Wild of [Terrascend (TSND.CN)] gobbling up stock all of 2023. This [month] we note insiders bought at Tilray Brands (TLRY).

Granted it's not a pure play cannabis company anymore (they bought a craft beer basket from BUD in 2023, e.g. ShockTop, RedHook, etc), but the CFO's spouse bought ~$37K worth, the CEO bought ~$101K worth, the GC bought ~$24K worth, and the Chief Strategy Officer bought ~$21K worth. In its FY 2024 guidance, the company is targeting adjusted EBITDA of $68 million to $78 million.

Continue reading here (subscription required).

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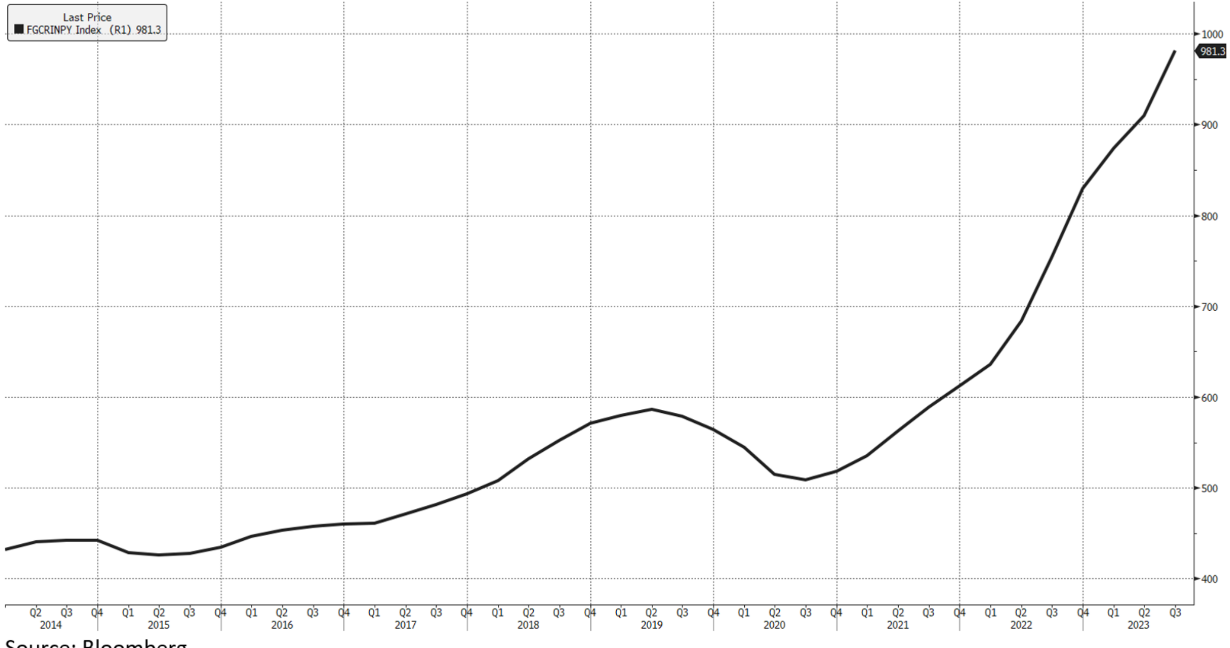
# PRECIOUS METALS

**2023 was a year of "divergences" for precious metals (from Ninepoint Partners Q4 2023 Commentary)...**

Divergence (noun): the situation in which two things become different.

Karl Pearson, a brilliant mathematician born in the 19th century coined the phrase, "correlation does not imply causation". We as humans, have yet to teach our machines this. Most gold trading is done by algorithms today. The algorithms started selling gold bullion because they were programmed into thinking that rising yields would be negative for the metal. Sadly, humans have also followed their computer overlords into the trade as seen through the lens of ETF flows.

A noteworthy exception to AI group thinking is the human central bankers that are trading in their depreciating USD for physical gold at a record pace. While Westerners have been focused on rising rates, very few have paid attention to the rising debts and even fewer have paid attention to the rising costs associated with servicing the debt. In the US for example, the Federal debt to GDP ratio has reached a staggering 120%. This number does not include unfunded liabilities and other public and private debt. The cost of servicing this debt is a hair under $1T, larger than the entire defence budget of the United States.




Source: Bloomberg





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Algo traders notwithstanding, the assumed inverse relationship between rising interest rates and gold prices has broken apart. Divergence means two similarities that no longer pertain. Machine traders are still operating in a relationship that is becoming extinct. Human traders haven't caught on either. That in large part explains the mysterious strength in gold prices that has occurred despite the absence of Western capital flows.

Western investors have typically treated gold almost like a zero coupon bond because gold has typically demonstrated a decent correlation to long duration bonds. The chart below shows the price of gold against an inverted 10-year. Note how higher yields have put pressure on gold prices and vice versa. This is yet another relationship that has diverged of late with gold remaining buoyant despite an enormous surge in yields.

Source: Bloomberg

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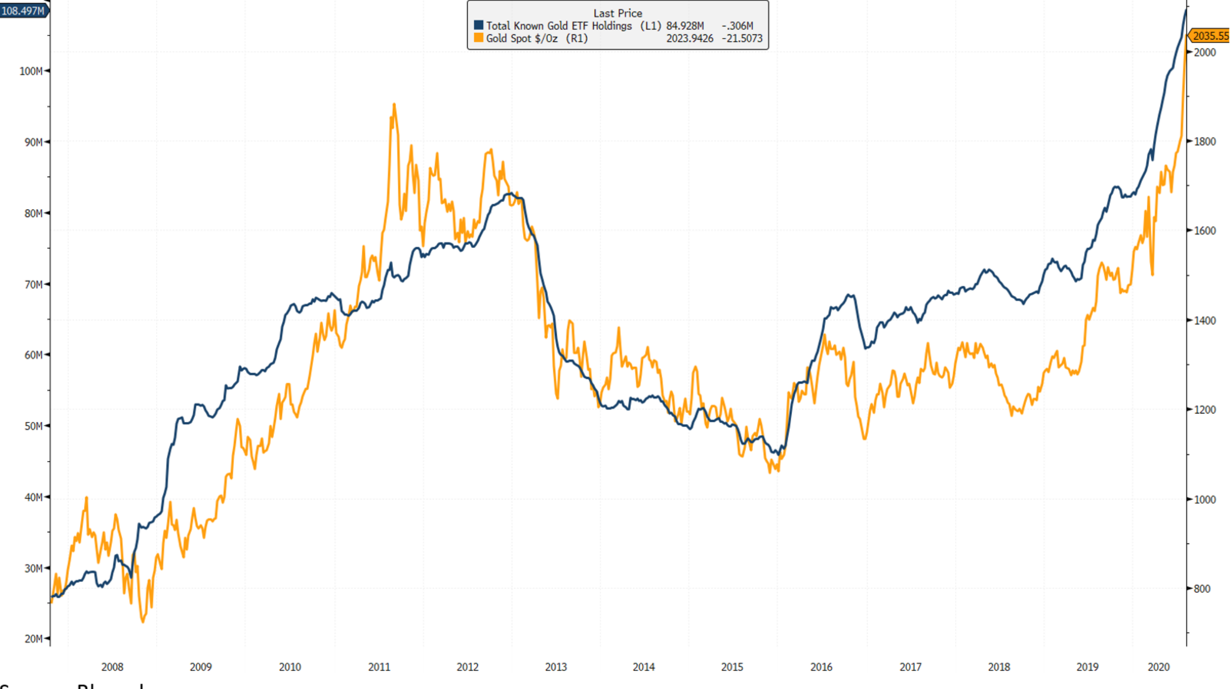
In 2023 investors were net sellers of their GOLD bullion. If money flows dictate the direction of price, then gold strength would appear inexplicable to mainstream pundits. The total number of ounces held by gold bullion ETFs declined 8.7%. Bullion ETFs held 93.8M oz at the beginning of 2023 which declined to 85.6M ounces as 2023 ended. Despite investor dislike for bullion, gold gained 13.1% and new all-time highs were established. The average price of gold through 2023 also registered a new record with the average price rising to $1942/oz versus $1802 in 2022 oz.

As for gold, 2023 was a year of divergence for silver. Silver bullion ETFs held 700M oz of silver as the year ended, down from 750M oz held at the outset of the year. Investors in silver bullion redeemed nearly 6.7% of their holdings for cash. Despite this selling, the price of silver was nearly flat for 2023, declining a mere 0.66%.

2023 was an important year for gold and silver alike for a simple reason. The relationship between investor capital flows and the price metal broke apart. Consider the chart below that graphs the price of gold (yellow) versus the total ounces held by bullion ETFs. It does not take a trained eye to recognize a correlation between the two. The reason is simple. Investor capital, when positive, was a source of demand for the metal and vice versa.



Source: Bloomberg





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This relationship started coming apart toward the back end of 2022 and persisted all through 2023. The message here is louder than the image below: there is a new buyer(s) of gold.

Source: Bloomberg

Central banks emerged as large buyers of gold in 2022 as the world and central bankers

grappled with the geopolitical impacts of the Russia-Ukraine war. Through 2022, central banks bought 1136 tons of gold, easily absorbing the impact of ETF sales. The 2022 purchases appear to have been a start of a trend as the gold purchases by central banks continued through 2023. While we do not have the final tally for the year, central banks had soaked up almost 800 tons of gold through the first three quarters.

The annual tax receipts collected by the federal government are around $2.8T. Contrast this with the debt servicing costs that are now at $1T, as stated earlier. Simple math shows that over 35% of all taxes are going towards the cost of servicing the debt, while the overall debt continues to only go higher. This is a situation that is not being appreciated by enough market participants

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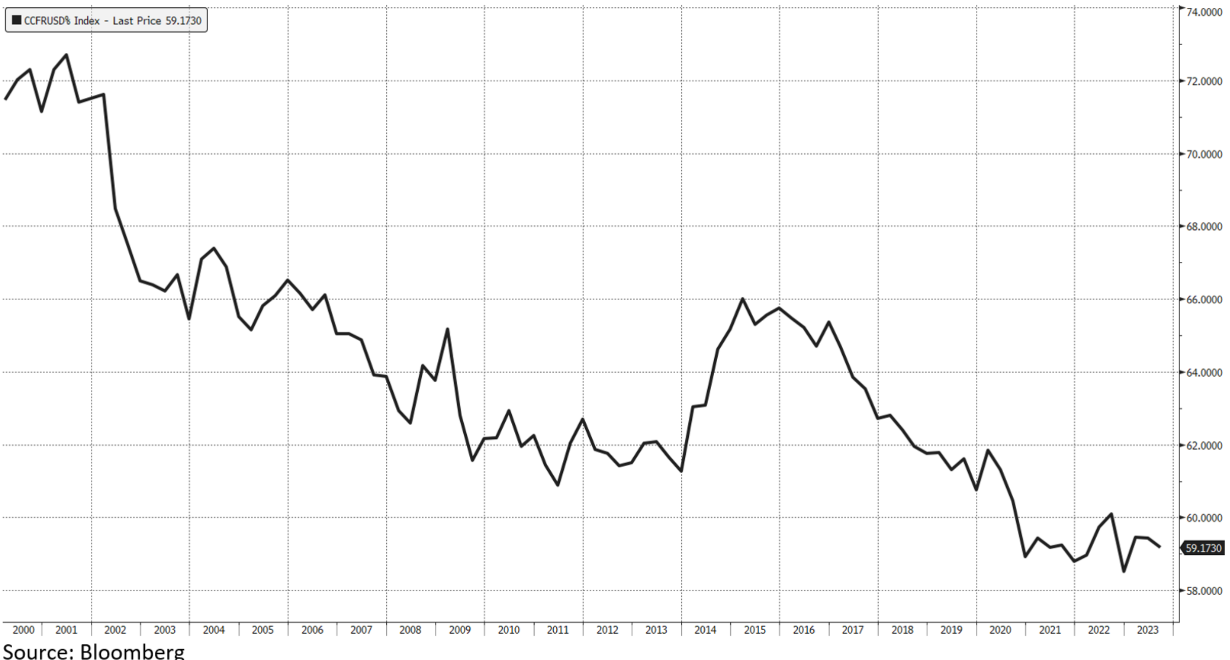
– yet. Nonetheless, this development is being viewed with eyes wide open by the central banks around the world which have a choice of holding bullion which has no counterparty risk, or an IOU issued by the US. Since the beginning of this millennium, the percentage of foreign exchange reserves denominated in the almighty US Dollar has continued to dwindle from over 72% in 2000 to under 60% at the time of writing.



Source: Bloomberg

Continue reading here.





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**Gold may be on the verge of a major new cycle (from Lawrence Lepard/Equity Management Associates' Q4 2023 Letter)...**

Quietly, the outlook for gold is improving. We say quietly because gold recently attained a new all-time high price of $2,077 per ounce and yet there has not been much fanfare. In part this is because the new all-time high did not hold, but nonetheless gold has reached a new all- time high in every currency except the dollar and it is knocking on the door of consistently breaking out in dollar terms as well.

We believe we are on the cusp of entering the third major gold cycle of the post 1971 era as outlined below in the excellent chart prepared by our friend Tavi Costa. If we are correct, it will turn into a mania for gold stocks and investors will be surprised by how well this asset performs in a sovereign debt crisis.

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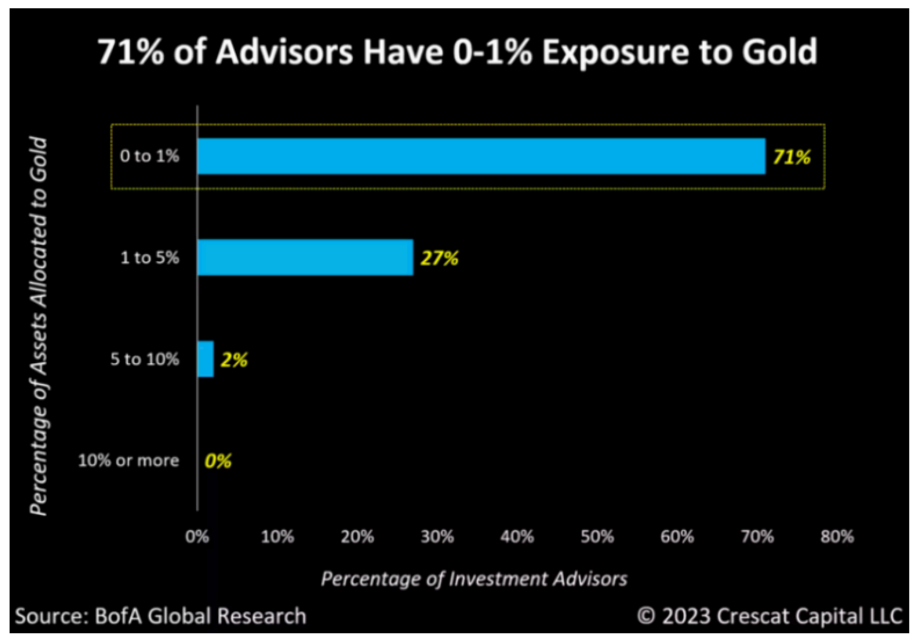
Furthermore, gold has achieved this in spite of it still being widely unknown and unloved.




Further note, (see next schedule) that while Central Banks have continued to purchase gold, the Futures and ETF buyers of gold have been generally absent since late 2020. We think a large part of the investment world still believes that the Fed has solved the inflation problem and that we will return to the conditions which existed before 2020. Given the Federal Budget issues we outlined above we think this conclusion is wrong. As investors come to see that it is wrong we fully expect that purchases by the Futures and ETF investors will return to the 2016, 2019, and 2020 levels.





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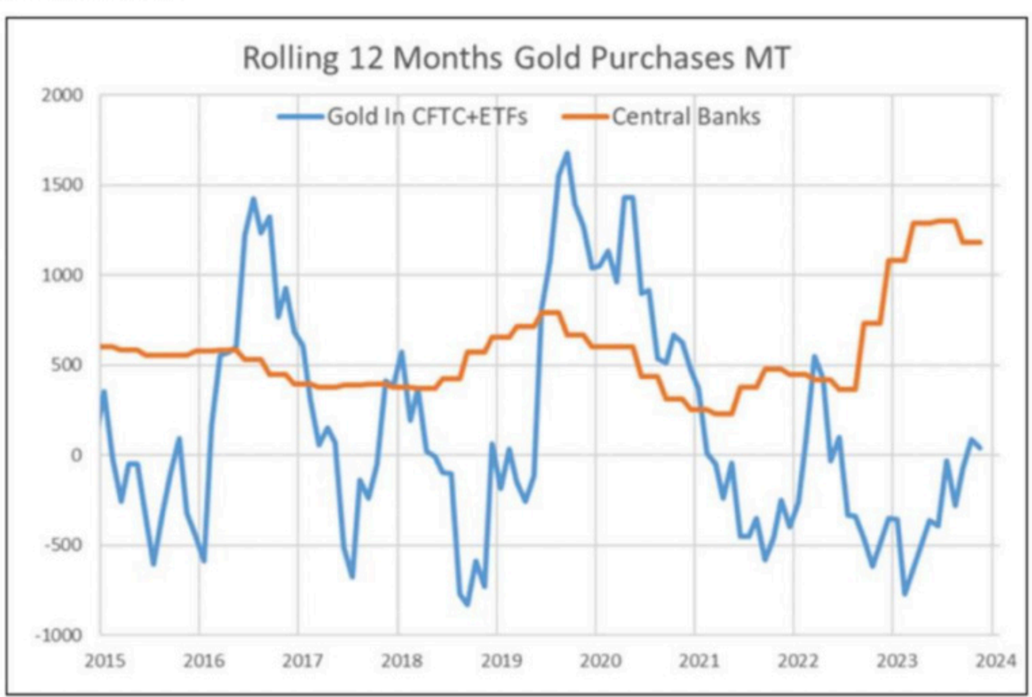
**Figure 5. 12-Month Rolling Gold Purchases by Central Banks and Investment Funds, Metric Tonnes**




In our view, we are headed into a decade where the investment climate resembles the 1970's and as a reminder, the schedule below shows how various asset classes performed in the 1970's.

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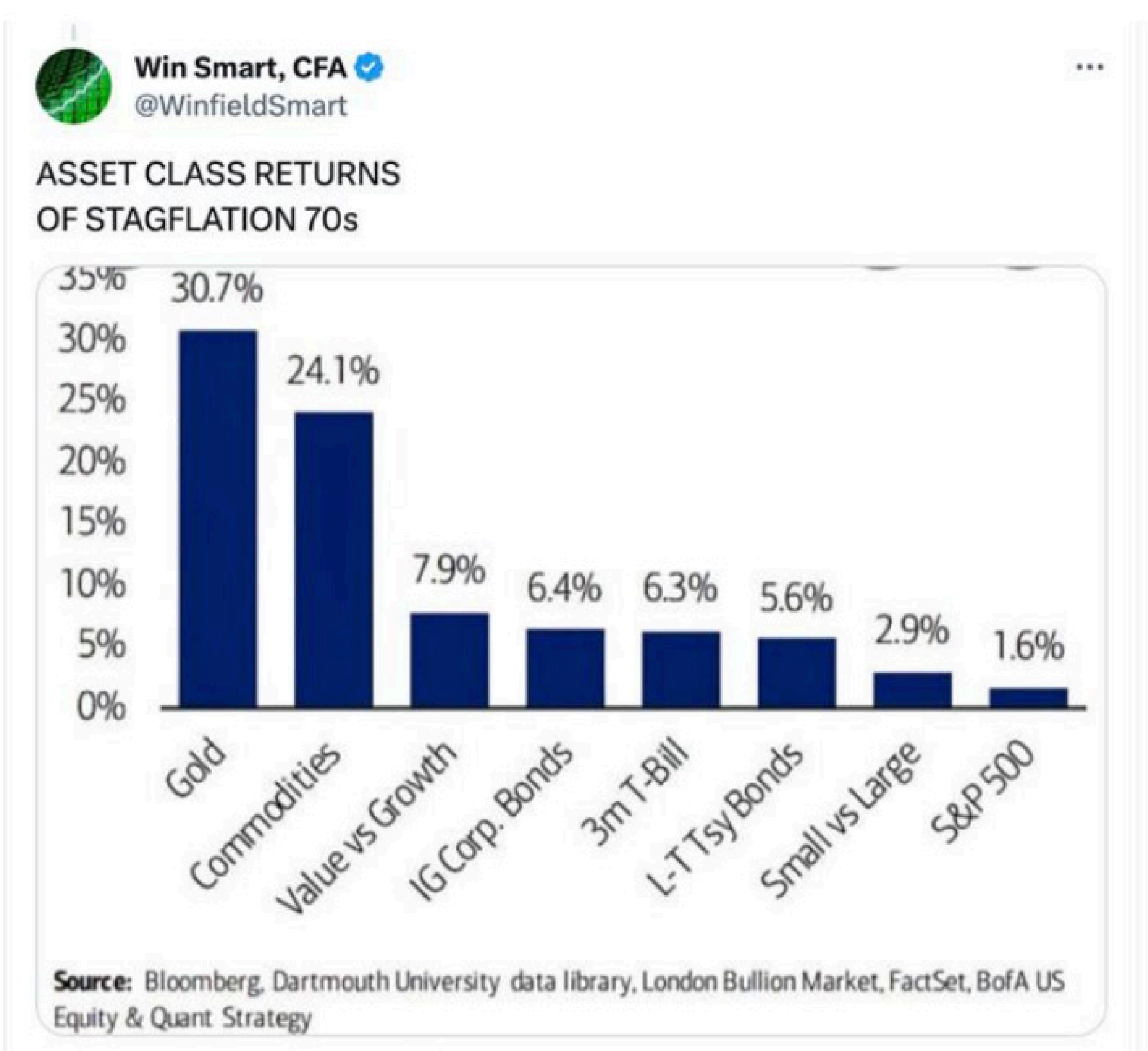






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**The gap between gold and gold-mining stocks has been widening again (from The Daily Shot)...**

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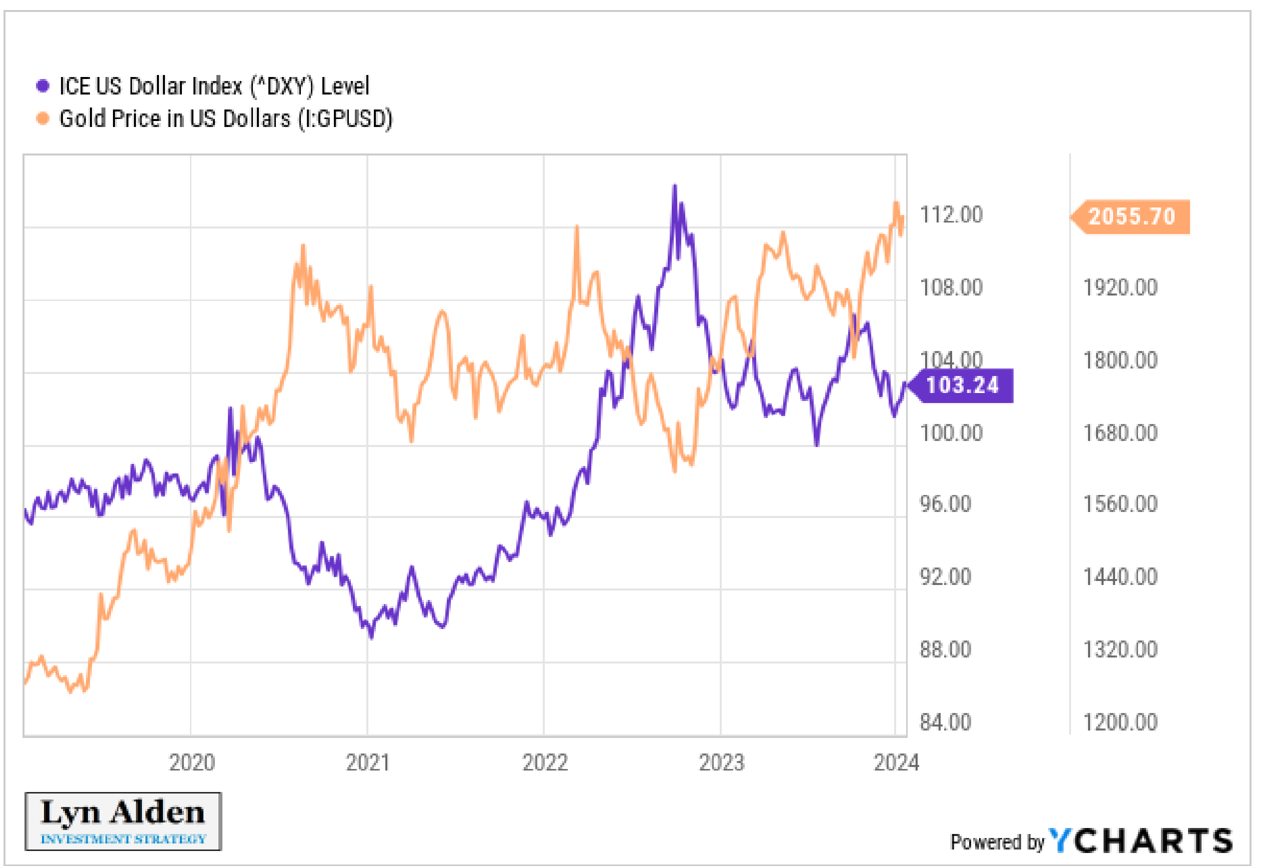
**Gold has yet to decisively break out in U.S. dollar terms (as it has in most other major currencies), but momentum remains positive for now (from Lyn Alden Investment Strategy)...**

The firming up of the dollar index in January helped keep a ceiling on various dollar-sensitive assets, including gold which is now back in its rangebound pathway:




I expect gold to eventually break out to the upside and likely have a sizable run when it does, but it has to perform that breakout first. Its December 2023 high represents basically the fourth failed attempt at a break out within the past four years. The momentum trend, however, is still positively in its favor:





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**Gold volatility also remains historically low, which suggests the recent rally has further to run ([from The Daily Shot](#))...**

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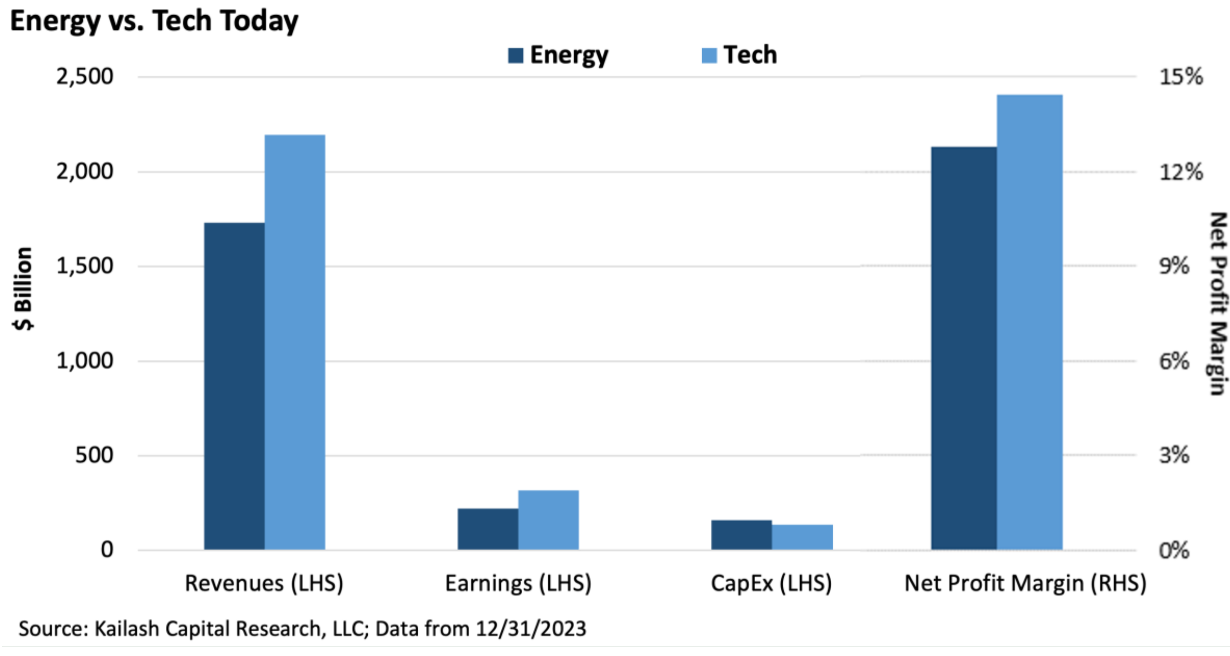
## ENERGY

**The fundamentals of the energy sector remain surprisingly strong today (from Kailash Capital Research)...**

In [an earlier white paper], we noted that based on fundamentals, Energy and Tech looked surprisingly similar. We've updated the chart below and admit, tech has pulled ahead a bit. We discussed the potential risks from inflated Tech sales and profits due to vendor financing in Everything AI, a problem that simply can't exist in Energy.




We agree that Tech's earnings are nothing like Energy's earnings. But the view that Tech is better than Energy is so consensus that Tech is now valued at a $10 trillion premium to Energy despite similar fundamentals.

We are not saying "buy energy, sell tech" – there's lots of tech we love. But as we reminded readers: Tech's earnings were far more cyclical than Energy's in the dot. com bubble and nearly as bad in the GFC.

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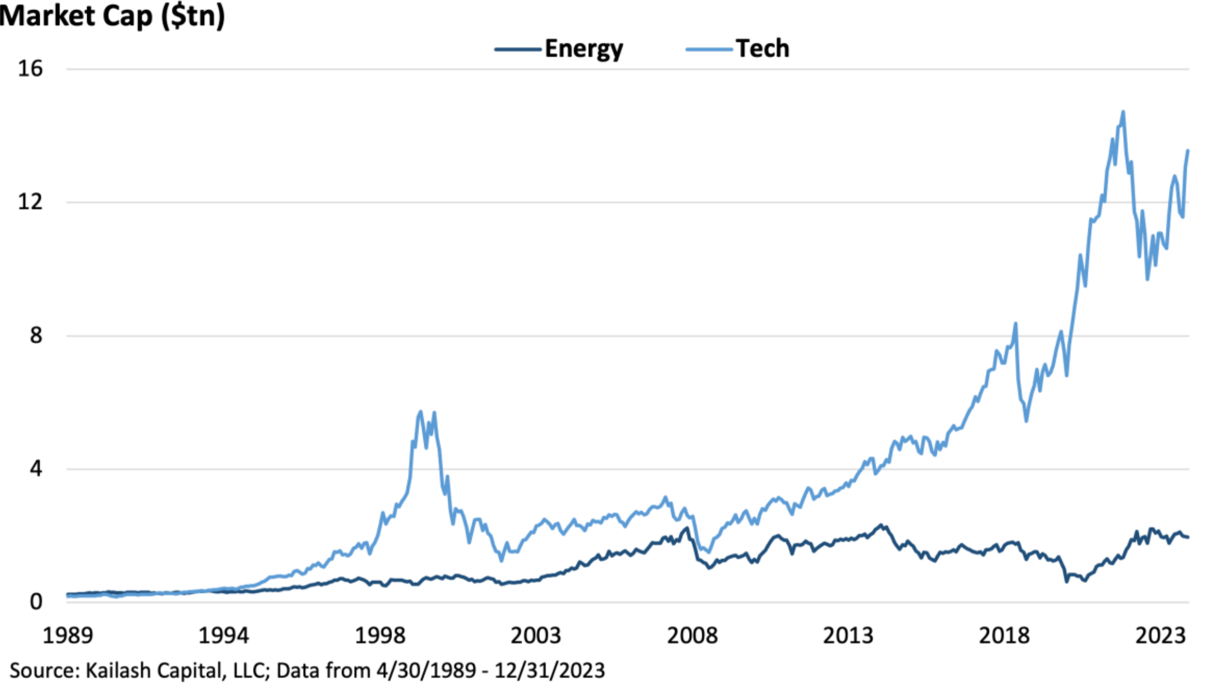






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**Uranium prices soared again this month (from Barchart via X)...**

URANIUM GOING PARABOLIC as prices surges above 100 for the first time since 2007 and reaches its most overbought level in history.

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**Bombshell report reveals that electric vehicles aren't nearly as energy-efficient as we've been led to believe (from *The Wall Street Journal*)...**

It's hard to think of a worse environmental scandal in recent years than Volkswagen's 2015 diesel-emissions cheating. The German automaker was rightly pursued by regulators, enforcement agencies and class-action lawyers.

The scandal ended up costing Volkswagen an estimated $33 billion in fines and financial settlements—and revealed that diesel-emissions cheating was endemic. In 2020 Daimler AG made a $1.5 billion settlement over emissions cheating in Mercedes-Benz diesel vehicles. (One of us helped secure that settlement.) Last year engine maker Cummins agreed to pay $1.7 billion to settle claims that it skirted diesel-emissions standards.

In all of these cases, regulators punished carmakers that had cut corners and misled the public. But when it comes to electric cars, the government has a cheating scandal of its own. That scandal, grabbing far fewer headlines, is buried deep in the Federal Register—on page 36,987 of volume 65.

When carmakers test gasoline-powered vehicles for compliance with the Transportation Department's fuel-efficiency rules, they must use real values measured in a laboratory. By contrast, under an Energy Department rule, carmakers can arbitrarily multiply the efficiency of electric cars by 6.67. This means that although a 2022 Tesla Model Y tests at the equivalent of about 65 miles per gallon in a laboratory (roughly the same as a hybrid), it is counted as having an absurdly high compliance value of 430 mpg. That number has no basis in reality or law.

For exaggerating electric-car efficiency, the government rewards carmakers with compliance credits they can trade for cash. Economists estimate these credits could be worth billions: a vast cross-subsidy invented by bureaucrats and paid for by every person who buys a new gasoline-powered car.

Until recently, this subsidy was a Washington secret. Carmakers and regulators liked it that way. Regulators could announce what sounded like stringent targets, and carmakers would nod along, knowing they could comply by making electric cars with arbitrarily boosted compliance values. Consumers would unknowingly foot the bill.

The secret is out. After environmental groups pointed out the illegality of this charade, the Energy Department proposed eliminating the 6.67 multiplier for electric cars, recognizing that the number "lacks legal support" and has "no basis."

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Carmakers have panicked and asked the Biden administration to delay any return to legal or engineering reality. That is understandable. Without the multiplier, the Transportation Department's proposed rules are completely unattainable. But workable rules don't require government-created cheat codes. Carmakers should confront that problem head on.

Continue reading here (subscription may be required).

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**This is what's driving the big increase in U.S. oil production (from *Bloomberg*)...**

In the early 2010s, US shale players were producing oil like crazy, with no concerns about profitability. Then the legs were kicked out from the industry, causing a massive bust, and massive oversupply. In 2021 and 2022, it looked like a very different story. Oil prices were surging and it seemed as though US players had found religion, learning how to maintain production discipline and improve profitability. But now we're in a new era that nobody saw coming: US oil production is booming. In in fact, it's at a record high. What's more, industry participants are actually making money at the same time. So how did they do it? And how did the prognosticators get things wrong? On this episode of the podcast, we speak with Bloomberg Opinion columnist and commodity specialist Javier Blas. We discuss the state of US supply and what it means for OPEC. We also talk about the rising tension in the Red Sea, as well as his reporting on the rise of electronic electricity trading in the European market. This transcript has been lightly edited for clarity...

Joe Weisenthal (00:10):
Hello, and welcome to another episode of the Odd Lots podcast. I'm Joe Weisenthal.

Tracy Alloway (00:15):
And I'm Tracy Alloway.

Joe (00:17):
Tracy, remember a couple years ago when oil prices started booming and there was this big story that production wasn't coming back? That all these oil companies had found discipline, they were all focusing on profits, etc., and not just volume? And that the expectation would be that production would be depressed for a long time?

Tracy (00:36):
Wait, I don't think it wasn't that production was ever coming back. ..

Joe (00:40):
Sure.

Tracy (00:40)
It was that production would slow substantially. And the idea was that this is one part of the oil boom story of the sort of mid 2010s that always fascinated me. It was actually a capital market story.

Joe (00:54)
Yeah.

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Tracy (00:54)
So it was all these investors who just poured money into shale oil basically, and thought they were going to make millions and millions. Shale completely overexpanded. It became very, very difficult for them to actually pump at a profit. And so they all started collapsing. They all started pulling back, all the investors got burned. They were like 'We're never going to touch this industry with a 10-foot pole ever again.'

And then lo and behold, in sort of the early 2020s, shale starts to become profitable again. It starts to expand. It says it's expanding at a more disciplined pace than previously. But I have questions about that. But it's all changed, It's all turned around.

Joe (01:36):
Yeah, I'm glad you brought up that capital markets aspect. That did seem to be this idea of depressed production [that] seemed to be all part and parcel of that. That suddenly financial conditions were tightening, that the market was placing this premium in this new non-zero sum world of cash flow today, etc.

And so I'm still confused what exactly happened with that story. There's lots of things as production has come back. It seems like investors are still into the space. Prices have come down, there's all kinds of obviously geopolitical stuff going on. It seems like it's time to sort of take stock of what's going on in the energy world.

Tracy (02:17):
Yeah. Well, US oil production in particular, I think that's an all time high. Actually if you look at domestic production in the US, I think it's something like 13 million barrels of crude per day and 20 million including LNG and things like that. So an all-time high. And it means that US oil basically accounts for one of every eight barrels of global output. So pretty big stuff there.

Joe (02:48):
Pretty extraordinary. So what happened to all the narratives? Is production coming back? Why have prices fallen? I'm very pleased to bring in the person we always love to turn to when it comes to oil and energy. We are going to be speaking to our colleague Javier Blas, Bloomberg Opinion columnist on oil and energy. Javier, thank you so much for coming back on Odd Lots.

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Javier Blas (03:09):
Thank you for having me again.

Joe (03:11):
Javier, what is the deal with that? So we're back at records again in the US production?

Javier (03:15):
We had record levels, and it's just an incredible number. As Tracy said, if you look just at what we say is ‘crude oil,’ it's more than 13 million barrels a day. But if you add on top of that number other things that go into the oil, liquids streams or condensates and NGLs (natural gas liquids), a bit of ethanol, etc., etc. — we are well above 20 million barrels a day of oil production that compares to a hundred million worldwide.

So you put everything together, the US is producing one in five barrels of oil consumed. That is just an incredibly high number. And it doesn’t seem to be stopping. Probably it's going to slow down a bit in 2024, but it's going to continue to go up.

Tracy (04:04):
Okay, where is all that new oil actually coming from? Because it's been a while since I've brought up the rig count chart. But if you look at the rig count chart, this is such a fun one because you can see the big humps of the early 2010s and then the big slide into 2015, and now it seems kind of flat. So there's been some increase between 2020 and 2022. The number of new rigs being drilled has gone up, but it's not like we're seeing a boom in new gas rigs and new explorations. So where is all this oil coming from?

Javier (04:43):
Well, it's coming from the very same places that it was coming about 10 years ago, but it's coming in some way, and for lack of a better word, better. So it's coming from Texas, it's coming from New Mexico, and it's coming a bit from North Dakota, Oklahoma, etc., etc. It’s coming from the shale regions of the United States.

But if we were to say ‘where’ in just one single or two, or in this case, three single words, it’s Texas and New Mexico. That's where the new oil is coming. And you are right Tracy, the recount is not significantly up. Actually, you look at [it] from a loan perspective, it's lower than it was during the previous booms of shale.

But it's just that the oil companies in Texas and New Mexico have [gotten] very good at extracting more oil from those rigs, from those wells that they're drilling. And they're also doing much longer wells. If you think about how a shale oil well looks like, it first goes down vertically and then it just turns around 90 degrees and it goes horizontal for a while. At the beginning, those horizontal wells were relatively short. Perhaps a quarter of a mile, half a mile at most. Now they're going as much as three miles horizontally. They can get a lot more oil than they were able to do a few years back.





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Joe (06:05):
So it's in part, and we're going to talk a lot about the capital markets and investor aspect, but it's in part just ongoing technological improvements as well. What else is happening on this sort of tip?

Tracy (06:17):
Can I read — sorry, I never get a chance to do this — can I read one of my all time favorite leads from a story that is all about technological improvements and oil drilling? Javier, Joe, you guys are ready? I'm going to read it. This is a story from 2016: "Last spring, Statoil announced it had used the same oil well design and components to drill three reservoirs for the price of one. While the specs for Norwegian sea drilling might provoke reactions akin to the oil field's name — the Snorre — such standardized pipes and casings could hold the key to a pervasive mystery about today's energy market. Why is everyone still drilling when prices are in the basement?" Snore! Get it?

Joe (07:02):
Oh, that's good!

Tracy (07:03):
Maybe you have to read it.

Joe (07:04):
So that really held up well. So what's changed since 2016 Javier? Tech?

Javier (07:09):
Technologically-wise, we can drill longer, particularly the laterals. We can pump fracking fluids at a higher pressure. And companies are also very good at doing this super quick. Previously our well could have taken 30 days — now it takes 10. Companies and the crews have gotten very good at doing it. And that means that they can do it cheaply. And that's the funny part of the whole boom of 2023 and 2024, a difference of the previous ones. Companies are making money and investors are making money. So everyone is loving it. This is the first time, and this is what really terrorized OPEC, that shale oil is growing and making money at the same time. And that's a big problem if you are in Saudi Arabia.

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Tracy (07:56):
Definitely want to get to the possible response from OPEC. But just in terms of technology, one of the things, and the reason I brought up that story, was the idea of standardization. So,before you used to have all these bespoke custom fittings for oil rigs or platforms or whatever. But then, I think there was actually an industry-wide effort or attempt to start standardizing some of these things so you didn't have to order a bespoke component for every single oil project that you were doing. And that seems to have helped make things go faster — to Javier's point and also brought down costs. Javier, how much of a big deal is that in the industry?

Javier (08:36):
It is a big deal. It has happened everywhere in the oil industry. Let me give you my favorite anecdote of a standardization in the oil industry. So you are working on a North Sea oil platform, this is offshore outside Norway and the United Kingdom. You need to paint a lot of the stuff yellow, kind of yellow [for] danger, very visible etc., etc. Very stormy areas of the wall. The North Sea fog, it's not the kind of place that you really want to spend an evening in winter there.

So every company has their own shade of yellow. There were 19 different kinds of yellow to paint things in the North Sea. Each company has their own shade with their own specification, and it was just ridiculous. So at one point, a few engineers in the industry got together and said ‘Well, this is a bit ridiculous. I mean, can we not just do a yellow North Sea?’

And so they got together and everyone decided this is the shade of yellow that we're going to use. And now everyone is painting everything that they need to paint in yellow with the same shade. That at a much bigger scale has happened across the oil industry. Everything has got a standard. And companies within themselves, they like to do everything bespoke. They really, in some way, gold-plated a lot of projects. So each well was a bit different to the other one. Now, companies are designing one single design. And when they have really thought ‘Okay, this is it. This really works very well, now copy and paste for the next 25, 50, 100 wells’ — that has cut costs significantly.

Joe (10:10):
I love the fact that just as something as simple as the color painting on the rigs.

Tracy (10:15):
I'm imagining a room full of oil executives looking at different swatches of yellow and being like ‘No, that one's too orange. Can we get something a little bit more buttermilk, maybe?’





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Javier (10:25):
I would love to be the competition lawyer who has to stop in in the meeting to make sure that no one is saying anything inappropriate that the Department of Justice could get us like 'There was a conspiracy for the yellow color.'

Joe (10:39):
Yeah. They're all looking at the different Pantone shades, but got to do so in a legal way. All right, let's talk about the capital markets aspect because it did seem like, you know, the way people thought about it was that the industry had to face a choice. Would it be pursuing volume or would it be pursuing profitability? And as you've just said, there seems to be this very weird situation in which volume is ramping and productivity is sustained. How is that happening and how sustainable is that?

Javier (11:06):
Well, to the question of how long and how sustainable — I'm going to be honest, I don't know. I thought that production growth would have a slowdown in 2023 and it never happened. It did the opposite, it accelerated. You look [at] every oil executive, if you look at the forecasters of the industry, everyone is saying it's going to slow down in 2024. But also they said the same for 2023, and they were wrong.

So we'll see what happens, really. But yes, I mean the industry went into this new era thinking about profitability. So everyone cut CapEx, everyone tried to get more efficient. And everyone thought that production growth was going to slow down because the focus was profitability. The fact that they were able to grow quite strongly came [as] a bit of a surprise to the industry. And then everyone kind of celebrated it.

But here there is a very important question. If OPEC has not cut production to make room for all this new shale oil from the United States, prices will have come down. And then the industry would have faced the same kind of dilemma of the past. You are producing too much, then the prices come down, your profitability comes down, and then you have a problem. So a lot of these that we are putting based on efficiency, it's true. But if not for OPEC cutting production and keeping prices above $70 a barrel, then shale companies will be in trouble.



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Tracy (12:47):
One thing I'm really curious about is who is actually funding production now versus, say, in the early 2010s.

Joe (12:56):
And just to add onto that a little bit, is there any difference between private and publicly-traded domestic US players?

Javier (13:02):
Okay, so let's in parts. On Tracy's question, who is funding this? Well back 10 years ago, five years ago, it was Wall Street. It was a mix of equity and credit markets which were funding all of this growth through different instruments. I mean sometimes it was just issuing fresh equity. Sometimes it was bonds, high-yield bonds, reserve lending where a bank is lending to an oil company based on the reserves underground; more or less like a mortgage rather than a house. You mortgage the oil reserves that they're underground.

And a lot of that is still there, but a lot of the money now needed for the expansion and to finance all this new growth is coming from cash flow generation. It’s the internal cash flow of these companies. They generate enough cash to pay for all the new drilling that they're doing to pay for all the capital investment that they need to do alongside new pipelines, etc., etc. And to pay the shareholders.

These companies now for the very first time are paying dividends. And that sounds like — well, publicly-listed companies should be paying dividends that's like normal. Well, that was not the case a few years back. But now they generate enough cash to do all of the above.

And in terms of is there a difference? Yes. Publicly listed companies have been a bit more cautious, they have been trying to. They have the shareholders, they have Wall Street on top of them, and they have to really try to focus as much as possible on paying dividends and buying back shares. Publicly-owned [companies] don't have that pressure, that super strong pressure. So they have done a bit more growing. And there is a suspicion in the industry that a lot of that growth was to try to maximize the amount of production that you are doing so you can sell yourself to a big player, say ExxonMobil or Chevron. And perhaps that's not as sustainable as it looks like.

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**The Great Convergence: Why natural-gas prices could soar in the months ahead (from Goehring & Rozencwajg Associates)...**

North American natural gas is the cheapest energy molecule on the planet by as much as 75%. Over the next twelve months, we believe this discount could close entirely, boosting US gas prices as much as four-fold. As we go to print, Henry Hub gas costs $3.00 per mcf while European and Asian gas is $14 and $16.50 respectively. One barrel of oil contains between six and eight mmbtu, so dividing oil by the midpoint of seven generates its energy-equivalent price of $10 per mcf.

FIGURE 11 Henry Hub Discount to WTI Oil on Energy Equivalent Basis

*Source: Bloomberg.*

Today's discount is nothing new; North American gas has traded 60-80% below world prices for nearly a decade with good reason. The shale gas revolution tilted the North American natural gas market in structural surplus. Since 2005, the US gas supply doubled from 54 to 104 bcf/d. Conventional production fell by 56% from 50 to 22 bcf/d, while shale production ramped to over 80 bcf/d – or 80% of total supply. The United States would have faced an acute gas shortage without the shales as conventional natural gas production had declined steeply. Instead, surging shale gas production produced a prolonged (and huge) disconnect to world prices. However, our models tell us that the shales are likely plateauing and the discount to world prices will narrow quickly and most likely disappear.

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Cheap US gas has caused demand to surge. Gas-fired electricity generation increased by 127% from 14 to 33 bcf/d, while industrial use increased by 20% or three bcf/d. Most notably, the United States went from being one of the world's largest gas net importer, at two bcf/d per day, to the largest net exporter, at 12 bcf/d per day – a swing of 14 bcf/d. Despite the surge in new demand, shale supply continued to outpace consumption and the market remained stuck in a structural surplus. Between 2005 and 2023, rolling twelve-month US natural gas inventories (to adjust for seasonality) increased by 50% from 2 tcf to 3 tcf.

Given such strong demand, if shale production ever faltered, the discount between US and world prices would close quickly, what we call convergence. Our models suggest the North American gas market will switch from structural surplus to structural deficit in six months. The results would be profound. The US consumes 90 bcf/d domestically; a move from $3 to $10-12 would cost US industry and consumers a combined $350 bn, or 1% of GDP.

We first outlined our convergence thesis in late 2021. However, an extremely warm winter in the United States and Europe and a fire that rendered the Freeport LNG export facility inoperative pushed the trade out by a year. We argued that the Marcellus, Haynesville, and associated gas from the Permian were all set to plateau and roll over. These three basins accounted for an incredible 58 bcf/d of growth since 2005; US production would have declined without them. However, despite their vast size and robust growth, they are not immune from the geological realities of depletion and field exhaustion. Immense is not the same as infinite, we like to say, and eventually, their production will decline.

The first two shale gas plays to be developed, the Barnett in Texas and Fayetteville in Arkansas, caught everyone off guard when their growth slowed, flattened, and rolled over. In December 2009, Exxon agreed to buy XTO Energy, a premiere Barnett producer, for nearly $40 bn. Before the recent announcement to purchase Pioneer Natural Resources, XTO was Exxon's most significant transaction since buying Mobil in 1999. Exxon paid four times XTO's PV-10 value plus debt, suggesting Exxon felt they could markedly grow reserves and production in the Barnett. Instead, Barnett production rolled over twenty months later, and today, it stands 65% below its November 2011 peak. Exxon has now written off half the value of its XTO purchase price.

What lessons can be learned from the Barnett and Fayetteville? We used our shale neural network to uncover hidden indicators, suggesting when production might plateau and decline. The neural network estimates the ultimate recovery of a well given the subsurface geology and well design. By tallying what had been produced and what remained to be developed, we evaluated the recovery for the entire basin. We estimated that Barnett and Fayetteville had reserves of 23 and 10 tcf, respectively. Notably,

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production in both fields plateaued once half their reserves had been produced – twelve tcf for the Barnett and five tcf for the Fayetteville.

The neural network predicts the Marcellus will eventually produce 135 tcf – one of the largest gas fields in history. The field has made 79 tcf to date, or nearly 60%. According to our models, Marcellus produced 50% of its recoverable reserves in May 2022; on schedule, production flattened. From December 2021 to June 2023, Marcellus dry gas production declined by nearly one bcf/d – the first time the field fell over eighteen months. Although preliminary data indicates a slight recovery in July and August, we believe it will prove temporary. While some analysts believe the pause in Marcellus growth is a function of pipeline bottlenecks, we disagree. If it were an infrastructure issue, we would not expect any impact on productivity. If top-tier drilling inventory depletion were to blame, productivity would fall. According to the EIA, per-well productivity in the Marcellus has slowed dramatically since peaking in 2021, which is confirmed by what our neural network tells us. We strongly believe top-tier drilling inventory depletion is the culprit.

Our neural network predicts that Haynesville will recover 73 tcf, of which 36 tcf, or 50%, have been produced. The field has exhibited strong growth in recent years, but we believe this will now moderate going forward. In fact, over the short term, declines are almost guaranteed. The basin is deep and highly over-pressured, meaning wells are expensive to drill and complete. As prices pulled back, producers curtailed development, laying down 40% of the rigs in the basin this year. With 45 rigs turning today, production is almost sure to fall. Most analysts believe growth will resume once prices advance. Our neural network tells us that 2022-2023 will be the production peak for the field.

Meanwhile, the Permian basin is suffering depletion problems of its own. We discuss the field in greater depth in the Oil section, but in summary, we do not expect it to be a significant growth driver in the future.

Supply issues are now in place and enough for convergence to occur. However, demand factors make convergence a near certainty in 2024. Six additional bcf/d of LNG export capacity are scheduled for operation in late 2024 and 2025. After years of surging supply, few are worried about where the gas will be sourced. Our models tell us that there is no way production can grow to meet this additional export demand. Driven by supply and demand trends, North American natural gas is about to enter a structural deficit for the first time in 20 years.

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If we are right, we would not be surprised if President Biden issued an executive order limiting exports to lower the natural gas price. If exports were limited, it would have a knock-on effect on Europe, which has come to rely on safe, secure US LNG to offset lost Russian volumes.

North American inventories have repaired much of the surplus accumulated after winter's mild weather. Stocks peaked at 300 bcf above ten-year averages in May and have been declining since, presently standing at only 100 bcf above average. Unfortunately, weather is always a wild card with natural gas. Another mild winter will forestall (but not prevent) convergence. If weather is seasonable, we expect inventories will end the withdrawal season in a mild deficit to seasonal averages, making it very difficult to replenish stocks to a level that can accommodate the new LNG demand.

Natural gas equities have some of the best return potential in the resources universe. Range Resources – our most significant gas holding – trades at $33. Its debt-adjusted SEC PV-10 per share from the 2022 10-K is $94 – or three times the stock price. Critics will argue that last year's 10-K reflected $6 gas – twice today's price. This is true; however, using the depressed spot prices, Range still represents a modest upside. If natural gas converged with world prices, and Range was able to realize $10 per mcf, its PV-10 would be $182 – five times today's stock price.

We have been early with our convergence call; however, we are confident that convergence will occur in 2024. Most fundamentals, including stagnating Marcellus production and Haynesville production, have progressed exactly as we predicted. Our timing error was mainly due to last winter's mild temperatures. Investors are getting a second opportunity to put this trade on—we believe the rewards versus the risks are hugely positive.

Continue reading here.





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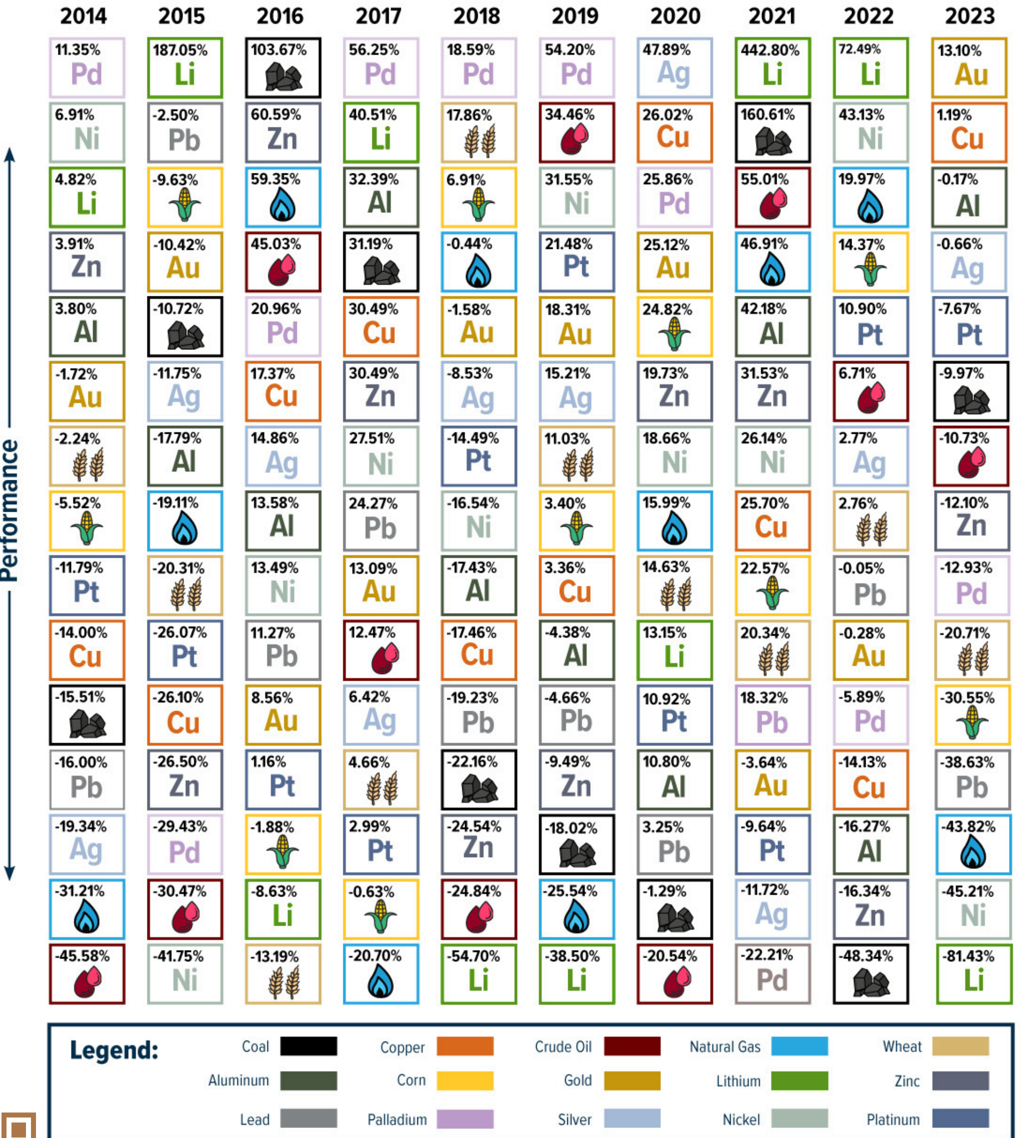
# OTHER COMMODITIES

**Here's a "periodic table" of commodities returns over the past 10 years (from Visual Capitalist)...**



## THE PERIODIC TABLE OF COMMODITIES RETURNS 2023

Natural resources are vital for global progress and prosperity, but their prices can fluctuate significantly over time, as demonstrated in a table highlighting price movements over the past decade. This volatility aligns with the principle of mean reversion, where returns tend to revert to their average levels. The prices of commodities exhibit both seasonal and cyclical patterns historically. Therefore, investing in natural resources necessitates a diversified portfolio managed by professionals knowledgeable about these assets and their global trends. However, diversification doesn't eliminate market risks or ensure profits, and past performance doesn't predict future outcomes.

| 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|
| 11.35% Pd | 187.05% Li | 103.67% | 56.25% Pd | 18.59% Pd | 54.20% Pd | 47.89% Ag | 442.80% Li | 72.49% Li | 13.10% Au |
| 6.91% Ni | -2.50% Pb | 60.59% Zn | 40.51% Li | 17.86% | 34.46% | 26.02% Cu | 160.61% | 43.13% Ni | 1.19% Cu |
| 4.82% Li | -9.63% | 59.35% | 32.39% Al | 6.91% | 31.55% Ni | 25.86% Pd | 55.01% | 19.97% | -0.17% Al |
| 3.91% Zn | -10.42% Au | 45.03% | 31.19% | -0.44% | 21.48% Pt | 25.12% Au | 46.91% | 14.37% | -0.66% Ag |
| 3.80% Al | -10.72% | 20.96% Pd | 30.49% Cu | -1.58% Au | 18.31% Au | 24.82% | 42.18% Al | 10.90% Pt | -7.67% Pt |
| -1.72% Au | -11.75% Ag | 17.37% Cu | 30.49% Zn | -8.53% Ag | 15.21% Ag | 19.73% Zn | 31.53% Zn | 6.71% | -9.97% |
| -2.24% | -17.79% Al | 14.86% Ag | 27.51% Ni | -14.49% Pt | 11.03% | 18.66% Ni | 26.14% Ni | 2.77% Ag | -10.73% |
| -5.52% | -19.11% | 13.58% Al | 24.27% Pb | -16.54% Ni | 3.40% | 15.99% | 25.70% Cu | 2.76% | -12.10% Zn |
| -11.79% Pt | -20.31% | 13.49% Ni | 13.09% Au | -17.43% Al | 3.36% Cu | 14.63% | 22.57% | -0.05% Pb | -12.93% Pd |
| -14.00% Cu | -26.07% Pt | 11.27% Pb | 12.47% | -17.46% Cu | -4.38% Al | 13.15% Li | 20.34% | -0.28% Au | -20.71% |
| -15.51% | -26.10% Cu | 8.56% Au | 6.42% Ag | -19.23% Pb | -4.66% Pb | 10.92% Pt | 18.32% Pb | -5.89% Pd | -30.55% |
| -16.00% Pb | -26.50% Zn | 1.16% Pt | 4.66% | -22.16% | -9.49% Zn | 10.80% Al | -3.64% Au | -14.13% Cu | -38.63% Pb |
| -19.34% Ag | -29.43% Pd | -1.88% | 2.99% Pt | -24.54% Zn | -18.02% | 3.25% Pb | -9.64% Pt | -16.27% Al | -43.82% |
| -31.21% | -30.47% | -8.63% Li | -0.63% | -24.84% | -25.54% | -1.29% | -11.72% Ag | -16.34% Zn | -45.21% Ni |
| -45.58% | -41.75% Ni | -13.19% | -20.70% | -54.70% Li | -38.50% Li | -20.54% | -22.21% Pd | -48.34% | -81.43% Li |



**Source:** Bloomberg and U.S. Global Investors

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**Commodities veteran: There's "definitely a bullish case" for 2024 (from *Bloomberg*)...**

Jeff Currie, who spearheaded commodities research at Goldman Sachs Group Inc. for almost three decades, remains bullish on the sector for this year.

Demand for raw materials is at record levels, inventories are low, and spare production capacity is largely "exhausted," the veteran analyst said in an interview with Bloomberg television. Copper, which drifted sideways for much of 2023, has the greatest scope for gains, he added.

"The set up for all of these markets is better than it was last year," and if central banks proceed with interest rate cuts "you're teeing yourself up for a fantastic 2024," Currie said. "This is just classic 'own commodities.'"

Oil prices slumped 10% last year in their worst annual performance since the 2020 pandemic, as booming crude production in the US and elsewhere overwhelmed record consumption. Brent futures have had a shaky start to 2024, trading near $77 a barrel.

Crude traders are reluctant to take a strong view after suffering losses last year, but conditions should change, Currie predicts. The "immaculate disinflation" and production surge that weighed on oil markets in 2023 is unlikely to be repeated this year, he said.

Currie said his next career move will be related to the energy transition, but hasn't yet been finalized. He left the Wall Street titan last August after an extensive career in which he cemented a reputation for bold and often bullish calls.

Continue reading here (subscription may be required).





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**History suggests a new commodity cycle is underway (from Crescat Capital)...**

We believe that November 2021 marked the beginning of a new investment cycle, characterized by a critical shift in market correlations across different asset classes. During this period, businesses operating at unsustainable valuations faced a moment of reckoning, and the global fixed-income market underwent a complete collapse. Safe-haven currencies, such as the Japanese Yen, notably faltered. Additionally, the transition from growth to value stocks was initiated, benefiting commodity-related firms, while resource-rich emerging markets notably outperformed their developed counterparts. Outside of mega-cap technology companies, these market trends have persisted and are likely to intensify in the years ahead.

The next decade is likely to be influenced by a set of significant factors. These include the deepening challenges associated with deglobalization, a critical shift for businesses to prioritize securing their logistics rather than focusing solely on cost-efficiency, rising social and political pressure favoring populist leaders in response to widespread global wealth disparities, anticipated widespread labor strikes as workers seek better compensation in light of corporate profits, and forthcoming issues arising from a prolonged period of underinvestment in natural resource industries that is yet to impact the supply of critical materials.

The convergence of these long-term macro trends is profound and leads us to anticipate that inflation will surpass its historical averages over the last 30 years. Consequently, we expect the cost of capital to rise significantly and sustainably in the decade ahead. The potential for such an environment sets the stage for profound changes in the price behavior of financial markets. As the overall cost of issuing debt and equity becomes more cumbersome, it is highly improbable that volatility will remain as subdued as it currently is. As a result, we believe a return to a more disciplined approach is inevitable, prompting companies to shift their focus back towards profitability. With these shifts unfolding, investors are likely to reward improvements in the bottom line, leading to a resurgence of fundamental-driven analysis.

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Similar to the preceding 30 years, these changes are not expected to be permanent; they are merely part of the cyclical nature inherent in long-term investment cycles. We believe that this evolving environment will present incredible opportunities, and the market behavior observed from November 2021 to the end of 2022 is more likely to replicate itself than to be characterized by trends similar to those experienced in 2023.

As central banks become politically constrained due to the exponential growth in overall debt, these institutions are likely to be compelled to use monetary policy as a funding mechanism to ensure the financial stability of their respective government securities markets. Consequently, even more meaningfully than in prior decades, the debasement of fiat currencies will probably be an important macro theme worldwide as a hard asset cycle is unleashed, particularly on a relative basis compared to historically expensive financial assets.

Courtesy of our friends at Incrementum AG, the following chart gives us an insightful historical perspective. Since the 1900s, we have had four notable commodity cycles. Three of them occurred during inflationary periods: the 1910s, 1940s, and 1970s. The fourth cycle took place in the early 2000s, coinciding with China's entry into the World Trade Organization and its emergence as the manufacturing hub of the global economy, leading to one of the most extensive construction booms in history. Now, we believe we are standing on the cusp of witnessing two macro tailwinds favoring commodities at once:

- The likely onset of another long-term inflationary cycle;
- A global manufacturing ramp in G-7 economies

In our view, another commodity cycle is underway.





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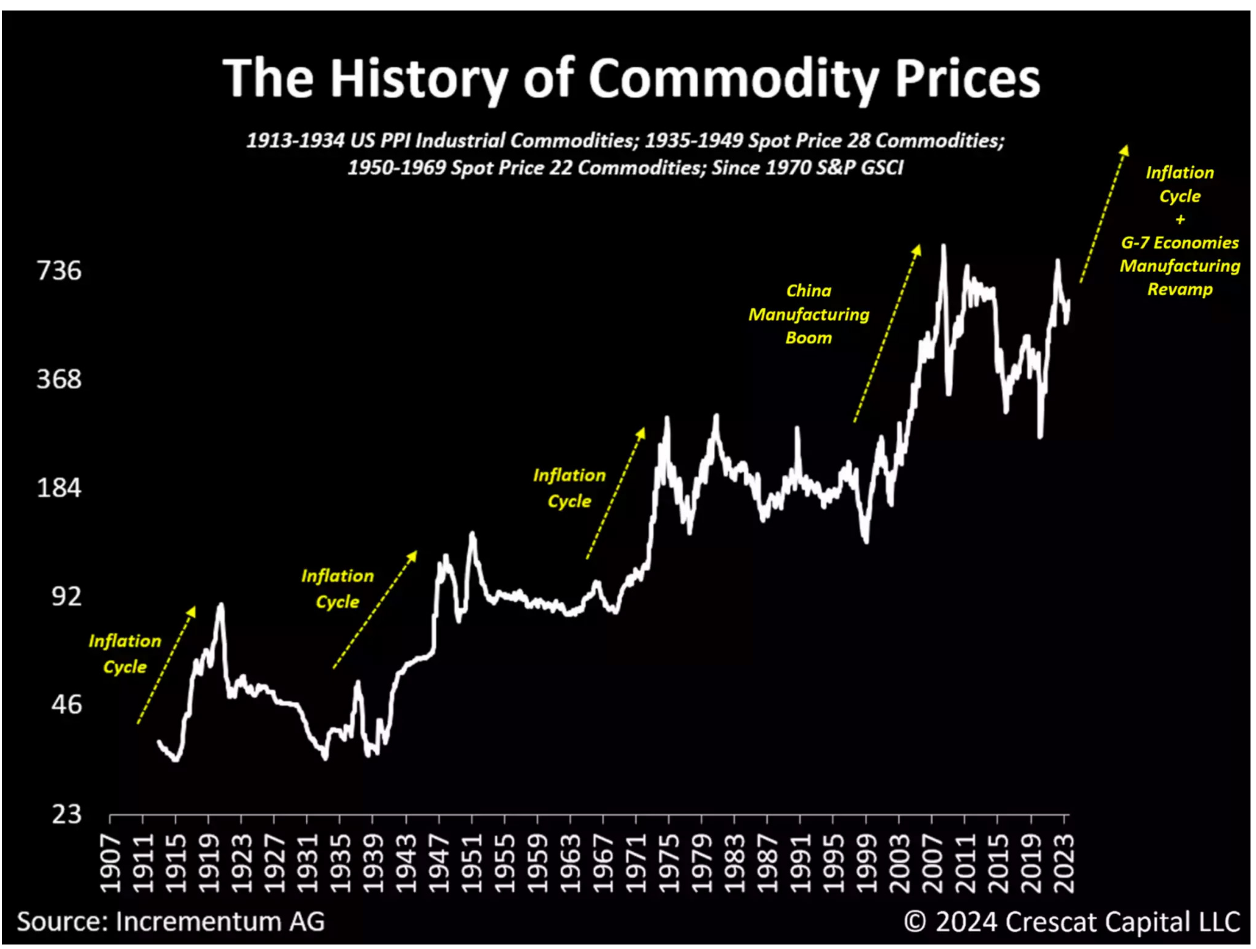


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**But this commodity cycle may be different from the last (from PauloMacro's Substack)...**

In 2003 I fell into commodities and related equities by sheer dumb luck. It felt like a curse at the time, but today I tell anyone in their 20s to embrace the research coverage that nobody on the team wants, especially if that sector or region has gone nowhere for ten years. Inside three years, they will very likely have the expertise everyone desperately needs.

At the time, Chinese commodity demand was just stretching its wings. I will never forget one night in 2004 watching hedge fund managers get up during a buyside dinner with CEO Andrew "Twiggy" Forrest to call in buy orders to their night traders for a penny stock nobody had heard of called Fortescue (Asia offices were not yet a thing).

*Cloudbear: "Didn't he destroy Anaconda Nickel?"*

*Jefferies Broker hosting dinner: "Nah mate, that asset is Minerva's screwup - he had the right idea. Acid leaching nickel laterite is just ahead of its time."*

The title of the presentation on the screen read 'The New Force in Iron Ore,' and the pitch was to build a vast iron ore system in Western Australia from scratch. I checked the stock quote on my corporate Blackberry (everybody had one by now).

*Cloudbear: "The stock ripped 10% last night and is up another 20% tonight. What the heck is going on?"*

*Jefferies Broker: "We were in Boston yesterday."*

Of course you were. I could feel the FOMO coursing through my veins.

The stock, like many others, proceeded to rally over 50x in the next few years. This was just the beginning of a bull run in commodities the likes of which we have not seen since.

I believe we are in a structural long-term commodity bull market again now, but the most dangerous four words in finance apply: *it's different this time*. And the difference, while subtle, may prove critical to unlocking outsized returns. What follows is a simple framework for how I think about navigating this key difference today.

**It comes down to this:** in the 2000s, China's emergence pushed the demand curves for all commodities out to the right. This rising tide lifted all boats as China needed more of everything. Curves backwardated to call inventory out of storage, which enabled passive speculators in futures to collect a positive yield as they rolled from front to second month futures. In June 2004, Gary Gorton and K. Geert Rouwenhorst of the National Bureau of Economic Research (NBER, the same entity that officially dates US

INVESTMENT CHRONICLES



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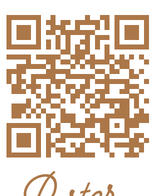
recessions) released their working paper *Facts & Fantasies About Commodity Futures* (link here). Per the abstract, the study looked at [emphasis mine]:

> "...an equally-weighted index of commodity futures monthly returns over the period *between July of 1959 and March of 2004* in order to study simple properties of commodity futures as an asset class. Fully-collateralized commodity futures have historically offered the same return and Sharpe ratio as equities. *While the risk premium on commodity futures is essentially the same as equities, commodity futures returns are negatively correlated with equity returns and bond returns.* The negative correlation between commodity futures and the other asset classes is due, in significant part, to different behavior over the business cycle. In addition, *commodity futures are positively correlated with inflation, unexpected inflation, and changes in expected inflation.*"

At the time of publication, the Federal Reserve had been holding rates at 1% for a year – a level last seen briefly in 1958. This condition had set off a scramble for yield and absolute returns, the US housing bubble was well underway, and Gorton & Rouwenhorst's paper rang the dinner bell for pensions and other long-term allocators. Just imagine: a 45-year passive allocation to commodity futures could provide equity-like, inversely correlated returns. ***But negatively correlated equity-like returns, with inflation protection, AND a positive roll yield? With the Fed at 1%? It wasn't a question of whether to allocate, but how much.***

The Goldman Sachs Commodity Index (GSCI) had already been around for over a decade, but the audience arrived in droves. With S&P's early 2007 acquisition of GSCI, the asset class's reputation was secured. Over $300 billion was allocated during the boom — inflows which further inflated commodity curves and lifted the tide until the party ended in 2011.

Today the situation is different. The Chinese demand story is challenged (over?), but perhaps offset by the demand from 3.5 billion people who live along the axis from Istanbul to Jakarta, as my friend Louis-Vincent Gave of GaveKal aptly puts it. While this baton changes hands — a process that could take years — focus has shifted to supply constraints and the decade of severe underinvestment prior to the pandemic. Underinvestment has gradually pushed supply curves up and to the left over time, and this in turn has changed the character of today's commodity price moves. While the 2000s rising tide shifted curves into backwardation all at once, the phenomenon today is characterized by a series of *Rolling Crackups* precipitated by lack of inventory and investment.



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An aside here: some credit is due to Kevin Muir at The Macro Tourist for a bit of inspiration. A few years ago he coined *The Era of Rolling Bubbles* to describe how different speculative enterprises like ARKK, BTC, ETH, and Dogecoin were ripping at different points in time going into the peak of the mania. The phenomenon of *Rolling Crackups* manifests similarly.

With supply curves pushed up and left, cyclical changes in demand move prices more sharply in shorter periods of time, but at different points and with lags that relate to substitution, demand destruction, cost push, and other outcomes. Just think: prior to Autumn 2021, most had never heard of TTF natural gas in Europe. Suddenly it rallied hard, taking seaborne thermal coal prices with it. Henry Hub rallied to $6, but quickly fell back below $4 with the warmest December in 60 years and the impossibility of the US "stocking out" that winter. Russia's invasion of Ukraine sent Brent to nearly $140 in early March, and the LME nickel contract exploded on the Chinese billionaire short squeeze around the same time. Corn rallied to a peak above $8 in late April, and Henry Hub began a huge move to nearly $10 in June.

Many like to compare the current environment to the 1960s-70s, and they are more right than they realize, as back then commodities also ripped at different times (sourced from charts in Stanley Kroll's *The Professional Commodity Trader*):

- The wheat Mar'73 contract rallied from $1.50 to $2.70 from July to December 1972 (during which time copper actually declined).
- The copper May'73 contract then rallied from 50c in December 1972 to 72c in April 1973. Silver then took over as the Mar'74 contract rallied from $2.20 in April 1973 to $3.45 in January 1974. As this move was finishing, gold ran from $90 in November 1973 to $195 in December 1974.
- The soybean July'73 contract ran from $5.10 in March 1973 to $12.80 in June. A month later, the wheat May'74 contract began rallying from a $2.50 low in July to $5.15 by September 1973.

To be sure, the entire commodities complex does have "common ground," and there are clearly times when it seems like everything is out of favor (like right now, except for maybe uranium and cocoa). But if we really are right back in the 1960s-70s, I believe the key to success is positioning in those commodities that nobody has cared about for a while and are seemingly invisible, and *being prepared to surf from one Rolling Crackup into the next invisible commodity*, particularly when there is a loose underlying connection.





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As a parting example, Henry Hub has traded in the $2's for nearly a year, and until recently was given up for dead on seemingly endless 100+ Bcfpd supply, with no tightness expected before 2025 LNG capacity comes on, a 5yr+ high inventory, and seemingly zero stock-out risk even with a cold and extended winter (which itself is a non-consensus outlook). Even many bulls don't see a scenario of end-of-season inventory approaching 5yr lows — impossible. But this commodity lives in the tails, and is showing early signs of a possible crackup. Were something to happen here, there is a loose line-of-sight from a rallying gas price to rising ammonia and nitrogen-intensive fertilizer pricing which could affect US spring planting decisions. Add in a potentially late Brazilian second corn harvest, and the enormous speculative net short position in corn futures (with a near-historic commercial net long) holds interesting unwind potential as we approach 2H24. One thing rolls into the next, but things move at different times. Perhaps a surprise 1H24 gas rally sets off a 2Q-3Q thermal coal rally as well?

As always, none of the above is meant as financial advice (please note my disclaimer link at the bottom), but rather as an illustration of my *Rolling Crackups* framework. This has helped me think about positioning opportunities since Covid...who knows if it continues to hold, but maybe it helps your thinking as well.

Continue reading here.

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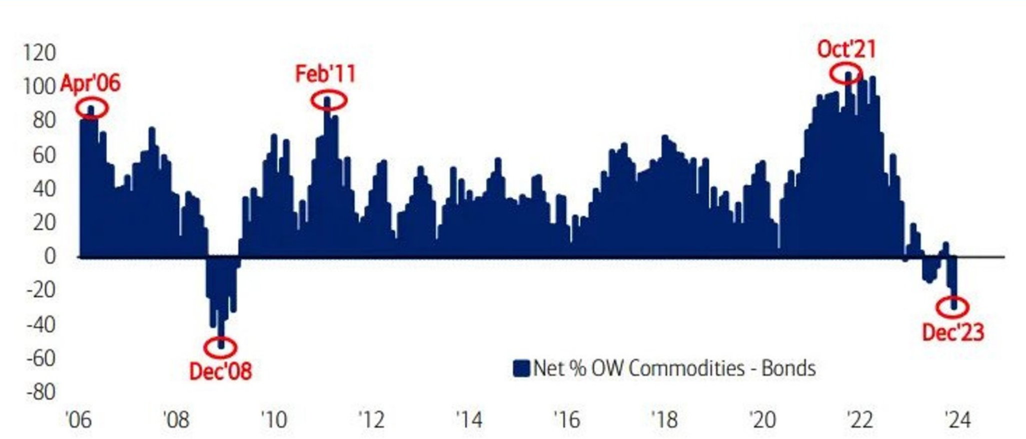
**Market positioning suggests commodities could be close to a significant bottom (from Ronnie Stoeferle via X)...**

## Asset Managers Most Underweight Commodities vs. Bonds since 03/09

**Net % overweight commodities – net % overweight bonds**




Source: BofA Global Fund Manager Survey

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## BITCOIN AND CRYPTO

**The U.S. SEC officially approved spot Bitcoin exchange traded funds (ETFs) this month (from *The Wall Street Journal*)...**

The first U.S. ETFs that hold bitcoin were cleared Wednesday by the Securities and Exchange Commission. They were hailed by the crypto industry as a game changer that would allow mainstream investors to buy and sell bitcoin as easily as stocks and mutual funds.

Investors responded enthusiastically. More than $4.6 billion of shares across 10 spot bitcoin ETFs changed hands Thursday, according to Dow Jones Market Data. BlackRock's fund had one of the highest-volume days on record for a brand-new ETF. Bitcoin prices edged up 0.5% to top $46,000.

Vanguard wasn't the only platform to limit investor access to the funds. Individual investors said on social-media platform X that they were unable to access the products on the trading platforms operated by Citigroup, Bank of America, Edward Jones and UBS as well.

Some of the hiccups may be because the funds haven't yet been approved by the brokerages' compliance departments. A representative from Citi said the bank is in the process of evaluating the products for individual investors. The other brokerages declined or didn't respond to requests for comment.

Vanguard has a history of limiting investor access to products it thinks are unsafe for investors. For instance, in 2019 it stopped accepting purchases of leveraged and inverse ETFs, citing their risks.

Some crypto enthusiasts expressed anger at Vanguard's move. Neil Jacobs, head of brand engagement at Swan Bitcoin, a bitcoin-investment firm, said he was planning to shift some assets in his personal retirement account into bitcoin ETFs when he discovered Vanguard's restriction. Now, he is planning to dump Vanguard for another provider, he said.

"I want to be treated like an adult," Jacobs said. "Any company that I am a customer of, I want them to treat me with respect. And that's not what I feel here."

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The record for first-day trading volume among ETFs is held by another BlackRock fund, the U.S. Carbon Transition Readiness ETF, which launched in April 2021 with $1.16 billion, according to Morningstar Direct. In second place is ProShares' bitcoin futures fund with $1.01 billion in volume in October 2021.

BlackRock's iShares Bitcoin Trust came in at just over $1 billion on Thursday.

The early days and weeks of trading will be key in ultimately determining winners and losers among the funds, analysts say. Coveted institutional investors are likely to favor the biggest funds with the highest trading volumes and best liquidity. Most of the funds are charging investors low expense ratios and will need to grow into the tens of billions in assets to generate significant profits.

"It's a blockbuster day in terms of new product launches for bitcoin ETFs, but it's only the first inning," said Charles Ragauss, head of trading at Tidal Financial Group. "Due diligence reviews and platform approvals will take time before these ETFs can be purchased at different institutions."

Among the other bitcoin funds, Fidelity Investments' Wise Origin Bitcoin Fund saw $713 million of shares change hands, followed by the fund run by Cathie Wood's ARK Investment Management and 21Shares with $289 million. (The Grayscale Bitcoin Trust, which converted into a spot bitcoin ETF, led the pack with $2.3 billion in trading volume.)

Other funds didn't fare as well. The Valkyrie Bitcoin Fund saw about $9 million of shares changing hands, while the WisdomTree Bitcoin Fund had less than $7 million in trading volume.

In a sign it was struggling to attract interest from investors and professional traders, the WisdomTree ETF experienced wide bid-ask spreads—the difference between the buying and selling price of shares. These spreads grew to more than 75 cents at some points Thursday, while bid-ask spreads for the bigger funds were just a few cents. WisdomTree said it was focused on "cultivating long-term organic demand."

Among the first-day investors in a spot bitcoin ETF was Keith Rauch, a 70-year-old retiree in Wisconsin. Soon after the funds started trading, Rauch initiated a small $10 weekly purchase of the bitcoin fund offered by Fidelity Investments where he has a brokerage account. He said the fund's low fee—zero for the first six months and then 0.25%—appealed to him, but he remains skeptical.

"I'm just sticking my toe in the water to see if I can live with this," he said. "In six months, I might be out of it or I might be increasing."

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An 11th fund didn't start trading as expected. The SEC has yet to clear the registration filing from Brazilian crypto investment firm Hashdex.

Unlike the other ETF hopefuls, Hashdex was seeking to convert its existing futures-based bitcoin fund into a spot bitcoin fund that holds actual bitcoins. The fund is still trading as a bitcoin futures ETF under the ticker DEFI. Hashdex said in a statement its fund will convert to hold bitcoin directly at a later date.

Continue reading here (subscription may be required).

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**Why Bitcoin ETFs matter (from Timothy Peterson, CFA CAIA via X)...**

This post explains the rationale for Bitcoin ETFs over self-custodied Bitcoin. (Speaking from experience, but not necessarily an endorsement of such ETFs):

ETFs fill a need and are designed to permit exposure to Bitcoin for professional, registered investment advisors in the US and others in the traditional investment system. Money managers in particular have unique circumstances as compared to individual investors.

Imagine you are an investment manager with 250 client accounts (an average-sized separate account manager would have 400). Owning Bitcoin means setting up another 250 accounts - major work with not a lot of reward. If you want to rebalance (stocks/bonds/Bitcoin) you have 250 transfers to make. This doubles the administrative workload and makes operational life very complicated. That is lots of work for a 5-10% allocation (or less!) to $BTC.

Client reporting is a nightmare. There are at least two sets of custodian statements that are not easily combined. A typical client already has 3 accounts, now it is 6 accounts & 6 statements, and there are few software feeds to consolidate data from crypto exchanges into traditional portfolio reports.

Tax advantages: Bitcoin ETFs can be held in an IRA, tax-deferred. Over the long run, you get most of the BTC return with far less tax liability, usually a net positive. This also simplifies transfer to heirs, a process that is automatic for securities but potentially crippling for self-custodied or exchange-custodied Bitcoin.

Regulatory simplicity: Many state and federal regulators hate Bitcoin. They can halt an investment advisor's operations on that basis, or at least make life hell. An ETF is a stock. Regulators may not like it but if the advisor is within the law there is nothing they can do.

So, for a registered investment advisor, a Bitcoin ETF is Bitcoin wrapped in equity. This allows the square peg of Bitcoin to fit in the round hole of the TradFi system. Maybe one day this will change, but that is how it is today. This “workaround” solves lots of problems and creates some benefits in a financial industry that is not yet aligned (operationally and regulation-wise) to accommodate BTC.

These ETFs are backed by actual Bitcoin held securely. As one person put it, if the average person can’t keep track of their car keys, how can you expect them to keep track of their cryptographic keys? The average person is not a cypherpunk and does not want to deal with seed phrases and Shamir’s Secret Sharing. You can think of an ETF as outsourcing your custody to a firm specializing in Bitcoin custody.

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For those who are so inclined, nothing prevents you from owning and securing your Bitcoin in a hot or cold wallet. In fact, having some set aside that is exclusively in your control is probably a good idea. The world economy is probably not going to collapse today or tomorrow, but if it does you might at least have something.

But it is also a good idea to diversify the 'operational risk' associated with conventional Bitcoin custody. It may even be wise to own several Bitcoin ETFs, each with different custodian arrangements.

Bitcoin ETFs allow exposure to BTC that would not otherwise exist. Just as Lighting Network is an overlay on top of Bitcoin to facilitate transactions, ETFs are an overlay that facilitates savings by the masses in traditional savings vehicles.

Complaining that an ETF is not really Bitcoin is not only misleading, it misses the point. Anything that facilitates adoption is good for Bitcoin ("Bitcoin Spreads Like a Virus")

True, an ETF is a legal/paper construct. If you own a home, did you pay for it in #gold coins, build a moat around it, and fortify it with cannons? No, you rely on legal social conventions – paper – to pay for it and secure the rights to your property. So it is with most things in life, and society is better for it.

Bitcoin: Virus in numeris.

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**Global-banking-giant Standard Chartered forecasts Bitcoin ETFs could ultimately see inflows of $50 to $100 billion this year (from Bitcoin Archive via X)...**

standard chartered

Digital Assets

Global Research
8 January 2024

# Bitcoin – Price upside from US spot ETF approval

- **The US SEC is expected to approve spot ETFs for Bitcoin imminently**
- **ETF approval could create significant BTC price upside, based on the historical experience of gold ETPs**
- **We see price gains materialising faster for BTC than for gold as BTC ETF market matures more quickly**
- **We look for USD 50-100bn of inflows to Bitcoin ETFs in 2024, opening up potential for BTC to reach the USD 200,000 level by end-2025**

## Go with the flow

The US Securities and Exchange Commission (SEC) is expected to approve spot ETFs for Bitcoin (BTC) as soon as this week. ETF approval is a key driver of BTC price upside, as we recently outlined (*Bitcoin – On track for USD 100,000 level by end-2024*). We see this as a watershed moment for normalising Bitcoin participation by institutional money, and we expect approval to drive significant inflows and price upside for BTC.

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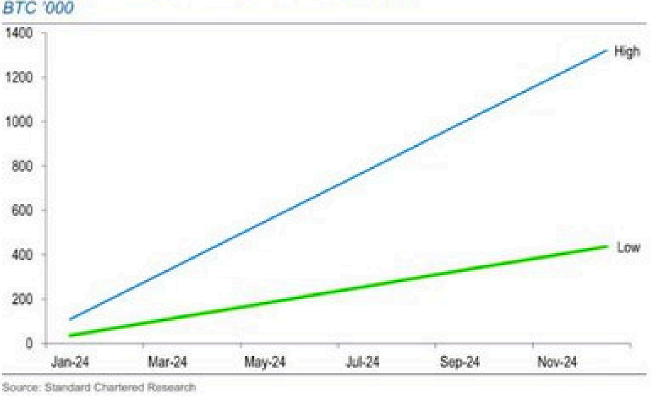
To gauge how big a driver this might become, we use the introduction of the first US-based gold ETP (in November 2004) as a point of comparison. The price of gold rose 4.3x in the seven to eight years it took for gold ETP holdings to mature after the first ETP was introduced.

We expect Bitcoin to enjoy price gains of a similar magnitude as a result of US spot ETF approval, but we see these gains materialising over a shorter (one- to two-year) period, given our view that the BTC ETF market will develop more quickly. This is consistent with our end-2024 view of Bitcoin at the USD 100,000 level. If ETF-related inflows materialise as we expect, we think an end-2025 level closer to USD 200,000 is possible. This assumes that between 437,000 and 1.32mn new bitcoins will be held in spot US ETFs by end-2024. In USD terms, this should be roughly USD 50-100bn.

**Figure 1: Estimated 2024 inflows to spot BTC ETFs**
*BTC '000*




Source: Standard Chartered Research

If you are in scope for MiFID II and want to opt out of our Research services, please *contact us*.

Issuer of Report: Standard Chartered Bank

Important disclosures and analyst certifications can be found in the Disclosures Appendix

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https://research.sc.com

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**Bitcoin ETFs represent a "spiritual reversal" of the U.S. government's confiscation of gold (from balajis.com)...**

History is running in reverse.

Ninety years ago, FDR and his fellow travelers rode the 20th century arc of centralization. The chokepoints of then-new technologies for mass media and mass production allowed them to gain control over the population, recruit top talent for their "Brain Trust", and seize the gold after a series of epic legal battles.





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Those gold clause cases are forgotten today, but received as much contemporary coverage as 9/11 or the Moon Landing. They were the most important issue in the country, receiving far more coverage than seemingly comparable Supreme Court decisions like Roe vs Wade. Why?

news and business sections. The decisions received significantly more coverage in the *Times* than did other major New Deal cases. For perspective, the number of articles devoted to them more closely resembles that of historic moments like the moon landing or 9/11 attacks than it did other major Supreme Court decisions such as *Roe v. Wade*. The phrase "gold clause" appeared in more *Times* articles (49) on the day after the decisions than did "poultry," (10) "minimum wage," (19) and "abortion" (15) combined, on the days after *Schecter*, *West Coast Hotel*, and *Roe*.[9] Academics also touted the cases' magnitude and import. A month after the decisions,

From Glick's article.

The reason is that the transition from a gold-backed to fiat-backed system was comparable to a soft communist revolution, as the *visible* seizure of gold laid the groundwork for the *invisible* seizure of wealth via money printing.

And the classically trained judges at that time fully understood this. Justice McReynolds' then-famous dissent denounced the ruling in the harshest terms, noting that the "Constitution is gone" and the "dollar...may be 30c tomorrow, 10c the next day, and 1c the day following."





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tractual obligations. Perhaps the attitude of Justice McReynolds upon the subject of contract impairments can best be appreciated by considering his dissenting opinion in the *Gold Clause Cases*.[18] The oral utterance of the Justice when the opinion in the first case was announced by the Chief Justice has become famous, and familiar to every newspaper reader.[19] The studied later expression of dissent in all four cases [20] is not so well known, at least to the laity. In that carefully reasoned dissent, written with due regard to the statutory situation and the decisions of the English, International and American Courts, McReynolds expands his views as to the sacredness of

16. 290 U. S. at 448.

17. Block v. Hirsh, 256 U. S. 135, 41 Sup. Ct. 458, 65 L. Ed. 865 (1921); Marcus Brown Holding Co. v. Feldman, 256 U. S. 170, 41 Sup. Ct. 465, 65 L. Ed. 877 (1921).

18. Norman v. Baltimore & Ohio R. R., 294 U. S. 240, 55 Sup. Ct. 407, 79 L. Ed. 885 (1935); Nortz v. United States, 294 U. S. 317, 55 Sup. Ct. 432, 79 L. Ed. 912 (1935).

19. "It seems impossible to over estimate the result of what has been done here this day. . . . God knows, I do not want to talk about such matters but it is my duty. . . . The Constitution is gone . . . this is Nero in his worst form. We are confronted with a dollar which has been reduced to 60c which may be 30c tomorrow, 10c the next day and 1c the day following.

"We have tried to prevent its entrance into our legal system but have tried in vain. . . ." Time, Feb. 25, 1935, p. 11, col. 3; N. Y. Times, Feb. 19, 1935, p. 15.

20. 294 U. S. 361-81.

From the McReynolds biography.

McReynolds was right. While the court was forced into a grudging institutional surrender by FDR's threat of court-packing[2], the gold clause case affected every economic decision-maker in the country, as it amounted to the US government explicitly defaulting on its bonds by seizing the assets of its citizens, laying the groundwork for the century of monetary debasement to come.

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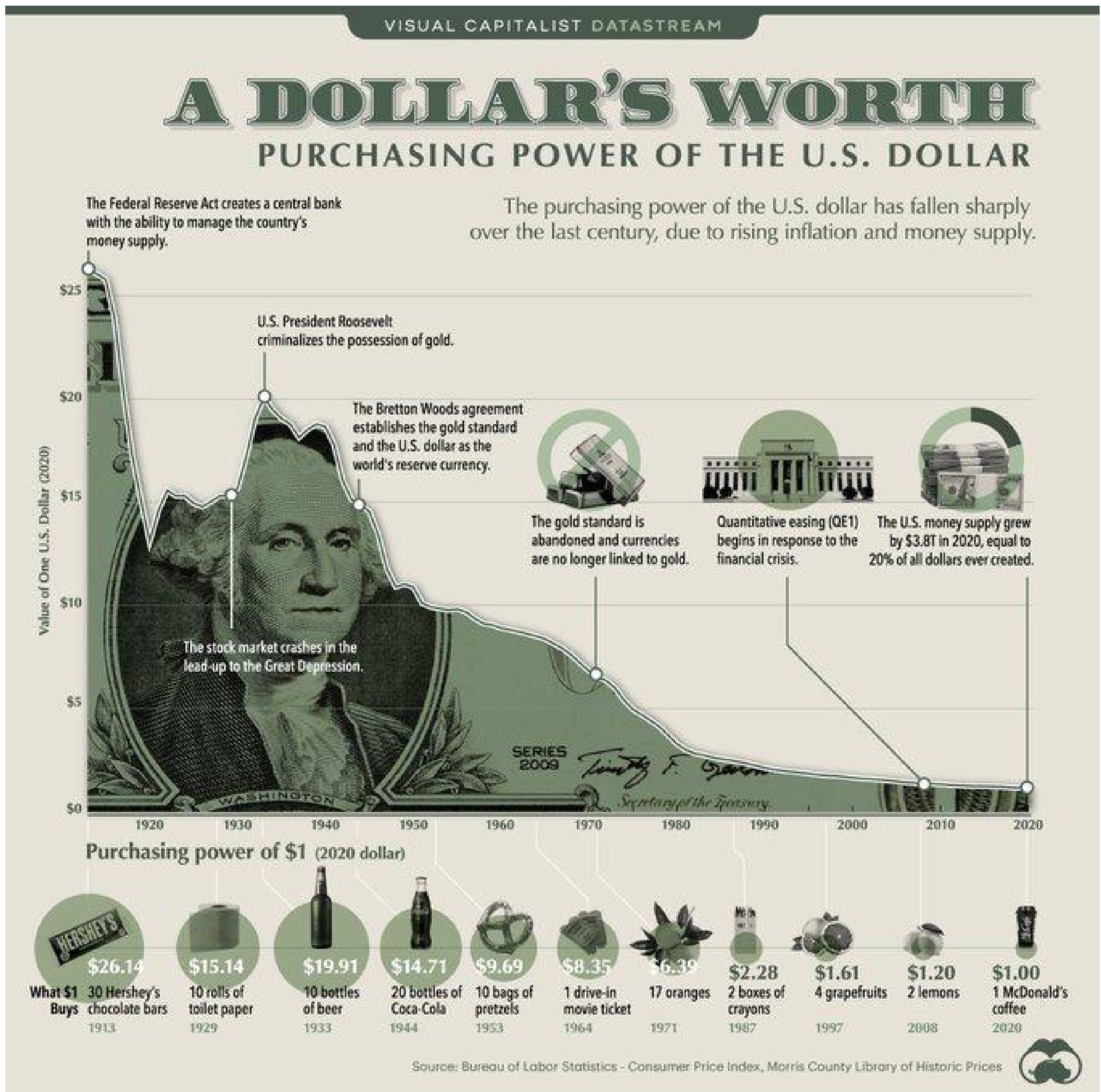


Now all of that is unwinding. FDR's team could ride the wave of centralizing technology that built giant states around the world. But today, technology favors *decentralization* — personal computers, end-to-end encryption, mobile phones, and of course cryptocurrency.





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Thus, top talent isn't being pulled into a government Brain Trust. It's being brain drained *out* of the US establishment. And as a consequence the epic legal battles are, on balance, going our way.

It's not just the DC Circuit case. The ideological conflict between decentralization and centralization is reflected in the 3-2 vote for the Bitcoin ETF approval itself. Read Peirce's brilliant pro-liberty approval, Crenshaw's dour denial, and Gensler's reluctant approval.

You'll see echos of the gold clause case, but in reverse. This time, it is the centralized state that is being forced into a grudging institutional surrender. And a surrender it is, as Crenshaw's dissent makes clear:

> "...there is no primary regulator for the bitcoin spot markets. Spot bitcoin ETPs will be participating in an unregulated, fragmented, continuously traded, global free-for-all. Even if there were a primary regulator for this market, much of it could be beyond the reach of U.S. regulation..."

Let that sink in! This is what the US establishment truly fears: not Bitcoin as "fraud," but Bitcoin as freedom. They want to rule not just you, but the world, so they're scared of the prospect of "a global free-for-all... beyond the reach of US regulation." And they know that any spot ETF will bid up the price of self-custodied Bitcoin outside their control, as Satoshi intended.

So: since FDR's seizure of gold, our lives have revolved around the centralized state rather than the decentralized market. The state has had control for so long we've forgotten what freedom is like. But now gold is slipping out of their hands, and back into yours.

And history is running in reverse.

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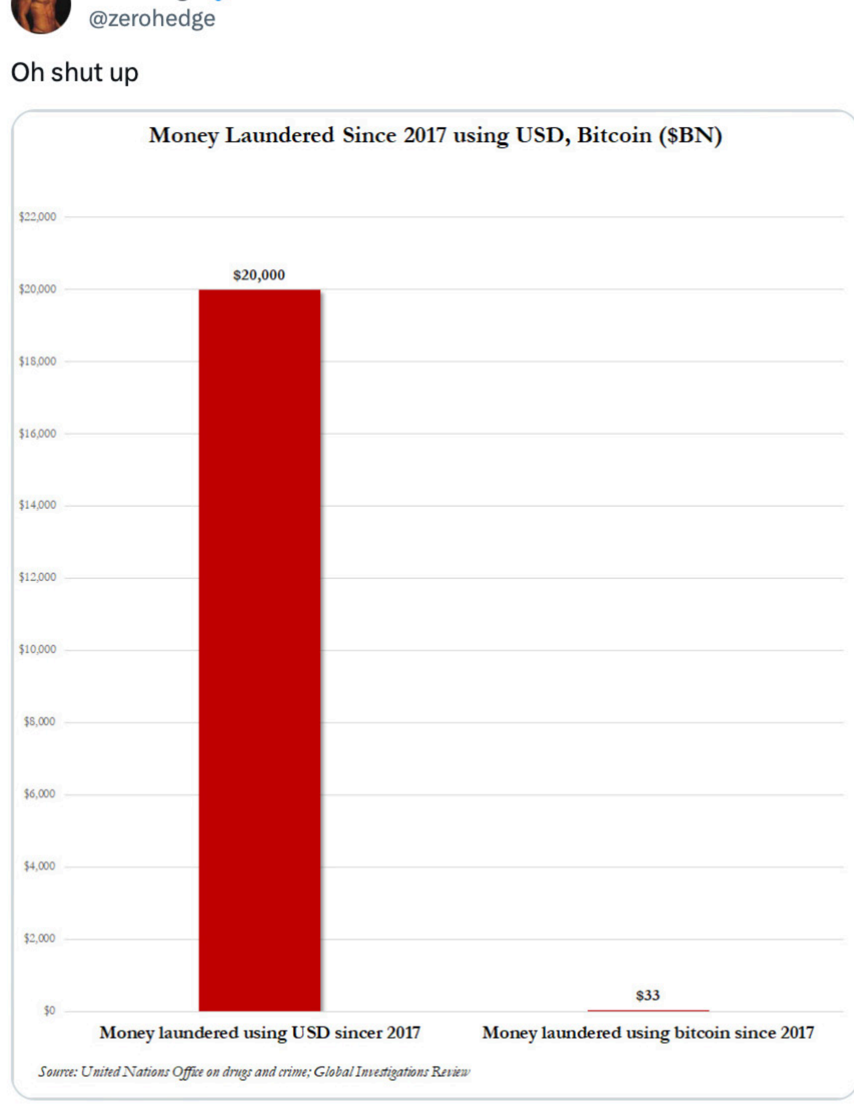
**Remember this chart the next time a disingenuous politician claims Bitcoin facilitates money laundering (from zerohedge via X)...**



The @SECgov is wrong on the law and wrong on the policy with respect to the Bitcoin ETF decision.

If the SEC is going to let crypto burrow even deeper into our financial system, then it's more urgent than ever that crypto follow basic anti-money laundering rules.



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**Bitcoin is already the second largest commodity ETF asset (from Bitcoin Archive via X)...**

JUST IN: #Bitcoin overtakes silver to become the second biggest commodity ETF.

1. Gold - $96b

2. BITCOIN - $27.5b

3. Silver - $11.5b

It's just week 1...

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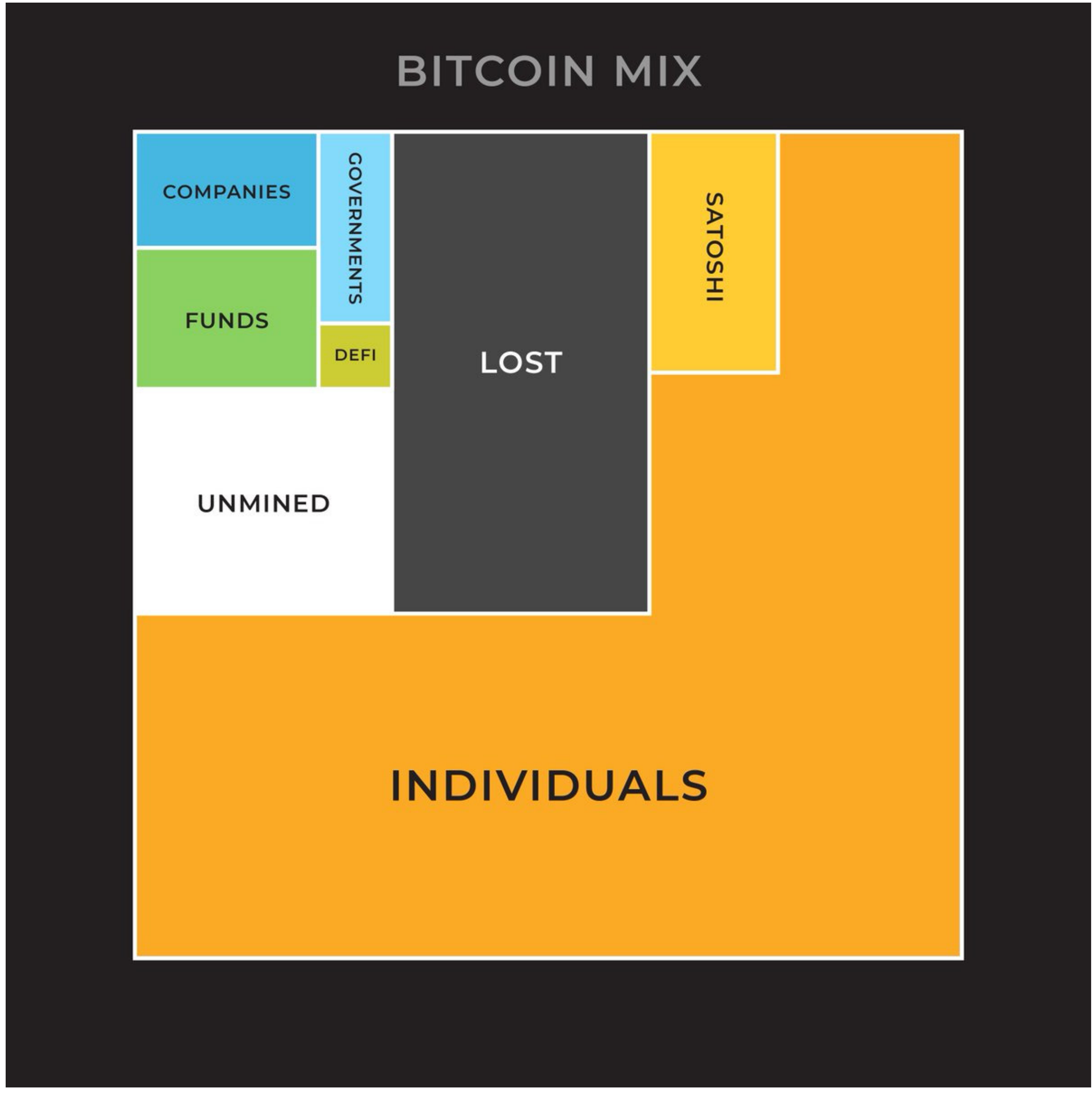
**You may be surprised to learn who owns the most Bitcoin (from Walker via X)...**

Twice as much #bitcoin is LOST as is currently controlled by institutions and governments.

Only a tiny fraction of the world owns bitcoin, and after the halving in April, only 1.3125 / 21M @btc will be left to be mined.

It might make sense to get some, just in case it catches on.





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# NOTABLE INSIDER BUYING

*From SEC Form 4 Filings by Top Executives and 10% Owners This Month*

| Stock Purchased/Sold | Ticker | Total Buy Value | Total Sell Value | Total Buy Filings | Total Sell Filings |
|---|---|---|---|---|---|
| TALOS ENERGY INC. | TALO | $230,000,000 | $0 | 1 | 0 |
| Liberty Media Corp | LSXMK | $84,970,848 | $0 | 2 | 0 |
| LIBERTY MEDIA LLC | LSXMK | $82,137,534 | $0 | 2 | 0 |
| PBF Energy Inc. | PBF | $74,499,366 | $0 | 2 | 0 |
| BlackRock ESG Capital Allocation Term Trust | ECAT | $28,302,356 | $0 | 12 | 0 |
| Dyne Therapeutics Inc. | DYN | $29,999,988 | $5,277,445 | 1 | 2 |
| Solid Biosciences Inc. | SLDB | $23,861,247 | $38,319 | 2 | 2 |
| Palmer Square Capital BDC Inc. | PSBD | $11,999,979 | $0 | 3 | 0 |
| BlackRock Capital Allocation Term Trust | BCAT | $10,693,015 | $0 | 5 | 0 |
| KalVista Pharmaceuticals Inc. | KALV | $11,048,031 | $360,453 | 5 | 1 |
| BlackRock Health Sciences Term Trust | BMEZ | $10,672,199 | $0 | 5 | 0 |
| Viridian Therapeutics Inc. | VRDN | $9,999,990 | $0 | 1 | 0 |
| BlackRock Innovation & Growth Term Trust | BIGZ | $9,185,309 | $0 | 5 | 0 |
| Elicio Therapeutics Inc. | ELTX | $7,047,530 | $0 | 1 | 0 |
| STAAR SURGICAL CO | STAA | $6,591,127 | $0 | 2 | 0 |
| LIVEPERSON INC | LPSN | $6,294,269 | $0 | 1 | 0 |
| Verrica Pharmaceuticals Inc. | VRCA | $5,561,324 | $0 | 2 | 0 |
| Celularity Inc | CELU | $5,331,335 | $0 | 1 | 0 |
| HighPeak Energy Inc. | HPK | $4,584,782 | $0 | 2 | 0 |
| OPKO HEALTH INC. | OPK | $4,495,798 | $0 | 11 | 0 |
| Evolve Transition Infrastructure LP | SNMP | $4,268,541 | $0 | 2 | 0 |
| Syros Pharmaceuticals Inc. | SYRS | $3,999,998 | $0 | 1 | 0 |
| UNIFI INC | UFI | $2,875,000 | $0 | 1 | 0 |
| NUVEEN PENNSYLVANIA QUALITY MUNICIPAL INCOME FUND | NQP | $2,239,303 | $0 | 6 | 0 |
| TILLY'S INC. | TLYS | $2,154,106 | $0 | 5 | 0 |
| Chavant Capital Acquisition Corp. | MOBX | $1,997,370 | $0 | 1 | 0 |
| My City Builders Inc. | MYCB | $1,900,000 | $0 | 2 | 0 |
| Globalstar Inc. | GSAT | $1,827,500 | $0 | 2 | 0 |
| NUVEEN NEW JERSEY QUALITY MUNICIPAL INCOME FUND | NXJ | $1,683,291 | $0 | 6 | 0 |
| INTERNATIONAL TOWER HILL MINES LTD | THM | $1,506,122 | $0 | 1 | 0 |
| Athira Pharma Inc. | ATHA | $1,462,895 | $17,541 | 1 | 2 |
| Marpai Inc. | MRAI | $1,216,464 | $0 | 3 | 0 |
| MainStay CBRE Global Infrastructure Megatrends Term Fund | MEGI | $1,073,524 | $0 | 3 | 0 |
| NEXTNAV INC. | NN | $1,172,775 | $100,200 | 1 | 1 |
| BLACKROCK MUNIYIELD PENNSYLVANIA QUALITY FUND | MPA | $1,040,618 | $0 | 4 | 0 |
| Annexon Inc. | ANNX | $1,008,000 | $4,055 | 1 | 1 |
| OLB GROUP INC. | OLB | $900,001 | $0 | 2 | 0 |
| Compass Diversified Holdings | CODI | $795,108 | $0 | 8 | 0 |
| PIONEER MUNICIPAL HIGH INCOME FUND INC. | MHI | $750,736 | $0 | 2 | 0 |
| One World Products Inc. | OWPC | $739,048 | $0 | 2 | 0 |
| Invesco Trust for Investment Grade New York Municipals | VTN | $789,470 | $91,665 | 4 | 1 |
| AGREE REALTY CORP | ADC | $656,985 | $0 | 1 | 0 |
| MERRIMACK PHARMACEUTICALS INC | MACK | $651,754 | $0 | 1 | 0 |
| AMREP CORP. | AXR | $595,812 | $0 | 5 | 0 |
| TILE SHOP HOLDINGS INC. | TTSH | $579,916 | $0 | 2 | 0 |
| Destra Multi-Alternative Fund | DMA | $560,510 | $0 | 4 | 0 |

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| Stock Purchased/Sold | Ticker | Total Buy Value | Total Sell Value | Total Buy Filings | Total Sell Filings |
|---|---|---|---|---|---|
| BNY MELLON MUNICIPAL INCOME INC. | DMF | $550,470 | $0 | 6 | 0 |
| ASSEMBLY BIOSCIENCES INC. | ASMB | $511,264 | $0 | 1 | 0 |
| NB Bancorp Inc. | NBBK | $469,092 | $0 | 8 | 0 |
| Kimbell Royalty Partners LP | KRP | $460,856 | $0 | 1 | 0 |
| Kayne Anderson Energy Infrastructure Fund Inc. | KYN | $441,800 | $0 | 1 | 0 |
| Invesco Pennsylvania Value Municipal Income Trust | VPV | $437,741 | $0 | 4 | 0 |
| PIONEER MUNICIPAL HIGH INCOME ADVANTAGE FUND INC. | MAV | $402,022 | $0 | 4 | 0 |
| EBIX INC | EBIX | $376,280 | $0 | 1 | 0 |
| Texas Pacific Land Corp | TPL | $361,710 | $0 | 20 | 0 |
| Allied Gaming & Entertainment Inc. | AGAE | $353,523 | $0 | 2 | 0 |
| CME GROUP INC. | CME | $340,014 | $0 | 2 | 0 |
| SIMON PROPERTY GROUP INC | SPG | $325,245 | $0 | 10 | 0 |
| FEDEX CORP | FDX | $302,663 | $0 | 2 | 0 |
| DWS STRATEGIC MUNICIPAL INCOME TRUST | KSM | $294,736 | $0 | 4 | 0 |
| Zivo Bioscience Inc. | ZIVO | $254,999 | $0 | 2 | 0 |
| RANGE IMPACT INC. | RNGE | $250,000 | $0 | 2 | 0 |
| Lovesac Co | LOVE | $236,594 | $0 | 1 | 0 |
| Western Asset Diversified Income Fund | WDI | $233,115 | $0 | 1 | 0 |
| FB Financial Corp | FBK | $217,980 | $0 | 3 | 0 |
| DORIAN LPG LTD. | LPG | $212,900 | $0 | 1 | 0 |
| Cell MedX Corp. | CMXC | $205,606 | $0 | 2 | 0 |
| CASEYS GENERAL STORES INC | CASY | $199,687 | $0 | 1 | 0 |
| Collective Audience Inc. | CAUD | $186,168 | $0 | 6 | 0 |
| EATON VANCE NEW YORK MUNICIPAL BOND FUND | ENX | $183,736 | $0 | 1 | 0 |
| SYNCHRONOSS TECHNOLOGIES INC | SNCR | $179,056 | $0 | 3 | 0 |
| Avid Bioservices Inc. | CDMO | $202,036 | $23,161 | 1 | 2 |
| Southland Holdings Inc. | SLND | $164,256 | $0 | 5 | 0 |



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