NAPLES GLOBAL ADVISORS

MARKET INSIGHTS

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> *Inspiration is a guest that does not willingly visit the lazy.* - Peter Tchaikovsky

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As Tchaikovsky summarized, inspiration and a strong work ethic tend to be highly correlated. Given the world's perpetual connectivity, keeping busy is rather easy, but that is not the same thing as being productive. There are distractions aplenty in our everyday lives, but as Denzel Washington explained, "don't confuse constant movement with progress." Are we sounding too philosophical? Don't worry, we will stay in our lane. The philosophical linkage to the financial markets is the surprising array of initial public offerings (IPOs) in 2021 that ended up being uninspiring. From celebrity endorsed SPACs (Special Purpose Acquisition Company) that circumvent battle scarred listing requirements to practically affixing "wouldn't it be nice" as the core business plan, we have seen a colorful section of masterly marketed companies coaxing billions of dollars of capital from its zero-interest rate lair.

While floods of monies have rushed into IPOs this year, we are less sanguine on the immediacy of need for direct shipped organic baby food… None the less, *Little Spoon* was able to gather in $200 million of fresh capital. Also in the IPO maze, an electronic flying taxi, labeled as urban air mobility, garnered a $7 billion market cap. The time to final production for an electric air transport vehicle via the FAA process is daunting, never mind the serviceable market. If flying taxis seem like an anomaly, how about plopping capital into a glamorous hot dog-based restaurant chain? The IPO for *Portillo's Hot Dogs* pushed the franchise to a $3.1 billion market cap. Not to be outdone by a vegetable focused restaurant, *Sweetgreen*, which jumped to a $4.3 billion market cap. Even *Starbucks* wasn't immune, with a dynamic competitor, *Dutch Brothers Coffee*, coming in around $8.6 billion. We noted the lowest price to earnings ratio of the group at 316x earnings; all of a sudden *Starbucks* seems relatively cheap at 32x earnings.

If NGA doesn't put monies in these IPOs, why the preoccupation? Well, it matters within the context of overall market dynamics, sentiments, volatility, and the skewing of relative comparisons. As such, we evaluate the deals bankers are presenting, staying attuned to directional flows and to the types of securities being consumed in the financial markets. The quality of the NGA diet, so to speak, hasn't changed, but we can see from the caloric labels there's a lot of "junk food" on the menu. What typically follows these overvalued IPOs is a period of indigestion, in the form of pivoting capital once the IPO excitement wears off, trade restrictions are lifted, stock options are exercised, and last but not least the financial reporting gets real. Analyzing deal flows lessens the risk of our making a knee jerk reaction during corrective periods and provides us the confidence to take on glaring opportunities in a mispriced world wholly distracted by any number of "busy" new offerings.

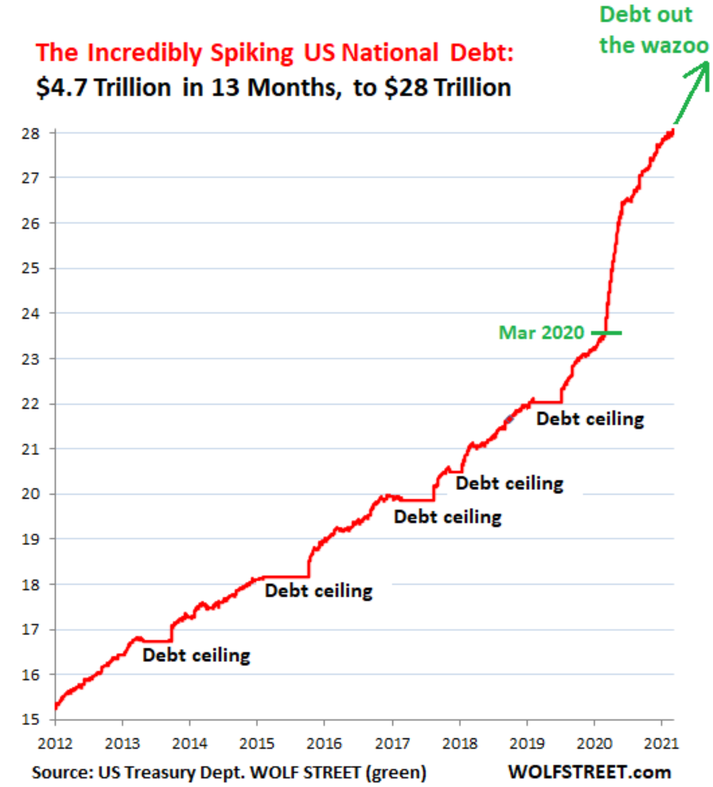
Still, market mispricing isn't really a new phenomenon, even if it is currently inflamed. And it is just one part of the current market story. Consider the slivers of light which have emerged from the pandemic in the form of corporate innovations and the speed of advancement. For us there are two basic screens for weighing compelling and investable corporate innovation: staying power and associated profitability. A relatable example is identified in the picture from a hamburger chain's test of Flippy the French Fry robot. Flippy is practically perfect in every way: Flippy doesn't get burned by hot oil (or doesn't flinch if it does), doesn't get Covid, and doesn't need a daily break (smoke, union, or otherwise). In

Photo credit: CNN Business

a world of litigation, employee shortages, and human frailty, robotic automation is both an immediate and long-lived contributor to many industrial needs and is a segment that has our investment ear.

Thinking a bit bigger than Flippy, consider wind turbines, both onshore and offshore, and the related supply chain. According to Bloomberg estimates, creating wind turbines capable of 1 gigawatt of power (roughly the equivalent of two coal fired power plants powering 750,000 homes) requires **387 tons of aluminum, 2,866 tons of copper**, and **154,352 tons of steel**. Additionally, the lithium-ion batteries needed to store that 1 gigawatt of energy require **729 tons of lithium, 1,202 tons of aluminum,** and **1,731 tons of copper**. If that sounds like a lot of material, it is. Add in a dash of nickel and a schtickle of manganese for strengthening and corrosion resistance, and we find that to electrify above the ground (and water), we still need to remove materials from below the ground. Factor in the refining, transporting, connecting, monitoring, and maintaining that are all process integrated, and suddenly a nice cash loop emerges. Source coders working from a San Jose basement can't quite deliver these items, so it is the full innovative collection which has our investment ear.

Leaving the exciting world of IPOs and innovation for the staid world of U.S. government debt might seem incongruous. However, given the amount of analytical head scratching both are causing, it turns out they aren't really too far apart. See the chart below regarding the U.S. Government debt explosion (for lack of a better term).



At $25 trillion plus, recognize there is **no capacity, effective timeline, or political intention of ever "paying off" the U.S. debt**. As an American taxpayer and business owner, it is perplexing to think in those terms (keep borrowing and never paying back) but as a global analyst, the reality of the situation is evident. That is, the U.S. government has the capacity to service, but not reduce with any measurable difference, the massive debt it has taken on the balance sheet. This circumstance remains a focal point of concern because of the associated interest rate impact in addition to the direction of the U.S. dollar and our purchasing power parity, as measured globally. When and exactly how this phenomenon is manifested is uncertain and feels problematic.

We have conceded that the Federal Reserve Board has reinvented itself. That is, its historical independence is no longer applicable, and the usage of any meaningful fiscal discipline has termed out. Yet, Fed board members are statistically well-informed, and no doubt mindful of the explicit budgetary cost of their raising interest rates. It seems logical, therefore, that the Fed will continue to be slow to act, corralling rates while in full view of renewed inflation. As to the fate of the U.S. dollar, perhaps the trajectory appears obvious but the pace less so. Be mindful that we operate in a relative world of populist leadership, and with only three reserve currencies of any capacity (Dollar, Yen, Euro), there is no clear-cut "biggest loser" among them. They are all profligate at the government spending level. Living in a world of crises and cross currents, be prepared for a glacial crawl downward for our dollar, but not a third world death spiral. So, our clients can thrive inside our borders by identifying earnings growth which stays in front of inflation's torrid pace, as well as outside our borders via ownership of fiscally disciplined foreign companies.

Finally, with a decade under our belt as an independent advisor, we have been experiencing generational transitions within our client base. While emotionally challenging to all, individuals and families are finding solace when they have a sound plan in place and an experienced team with known connections to the family. The passing of a matriarch or patriarch is heart wrenching but getting lost in corporate bureaucracy or a static legal system adds unnecessary delays and stresses. In our experience, generational transitions can occur smoothly with proper up-front planning and advisor familiarity with intent. If you seek additional guidance in this area (including a generational pow wow), please let us know. We are prepared to help.

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