



# Wealthpin **Pro**

**FEBRUARY 2023**

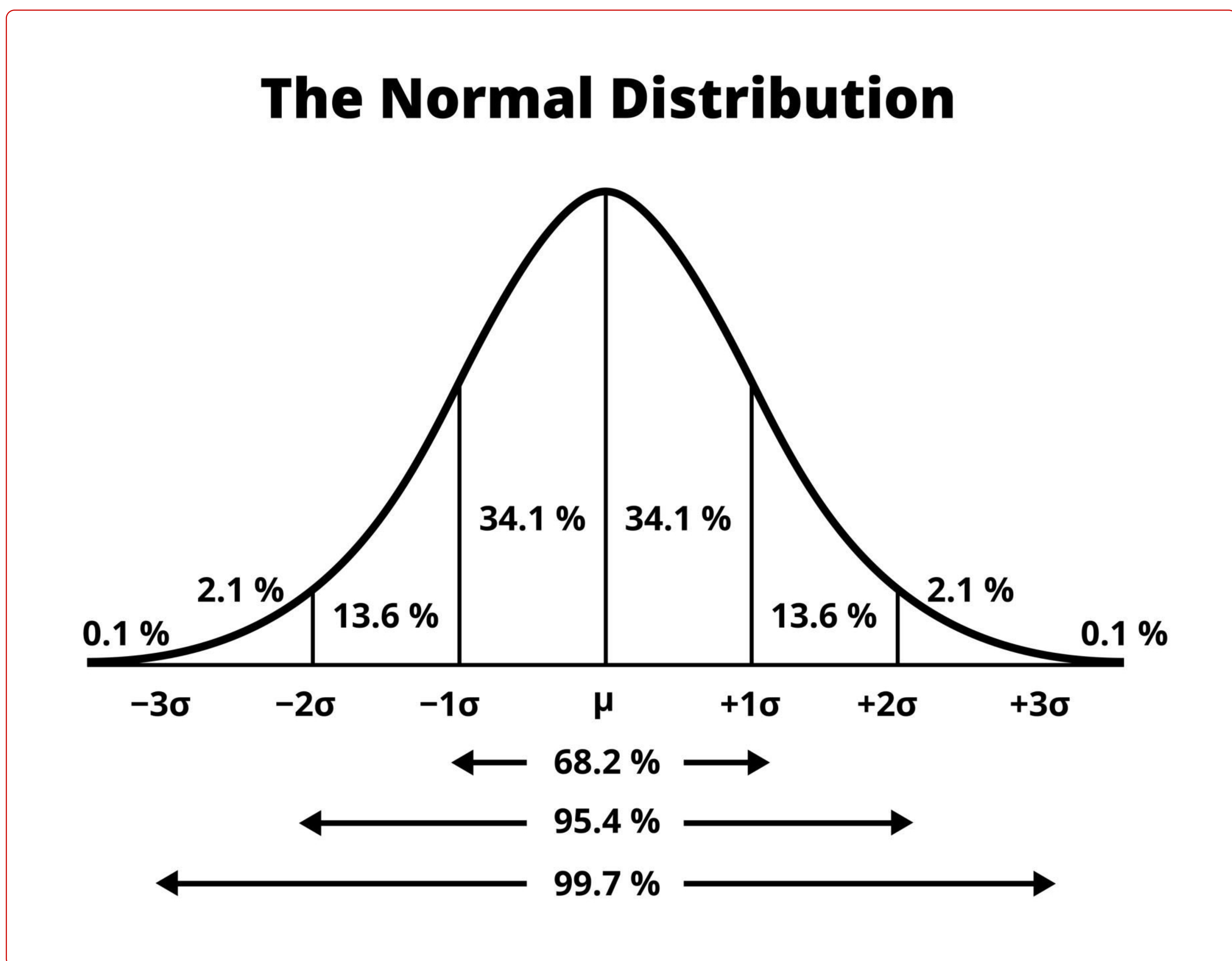
## THEY NEVER SAW IT COMING

Weird happenings are afoot.

Last week, the January jobs report was released. And boy was it a big one.

517,000 jobs were added in January. That blew away the consensus expectations of just 188,000 jobs.

To say this is a surprise is an understatement. This jobs report was an 8-sigma beat. If you don't know what an 8-sigma is, allow me to explain:



Statistical datasets organize themselves into standard distributions. And a bell curve allows us to quantify how far above or below the mean that a piece of data is. Most datapoints will fall into the middle of the bell curve. As you approach the tails, the results get rarer and rarer.

As you can see from the graphic above, a 3-sigma result is at the very end of the tails. But the jobs report that we got last week was an 8-sigma. Which means the likelihood of the results was about the same as winning a \$1 million off a scratch off lottery ticket while simultaneously getting struck by lightning.

In other words, pretty much statistically impossible.

Not only did new payrolls come in three times higher than expected, but the unemployment dropped to 3.4% -- the lowest unemployment rate since 1969.

Literally nobody was expecting this. But what does it mean?



## RECESSION = CANCELED

A few weeks ago, I wrote a piece titled: "Did the Recession Already Happen and We Missed It." Just so we're all on the same page, here it is:

*Well, it seems like we've been waiting for a recession for over a year now. Maybe even longer.*

*And now, Wall Street is telling us that we will most certainly, definitely, without a doubt hit a recession in 2023.*

*Just look at this recent Wall Street Journal headline:*

### **Big Banks Predict Recession, Fed Pivot in 2023**

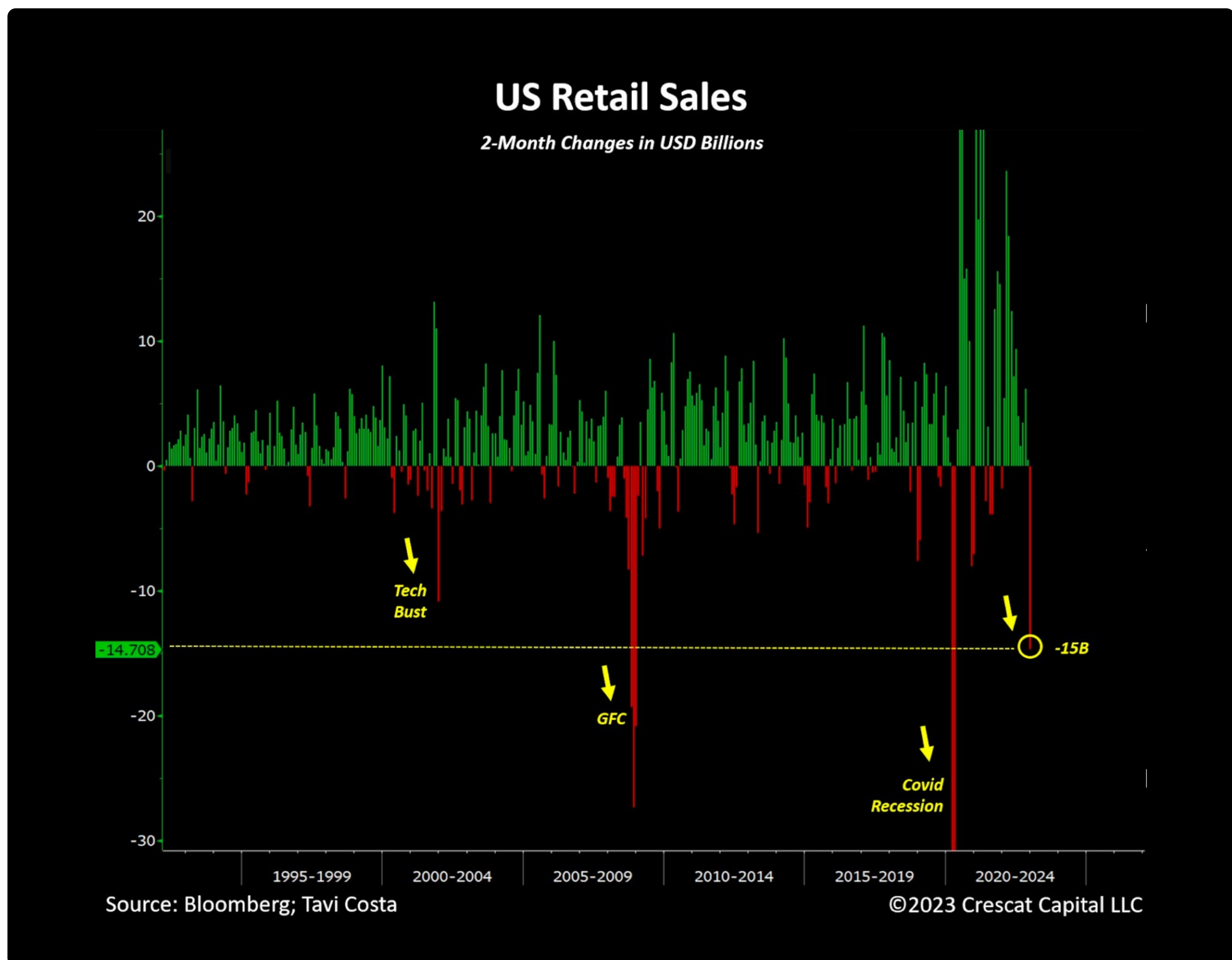
More than two-thirds of economists at 23 major financial institutions expect the U.S. to have a downturn this year

*The tech sector is shedding jobs like there's no tomorrow.*

*Layoffs are spreading to IBM, SAP, and Dow.*

*And in Q4 retail sales dropped off a cliff — the only other drops that were bigger were during the COVID outbreak, the Global Financial Crisis, and the Dot-Com collapse.*

*Take a look at this chart by **Tavi Costa** on Twitter:*



*So, the signs are all there that we're either in or hurtling towards an economic downturn.*

*Or are they?*

*What if we've already hit a recession, gone through a recession, and come out the other side?*

***Here me out:***

*First, let's look at jobs. While 10,000 workers laid off at Google may seem like a lot of jobs, in reality, it's not.*

*In a dynamic economy like the United States, there's an ambient level of labor market turnover.*

*Under average conditions, 6 million people either lose their job or exit the labor force every month. Meanwhile, 4.5 million either get a new job or enter the labor force each month.*



*So, not to diminish anyone losing their job, but numbers-wise, 10,000 jobs is nothing when compared to the overall labor market.*

*Not only that, but while Google, Amazon, and IBM might be shedding employees, other companies like Chipotle and Airbus are going on hiring sprees. (Chipotle just announced it will hire 15,000 additional workers)*



*So, while tech, banking, and office workers may be losing their jobs, workers in the hospitality/leisure, food, and retail are still going strong.*

*The four week moving average of jobless claims was 197,500, almost exactly where it was pre-pandemic.*

*And let's not forget that the recent tech layoffs are coming after a decade of virtually unlimited growth in Silicon Valley. I mean, it was a truly unprecedented hiring spree.*

*But let's dive a little deeper, and go away from the headlines.*

*Let's look at one of the strongest economic signals there is:*

## ***Trucking.***

*Most people don't think about it all too much, but it's the lifeblood of the American economy.*

*The trucking industry is responsible for transporting 70% of our nation's freight.*

*15% of all registered vehicles are commercial trucks.*



*And all of those trucks move as much as 11 billion tons of product around our borders, worth a whopping \$772 billion.*

*Of course, in a recession, people buy less. So, there's less freight being carried by American trucks.*

*You can watch this interplay between demand vs. supply in the trucking freight rates.*

*There's two types of rates.*

- 1** *The spot rate, which is nothing more than a short-term deal made on the shipping price of a product.*
- 2** *And the contract rate, which is a longer term deal made between carriers and shippers.*

*The spread between these prices can be used to gauge freight demand, and thus, economic activity.*

*If the spot vs. contract spread is higher, that means that there's more people shipping more goods. Which means there's more demand for freight trucks, so they can charge higher prices.*

*When the spot vs. contract is lower, that means there's less people shipping less goods. Which means there's less demand for freight trucks, so they have to lower their prices.*

*Take a look at this great chart provided by Craig Fuller over at FreightWaves.*



*In 2020, you can see the spot price (economic demand) falling precipitously. Which makes sense, considering we were locked down. But then, as things opened back up and all that pent-up demand was unleashed, the spot rates skyrocketed.*

*Everyone was trying to get products out, so shipping rates were going through the roof.*

*But then what happened?*

*Starting at the beginning of 2022, the spread began to fall again. Which means freight rates were going down. In June 2022, spot prices bottomed hard, even lower than they were at the height of the pandemic.*

*Now, despite some hiccups along the way, spot prices are climbing again — approaching pre-pandemic normalization levels. Typically, freight leads the broader economy by 6-9 months.*

*Which means we could actually be exiting a recession right now, instead of falling into one.*

*An interesting data point that may back this up is the revised labor market data recently released by the Bureau of Labor Statistics (BLS).*

*It found that in Q2 2022, there was actually negative job growth. That — combined with the negative GDP prints in both Q1 and Q2 — means that the U.S. technically hit the definition of a recession.*

*Interesting indeed.*

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So, even before the jobs report last week, there were signs that the economy was doing better than expected.

And now, after the jobs report, I think that we can say a few things.

**One**, the U.S. most likely did in fact already enter and exit a recession over the past year.



**Two**, the U.S. economy is robust and can handle higher interest rates. We can't let the past decade or so cloud our long-term perspective — a 0% interest rate environment is not required for economic expansion.

The U.S. economy has grown tremendously in a variety of high-interest rate environments before. And it looks like it's doing it again.

**Third**, the booming economy is starting to prove that the Fed may not have as much

control over the financial landscape as we're led to believe. Do you know why the Fed kept rates so low during the '10s? It was because they wanted to stoke inflation.

Following the '08 financial crisis, the entire economy freezing up was a distinct possibility. Which would have led to deflation (which if it goes too far, is much, much worse than inflation, actually).

**But guess what?** While we did avoid deflation, inflation remained stubbornly low – below the Fed's target. Now, the Fed is trying to raise rates in order to soften the labor market and reduce inflation. But the labor market isn't softening.

So, does the Fed actually have any power? It's hard to say. It may be that the Fed's actions affect short-term market activity more than the long-term economic activity of our country.

On the other hand, maybe the Fed does have power, and the whole reason we're having this discussion is because nobody actually believed that the Fed could engineer a soft landing by lowering inflation while keeping unemployment low and the economy strong.



I will be the first to admit that I didn't think the Fed would be able to achieve the best possible outcome. After all, these were the same people who took a year to notice inflation.

But if inflation continues to tumble (take a look at last month's issue to see a more detailed write-up on why it looks like inflation is indeed falling)...

And we do manage to not obliterate a large portion of the workforce...

Well, that's a spectacular outcome. Some financial pundits seem to want the world to topple into a fiery abyss, but I don't want that. You don't want that. Your family doesn't want that.

So, if these numbers keep holding up, and we do achieve a soft landing, well, hats off to you Mr. Powell!

Of course, we don't know what the next few months will bring.

As investors, we never have complete information. All we have is good enough information. And we have to make decisions based on that.

So, considering the information we have in hand, what informed decision can we make?

## **RISK ON, BABY!**

Markets operate in cycles. You've probably heard me use the terms "risk on" or "risk off" before. The markets flop between these two cycles.

During a "risk on" period, higher growth plays perform better. In investing lingo, these are called "cyclicals." Cyclicals get their name because they generally follow the curves of the markets – they perform well during period of expansion and cool off during periods of contraction.



Cyclicals can include companies involved in manufacturing, restaurants, hotels, stores, homebuilding, travel, ecommerce – pretty much anything that declines as people feel the bite of harsher economic conditions.

In general, small caps are also considered are a cyclical sector. These are companies with market caps between \$250 million and \$2 billion. Small caps are usually leading indicators of market direction – they generally outperform on the upswing of an expansion, and start to tumble prior to a recession.

On the other side are defensives. These are things like gold and treasury bills, but can

also encompass larger, more stable blue chip companies.

And wouldn't you know it, just like the rest of the data is pointing too, small caps are starting to rise. Below is a chart of the iShare Russell 2000 Small Caps Index (IWM).



Since late December, small caps have been on a tear. And as investors, we have to gather information, analyze it, act, then reevaluate.

If things turn sour in a few months, we'll likely see this small cap surge reverse. But for now, we're going to follow the money.



Which brings me to our trade idea for February.

## **MALIBU BOATS (NASDAQ: MBUU)**



**PRICE AT PUBLICATION: \$63.77**

**MARKET CAP AT PUBLICATION: \$1.3 BILLION**

**SHARES OUTSTANDING: 20.35 MILLION**

**52-WEEK RANGE: \$46.30-\$72.47**

### **THE ELEVATOR PITCH**

What better way to lean into a booming economy than buying a boat? I know, I know – this seems like a joke. And it might be, if Malibu Boats wasn't such a darn good company.

Strong quarter-over-quarter and year-over-year growth; strategic acquisitions; vertical integration; and a wealth of free cash flow mean that Malibu is perfectly primed to take advantage of expanding economic conditions.



Not just that, but Malibu is about as cyclical as a stock as you can imagine – and in a world where cyclical stocks are booming, I expect Malibu Boats to lead the charge.

## THE THOUGHT PROCESS

If you've been with Wealthpin for a while, you've probably noticed that most of our trade ideas have been defensive or conservative in nature. With inflation running rampant and an uncertain economy ahead of us, the best thing to do was to hunker down.

That's not to say we weren't looking for profit. But we wanted to hedge that profit opportunity with a safety net. We accomplished that with dividend-heavy stocks in sectors like real estate, commodities, and banking.

But the markets are cyclical, and it seems like we're heading for a bull market. How long will it last? Hard to say. There's still structural clouds on the horizon (debt ceiling, a reemergence of inflation, overtightening of the Fed), but for the time being, I think it's best to try and capture some of this rising equity value with a more aggressive stock play.



I believe Malibu's business will be bolstered by a number of demographic trends.

**One**, Boomers will continue to retire in record numbers over the coming decade and Gen X will continue to age. These two generations make up the vast majority of boat ownership.

However, millennials' share of boat ownership is also growing – they now comprise 31% of boat owners. As the largest demographic now, millennials purchasing power will increase as they move up in the workplace. More money, more boats.

**Two**, America's population is flocking into states like Florida, Texas, and the Carolina's, where boat ownership tends to be more prevalent than other places.

**Three**, boating is booming. During the COVID pandemic, boat sales surged 40%. In fact, as we'll get into below, boat manufacturers like Malibu are just now getting through the backorders. Not only that, but upgrade cycles tend to follow new boat sales. Which means in a few years-time, many of those boat owners are going to want to upgrade their existing boat or buy a new one.

**Four**, people underestimate just how important recreational boating is to the American economy. About 100 million Americans go boating each year. And we spend a whopping \$49.3 billion on boats and associated products and services each year.

## THE BUSINESS MODEL

Malibu Boats manufactures a range of recreational powerboats. The company was founded in 1982, and has established a dealer network of more than 400 locations across the world. The company operates in three segments:

It's first and main segment is the recreational performance sport boat market. This segment accounts for roughly 41% of Malibu's business.



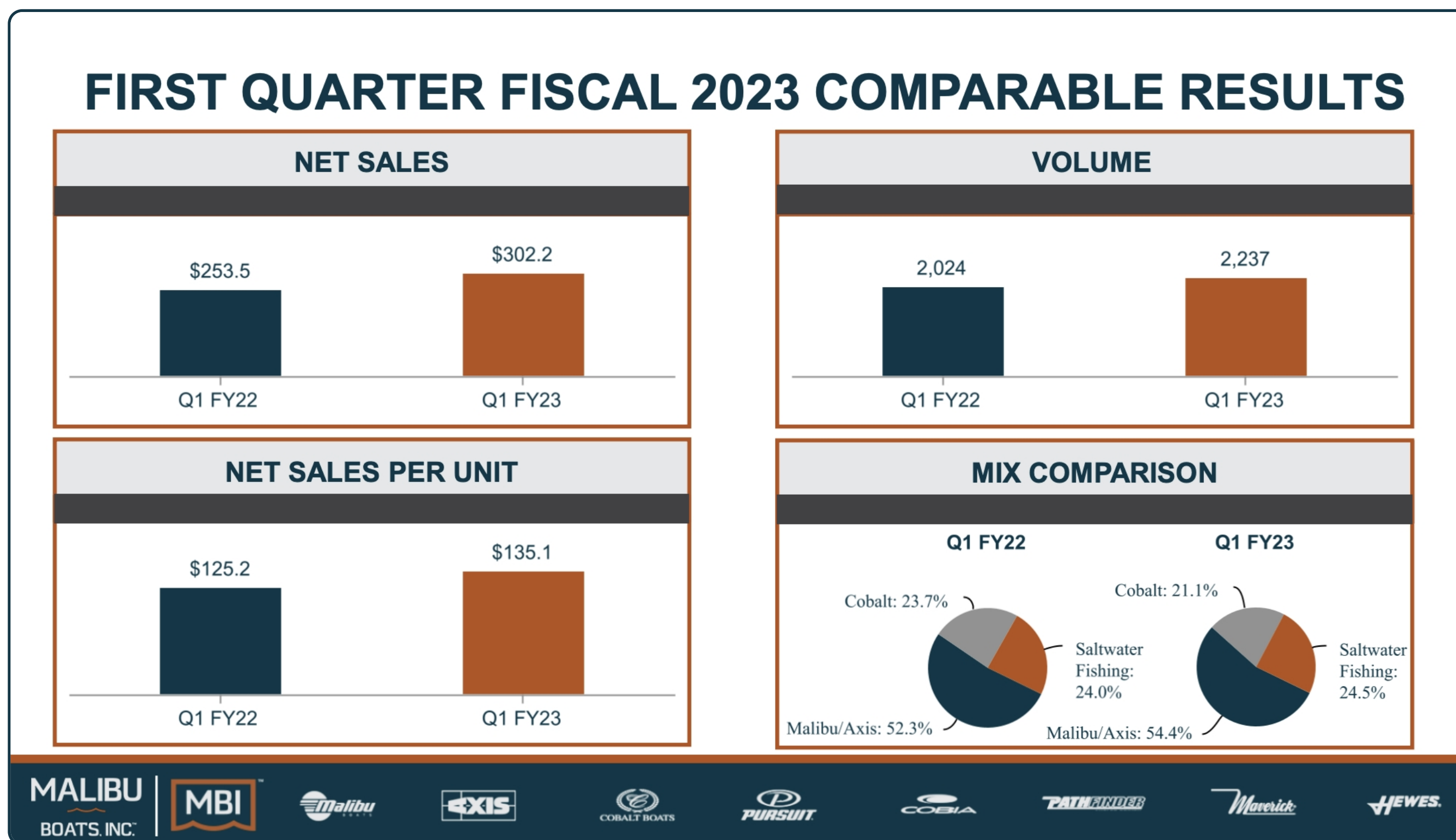
The second segment is the saltwater fishing segment, which accounts for about 27.2% of the company's revenue.

*In 2017, Malibu acquired Cobalt Boats, one of Malibu's top competitors, for \$130 million. Cobalt continues to operate under its brand name, and the segment now accounts for the remaining 20% of Malibu's business.*

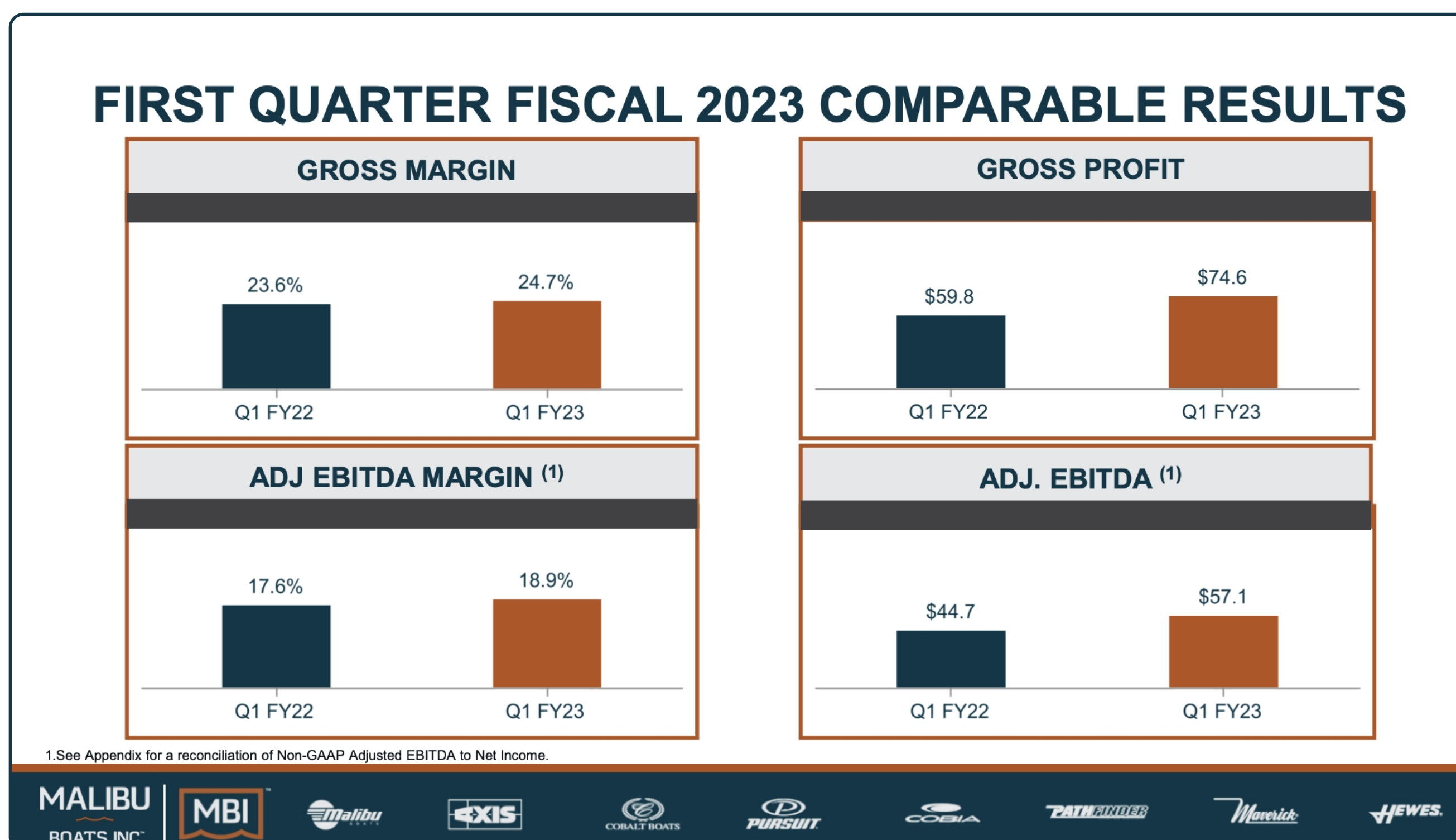
## THE FINANCIALS

Malibu just released their Q1 results for fiscal year 2023 (Starting on October 1st and running through December).

The results were outstanding.



Net sales increased 19% year-over-year (YoY) to \$302 million. At the same time, gross margin was 24.7% — up 1.1% YoY. This was largely due to declining material and labor costs.



Meanwhile, net income for the quarter jumped from \$27.9 million in 2022 to \$36.1 million – a 29% jump.

	Three Months Ended September 30,	
	2022	2021
Net income	\$ 36,105	\$ 27,933
Provision for income taxes	11,023	8,084
Interest expense	1,285	684
Depreciation	5,296	4,918
Amortization	1,716	1,856
Stock-based compensation expense <sup>1</sup>	1,635	1,258
Adjusted EBITDA	\$ 57,060	\$ 44,733
Net Sales	\$ 302,211	\$ 253,497
Net Income Margin <sup>2</sup>	11.9 %	11.0 %
Adjusted EBITDA Margin <sup>2</sup>	18.9 %	17.6 %

All of this combined led Malibu to significantly beat earnings expectations. However, the price action was rather muted following such spectacular results. Since the release of their latest earnings this past November, the share price is only up 10%.

I think this stock has a lot more room to rise. For a few reasons:

## THE ONCE AND FUTURE BOAT KING

### GROWTH DRIVER #1:

## STRONG ACQUISITIONS SET MALIBU UP FOR LONG-TERM SUCCESS

Beyond the previously-mentioned Cobalt purchase, Malibu has also made two other strategic acquisitions over the past five years. In 2018, Malibu bought Pursuit Boats for \$100 million. This purchase allowed Malibu to enter the higher-end luxury segment of the recreational boat market.

Then, in 2021 Malibu bought Maverick Boating Group for \$150 million. This allowed Malibu to gain exposure to the bay boat segment (lower gunwales, and a smaller degree of deadrise, which allows the boats to get into back-country fishing spots).



Combined, these three strategic segments paid off big time. The Cobalt segment alone experienced 25% growth in revenues YoY. The other two purchases contributed to the strong income growth in the recreational boating, and saltwater boating segments mentioned above.

Even better, the cash that these acquisitions generated will allow Malibu to fund further acquisitions as competitors pop up. Malibu will be able to buy out its competition before they're able to threaten Malibu's market share.

## **GROWTH DRIVER #2:**

## **VERTICAL INTEGRATION**

One of Malibu's latest pushes is to vertically integrate a portion of its supply chains. Since 2009, the company has been expanding its vertically-integrated footprint. They manufacture their own engines, trailers, and flooring in-house.

And In February 2022, Malibu introduced Malibu Electronics. They are a wholly-owned subsidiary that Malibu is now using to produce its own wire harnesses. You can think of wire harnesses like the electrical skeleton of a boat.



Vertical integration allows Malibu to control the pricing of its products, and avoid supply chain disruptions. The leadership has teased that more vertical integration initiatives will be unfolding in 2023, so their pricing power could only increase over the coming months.

**GROWTH DRIVER #3:****NETWORK EFFECT**

Malibu has dealer-relationships with 300 sites in North America, and another 100 dealer-relationships spread across Europe, Asia, South Africa, and the Middle East. This is a strong network effect that allows Malibu to negotiate favorable pricing plans and financing terms that smaller companies simply cannot do. As Malibu grows their dealer footprint, their power will only grow. Combined with their aggressive acquisition stance, it will be hard for market entrants to disrupt their power over the recreational boating market

**Conclusion:**

**Amazing financials, strong macroeconomic factors, and a very growth oriented corporate setup mean Malibu Boats is going into our model portfolio with a buy limit of \$72.47. Our 12-month price target is \$90.43.**



To your wealth,  
**Alex Reid**  
Founder, Wealthpin Pro

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