MacNicol & Associates Asset Management Inc., 145 Adelaide Street West, Third Floor, Toronto, Ontario, M5H 4E5

November 2017

The Monthly

With this commentary, we plan to communicate with you every month about our thoughts on the markets and some snap-shots of metrics. I hope you enjoy this information, and it allows you to better understand what we see going on in the market place.

""If you don't study any companies, you have the same success buying stocks as you do in a poker game if you bet without looking at your cards."

- Peter Lynch

The Numbers:

Index:	**Year-to-Date:**
S&P/TSX:	13.25%
NASDAQ:	32.42%
Dow Jones:	32.20%
S&P500:	24.03%

Interest Rates:	
90-Day T-Bill:	0.87%
5-Year Bond:	1.60%
10-Year Bond:	1.89%
30-Year Bond:	2.22%

Financial Market Data:

- Canadian dollar gives back summer gains
- Governor Stephen Poloz delivers speech in Montreal that was viewed as "neutral" on interest rate hikes
- Dow Jones crosses 23,000
- US wage inflation levels off at 2.5%
- Industrial metals Copper and Nickel strong but begin a period of consolidation
- Crude Oil comfortably through the $56 level
- Japanese PM Shinzo Abe wins landslide election
- BITCOIN eclipses $7,000 though fails in run at $8,000

Valuation Measures: S&P 500 Index

Valuation Measure	**Latest**	**1-year ago**
P/E: Price-to-Earnings	20.1	17.9
P/B: Price-to-Book	3.2	2.7
P/S: Price-to-Sales	2.10	1.8
Yield: Dividend Yield	2.0	2.4

Year-to-date Performance, by Sector: Nov 8th, 2017

U.S. Markets	Close	Net	1 Day %	YTD %
Dow Jones	23516.26	81.25	0.35%	18.99
Dow Jones Transports	9778.33	-5.48	-0.06%	8.12
Dow Jones Utilities	750.97	2.02	0.27%	13.85
S&P 500	2579.85	0.49	0.02%	15.23
S&P 400 Midcap	1831.34	1.24	0.07%	10.28
S&P 600 Smallcap	906.67	0.25	0.03%	8.20
NASDAQ	6714.94	-1.59	-0.02%	24.74
Russell 2000 (Smallcaps)	1496.55	3.77	0.25%	10.27
BKX (Banking)	102.31	0.62	0.61%	11.46
BTK (Biotech)	4145.28	59.50	1.46%	34.81
XOI (Oil Index)	1261.86	10.93	0.87%	-0.48
SOXX (Semiconductor)	1277.34	5.83	0.46%	40.91

The solution to low oil prices? Low oil prices…

In this month's edition of *Monthly Commentary,* we pause from the exercise of trying to determine whether the secular bull run in equities [or bonds for that matter] is over or not over and instead turn our attention to a sector completely forgotten by a world pre-occupied with artificial intelligence, cryptocurrencies and "FANG" stocks.

Oil

[West Texas Intermediate (WTI) 5-year price chart]

After almost two full years of suffering and one year of pondering, crude oil prices are now materially off their lows from the painful 2014-2016 period. The MAAM investment team has been following crude oil prices closely and is now examining energy companies more closely after having been notably absent the sector for nearly 3 years.

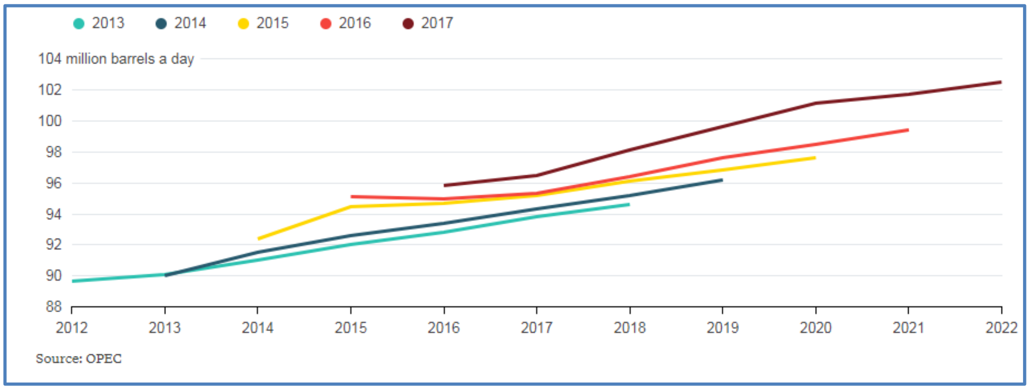
But before getting our fingers oily, let us briefly take a trip down memory lane:

In the fallout of the 2008/2009 global financial crisis demand for energy was temporarily flat lined and oil prices tanked. The economic recovery that began after the last boardroom at Lehman Brothers was vacated sent the price of crude oil back to $100. Crude oil continued to hover between $100 and $125 until mid 2014 when prices began to skid once more. A number of factors are attributed to crude oil's plunge in mid 2014. Economies, such as the rapidly growing economies, of Brazil, Russia, India and China began to slow. Developed economies such as the United States and Canada extracted productivity gains from their own oil reserves using technology. In the United States, the wide-spread use of hydraulic fracking technology was used to extract oil from shale formations in states such as North Dakota. In Canada, Steam-Assisted Gravity Drainage [SAGD] technology was used to enhance recovery rates in Alberta's oil sands region. Oil imports into North America were thus not as copious as before since local production did a better job at meeting local supply. While all of this was happening, Saudi Oil Ministers were concerned that oil export revenues were falling. What happened next isn't so much the key factor that *started* oil prices to fall as much as it is the factor that started oil prices to nose dive lower at a much more frenzied pace. Saudi Arabia [in November 2014] made a pivotal decision about whether to allow prices to continue falling, which hurts deficits but maintains market share or to curtail production to raise revenues and cede market share. Saudi Arabia can produce oil at a lower cost when compared to hydraulic fracking and mining the Canadian oil sands formations. On November 27th, 2014 at the OPEC meeting in Vienna, Ministers backed away from the long-standing policy of defending oil prices…Brent oil fell more than $6 that day to $71.25 a barrel. Saudi Arabia had fired the shot heard around the world that it would rather lose money in the short-term than cede market share…

A two-year period of carnage followed with many oil companies forced to slash capital expenditures, cut or suspend dividend payments and lay off thousands of workers. It was not only a painful time for those directly involved in the oil business but for people who serviced or financed it too.

As the carnage was unfolding, this Portfolio Manager recalls vividly his discussion with a well-known senior money manager about oil prices. Asked when oil prices would rebound the manager responded: *"Well, the solution to low oil prices is low oil prices",* and it would appear that this little kernel of advice was more than just notionally correct.

OPEC met this past Tuesday for their annual World Oil Outlook [known internally as "WOO"]. Some of the near-term views expressed by the cartel would indeed make energy investors shout "WOO-WHO"!



[OPEC's medium-term *demand* forecast for oil has moved higher…especially recently]

The chart above, from OPEC, shows OPECs own demand forecast for oil and you can see it has certainly moved higher. That's the demand side of the story.

Worried that electric cars will take over the world?

Perhaps some day…but that could be a long time from now. Not everyone is convinced…recall the below quote from Ferrari's CEO when asked about his company's plans for electric or autonomous cars:

"You'll have to shoot me first."

- Sergio Marchionne

And OPECs Secretary General along with member states and Russia continue to eradicate a supply glut by cutting production by 1.8 million barrels per day until next March. Secretary General Barkindo also made comments at Tuesday's meeting that would suggest production cuts be extended deeper into 2018. An announcement on possible production curtailments is due at the end of November 2017 and we will be listening very closely. For now, here is another sound bite from OPEC's chief figure head from Tuesday's media scrum with the press:

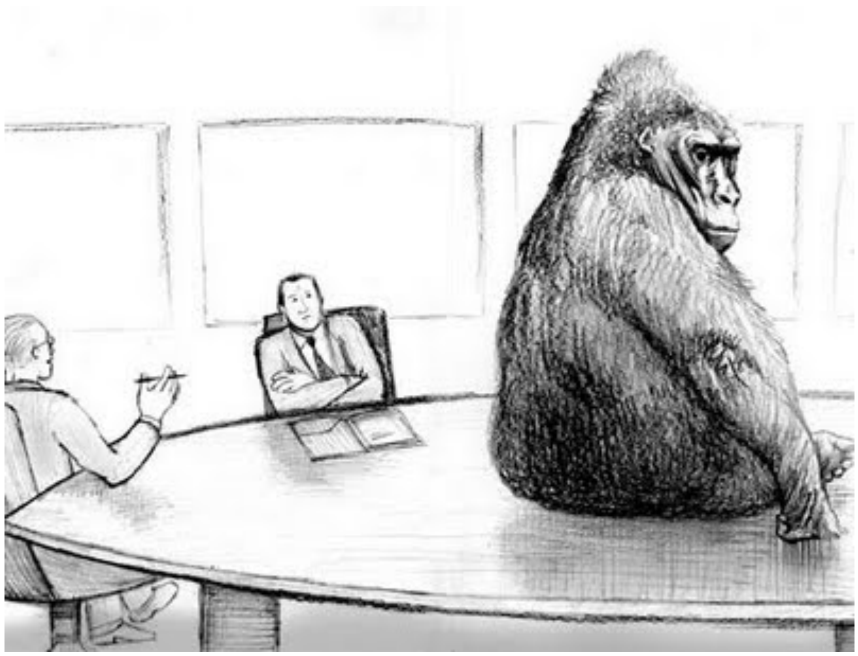
"Extensive consultations are currently ongoing to reach some consensus before Nov. 30 on the duration beyond the March 2018 deadline". "I have not heard so far any participating country that is violently objecting to extending the decision."

- OPEC Secretary General Mohammed Barkindo

Tensions in the Middle East are also supportive of higher oil prices.

High profile arrests in Saudi Arabi are viewed as politically motivated on the part of the Crown Prince Mohammad bin Salman to consolidate power and push through economic reforms [translation: pro-oil reforms]. Political lynching or not, the moves are bullish for oil…at least for the time being. After all, Saudi Arabia cannot afford a return to lower oil prices or a decline in oil revenues, regardless of aspirations to maintain market share. The IMF estimates that Saudi Arabia needs Brent oil prices at $73+ in order for Saudi Arabia to achieve a zero-deficit budget in 2017.

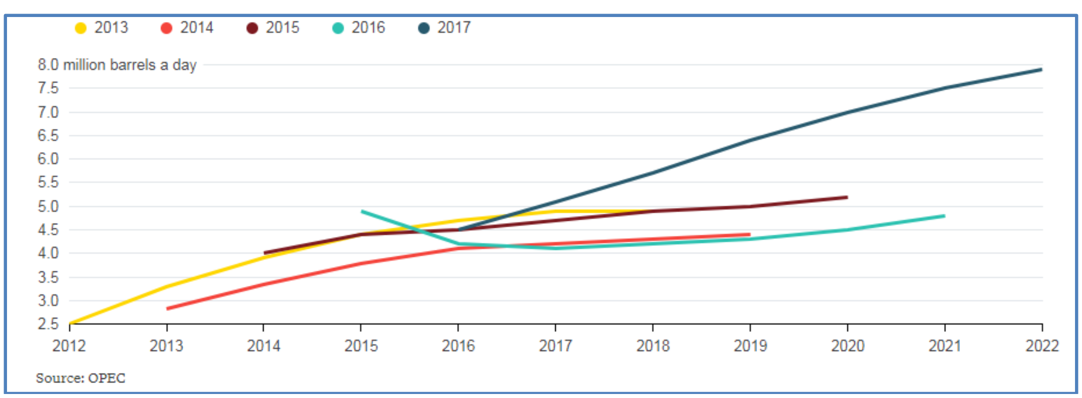
But is OPEC the 800-pound Gorilla it once was in the jungle of world oil affairs?



Credit: lobojosden.blogspot.com

[OPEC once called the shots in global oil affairs and November 27th, 2014 is a stern reminder of that…but what about today?]

A quick glance at OPECs own view of North American shale production might provide us with some clues.



[OPEC's view on North American Shale production has changed: the reader's attention is drawn to the difference in slope between the 2016 and 2017 lines]

Which brings us to the *real* noteworthy quote from Secretary General Barkindo scrum with the media:

"We are in the process of inviting other producers who have shown an interest in joining this noble global effort."

Hmmm…

An OPEC Secretary General who is on the one hand confident about the extension of production cuts yet who is at the same time inviting "other producers" to join in this noble effort just for good measures?

Obviously the jury is still out on this one….

The longer running narrative on crude oil we feel is one of a commodity that has almost certainly bottomed yet not quite poised for the type of growth some might expect. There is clearly an air of concern on the part of many investors [and OPECs Top Secretary General] that more needs to be done to galvanize oil's upward plight. The MAAM investment team has recently observed analysts and forecasters already predicting oil to hit $70. Let's see how crude contends with the $60 level first.

And what about Oil Stocks?

Energy equities in general have rallied off the lower levels of July and August, but this dynamic you will recall played out in early 2016. For a short period in 2016, energy stocks were hotter than BITCOIN. Yet many names in the space still lack appropriate growth potential relative to their fair market value. Our advice is do your homework: not all energy companies are created equal…or…let us do it for you.

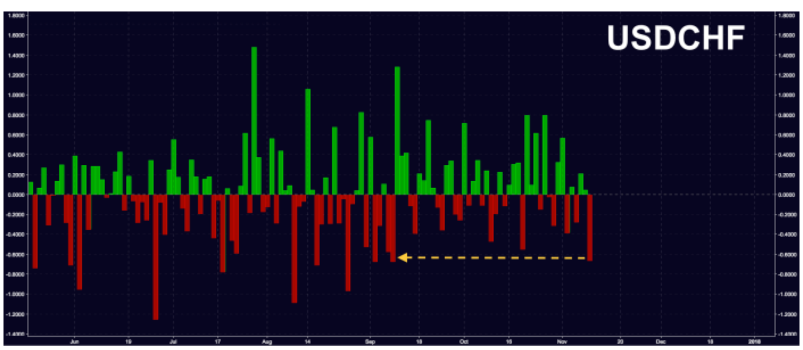
What a truly "taxing" day it was…

It is no secret to readers of our commentaries that the Trump White House is badly in need of a meaningful "victory"…soon. Trump's first full year in office is rapidly approaching its conclusion and [unlike oil] the solution to a diminuendo White house is not a diminuendo White House. GOP Senate leaders on Thursday November 9th stated they plan to file legislation that would **delay** cutting the corporate tax rate from 35% to 20% until 2019.

A major departure from President Trump's insistence on the immediacy of such cuts. The one-year delay would lower the cost of the tax bill by more than $100 billion, and negotiators are trying to preserve as much revenue as they can in the name of other changes. But it could also delay decisions by companies to *move back* to the United States from other parts of the world or prompt them to hold off on other decisions as they wait for the corporate rate to fall.

Markets were not impressed: the Dow and S&P500 sold off, the US Dollar Index was lower by one quarter of one percent and 10-Year yields nose diving lower just after the Thursday lunch hour before recovering slightly. The French Franc actually recorded its best day [versus the dollar] since September 8th. Obviously, the market "Gods" were not impressed and indeed that is part and parcel the problem. No one knows what is going on and that kind of uncertainly that has a tendency to be the straw that breaks the camel's back on days when there are already issues.

[US 10 Year Yields and VIX Volatility]



[US Dollar gives back versus the French Franc]

The MAAM investment team is a long, long way away from being experts on tax legislation. But what we do know is that in a market priced-to-just-about-perfection any little wrinkle in the market's plans is bound to set off a cascade of drama across the investment landscape.

Stay tuned…

The Psychology of Mania…and BITCOIN…

The MAAM investment team was one of the very first Canadian asset managers to blend [in real time] conventional finance and alternative finance. It's been our signature dish for over a decade now and a material reason for our success. Recently, though we have been getting some unambiguously **direct** questions about our own take on BITCOIN and cryptocurrencies. Is this the latest "Tulip Crisis" or is it really, *really* different this time?

The wave of excitement over cryptocurrencies is infectious. Few Portfolio Managers and Analysts can make it through their busy work day without at least one question, analyst report or news release that is at the very least parenthetically related to the space.

The venerable Wall Street Journal recently announced that the CME [Chicago Mercantile Exchange] was in works to create a BITCOIN futures contract.

So what is our take?

Despite the meteoric rise of cryptocurrencies be they BITCOIN, Ethereum or a pseudonym for the plethora of other cyber currencies out there, the MAAM investment team is united in the belief that the **underlying technology** is here to stay. With that out of the way, what do we make of the massive gains in BITCOIN's price? Well, BITCOIN itself doesn't appear to exhibit any of the psychological symptoms of a bubble. The cyber currency hasn't become a mainstream topic on social media or gatherings although that could change soon. Secondly, most Canadians aren't quitting their day jobs to speculate on BITCOIN. And finally, skeptics of BITCOIN are not immediately dismissed or chastised as being over-the-hill or woefully behind the times. All that can be said is that the digital currency has moved, a lot. We note that many analysts [good ones] are suggesting that in time, recent price movements in cryptocurrencies will be a memory as more and more interest [and contempt for Central Banks and authorities] flows into what is arguably the most significant technology this decade.

MAAM's investment team continues to research this area. Where we move to the application or protocol space is a matter of time. But one thing is for certain we will do so as we have always done: with a focus on protecting and diversifying client capital.

For now, sit back, buckle up and behold: the next internet is here.

MacNicol & Associates Asset Management pays tribute to those who paid the ultimate price

Remembrance Day [Nov 11th] is a Memorial Day observed in Canada to remember the members of armed forces who have died in the line of duty.

MacNicol & Associates Asset Management Inc.
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